Schein-ing a Light on Circuit Splits

Chartered Institute, North America Branch

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September 15, 2020

Nonsignatories' Arbitration Rights: *GE Energy* and Beyond

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U.S. Court Assistance With Foreign Arbitration Discovery

Should it, will it, be allowed?

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Nonsignatories' Arbitration Rights: *GE Energy* and Beyond

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Agenda

- Overview of relevant provisions of Federal Arbitration Act
- Overview of relevant provisions of Convention on Recognition and Enforcement of Arbitral Awards (the “New York Convention”)
- Discussion of important Supreme Court decisions
- Issues remaining to be decided and conclusion

- "Congress' clear intent, in the Arbitration Act, [was] to **move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible**." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp*., 460 U.S. 1, 22 (1983).
- "The goal of the Convention . . . was to encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries." *Scherck v. Alberto-Culver Co.,* 417 U.S. 506, 520 n.15 (1974).

Yeah, about that . . . .

Federal Arbitration Act: Ch. 1 v. Ch. 2

- Chapter 1 of the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*) applies generally to arbitration agreements.
- Chapter 2 of the Federal Arbitration Act (9 U.S.C. § 201 *et seq*.) applies to arbitration agreements where one of the parties is not a citizen of the United States.
- Chapter 2 implements the New York Convention.
- 9 U.S.C. § 208: Chapter 1 applies to all actions **to extent not in conflict** with Chapter 2 or New York Convention.

New York Convention

- Article II, § 1 of the New York Convention provides that "each Contracting State shall recognize an **agreement in writing** under which the parties undertake to submit to arbitration . . .."
- Article II, § 2 of the New York Convention provides: "The term 'agreement in writing' shall include an arbitral clause in a contract or an arbitration agreement, **signed by the parties**, or contained in an exchange of letters or telegrams."

Arthur Andersen LLP v. Carlisle, 556 U.S. 624 (2009)

- 9 U.S.C. § 3: federal courts must stay litigation if the claims are "referable to arbitration under an agreement in writing."
- Nonsignatories can stay litigation under Section 3 of FAA at least when "traditional principles" of state contract law allow that nonsignatory to enforce the arbitration agreement.
- "Traditional principles" include assumption, piercing the corporate veil, alter ego, incorporation by reference, third party beneficiary theories, waiver, and estoppel.

Does Convention Bar Nonsignatory Enforcement?

- New York Convention: Requires “agreement in writing,” defined as “signed by parties or contained in an exchange of letters or telegrams.”
- Ninth and Eleventh Circuits: Under Convention, only those that actually signed agreement have rights to arbitration.
- First and Fourth Circuits: Under Convention, nonsignatories can also enforce arbitration agreements using (e.g.) equitable estoppel.

GE Energy v. Outokumpu, 140 S.Ct. 1637 (2020)

- New York Convention sets a floor, not a ceiling.
- New York Convention is silent on nonsignatory enforcement, so no actual conflict between FAA and Convention.
- Numerous other Convention member countries allow enforcement by nonsignatories.
- Remand: Determine whether equitable estoppel applies here and which body of law governs.

Shrinivas Sugandhalaya v. Setty (USSC June 8, 2020)

- "Is a foreign defendant's right to stay litigation under Section 3 of the Federal Arbitration Act (9 U.S.C. § 3) conditioned upon that defendant's right to compel arbitration?"
- *Shanferoke Coal v. Westchester*, 293 U.S. 449 (1935): "No reason to imply that the power to grant a stay is conditioned upon the existence of power to compel arbitration . . ."
- *The Anaconda v. American Sugar*, 322 U.S. 42 (1944): ". . . for, if a stay be granted, the plaintiff can never get relief unless he proceeds to arbitration."

What We Still Don't Know . . ..

- What law applies to decide who has rights?
- Is the question of which body of law governs the merits distinct from the question of which body of law governs arbitrability?
- Who decides who is a party?
- How (and where) do these issues get raised?

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Should it, will it, be allowed?

