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FLOYD ZADKOVICH

Arbitrability in the US – The Fifth Circuit Takes Another Crack At Interpretation Of Arbitration Clause, Finds Placement of Carve-Out Dispositive

Introduction

On Wednesday August 14, 2019, the Fifth Circuit issued its opinion in *Archer and White Sales, Inc. v. Henry Schein, Inc*., No. 16-41674. In light of the Supreme Court's recent 2019 decision in the matter, the court considered anew the question of whether the parties in this dispute delegated the threshold arbitrability determination to an arbitrator.

Earlier this year, we looked at Justice Kavanaugh's first opinion of his tenure as Associate Justice on the United States Supreme Court (*Henry Schein, Inc., et al. v. Archer & White Sales, Inc*., 139 S. Ct. 524, 586 U. S. ____ (2019)). There, on petition by Schein, SCOTUS vacated and remanded the decision by the Fifth Circuit Court of Appeals, with the Court holding the "wholly groundless" exception to arbitrability – albeit a narrow one – inconsistent with the Federal Arbitration Act and the Court's precedent.

The Court reiterated that under the FAA, arbitration is a matter of contract, so courts are generally bound to enforce arbitration contracts according to their terms. Thus, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless, when the parties' contract delegates the arbitrability question to an arbitrator, see *AT&T Technologies, Inc. v. Communications Workers*, 475 U. S. 643, 649– 650 (1986). Whether the question of arbitrability was left to the arbitrators is the central question of fact that was left to the Fifth Circuit Court of Appeals to decide on remand.

Generally, contracting parties must express their intent to delegate questions of arbitrability to an arbitrator "clearly and unmistakably," see *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649; *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995). Otherwise the determination of whether to arbitrate is left to the courts.

In our piece on the SCOTUS decision, we wrote that this may from time to time be a high burden to meet and clear language in the governing contract is key for foregoing disputes on this issue – this proved spot-on considering the below.

Analysis

In the Fifth Circuit's recent decision in *Schein*, the court held that the parties had not clearly and unmistakably delegated the question of arbitrability to an arbitrator. Thus, the court affirmed the decision by the district court that it had the power to decide arbitrability.

The arbitration clause in the matter provided as follows:

> *Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of Pelton & Crane), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina. [Dealer Agreement]* [*Schein*, No. 16-41674, p. 3]

Under AAA Commercial Arbitration Rule 7(a), "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim."

From the outset, Archer had opposed a motion to compel arbitration arguing that its complaint sought injunctive relief and the arbitration clause explicitly excluded actions seeking such relief by way of a carve-out. Henry Schein argued in response that, by operation of AAA Commercial Arbitration Rule 7(a), the parties had expressly delegated that issue to the arbitrator. The magistrate judge tasked with the matter granted the motion, determining that the arbitrability question should be left to an arbitrator because the Dealer Agreement incorporated the AAA rules and there was at least a "plausible construction" that would compel arbitration. The district court vacated that order and held that the court could decide the threshold arbitrability question, reasoning that this action fell squarely within the arbitration clause's express exclusion of actions seeking injunctive relief. The Fifth Circuit later affirmed, based on the "wholly groundless" exception that was then reversed by the Supreme Court.

SCOTUS' decision in *Schein* had reemphasized that the arbitrability inquiry is to be based on the 'clear and unmistakable' evidence standard from *First Options*. Having to start from scratch, the Fifth Circuit considered whether arbitrability was "clearly and unmistakably" delegated to arbitrators in this matter, pointing out that "[a] contract need not contain an express delegation clause to meet this standard," see *Schein*, No. 16-41674, p. 6. The court further pointed to its decision in *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co.*, 687 F.3d 671 (5th Cir. 2012) where an arbitration agreement that incorporated the AAA Rules "present[ed] clear and unmistakable evidence that the parties agreed to arbitrate arbitrability," see *Id*. at 675. This view is not without opposition in other circuits. A different position was taken by a district court in the Fourth Circuit. In *Bayer Cropscience AG v Dow Agrosciences*

LLC, 2012 WL 2878495 (E.D. Va. July 13, 2012), the District Court for the Eastern District of Virginia declined to recognize incorporation of the ICC Arbitration Rules in an agreement to arbitrate as "clear and unmistakable" intent to let the arbitral panel decide threshold questions of arbitrability.

However, the parties in *Schein* both attempted to rely on the relevancy of the carve-out clause (on injunctive relief), whereas the agreement in *Petrofac* had explicitly covered "all claims and disputes" with no mention of carve-outs. Here, the issue was (at least perceived) *ambiguity*.

The court closely reviewed the Second Circuit's decision in *NASDAQ OMX Grp., Inc. v. UBS Securities, LLC*, 770 F.3d 1010 (2d Cir. 2014), where the court had considered an arbitration clause that incorporated the AAA rules and exempted certain claims from arbitration. The court in *NASDAQ* noted that it had "found the 'clear and unmistakable' provision satisfied where a broad arbitration clause expressly commits all disputes to arbitration, concluding that all disputes necessarily includes disputes as to arbitrability." However, the parties in *NASDAQ* had not clearly and unmistakably delegated arbitrability "where a broad arbitration clause is subject to a qualifying provision that at least arguably covers the present dispute." Because there had been ambiguity as to whether the parties intended to have arbitrability questions decided by an arbitrator—the dispute arguably fell within the carve-out—the court held the arbitrability question was for the court to decide. *Id*. at 1032.

In *Schein*, the court found that the placement of the carve-out was dispositive, distinguishing the clause from the one in its earlier decision in *Crawford Prof'l Drugs, Inc. v. CVS Caremark Corp*., 748 F.3d 249, 256 (5th Cir. 2014). The court finds that in the language of the clause, any dispute, *except actions seeking injunctive relief*, shall be resolved in arbitration in accordance with the AAA rules. Thus, the court concludes, "[g]iven that carve-out, we cannot say that the Dealer Agreement evinces a "clear and unmistakable" intent to delegate arbitrability," see *Schein*, No. 16-41674, p. 10.

As to the question of whether arbitration itself would be proper under the carve-out, the Circuit court further finds that where the language of the clause clearly carves out "actions seeking injunctive relief," such language must be interpreted to include actions merely containing claims for injunctive relief and is not limited to those actions "only for injunctive relief," *Id*. p.11. The court dismisses arguments based on the policy favoring arbitration and is equally dismissive of concerns that

Conclusion

The above illustrates how important attention to detail is when drafting contracts. We can only emphasize the point made by the Fifth Circuit in *Schein* that the parties must take care in drafting of their exclusionary clauses and that "placement of carve-out[s] [can be] dispositive," as courts, esp. the Fifth Circuit, seem unwilling to "re-write the words of the contract." The court had opportunity to impose its own interpretation where it found ambiguity. In view of differing opinions in the circuits, one should generally expect these issues to appear again. As of *Schein,* the case law seems to track a development less favorable to leaving arbitrability questions in the hand of arbitrators, as exceptions and carve-outs are given effect liberally in *Schein*.

Floyd Zadkovich (US) LLP
Jonas Patzwell at
jonas.patzwell@floydzad.com
and +1 251 414 6317
Ed Floyd at
ed.floyd@floydzad.com
and +1 (917) 999 6914

zeiler.partners
Rechtsanwälte GmbH
Gerold Zeiler at
gerold.zeiler@zeiler.partners
and + (43) 1 8901087 0–80
Thomas Herbst at
thomas.herbst@zeiler.partners
and + (43) 1 8901087 0–94