ARBITRABILITY: THE IMPLICATIONS OF *HENRY SCHEIN v. ARCHER AND WHITE SALES, INC.*, 139 S. CT. 524 (2019) FOR THE REINSURANCE INDUSTRY[1]

Arbitration has been the principal dispute resolution forum among parties in the reinsurance industry for decades. This is so because the industry places a premium on having experts familiar with industry custom and practice resolve disputes. However, not all disputes are arbitrable; arbitration is a creature of contract. Where there is a disagreement as to whether a particular dispute is subject to arbitration, who decides whether that dispute is, in fact, arbitrable? Should a court decide issues of arbitrability, or do the arbitrators have that authority? Courts and arbitration panels alike have been navigating so-called gateway issues — arbitrability, as well as other relevant threshold arbitration issues, such as waiver, estoppel and laches. As set forth below, the U.S. Supreme Court's decision in *Henry Schein v. Archer and White Sales, Inc.*[2] confirms that, if the parties' agreement grants the arbitration panel the authority to determine questions of arbitrability, the courts will enforce the parties' choice in that regard.

In the reinsurance industry, it is generally understood that whether a dispute is heard by an arbitration panel as opposed to a court may be outcome determinative. Take for example, classic reinsurance "*Bellefonte* disputes." In *Bellefonte Reinsurance Co. v. Aetna Casualty and Surety Co.*, the Court of Appeals for the Second Circuit determined, based solely on the contract language, that the reinsurance limit of liability in a facultative certificate capped both reinsurance liability and expenses regardless of how expenses were paid under the reinsured policy.[3] Many in the reinsurance industry felt that the *Bellefonte* decision was contrary to long-standing reinsurance industry custom and practice.[4] The rumor mill has taught us that

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[2] *Henry Schein v. Archer and White, Inc.*, 139 S. Ct. 524 (2019).

[3] *Bellefonte Reinsurance Co. v. Aetna Casualty and Surety Co.*, 903 F.2d 910 (2d Circ. 1990).

[4] *See, e.g.*, Eugene Wollan, *Handbook of Reinsurance Law* 2-31 (2003 Supplement) ("[T]he industry generally views [capping recovery of expense at the loss limit] as diametrically opposed

arbitration panels presiding over "*Bellefonte* disputes" typically eschewed *Bellefonte* and issued their decisions in accord with the industry custom and practice.[5] Many courts, however, (particularly in New York) closely adhered to the *Bellefonte* precedent issuing like decisions for over 20 years.[6] This dichotomy between how the courts and arbitrators resolved *Bellefonte* disputes often rendered where a *Bellefonte* dispute was resolved — court or arbitration — determinative of the merits of the ultimate fight.[7]

The issue of "who decides" the threshold question of arbitrability can equally be outcome determinative. Indeed, not only can *who* decides questions of arbitrability influence the outcome of major industry rows, but it can also affect the efficiency and costs associated with alternative dispute resolution, as court involvement in the arbitral process often causes delays and increases expense. As such, parties to reinsurance contracts need to pay close attention to the language that they utilize in their arbitration clauses. Not only must cedents and their reinsurers clearly state the types of disputes that are subject to arbitration under their reinsurance agreements, but they also must plainly set forth who — the arbitration panel or the court — should resolve the threshold issue of arbitrability. The Supreme Court has affirmed that, if they do, the courts must strictly enforce that language.

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to long-standing practice and by and large continues to ignore the cases and adhere to the practice.").

[5] Of course, since arbitration awards are confidential, this industry "scuttlebutt" cannot be definitively established.

[6] *See, e.g., Unigard Sec. Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049, 1071 (2d Cir. 1993) (holding that, "Bellefonte's gloss upon the written agreement is conclusive".*); Excess Ins. Co. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 577 (2004) (determining that the reinsurers' liability was capped without regard to industry custom and practice*).*

[7] Although the *Bellefonte* decision reigned supreme for over two decades, its precedential effect was effectively eliminated in 2018 when the Second Circuit held that it had been premised on an erroneous interpretation of New York state law. *See Global Rein. Corp. of Am. v. Century Indem.* Co., 890 F.3d 74 (2018).

