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Legal Sidebar

An Avalanche of Arbitration: Three Federal Arbitration Act Cases at the Supreme Court

Updated January 15, 2019

UPDATE: On January 15, 2019, the Supreme Court issued its decision in New Prime v. Oliveira. *In an opinion authored by Justice Gorsuch, the Court unanimously ruled in favor of respondent Oliveira on both of the questions discussed below. First, the Court held that courts—not arbitrators—had to determine whether or not an arbitration agreement falls within the ambit of Sections 1 and 2 of the Federal Arbitration Act, even if the parties sought to delegate that question to arbitration. Second, the Court held that an independent contracting agreement was a "contract of employment" such that it was subject to the Federal Arbitration Act's exemption for such contracts involving interstate transportation workers like Mr. Oliveira. Justice Ginsburg concurred, writing a short separate opinion to observe that, while ordinarily it is appropriate to look at the ordinary meaning of the words in a statute at the time the statute was enacted (as the Court did in* New Prime *with the language "contract of employment"), Congress may also craft statutes with broad language that can govern changing circumstances. Justice Kavanaugh did not participate in the case.*

In addition, on January 9, 2019, the Court decided the second of the cases discussed below, Henry Schein, Inc. v. Archer & White Sales, Inc. *In another unanimous opinion, this time authored by Justice Kavanaugh, the Court rejected the existence of a "wholly groundless" exception to so-called delegation clauses, which some lower courts had adopted in order to decide arbitrability questions even where the parties had sought to delegate the question of arbitrability to an arbitrator. Instead, the Court explained that, under the Federal Arbitration Act and the Court's prior precedents, courts may never decide an arbitrability question—or a merits question—that the parties have delegated to an arbitrator. The Court expressed no view on whether the contract at issue in the case actually delegated arbitrability, but remanded for the lower court to make that determination.*

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LSB10205

As of the date of this update, the Supreme Court has yet to issue a decision in the third case discussed below, Lamps Plus, Inc. v. Varela.

The original post from October 12, 2018, follows below.

Few federal statutes have occasioned as many debates at the Supreme Court in recent years as the Federal Arbitration Act (FAA). The FAA is the federal law that makes arbitration agreements "valid, irrevocable, and enforceable," allowing parties to agree in their contracts to submit future disputes to arbitration and, in so doing, forfeit their right to go to court. Under the FAA, the Supreme Court has enforced, for example, arbitration clauses in employment agreements, contracts between corporations, and agreements between consumers and large companies. These often narrowly decided cases have caused the Supreme Court to split along ideological lines, with the majority favoring an expansive approach based on the plain text of the FAA, and the dissenters arguing that the FAA should be interpreted more narrowly, in accord with the statute's alleged intent to only promote arbitration between merchants of equal bargaining power. Most recently, last term the Supreme Court, in a 5-4 decision in *Epic Systems Corp. v. Lewis*, held that the FAA requires courts to enforce arbitration agreements where those agreements preclude employees from bringing class action suits against their employers.

This term, a disproportionate number of FAA cases are before the Court. In October, the Supreme Court is scheduled to hear three cases that all focus on the FAA, including two that center around the important threshold question of who should decide whether a claim is arbitrable or not—a court or the arbitrator. Because of the importance of the FAA, each case is significant to Congress, which has, on several occasions, entertained legislation proposing revisions to the statute. This Sidebar briefly reviews each of these Supreme Court cases and discusses issues that may be significant for Congress.

New Prime v. Oliveira. On October 3, 2018, the Supreme Court heard oral argument in *New Prime, Inc. v. Oliveira*. In *New Prime*, respondent Oliveira, a truck driver and former contractor for petitioner New Prime, sought to bring a class action suit against New Prime notwithstanding a provision in his agreement with New Prime in which the parties agreed to arbitrate their disputes. Specifically, Oliveira's agreement pledged that the parties would arbitrate "any disputes arising under, arising out of or relating to [the contract]…including the arbitrability of disputes between the parties." As explained above, the FAA requires courts to enforce arbitration agreements, including arbitration agreements between employers and employees. However, Section 1 of the FAA specifically exempts "contracts of employment of seamen, railroad employees" and other transportation employees from the FAA's coverage.

New Prime presents two questions. First, the case raises the question of who should decide the applicability of the Section 1 exemption when the contract delegates the question of arbitrability to the arbitrator. The First Circuit concluded that this question was for the courts, deepening an already-existing circuit split over this issue. The second question presented in *New Prime* is whether an independent contractor agreement is a "contract of employment" such that it is within the coverage of Section 1's exemption. Modern employment law generally distinguishes between an employee and an independent contractor, which Black's Law Dictionary defines as "someone who is entrusted to undertake a specific project but who is left free to do the assigned work and to choose the method for accomplishing it." Despite this distinction, the First Circuit reviewed the historical evidence from the time of the FAA's passage in 1925 and concluded that the exemption applied because, historically, the language "contract of employment" meant any agreement to do work, rather than the specific employer-employee relationship.

