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Delegating Authority to Decide Arbitrability: The Problem with Carve-Outs

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When parties disagree over whether their dispute must be submitted to arbitration, a preliminary question arises: Who decides the question of arbitrability, a court or the arbitrator? The Supreme Court has given a general answer: "Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator."[1] Lower courts have found, with near unanimity, that parties have "clearly and unmistakably" delegated the issue of arbitrability to the arbitrator when their arbitration clause provides for application of rules that authorize arbitrators to decide on their own jurisdiction.[2] An example is Rule R-7(a) of the Commercial Arbitration Rules of the American Arbitration Association (AAA):

> The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence,

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[1] *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649 (1986); *accord Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002).

[2] *See Blanton v. Domino's Pizza Franchising LLC*, 962 F.3d 842, 845-46 (6th Cir. 2020) (collecting cases).

> scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim, without any need to refer such matters first to a court.

The delegation issue becomes complicated when the arbitration clause includes not only the incorporation of rules like the AAA rules but also a carve-out from the scope of disputes subject to arbitration. Consider the following arbitration clause:

> Any 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 American Arbitration Association.

Does a court or an arbitrator decide whether the exception for injunctive relief applies to a dispute? Phrased differently, does the carve-out for injunction actions apply to the incorporation of AAA rules, which delegates arbitrability to the arbitrator, or just to the scope of the arbitration clause? In the past few years, several courts have addressed this issue. The case law does not provide clear and consistent guidance.

I. Conflicting Decisions

Archer & White Sales, Inc. v. Henry Schein, Inc. involved the application of an arbitration clause, essentially identical to the one quoted above, to an antitrust claim seeking both treble damages and injunctive relief.[3] The defendant argued that the clause required arbitration of the treble damages claim and carved out for the court's decision only issues relating to the availability of injunctive relief, while the plaintiff contended that the entire dispute was carved out from the requirement to arbitrate.[4] The defendant further argued that the arbitrator, rather than the court, should decide on the arbitrability of the treble damages claim.[5] The Fifth Circuit disagreed: "The

[3] 935 F.3d 274, 277 (5th Cir. 2019). The arbitration clause also carved out other categories of disputes.

[4] *Id.* at 283.

[5] *Id.* at 282-83.

plain language incorporates the AAA rules—and therefore delegates arbitrability—for all disputes except those under the carve-out."[6]

The Second Circuit reached a similar result in *NASDAQ OMX Group, Inc. v. UBS Securities, LLC.*[7] The NASDAQ stock exchange faced an arbitration demand from UBS for alleged failures in handling an IPO. The arbitration clause at issue incorporated the AAA rules and began with the phrase: "Except as may be provided in the NASDAQ OMX Requirements . . . ."[8] One of these requirements arguably immunized NASDAQ from liability for the type of claim that UBS was asserting in arbitration.[9] The Second Circuit held that this requirement was not only a potential defense to the claim but also grounds for finding against delegation of the issue of arbitrability. The Court explained that the arbitration clause "carves out certain issues from arbitration, a circumstance that thus delays application of AAA rules until a decision is made as to whether a question does or does not fall within the intended scope of arbitration, in short, until arbitrability is decided."[10]

The Ninth Circuit took a different approach in *Oracle America, Inc. v. Myriad Group A.G.*[11] The arbitration clause, like the others in this series of cases, carved out a category of disputes from the requirement to arbitrate, specifically disputes relating to certain intellectual property rights, and it called for the application of UNCITRAL rules which, like the AAA rules, authorize the arbitrator to decide issues of arbitrability.[12] The district court had enjoined an arbitration on the grounds that the dispute related to the carved-out intellectual property rights. The Ninth Circuit reversed,

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[6] *Id.* at 281.

[7] 770 F.3d 1010 (2d Cir. 2014).

[8] *Id.* at 1016.

[9] *Id.* at 1031-32, 1033-34.

[10] *Id.* at 1032.

[11] 724 F.3d 1069 (9th Cir. 2013).

[12] *Id.* at 1071. "UNCITRAL" is the United Nations Commission on International Trade Law.

holding that the issue of arbitrability was for the arbitrator to decide, and specifically rejected an argument that the carve-out required a different conclusion:[13]

> Oracle's argument conflates the *scope* of the arbitration clause, *i.e.*, which claims fall within the carve-out provision, with the question of *who* decides arbitrability. The decision that a claim relates to intellectual property rights . . . constitutes an arbitrability determination, which the parties have clearly and unmistakably delegated to the arbitrator by incorporating the UNCITRAL rules.

