SCOTUS Decision Applies FAA to Empower Businesses and Arbitrators

BY GENE COMMANDER

There has been a longstanding debate over whether a trial court should decide gateway arbitrability issues. The U.S. Supreme Court's opinion in Henry Schein, Inc. v. Archer and White Sales, Inc. *should put an end to it.*

This article addresses whether a trial court has jurisdiction to determine threshold arbitrability issues in disputes governed by the Federal Arbitration Act (FAA), where the contracting parties' arbitration agreement expressly delegates that authority to an arbitrator.[1]

This jurisdictional question arose from numerous conflicting federal court of appeals decisions regarding the legitimacy of a judicially created "wholly groundless" exception to the arbitrator's contractual authority to enforce the parties' binding arbitration agreement.[2]

The U.S. Supreme Court opinion issued on January 8, 2019, in *Henry Schein, Inc. v. Archer and White Sales, Inc.*, should put an end to the longstanding debate over whether a trial court—rather than a duly appointed and authorized arbitrator—should decide gateway arbitrability issues. *Schein* had gone before the U.S. Court of Appeals for the Fifth Circuit on a writ of certiorari. In a unanimous decision authored by Justice Kavanaugh, the U.S. Supreme Court vacated the lower court's decision, which it decided had erroneously upheld the authority of the U.S. District Court in Texas to reject a contracting party's arguments in support of the enforceability of a written arbitration agreement by relying on what the circuit court characterized as the FAA's "wholly groundless" exception.

The *Schein* Arbitration Agreement

The parties' arbitration agreement in *Schein* (the Agreement) contained a provision stating:

> 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 [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association.* The place of arbitration shall be in Charlotte, North Carolina.[3]

The Dispute

The underlying dispute in *Schein* was between two businesses involved in the manufacture (Henry Schein, Inc.) (Schein) and distribution (Archer and White, Inc.) (Archer and White) of dental equipment. Their contractual business relationship had deteriorated over time.

Rather than demanding arbitration pursuant to the Agreement, Archer and White filed a civil complaint against Schein in U.S. District Court asserting federal and state antitrust violations and seeking monetary damages and injunctive relief.

In response to the complaint, Schein asked the court to apply the FAA and compel arbitration for the antitrust claims. Archer and White objected to the motion because the complaint also sought injunctive relief, which was specifically excluded from the scope of the Agreement. Archer and White also urged the court to decide these threshold arbitrability questions—rather than refer them to an arbitrator—because Schein's arguments in support of its motion were wholly groundless.

The court accepted Archer and White's arguments and found that Schein's motion to compel was wholly groundless. Consequently, the court denied the motion. Schein appealed, and the Fifth Circuit affirmed the U.S. District Court's decision. The U.S. Supreme Court then granted certiorari to resolve the appellate courts' conflicting decisions.[4]

The Arguments

To avoid the consequences of application of the FAA, Archer and White offered several public policy arguments to support its position, all of which were rejected by the Supreme Court.

First, Archer and White contended that the elimination of the "wholly groundless" exception would waste the parties' time and resources if a trial court is required to send threshold arbitrability questions to an arbitrator, when the arguments in favor of arbitration are "wholly groundless" in the eyes of the court. In response, the Court emphasized that no "wholly groundless" exception exists in the text of the FAA, and courts do not have the liberty to override the parties' contractual decisions and short-circuit an arbitration proceeding when Congress elected not to do so in the FAA.[5]

The Court also observed that the exception would undoubtedly encourage further traditional civil litigation between the contracting parties and thus contribute to the unavoidable costs and additional time associated with the adjudication of a dispute over seemingly unmeritorious arguments to determine whether they are "wholly groundless"

or simply "groundless" as a matter of law. While the Court recognized the possibility that the exception might save some time and expense in an individual case, it cast understandable doubt on any suggestion that enforcement of the exception would produce appreciable systemic efficiencies and cost savings for the contracting parties.[6]

Second, Archer and White asserted that the elimination of the judicial exception would encourage frivolous motions to compel arbitration. The Court found that argument to be overstated, recognizing that qualified arbitrators are more than capable of fairly and efficiently spotting frivolous arguments and promptly determining when claims are outside the intended scope of the parties' arbitration agreement.[7]