Presented By:
Elizabeth Sandza, FCIArb
Lindsay Bethea
September 2020

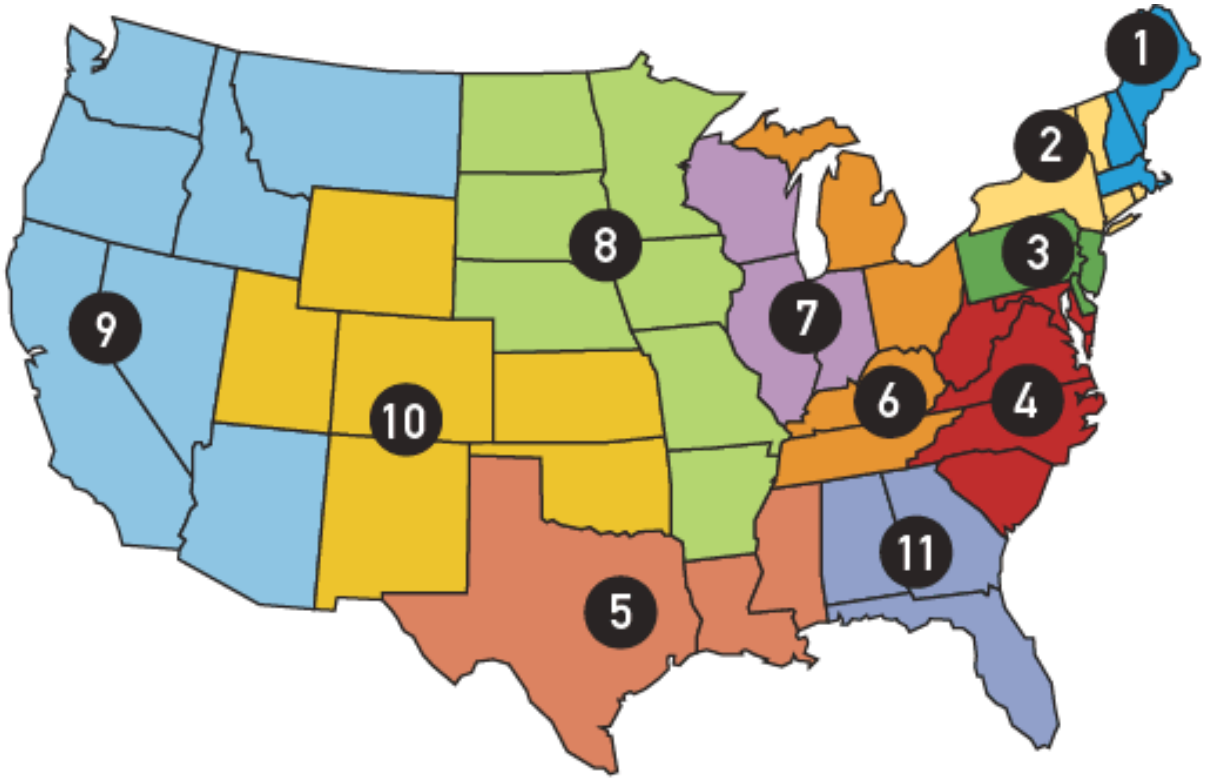
Statute

28 U.S.C. § 1782 states:

The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation...

In the United States, the 94 U.S. District Courts (federal trial courts) are assigned to twelve appellate circuits covering regional groupings of states and the District of Columbia, which stands alone in its circuit.

There is also a thirteenth circuit, called the Federal Circuit, which handles appeals from U.S. specialty courts such as the Court of Federal Claims. Each circuit has a U.S. Court of Appeals that handles appeals coming out of the District Courts in its circuit.



