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U.S. Supreme Court continues to define contours of arbitration under FAA

By: Michael R. Stanley January 31, 2019

The U.S. Supreme Court continued to shape the contours of the Federal Arbitration Act in two decisions last month.

First, in *Henry Schein Inc. v. Archer & White Sales Inc.,* the court, in a 9-0 decision, continued its trend of enforcing arbitration agreements and clarified who decides whether an issue is arbitrable in the first instance.

Justice Brett Kavanaugh, writing his first opinion for the Supreme Court, started with the FAA's command that an arbitration clause in matters involving commerce is "valid, irrevocable, and enforceable."

From that premise, the court noted its longstanding policy that the FAA allows the parties to "agree by contract" to delegate the question of whether the substantive dispute is arbitrable to the arbitrator.

That straightforward recitation of precedent did not pave any new ground.

However, federal district courts and courts of appeals developed a judge-made exception to that statutory command. They found that when the question of arbitrability is "wholly groundless," the court can decide the issue of arbitrability — notwithstanding the commands of 2010's *Rent-A-Center, West, Inc. v. Jackson* and 1995's *First Options of Chicago, Inc. v. Kaplan* — because it would conserve time and resources.

The Supreme Court rejected the judge-made exception, explaining that when a contract "delegates the arbitrability question to an arbitrator, a court may not override the contract."

Kavanaugh explained that, in such circumstances, “a court possesses no power to decide the arbitrability issue. That is true even if the court thinks that the argument that the arbitration agreement applies to a particular dispute is wholly groundless.”

Put simply, if the question of arbitrability delegation is bargained for in a contract, courts must honor the contract’s terms and order the parties to arbitrate that question.

The court’s remand left open the question of whether the parties actually delegated the arbitrability question to the arbitrator. Supreme Court precedent states that courts “should not assume that the parties agreed to arbitrate arbitrability.” Instead, there must be “clear and unmistakable evidence that they did so.”

Here, the parties’ contract incorporated the American Arbitration Association Commercial Arbitration Rules, and those rules “delegate[] the question of arbitrability to the arbitrator.”

However, by preserving this issue on remand, the court may be questioning whether incorporation by reference of an arbitrator provider’s rules is “clear and unmistakable evidence” of the parties’ intent to delegate the question of arbitrability to the arbitrator.

Just one week later, the Supreme Court’s decade-long streak of enforcing arbitration agreements came to an end in *New Prime Inc. v. Oliveira*.

The scope of *New Prime* is narrow but important. It focuses on the FAA’s “transportation” exclusion, which provides that “nothing” in the FAA applies to “contracts of employment of ... seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”

Like in *Henry Schein*, the court first faced the question of whether the court or the arbitrator should decide the issue of arbitrability. In other words, should courts or arbitrators decide whether the FAA’s transportation exclusion applies in the first instance.

Unlike in *Henry Schein*, the court concluded that the courts must determine whether the FAA excludes the contract from its scope. In reaching that holding, Justice Neil Gorsuch, writing for a unanimous court (8-0; Kavanaugh did not participate), started with the statutory text.

Gorsuch explained that the FAA’s command to stay litigation and compel arbitration applies only to disputes covered by the FAA. He reasoned that because “nothing” in the FAA applies to disputes covered by the transportation exclusion, “a court should decide

Stated differently, “a court must first know whether the contract itself falls within or beyond the boundaries of FAA prior to staying the litigation and compelling arbitration under FAA sections 3 and 4.”

In short, *New Prime* stands for the proposition that courts must decide whether the FAA applies to the dispute.

Curiously, Gorsuch does not discuss *Henry Schein*’s holding in *New Prime*. Perhaps that was intentional or a production of Supreme Court machinations. However, the two cases work seamlessly together. The holding in *New Prime* rests on a court’s statutory interpretation of the FAA and requires the court to find whether the FAA applies to the dispute. If it does, then the *Henry Schein* holding applies and requires the court to stay the case and compel arbitration if the parties contractually agreed to delegate the issue of arbitrability to the arbitrator.

After holding that a court is the correct forum to decide whether the transportation exclusion applies, the Supreme Court evaluated whether the transportation exclusion applied to independent contractors.

In the “key to the case,” Gorsuch applied the meaning of the FAA’s term “contracts of employment” “at the time Congress enacted the [FAA].”

Using historical references, Gorsuch concluded that the word “employment” was not “then a term of art,” but “a synonym for ‘works.’” Using that definition, he concluded that “at the time of the [FAA’s] adoption in 1925 ... most people ... would have understood § 1 to exclude not only agreements between employers and employees but also agreements that require independent contractors to perform work.”

Taken together, “contracts of employment of ... seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce” now include contracts evidencing an independent contractor relationship.

Following *Henry Schein* and *New Prime,* the court’s role in deciding arbitrability is clear. Step one: The court decides if the FAA, or its exclusions, apply. Step two: If the FAA applies to the type of dispute, and the parties’ contract contains “clear and unmistakable” evidence that they intended to delegate the issue of arbitrability to the arbitrator, courts must stay the litigation and compel arbitration. That rule applies even if the scope of the parties’ dispute is not captured by the types of disputes covered by the arbitration clause.

In addition, *New Prime* expands the transportation exclusion to encompass “seamen, railroad employees, or any other class of workers engaged in foreign or interstate

The Supreme Court will complete its trifecta of arbitration cases in *Lamps Plus v. Varela*(argued Oct. 29, 2018), in which it will decide whether the FAA forecloses a state-law interpretation of an arbitration agreement that would authorize class arbitration based solely on general language commonly used in arbitration agreements.

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