Schein argued, and the Court agreed, that the express terms of the Agreement should be enforced and an arbitrator appointed by the American Arbitration Association (AAA), not the U.S. District Court, should determine the gateway arbitrability issues raised by its motion to compel.[8]

The Result

Since arbitration is a matter of contract, the Supreme Court reasoned that the judicially created "wholly groundless" exception to arbitration is inconsistent with both the FAA and Supreme Court precedent cited in the *Schein* opinion.[9] Therefore, courts must respect the parties' contractual alternative dispute resolution decisions.[10]

The Court reversed the Fifth Circuit's decision and remanded the case for further proceedings consistent with its opinion.

Lessons Learned

Schein confirms that businesses can agree in advance to delegate authority to an arbitrator to decide any disputes that may arise out of their contractual relationships, including the authority to decide threshold arbitrability issues. The FAA requires courts to enforce the parties' alternative dispute resolution decisions in accordance with the express terms of their arbitration agreements, even if the arguments in support of arbitration might seem to be wholly groundless in the eyes of the court.

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Impacts on Colorado Arbitration

But these lessons beg the question: When should the FAA and federal arbitration law apply to arbitration proceedings governed by Colorado law? The Colorado Court of Appeals' position on the resolution of threshold arbitrability disputes seems to be in line with the *Schein* decision.

In *BRM Construction, Inc. v. Marais Gaylord, L.L.C.*, the plaintiff's motion to confirm an arbitration award was opposed by the defendant's motion to vacate. The district court denied the motion to vacate and confirmed the award. The Court of Appeals concluded, "the issue whether BRM failed to comply with procedural conditions precedent to arbitration was for the arbitrator to decide, and . . . an arbitrator's resolution of that issue, even if erroneous, is not a ground for vacating or refusing to confirm an award."[11]

In *BRM Construction*, the Court relied on a prior decision by another division in *Galbraith v. Clark*, where the plaintiff appealed a district court's judgment that compelled arbitration for her claims. The FAA was applicable to the dispute, and the Court found that "arbitration is ultimately a matter of contract between the parties. If the parties agree, arbitrability may be decided by the arbitrator in the first instance." The Court further found that "the arbitration contract contains clear and unmistakable evidence that [the parties] agreed to have the arbitrator decide arbitrability," because their contract empowered the arbitrator to decide "the way it was formed, its applicability, meaning, enforceability, or any claim that all or part of the [agreement] is void or voidable."[12] In reaching its conclusion, the *Galbraith* panel relied on the U.S. Supreme Court's opinion in *First Options of Chicago, Inc. v. Kaplan*,[13] on which the U.S. Supreme Court also relied in the *Schein* decision.[14]

Thus, it seems that any debate over the jurisdiction and power of an arbitrator to determine gateway arbitrability issues has been settled whenever the FAA applies and the contracting parties have entrusted the arbitrator with the authority to resolve those questions.

Remaining Questions

Nonetheless, at least one unanswered question remains: Does the FAA preempt any provisions of the Colorado Revised Uniform Arbitration Act (CRUAA)?

Congress enacted the FAA in 1925 to establish a liberal federal public policy in favor of arbitration that (1) rejected any notion that court proceedings are superior to contractually agreed-upon arbitration proceedings, and (2)

granted to arbitration agreements the same degree of acceptance and enforceability that the judiciary gives to other types of contracts.[15] The FAA applies whenever a written contract between two parties involves a transaction in commerce and provides that future disputes between the parties arising out of the contract will be resolved through arbitration.[16]

"Commerce" is defined by the FAA to include "commerce along several states or within foreign nations."[17] For all practical purposes, however, the term has taken on the meaning of "interstate commerce" under the U.S. Constitution; thus, the commercial nexus required by the FAA does not need to be substantial for it to apply to arbitrability issues pending before Colorado state or federal courts.[18] Once the FAA's minimum interstate commerce requirement has been satisfied, its provisions should be applicable to arbitrability disputes before all arbitration tribunals and all state and federal courts with competent jurisdiction over the parties.[19]