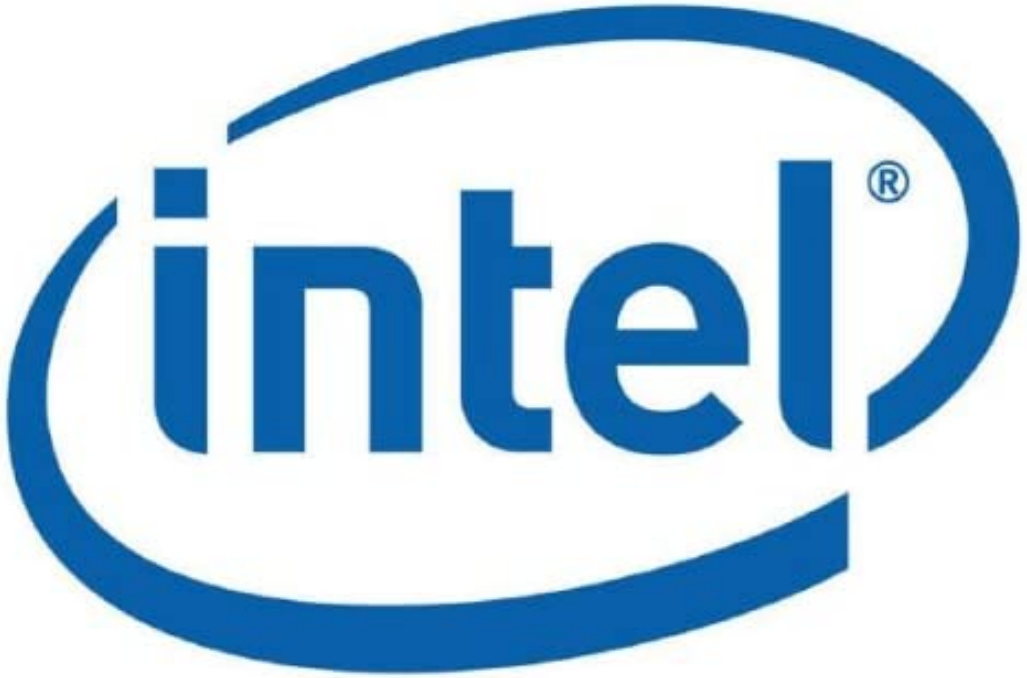
Section 1782 is Not Available in Private Arbitrations

Second Circuit

- *National Broadcasting Co., Inc. v Bear Stearns & Co., Inc., 165 F.3d 184 (2d Cir. 1999)*

Fifth Circuit

- *Republic of Kazakhstan v. Biedermann Int'l, 168 F.3d 880 (5th Cir. 1999)*



- ***Intel Corp. v. Advanced Micro Devices, Inc., 542 U.S. 241 (2004)***
- ***Arose out of a non-judicial proceeding conducted by the Directorate-General for Competition of the European Commission.***

Statutory Requirements

An applicant pursuing Section 1782 discovery must establish first that:

a. The discovery is for use in an actual or contemplated proceeding in a "foreign or international tribunal";

b. The applicant is an "interested person" in that proceeding; and

c. The person from whom the discovery is sought resides or is otherwise found in the district of the court where the application is filed.

The *Intel* Factors

1. Is the discovery, accessible without resorting to Section 1782?
2. The receptivity of the foreign government or the court or agency abroad to U.S. federal court judicial assistance.
3. Whether the applicant's request is actually an attempt to circumvent foreign proof-gathering restrictions.
4. Whether the request is unduly intrusive or burdensome.

Second and Fifth Circuits v. Sixth and Fourth Circuits

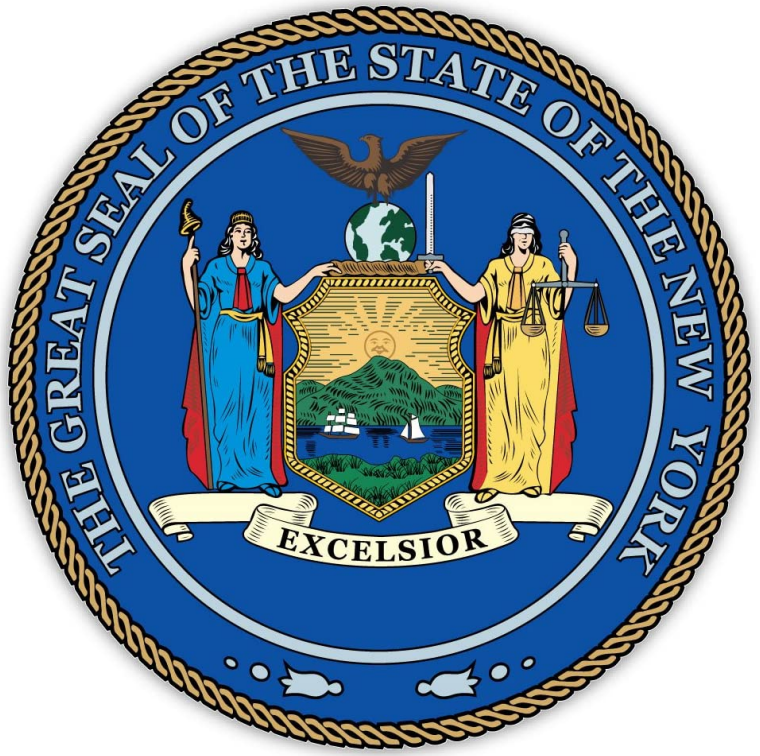
- *Abdul Latif Jameel Transp. Co. v FedEx Corp., 939 F.3d 710 (6th Cir. 2019)*
- *Servotronics Inc. v. Boeing Co., 954 F.3d 209, (4th Cir. 2020)*