Several other courts have followed the Ninth Circuit's *Oracle* decision.[14]

II. Why Do These Decisions Differ?

The differences in these lines of cases derive largely from the Supreme Court's holding that arbitrability is an issue for the court unless "the parties clearly and unmistakably provide otherwise."[15] In *Archer & White,* the Fifth Circuit wrote: "Given that carve-out, we cannot say that the [arbitration clause] evinces a 'clear and unmistakable' intent to delegate arbitrability."[16] The Second Circuit has explained its rulings as follows: "where there is a qualifying provision (whether described as a carve-out or carve-in) that arguably excludes the present dispute from the scope of the arbitration agreement, that provision creates ambiguity regarding the parties' intent to delegate arbitrability to the arbitrator."[17]

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[13] *Id.* at 1076.

[14] *See Blanton*, 962 F.3d at 847-48; *Hammond, Kennedy, Whitney & Co. v. Freudenberg*, 2023 WL 2525026 at *2-3 (N.D. Ill. March 23, 2023); *KONE Inc. v. Chenega Worldwide Support, LLC*, 2021 WL 827163 at *5-7 (D.D.C. March 3, 2021); *TotalEnergies E&P USA, Inc. v. MP Gulf of Mexico, LLC*, 2023 WL 2939648 *12-16 (Tex. April 14, 2023); *Ally Align Health, Inc. v. Signature Advantage, LLC*, 574 S.W.3d 753, 756-58 (Ky. 2019); *see also WasteCare Corp. v. Harmony Enterprises, Inc.*, 822 Fed. Appx. 892, 896 (11th Cir. 2020) (not citing *Oracle* but reaching the same conclusion.)

[15] *See AT&T Technologies, Inc.*, 456 U.S. at 649.

[16] 935 F.3d at 281-82.

[17] *DDK Hotels, LLC v. Williams-Sonoma, Inc.*, 6 F.4th 308, 322 (2d Cir. 2021).

It is helpful to consider the reason for the Supreme Court's requirement that the parties "clearly and unmistakably" provide for delegation of the arbitrability issue to the arbitrator. In *First Options of Chicago, Inc. v. Kaplan*, the Court explained that it is a presumption designed to reflect the likely intentions of the parties:

> [T]he former question—the "who (primarily) should decide arbitrability" question—is rather arcane. A party often might not focus upon that question or upon the significance of having arbitrators decide the scope of their own powers . . . . And, given the principle that a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration, one can understand why courts might hesitate to interpret silence or ambiguity on the "who should decide arbitrability" point as giving the arbitrators that power, for doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide. [18]

This presumption has questionable relevance when an arbitration clause incorporates rules of procedure, like AAA Commercial Rule R-7(a), which expressly authorizes arbitrators to decide issues of arbitrability. These clauses are not silent, or even ambiguous, on whether arbitrability is delegated. The AAA rule in particular is very broad. It authorizes the arbitrator to rule on "any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim."[19]

One possible response to the clarity of the AAA rules is to argue that the incorporation of these rules in their entirety does not reflect a specific intention to delegate the issue of arbitrability. The plaintiff in *Archer & White* made that argument to the Supreme Court in an appeal from the Fifth Circuit's decision, contending that incorporation of the AAA rules does not "clearly and unmistakably" delegate arbitrability because "the only relevant rule is buried among 58 separate rules spanning

[18] 514 U.S. 938, 945 (1995).

[19] Commercial Arbitration Rules of the American Arbitration Association, Rule R-7(a) (eff. Sept. 1, 2022) (emphasis added).

dozens of pages."[20] The Supreme Court never addressed this argument. Rather, the Court dismissed the case on the ground that certiorari had been improvidently granted.[21] Unless and until the Supreme Court chooses to address the issue, the legal landscape is that all of the federal circuit courts of appeal to have addressed the issue, 12 of the 13, have found that the incorporation of AAA or similar rules, without any carve-outs, expresses a clear and unmistakable intent to delegate.[22]

III. What Did the Parties Intend?

None of the decisions of the Second or Fifth Circuits, or courts following them, rely on the possibility that the parties did not know the contents of the rules that they agreed to follow. They rely, rather, on interpretations of the specific arbitration clauses at issue. In *Archer & White*, the Fifth Circuit distinguished its earlier decision in *Crawford Professional Drugs, Inc. v. CVS Caremark Corp.*, in which it had found that the arbitrability issue had been delegated to the arbitrator under the following arbitration clause:

> Any and all disputes in connection with or arising out of the Provider Agreement by the parties will be exclusively settled by arbitration before a single arbitrator in accordance with the Rules of the American Arbitration Association. . . . [P]rovided, however,

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[20] *Henry Schein, Inc. v. Archer & White Sales, Inc.*, No. 19-963 (US), Brief for Respondent at 13-14 (filed Oct. 13, 2022).