Given the nature and extent of modern-day interstate commerce, the FAA would seem to be applicable to nearly every commercial dispute. But that does not automatically establish federal question jurisdiction. As a matter of fact, diversity of citizenship is still the most common basis for federal district court jurisdiction over arbitrability questions. In the absence of diversity or some other statutory basis for federal question jurisdiction, the parties will typically be headed to a Colorado district court to resolve their arbitrability disputes.[20]

Compared to the limited subject matter jurisdiction of the federal district courts, Colorado district courts have broad jurisdiction over nearly all issues arising out of an arbitration agreement, even when the FAA is applicable to the dispute, provided that the court has jurisdiction over the parties based on some minimum contact with the State of Colorado.[21]

The U.S. Constitution's Supremacy Clause outlines the preemption doctrine for resolving conflicts between state and federal arbitration laws. When Colorado substantive law applies, the CRUAA, which applies to all written arbitration agreements in effect on or after August 4, 2004,[22] governs disputes related to the enforcement of arbitration agreements, unless it is preempted by the FAA. A comparison of the CRUAA with the FAA reveals few potential grounds for preemption,[23] but the following potential conflict areas merit consideration.

> "When drafting contractual arbitration provisions or analyzing a demand for arbitration, practitioners should carefully consider whether the FAA will preempt the potentially conflicting CRS § 13-22-206 provisions."

While CRS § 13-22-206 embraces a broad state public policy in favor of arbitration, as does the FAA, CRS §§ 13-22-206(2) and (4) also assign certain duties and authority to the Colorado district court to make threshold arbitrability decisions. Specifically, CRS § 13-22-206(2) contemplates decisions by the court about whether a valid arbitration agreement exists and whether the parties' dispute is subject to the agreement, and CRS § 13-22-206(4) allows arbitration proceedings to continue while the court considers the arbitrability issues contemplated by CRS § 13-22-206(2). Given the FAA's intent to preempt existing and future state arbitration laws that limit the validity and enforceability of arbitration agreements when compared to other forms of contract, or interfere with Congress's intent to eliminate a historic judicial bias against the enforcement of arbitration agreements, the FAA could potentially preempt the CRUAA. But even when preemption applies, it most likely only voids the conflicting portions of the state arbitration laws without replacing them.[24]

When drafting contractual arbitration provisions or analyzing a demand for arbitration, practitioners should carefully consider whether the FAA will preempt the potentially conflicting CRS § 13-22-206 provisions. If the FAA applies, *Schein* suggests that preemption is likely when the arbitration agreement expressly empowers the arbitrator to decide threshold arbitrability questions.

Best Practices

A binding mandatory arbitration strategy can be a valuable tool for companies that are interested in the efficient resolution of commercial disputes in a confidential, businesslike setting that typically avoids the more costly and protracted consequences of traditional civil litigation. There is a growing body of evidence to support the long-standing belief held by alternative dispute resolution commentators that customized arbitration strategies will better serve industry leaders who have responsibility for dealing with and settling business-to-business disputes.[25]

One convincing example that supports this belief is a recent report by Micronomics, Inc. analyzing adjudicatory delays. The report presents clear and convincing evidence that, on average, mandatory binding arbitration proceedings administered by the AAA provide a significantly faster and less expensive method of resolving business-to-business disputes when compared with the results obtained through traditional civil litigation in federal district

courts across the country. The report's findings are even more compelling when the results of mandatory binding arbitration are compared with similar state court outcomes.[26]

As shown by the *Schein* decision, businesses can design their risk management strategies to avoid traditional civil litigation almost entirely. But it will be up to their leadership, in-house and outside legal counsel, arbitration administrators, and professional neutral arbitrators to provide the legal framework necessary to produce the desired outcome by adopting sound practices.[27]

Arbitration best practices start with carefully drafted contractual arbitration provisions designed to meet the foreseeable needs of the parties when future business-to-business disputes arise, including:

- a contractual provision stating that the FAA is applicable to the interpretation and enforcement of the parties' arbitration agreement;[28]
- a contractual provision that incorporates by reference the applicable industry, trade association, or religious organization rules of practice and procedure that are intended to govern the arbitration proceeding; and
- a clear and unambiguous contractual delegation of power to the arbitrator(s) to determine any threshold arbitrability questions involving the formation, interpretation, and enforcement of the arbitration agreement, and the merits of all arbitrable issues that properly come before the arbitrator.[29]