VS

- *National Broadcasting Co., Inc. v Bear Stearns & Co., Inc., 165 F.3d 184 (2d Cir. 1999)*
- *Republic of Kazakhstan v. Biedermann Int'l, 168 F.3d 880 (5th Cir. 1999)*

The Empire Strikes Back

- *Hanwei Guo v. Deutsch Bank Securities, Inc., Case No 19-781 (2nd Cir. 2020)*



Will Other Circuits Be Drawn Into The Fight?

USDC Northern District of Illinois – Seventh Circuit

•*In re Application of Servotronics, Inc., for an Order Pursuant to 28 U.S.C. § 1782 To Take Discovery for Use in a Foreign Proceeding, CV-19-7847*

USDC for the District of Delaware - Third Circuit

- *EWG Gasspeicher GMBH v. Halliburton Co., Case No. 20-1830 (D.Del.) (March 17, 2020)*

USDC for the Northern District of California – Ninth Circuit

- *HRC-Hainan Holding Company, LLC v. Yihan Hu, et al, Case No. 19-mc-80277-TSH (N.D. California) (Feb. 25, 2020)*

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What are the Practical Implications for International Arbitrations?

China International Economic and Trade Arbitration Commission
Hong Kong Arbitration Center

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September 15, 2020

Round 1 – *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S.Ct. 524 (2019) *(Schein I)*

- Recognized that application of the "wholly groundless" exception would enable courts to block frivolous attempts to invoke arbitral jurisdiction, BUT . . . .
- The FAA "requires that we interpret the contract as written. When the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract … even if the court thinks that the argument [for arbitral jurisdiction] is wholly groundless." 139 S.Ct. at 529. "[T]he Act contains no 'wholly groundless' exception, and we may not engraft our own exceptions onto the statutory text." *Id*. at 530.

Round 1 – *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S.Ct. 524 (2019) *(Schein I)*

- "We express no view about whether the contract at issue in this case in fact delegated the arbitrability question to an arbitrator."
- Remanded for determination on this issue by the Fifth Circuit.

The "Clear and Unmistakable Evidence" Requirement for Delegation under the FAA

- Under the Federal Arbitration Act (FAA), there is no provision providing that the tribunal may decide its own jurisdiction. It is treated as another matter decided by contract.
  - "Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. Applying the Act, we have held that parties may agree to have an arbitrator decide not only the merits of a particular dispute but also gateway questions of arbitrability, such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy." *Schein*, 139 S.Ct. 524, 526 (2019).

The U.S. Approach – Delegation to the Tribunal (cont'd)

- "Courts should not assume that the parties agreed to arbitrate arbitrability unless there is **'clea[r] and unmistakabl[e]" evidence** that they did so.' *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (emphasis added).

The *Schein* arbitration clause

"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 [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina."

Archer & White Sales, Inc. v. Henry Schein, Inc., 935 F.3d 274 (5th Cir. 2019)

- "As we held in *Petrofac*, an arbitration agreement that incorporates the AAA Rules 'presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability.' Under AAA Rule 7(a), 'the 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.'" 935 F.3d at 279-80.

Archer & White Sales, Inc. v. Henry Schein, Inc., 935 F.3d 274 (5th Cir. 2019)

- Cases considered in the opinion include:
  - *Crawford Prof'l Drugs, Inc. v. CVS Caremark Corp.*, in which the 5th Circuit had found clear and unmistakable evidence of delegation even though the arbitration clause contained a carve-out for injunctive relief
  - *NASDAQ OMX Grp., Inc. v. UBS Securities* (2d Circuit), which held that the parties 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."