Navigating the Case Law: Procedural v. Substantive Questions of Arbitrability

Under long-standing Supreme Court precedent, questions surrounding "arbitrability" are typically classified into two types: procedural and substantive. Procedural questions of arbitrability involve those that "grow out of the dispute and bear on its final disposition."[8] They include, for example, whether a party has waived the right to arbitrate, whether a litigant is precluded from arbitrating on statute of limitation grounds and/or under the equitable doctrines of laches or estoppel, and whether a party has met contractual condition precedents to arbitration under the agreement at issue (among others).[9] As the Supreme Court explained over 50 years ago in *John Wiley & Sons v. Livingston*, "[q]uestions concerning the procedural prerequisites to arbitration do not arise in a vacuum; they develop in the context of an actual dispute about the rights of the parties to the contract or those covered by it."[10] Given their nexus to the merits of the principal controversy, the Supreme Court has for decades uniformly ruled that procedural questions of arbitrability should be decided by arbitrators.[11]

In contrast, "substantive" questions of arbitrability involve the threshold or gateway issue of whether a dispute must be sent to arbitration. They include questions akin to whether a binding arbitration agreement between the parties exists and whether an arbitration clause in a binding contract applies to a particular type of controversy.[12] Because these issues arise independently from the actual dispute and are fundamental to whether the parties must proceed in arbitration, the Supreme Court has repeatedly affirmed that they are presumptively for the courts to decide.[13] Importantly, however, the Supreme Court has also made clear that, under the

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[8] *John Wiley & Sons v. Livingston*, 376 U.S. 543, 556-57 (1964); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79,84 (2002).
[9] *Howsam*, 537 U.S. at 79; *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).
[10] *John Wiley*, 376 U.S. at 556-57.
[11] *Id.; Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25; *Howsam*, 537 U.S. at 84.
[12] *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).
[13] *Howsam*, 537 U.S. at 85; *Green Tree Financial Corp. v.* Bazzle, 539 U.S. 444 (2003) (plurality opinion).

Federal Arbitration Act ("FAA")[14] parties to a contract involving interstate commerce (as many insurance/reinsurance contracts do) may delegate to an arbitrator, in place of a court, all issues arising out of the contract — including, without limitation, the threshold issue of substantive arbitrability.[15] An "agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce and the FAA operates on this additional arbitration agreement just as it does on any other."[16] Thus, if the arbitration clause at issue assigns questions of arbitrability to arbitrators, the arbitral tribunal decides and, importantly, courts have extremely limited ability to review and set aside that decision under Section 10 of the FAA.[17] However, if no such delegation exists, the Supreme Court has held that courts are empowered to settle the arbitrability dispute under the very standards that courts are empowered to adjudicate all other legal questions that are not subject to alternate dispute resolution — *i.e.*, independently.[18] This "flow[s] inexorably from the fact that arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes — but only those disputes — that the parties have agreed to submit to arbitration."[19]

The controversies that have been born out of the law on arbitrability primarily involve whether contracting parties have, in fact, delegated questions of substantive arbitrability to arbitrators under their contracts. There exist two main avenues for doing so: (1) expressly providing for delegation in an arbitration provision; and (2) implicitly providing for delegation by incorporating into an arbitration clause the arbitration rules and procedures established by third-party organizations such as the American Arbitration Association ("AAA"), which

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[14] 9 U.S.C. §§ 1 et seq.
[15] *See, e.g., Rent-A-Center West, Inc. v. Jackson*, 561 U.S. 63, 68-70 (2010) (parties can agree to arbitrate arbitrability); *Schein*, 139 S. Ct. at 527 ("Under the [FAA] and this Court's cases, the question of who decides arbitrability is itself a question of contract. The [FAA] allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes.").
[16] *Schein*, 139 S. Ct. at 529.
[17] *See* 9 U.S.C. § 10 (courts may set aside arbitration awards procured by corruption, fraud, evident partiality or undue means; arbitrator exceeded powers).
[18] *First Options*, 514 U.S. at 944.
[19] *Id.*

authorize arbitrators to determine the boundaries of their jurisdiction.[20] No matter which avenue is selected, when parties to a contract disagree over whether they have assigned the issue of arbitrability to an arbitration tribunal, the Supreme Court has instructed courts to apply ordinary state law principles governing the formation of contracts to resolve the contest – with a caveat.[21] The Supreme Court has also instructed that, under the FAA, regardless of the applicable state-law contract principles, courts must not assume that the parties have agreed to arbitrate the threshold issue of arbitrability; there must, instead, exist "clear and unmistakable evidence" that they reached this agreement.[22] If no such evidence exists, a court must decide the issue of arbitrability itself. In other words, when an arbitration agreement in an reinsurance contract is silent or ambiguous with respect to who should decide substantive arbitrability, a judge will undertake the task.[23]