[21] *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 141 S. Ct. 656, 656 (Jan. 25, 2021).

[22] *Blanton*, 962 F.3d 842 at 845-46. The Seventh Circuit has not addressed the issue. Most district courts in the Seventh Circuit have found that incorporation of the AAA rules is a delegation of the issue of arbitrability to the arbitrator. *See Telephone Investments USA, Inc. v. Lumen Technologies, Inc.*, 2022 WL 2828751 at *4 (N.D. Ill. July 20, 2022). *But see Taylor v. Samsung Electronics America, Inc.*, 2020 WL 1248655 at *4 (N.D. Ill. March 16, 2020) ("It is hard to see how an agreement's bare incorporation by reference of a completely separate set of rules that includes a statement that an arbitrator has authority to decide validity and arbitrability amounts to 'clear and unmistakable' evidence that the contracting parties agreed to delegate those issues to the arbitrator and preclude a court from answering them.").

> that nothing in this provision shall prevent either party from seeking injunctive relief for breach of this Provider Agreement in any state or federal court of law. [23]

This arbitration clause differs from the clause in *Archer & White* only in that the carve-out appears in a separate sentence following the sentence incorporating the AAA rules. The ruling in *Archer & White* is that "the placement of the carve-out here is dispositive."[24] Other courts have followed *Archer & White* and have found no delegation based on the word order or sentence structure of the arbitration clause.[25] Some courts have accepted the approach in *Archer & White* but have found a delegation based on smaller differences in the language of the arbitration clauses.[26]

This is not a persuasive reading of the parties' intentions. In both *Archer & White* and *Crawford*, the parties adopted an arbitration rule authorizing the arbitrator to decide "any objection . . . to the arbitrability of any claim."[27] The breadth of that rule is not reduced by its placement in a separate sentence from the carve-out.

Furthermore, under the Second and Fifth Circuit line of cases, carve-outs frequently are treated differently from the language in the arbitration clause that affirmatively describes the scope of disputes to be submitted to arbitration, such as "all disputes arising under this agreement." When issues of arbitrability relate to such general language, rather than to the carve-out, courts in these circuits have found that the

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[23] *Crawford Professional Drugs, Inc. v. CVS Caremark Corp.*, 748 F.3d 249, 256 (5th Cir. 2014).

[24] 935 F.3d at 281.

[25] *See Maguire Insurance Agency, Inc. v. Amynta Agency, Inc.*, 2023 WL 372381 at *6-8 (W.D. Wash. Jan. 24, 2023); *J2 Resources, LLC v. Wood River Pipe Lines, LLC*, 2020 WL 4227424 at *12-13 (S.D. Tex. July 23, 2020); *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 81 (Del. 2006).

[26] *See Telephone Investments*, 2022 WL 2828751 at *7 (finding the "arbitration provision here is more similar to the ones in *Crawford* and *Oracle* than *Archer*"); *Aerpio Pharmaceuticals, Inc. v. Quaggin*, 2019 WL 4717477 at *12-17 (S.D. Ohio Sept. 26, 22019).

[27] *See Crawford*, 748 F.3d at 256; *Archer & White*, 935 F.3d at 277 (5th Cir. 2019), *cert. denied*, 141 S. Ct. 113 (2020); Commercial Arbitration Rules of the American Arbitration Association, Rule R-7(a) (eff. Sept. 1, 2022).

incorporation of AAA rules, or similar rules, mean that the issue of arbitrability is delegated to the arbitrator.[28] In most cases, there is no reason to conclude that the parties intended to make a delegation for the general language but not for the carve-outs.