Archer & White Sales, Inc. v. Henry Schein, Inc., 935 F.3d 274 (5th Cir. 2019)

- Concluded that "the placement of the carve-out" in the arbitration clause was dispositive.
- "The most natural reading of the arbitration clause at issue here states that any dispute, except actions seeking injunctive relief, shall be resolved in arbitration in accordance with the AAA rules. The plain language incorporates the AAA rules—and therefore delegates arbitrability—for all disputes *except* those under the carve-out. Given that carve-out, we cannot say that the Dealer Agreement evinces a 'clear and unmistakable' intent to delegate arbitrability." *Id*. at 281-82.

Henry Schein, Inc. v. Archer & White Sales, Inc., No. 19-963 (*Schein II*)

- SCOTUS granted second round of review on June 15, 2020
- The issue to be reviewed (per Schein's petition): "Whether a provision in an arbitration agreement that exempts certain claims from arbitration negates an otherwise clear and unmistakable delegation of questions of arbitrability to an arbitrator"

The Bermann Objection

- "If ordinary competence-competence language found in all modern arbitral rules and all modern arbitration laws were sufficient to rebut the *First Options* presumption, that presumption would cease to exist." Prof. Bermann's Amicus Brief to *Schein I* at 14.
- "In short, general competence-competence language cannot constitute the clear and unmistakable evidence required by First Options." *Id*.

One-Stop Shopping – Refuting Bermann and the Fifth Circuit with a Single Citation

Blanton v. Domino's Pizza Franchising LLC, 962 F.3d 842 (6th Cir. 2020) – decided two days after SCOTUS granted cert

- Makes no mention of Professor Bermann's amicus argument in *Schein I*
- Twelve of the thirteen federal circuits (including the Sixth) have found that the incorporation of the AAA Rules (or similarly worded arbitral rules) provides "clear and unmistakable" evidence of delegation, and the one remaining circuit has precedent suggesting it would join in the consensus. *Id*. at 846

One-Stop Shopping – Refuting Bermann and the Fifth Circuit with a Single Citation

- "[T]he AAA seems to have adopted its jurisdictional rule … to provide 'clear and unmistakable' evidence that the parties agreed to arbitrate 'arbitrability.' That's at least how the AAA and other sources described the rule at the time of its adoption." *Id*. at 849-50 (citing Professor Alan Scott Rau's article, "Arbitrating 'Arbitrability'," available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2241774)

One-Stop Shopping – Refuting Bermann and the Fifth Circuit with a Single Citation

- As for the Fifth Circuit's interpretation of the carve-out clause, *Blanton* interprets such a clause as carving out certain claims from the arbitration agreement in general, not from the provision incorporating AAA's rules.
- Consistent with other cited cases, *Blanton* interprets the carve-out as impacting the scope of the arbitration agreement, not the scope of delegation

Additional context

- Amicus briefs argue that:
  - The parties in this case are sophisticated businesses reliant on the efficiencies of arbitration
  - Having courts decide arbitrability dramatically increases cost and delay, robbing businesses of much of the desired benefit of submitting disputes to arbitration
  - The interpretation advanced by the Fifth Circuit does not comport with the intent behind these clauses
  - Carve-out clauses like the one at issue are very common

Additional context

- The comments to AAA and CPR's previous versions of their corresponding arbitration rules makes clear that their rules were adopted to provide "clear and unmistakable evidence" of delegation, consistent with *First Options*.
- SCOTUS only granted cert on Henry Schein, Inc.'s petition, which framed the question as whether a clear and unmistakable delegation is negated by a carve-out provision in the arbitration clause. Denied A&W's conditional petition to determine whether incorporation of institutional rules is "clear and unequivocal" evidence . . . .

Lessons Learned

- Draft your arbitration clauses carefully – the ***Schein*** litigation has been going for nearly a decade, all due to an ambiguity that was easily avoided
- Delegation clauses and carve-outs in the same arbitration agreement are a recipe for disaster without careful drafting.

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