Delegation clauses — *i.e.*, those provisions in a contract that "delegate" or "assign" substantive questions of arbitrability to the arbitrators — can require a party to submit to arbitration claims that are highly attenuated from the parties' agreement and that were never intended to be subject to arbitration. As a result, over the last decade and in the run-up to the *Schein* decision, several federal appeals courts — including, the Fourth, Fifth, Sixth and Federal Circuits — invoked a judicially crafted exception to the Supreme Court precedent with respect to delegation, known as the "wholly groundless exception."[24] Pursuant to the wholly groundless exception, courts took it upon themselves to decide the issue of arbitrability, even where the

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[20] *Schein*, 139 S. Ct. at 528 ("The rules of the American Arbitration Association provide that arbitrators have the power to resolve arbitrability questions.").
[21] *Id.*
[22] *AT & T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649 (1986) (the question of whether the parties have submitted a particular dispute to arbitration is "an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise."); *First Options*, 514 U.S. at 944 (1995) ("Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e]' evidence that they did so.").
[23] *Id. (quoting AT & T Technologies*, 475 U.S. at 649).
[24] *See, e.g., Simply Wireless, Inc. v. T-Mobile US, Inc.*, 877 F.3d 522, 528-29 (4th Cir. 2017); *IQ Products Co. v. WD-40 Co.*, 871 F.3d 344, 350 (5th Circ. 2017); *Turi v. Main Street Adoptions Servs., LLP*, 633 F.3d 496, 511 (6th Cir. 2011); *Qualcomm, Inc. v. Nokio Corp.*, 466 F.3d 1366, 1373-375 (Fed. Cir. 2006).

contract at issue contained a clear and unmistakable delegation clause. These courts contended that they were authorized to take this action under the FAA in circumstances where the arguments in support of arbitration were "wholly groundless."[25]

As the Fifth Circuit explained in *Douglas v. Regions Bank*, "what must be arbitrated is a matter of the parties' intent."[26] Therefore, when a party advocates for arbitration with a wholly groundless position, a court can deduce that the opposing party "never intended that such arguments would see the light of day at an unnecessary and needlessly expensive gateway arbitration."[27] The wholly groundless exception — although only available in certain jurisdictions — served as an important tool for parties resisting arbitration in the face of an unmistakable delegation clause. That tool no longer exists.

Henry Schein v. Archer and White

On January 9, 2019, the Supreme Court in *Henry Schein, Inc. v. Archer and White Sales, Inc.*, held that the "wholly groundless" exception to arbitrability is inconsistent with the FAA and the Supreme Court's precedent.[28] The Supreme Court held, consistent with its prior decisions, that the FAA requires courts to enforce arbitration agreements as written; therefore, when a delegation clause is present, it must be enforced.[29] In *Schein*, Archer and White Sales, Inc. ("Archer and White") sued Henry Schein, Inc. ("Schein") seeking monetary damages and injunctive relief for alleged violations of federal and state antitrust law.[30] The dispute arose under a contract between Archer and White and Schein's predecessor-in-interest, Pelton and Crane, in which Archer and White agreed to distribute dental equipment manufactured by

[25] *IQ Products*, 871 F.3d at 350.
[26] *Douglas v. Regions Bank*, 757 F.3d 460, 464 (5th Cir. 2014).
[27] *Id.*
[28] *Schein*, 139 S. Ct. at 529.
[29] *Id.*
[30] *Id.* at 526.

Pelton and Crane.[31] That contract contained an arbitration clause that provided, *inter alia*, that "[a]ny dispute arising under or related to this Agreement (except for actions seeking injunctive relief ...) shall be resolved by binding arbitration in accordance with the arbitration rules of the [AAA]."[32]

In response to the lawsuit, Schein moved to compel Archer and White to arbitrate the parties' antitrust dispute. Archer and White opposed the application on the grounds that, because its complaint sought injunctive relief, the dispute was not subject to arbitration per the plain language of the arbitration clause.[33] The disagreement then centered on who — the court or the arbitrators — was empowered to decide whether the parties' dispute was arbitrable.[34] Under the AAA rules, which had been incorporated into the parties' arbitration agreement, arbitrators possess jurisdiction to resolve questions of arbitrability. On that basis, Schein argued that the parties had delegated the arbitrability issue to arbitrators in their contract, and therefore it was not for the court to determine.[35] In response, Archer and White contended that Schein's argument that the controversy was arbitrable was "wholly groundless," and, therefore, the district court was empowered to determine the issue.[36]

In denying Schein's motion to compel arbitration, the district court, in accord with Fifth Circuit precedent, concluded that Schein's arguments for arbitration were wholly groundless.[37] Despite the delegation clause, the district court relied on the fact that the arbitration provision