IV. Blurring the Line Between Arbitrability and Who Decides It

A further problem with the Second and Fifth Circuit line of cases is that courts effectively decide the issue of arbitrability in the context of deciding on delegation. In *Archer & White*, the Fifth Circuit found no delegation based on its own interpretation of the arbitration clause: "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."[29]

In the Second Circuit, courts decide on delegation by making a preliminary decision on whether the underlying decision could fall within the scope of the carve-out.[30] The Court of Appeals has written that the "clearer it is that the terms of the arbitration agreement reject arbitration of the dispute, the less likely it is that the parties intended to be bound to arbitrate the question of arbitrability . . . ."[31]

There is some efficiency in this approach. Why impose on the parties the delay and expense of commencing arbitration when the expected decision of the arbitrator is to send the case back to the court? Nonetheless, these decisions are hard to reconcile

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[28] *See Crawford, supra* at footnote **Error! Bookmark not defined.** above**Error! Reference source not found.Error! Reference source not found.**; *Saizhang Guan v. Uber Technologies, Inc.*, 236 F. Supp. 3d 711, 728-29 (E.D.N.Y. 2017); *Consolidated Precision Products Corp. v. General Electric Co.*, 2016 WL 2766662, at *6 (S.D.N.Y. May 12, 2016).

[29] 935 F.3d at 281.

[30] *See Armor All/STP Products Co. v. TSI Products, Inc.*, 337 F. Supp.3 d 156, 165-66 (D. Conn. 2018).

[31] *Metropolitan Life Ins. Co. v. Bucsek,* 919 F.3d 184, 191 (2d Cir. 2019).

with the Supreme Court's recent ruling that courts must enforce agreements to delegate the issue of arbitrability even when the argument that the dispute is subject to arbitration is "wholly groundless."[32]

Delving into the merits of the arbitrability issue reached an unreasonable point in a recent district court decision, *Anhui Powerguard Technology Co. v. DRE Health Corp.*[33] To settle amounts due the plaintiff, the defendant agreed to make a series of installment payments. This new agreement included the following clause:

> After that initial payment of $1,970,000 USD and in consideration of future payment commitments, [plaintiff] agrees to release [defendant] from all legal claims (granted [defendant] completes installment payments), agree that the venue for any future disputes shall be binding arbitration with Hong Kong International Arbitration Centre (HKIAC) . . . .[34]

The plaintiff later sued, alleging a failure to make the agreed installment payments. The defendant moved to compel arbitration. Even though the Hong Kong International Arbitration Center, like the AAA, has a rule empowering arbitrators to decide on their own jurisdiction, the district court heard and denied the motion to compel arbitration. The court read the arbitration clause to mean that completion of the installment payments is a condition precedent to arbitration: "Under the contracted terms, Plaintiff has not agreed to arbitrate anything, including arbitrability, until AFTER the condition precedent is met."[35] In effect, the defendant could arbitrate the issue of arbitrability only if it first provided the plaintiff with the relief that the plaintiff would seek in the arbitration.

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[32] *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019).

[33] 2023 WL 3035456 (W.D. Mo. March 21, 2023).

[34] *Id.* at *1.

[35] *Id.* at *3.

V. Predictability

The case law expresses no policy favoring or disfavoring the delegation of the issue of arbitrability. The Supreme Court has held that 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."[36] A decision on delegation should depend entirely on the agreement of the parties. In negotiating contract terms, however, many of the details of arbitration, such as delegation, are not addressed in the written contract or even discussed by the parties during negotiations. In these circumstances, predictable rules of interpretation facilitate outcomes that are more likely to reflect the parties' intentions than efforts to parse the language of the arbitration clause.

The Ninth Circuit's *Oracle* decision provides such a predicable rule. Under the current state of the case law, parties can and should know, at the time of contracting, that when they incorporate the AAA rules, or similar rules into an arbitration clause, issues of arbitrability will be decided by arbitrators. If the parties wish to have the benefit of a set of arbitration rules but do not wish to delegate arbitrability, they can make an express exception. For example, the clause could provide for "arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, except for any rule that authorizes the arbitrator to determine whether a dispute is subject to arbitration under this Agreement."

The approach of the Second and Fifth Circuits does not encourage predictable results. The courts closely examine the sentence structure and word order of the arbitration clause to determine whether or not the carve-out is subject to the arbitration rules. Can the parties be confident that an arbitration clause with both carve-outs and the incorporation of AAA-like rules will be interpreted as they intend? Will inartful phrasing or punctuation errors lead to unintended outcomes?

Because of this unpredictability, the Ninth Circuit's *Oracle* decision is the better approach to the delegation issue, but federal courts in the Second and Fifth Circuits

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[36] *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 70 (2010).

are bound to take a different approach. This split will remain unless and until it is resolved, either by the Supreme Court or by *en banc* decisions in the two circuits.