Conclusion

After *Schein*, it is clear that an arbitrator has jurisdiction to determine threshold arbitrability issues where the parties' arbitration agreement expressly delegates that authority to an arbitrator and the disputes is governed by the FAA. But when the CRUAA applies, practitioners must consider potential FAA preemption of the CRUAA and use best practices to draft arbitration provisions accordingly. CL

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NOTES

1. As used in this article, the term "arbitrability" means any questions about an arbitrator's power to rule on his or her jurisdiction to decide a dispute, including any questions about the existence, scope, and validity of an arbitration agreement.
2. *See Schein, Inc. v. Archer and White Sales, Inc.*, 586 U.S. ___ (2019), for citations to the numerous conflicting lower appellate court decisions on the "wholly groundless" exception.
3. *Id.* (emphasis added).
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*
8. The *Schein* opinion is based on the parties' specific arbitration agreement. The opinion does not analyze the AAA rules that were incorporated by reference into their arbitration agreement. *See* AAA Rule R-1(a), amended and effective October 1, 2013, which provides in pertinent part that the AAA Rules and any amendments thereto shall be applied as promulgated at the time when all of the AAA's administrative requirements for a demand for arbitration are satisfied. *See also* AAA Rules R-7 and R-8, which specifically empower the arbitrator to determine (1) the extent of his or her jurisdiction, (2) the arbitrability of the parties' claims and defenses, and (3) the merits all arbitrable issues. The AAA rules are at www.adr.org/Rules.
9. *See, e.g.*, *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 68–70 (2010); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943–944 (1995); *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649–650 (1986).
10. *Schein*, 586 U.S. ___ (2019).
11. *BRM Construction, Inc. v. Marais Gaylord, L.L.C.*, 181 P.3d 283, 284–285 (Colo.App. 2007).
12. *Id.* at 1064.
13. *First Options of Chicago, Inc.*, 514 U.S. 938.
14. *Galbraith v. Clark*, 122 P.3d 1061, 1064 (Colo. App. 2005).
15. *See* Benson, *Colorado and Federal Arbitration Law and Practice* (3d ed. CLE in Colo., Inc. 2017), for a comprehensive discussion of the body of arbitration law pertinent to this article, especially Chapters 3, 4, and 8.
16. *See* 9 USC § 1, which excludes "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce" from the scope of "commerce" that is governed by the FAA, unless otherwise agreed by the parties.
17. *Id.*
18. Benson, "Application of the Federal Arbitration Act in State Court Proceedings," 43 *Colo. Law.* 33 (Dec. 2014).
19. *Id.* at 34.
20. *Id.* at 37–38.
21. *Id.* at 34.
22. CRS § 13-22-203.
23. Benson, *supra* note 18.
24. *Id.* at 34–37.
25. Commander, "Making the Economic Case for Mandatory Binding Arbitration," 47 *Colo. Law.* 30 (May 2018). This is the second article by this author that makes the case for the use of business-to-business binding mandatory arbitration to resolve commercial disputes through a process that is more efficient and cost-effective than traditional civil litigation.
26. Weinstein et al., "Efficiency and Economic Benefits of Dispute Resolution through Arbitration Compared with U.S. District Court Proceedings," Micronomics Economic Research and Consulting (Mar. 2017), www.micronomics.comarticles/Efficiency_Economics_Benefits_Dispute_Resolution_through_Arbitration_Compared_with_US_District_Court_Proceedings.pdf.
27. *See* College of Commercial Arbitrators, "Protocols for Expeditious, Cost-Effective Commercial Arbitration" (2010), www.ccaarbitration.org/wp-content/uploads/CCA_Protocols.pdf; "The College of Commercial Arbitrators Guide to Best Practices in Commercial Arbitration" (4th ed. 2017), www.jurispub.com.
28. This best practice should overcome any argument that the FAA does not apply to the dispute when that argument is based solely upon a generic boilerplate provision stating that Colorado law or the law of the place where the project is located shall govern.
29. Commander, *supra* note 25.