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[31] *Id.* at 528.
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Archer and White Sales, Inc. v. Henry Schein, Inc.*, No. 2:12-cv-572 (JRF), 2016 WL 7157421 at *1, *8-*9 (Dec. 7, 2016).

carved out claims involving injunctive relief. On appeal, the Fifth Circuit affirmed the district court's decision.[38]

Given the split among certain federal circuit courts over the legitimacy of the wholly groundless exception, the Supreme Court granted *certiorari*.[39] In a unanimous decision authored by Justice Kavanaugh, the Supreme Court reversed the Fifth Circuit and held that, under the FAA, a court may not re-write or override an arbitration provision that delegates the threshold issue of arbitrability to the arbitrators.[40] Justice Kavanaugh, writing for the Supreme Court for the first time, stated that the FAA requires courts to interpret and enforce contracts pursuant to their plain terms, and, in circumstances where the contract clearly assigned questions of arbitrability to the arbitrators, those courts are powerless to resolve that issue — even when the court believes that the argument for arbitration is wholly groundless.[41] The Supreme Court affirmed, in accord with its precedent, that the parties' agreement must include "clear and unmistakable evidence" of delegation and that a court must first conclude that a valid arbitration agreement exists.[42] Moreover, the Supreme Court rejected Archer and White's arguments that, as a practical and policy matter, it would be a waste of the parties' time and economical resources to send a wholly groundless arbitrability contest to arbitration. The Supreme Court was not convinced that the wholly groundless exception actually saved time or money on a macro basis, since the exception "would inevitably spark collateral litigation (with briefing, argument, and opinion writing) over whether a seemingly unmeritorious argument for

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[38] *Archer and White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488 (5th Cir. 2017).
[39] *See supra* at fn.23; *Belnap v. Iasis Healthcare*, 844 F.3d 1272, 1286 (10th Circ. 2017) ("[h]aving thoroughly considered its merits, we decline to adopt the 'wholly groundless' approach."); *Jones v. Waffle House, Inc.*, 866 F.3d 1257, 1269 (11th Cir. 2017) ("We join the Tenth Circuit in declining to adopt what has come to be known as the wholly groundless exception.").
[40] *Shein*, 139 S. Ct. at 527-28.
[41] *Id.*
[42] *Id.* at 530.

arbitration is wholly groundless, as opposed to groundless."[43] Justice Kavanaugh found "no reason to create such a time-consuming sideshow."[44]

Finally, in *Schein*, the Supreme Court expressed no view as to whether the contract at issue actually delegated the gateway question of arbitrability to an arbitrator (the issue had not been decided by the Fifth Circuit).[45] The high court, instead, remanded the case to the Fifth Circuit to make that determination.[46] As a result, what precisely constitutes "clear and unmistakable" evidence of intent to have substantive arbitrability questions answered by the arbitrators, rather than a judge, remains unsettled and room for future litigation on the subject still exists.

Lessons Learned from *Henry Schein v. Archer and White*

Many reinsurance contracts involve interstate commerce; therefore, many — if not most — arbitrations in the industry are governed by the FAA. While *Schein* does not involve a reinsurance controversy, its holding will certainly have an impact on dispute resolution within the industry.

First and foremost, *Schein* reinforces the Supreme Court's long-standing position that the FAA must be interpreted broadly in favor of arbitration and that arbitration provisions must be strictly enforced — including those provisions that delegate gateway issues of arbitrability to arbitrators. As a result, it is more important than ever for cedents and reinsurers to fully and plainly set forth in their contracts those disputes which are subject to arbitration and those that are not. As *Schein* reinforces, this principle applies equally to all threshold or gateway issues. In other words, do not stay silent. Expressly describe in your arbitration clauses whether you want a court or an arbitration panel to resolve your disputes, including disputes over gateway issues.

[43] *Id.* at 531.
[44] *Id.*
[45] *Id.*
[46] *Id.*

And, when incorporating an arbitration body's arbitration rules, be sure to ascertain whether those rules address the question of arbitrability.

Notably, with the elimination of the wholly groundless exception, players in the reinsurance industry can feel more assured that their disputes will be resolved in arbitration ***so long as*** they make it clear that this is their desired result. While this is likely good news for many in the reinsurance industry who seek to have industry experts resolve industry controversies, it is important to remember that reinsurance arbitrators will not necessarily conclude that a particular dispute is arbitrable. It is therefore essential that the arbitration provisions in reinsurance agreements leave no room for doubt whom the parties wish to handle their disputes — including those disputes over arbitrability.

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