New Prime is not the first time the Supreme Court has considered the enforceability of a contract provision purportedly delegating a so-called "gateway issue" to arbitration. Most recently, in *Rent-A-Center, West, Inc. v. Jackson*, the Court explained that clauses that delegate arbitrability to the arbitrator (i.e., "delegation clauses") are simply a species of arbitration agreement, and as such, have to be enforced under the FAA unless the delegation clause is, standing alone, unenforceable. In *Rent-A-Center*, the Court applied that principle to submit a case to arbitration, even though the party resisting arbitration argued

that the arbitration agreement as a whole (and not just the delegation clause) was unconscionable. The Court explained that because the delegation clause was a separate and enforceable agreement that was not itself unconscionable, under the FAA, it was up to the arbitrator, not the court, to determine if the agreement as a whole was unconscionable.

On the surface, *New Prime* presents a similar question to the one raised in *Rent-A-Center*: did the parties choose to delegate the question of whether the Section 1 exemption applies to the arbitrator in the same way unconscionability was delegated in *Rent-A-Center*? If so, the petitioner in *New Prime* argues that *Rent-A-Center* requires the delegation to be treated like any other arbitration agreement and enforced under the FAA. This theory is essentially how the Eighth Circuit decided a similar case. The court below, however, disagreed. Instead the First Circuit concluded, agreeing with the Ninth Circuit, that courts must make an antecedent determination that a contract is arbitrable under Section 1 of the FAA before ordering arbitration pursuant to the FAA. Unlike an inquiry into whether an agreement is unconscionable, the application of the FAA to the contract must, in the view of the First Circuit, be established before the case can be submitted to arbitration because the applicability of the FAA must be established as a prerequisite to the Court having jurisdiction to compel arbitration. In other words, if "the only basis for seeking arbitration in federal court is the FAA," the lower court reasoned that "the district court can grant the requested relief only if it has authority to act under the FAA."

If the *New Prime* Court determines that a court, rather than an arbitrator, should decide the applicability of the Section 1 exemption, the question then becomes whether or not the Section 1 exemption applies to independent contractors in the transportation industry. This is a question of statutory interpretation. The FAA states that nothing in the statute "shall apply to contracts of employment" of transportation workers. The First Circuit, as discussed above, after reviewing the historical usage of the term "contracts of employment," concluded that the "ordinary meaning of the phrase at the time Congress enacted the FAA" suggested that it simply encompasses any agreement to do work, including independent contractor agreements. In its brief to the Supreme Court, New Prime argues, among other things, that this interpretation ignores the weight of authority holding that when Congress uses the term "employee," it generally means only the traditional employer-employee relationship and means to specifically exclude independent contractor arrangements.

Oral argument in *New Prime* took place on October 3, 2018, prior to Justice Kavanaugh's appointment. While it is difficult to derive firm conclusions from oral argument, at least the antecedent question appears likely to be resolved in favor of the trucker, as even the attorney for petitioner seemed to concede the point, stating that he would be "happy" for the Court to decide whether the contract was arbitrable. Similarly, Justice Gorsuch, who adopted a plain-meaning and expansive approach to the FAA in authoring last term's *Epic Systems*, asked a question in which he cited the fact that, in 1925, when the FAA was enacted, the law did not have a firm distinction between independent contractors and employees. This questioning suggests an understanding on the part of Justice Gorsuch that the Section 1 exemption should apply to at least some independent contractors in the transportation industry.

Whatever the Court decides in this case, it is sure to have significant implications for the economy and for Congress. For example, one amicus brief to the Court argues that over 545,000 trucks in the United States are operated by independent contractors, many of whom likely have contracts which could be implicated by the outcome of the case. The Court is likely to issue a decision in *New Prime* by early-2019.

Henry Schein, Inc. v. Archer and White Sales, Inc. On October 29, 2018, the Court is scheduled to hear oral argument in another FAA case involving the "who decides" question. In *Henry Schein, Inc. v. Archer and White Sales, Inc.*, the Court is to consider whether the FAA requires the enforcement of a delegation clause in an arbitration agreement even if a court has concluded that the claim of arbitrability is "wholly groundless." Unlike *New Prime*, this case involves a question of arbitrability involving the substance of the contract, rather than the overall applicability of the FAA. However, like the question in *New Prime*,

this petitioner has argued that the Fifth Circuit's decision in this case deepened a circuit split among the Federal Courts of Appeals.

In *Henry Schein*, the defendant Henry Schein, Inc. (Henry Schein), a dental equipment manufacturer, sought to compel arbitration when it was sued by competitor and distributor Archer and White Sales (Archer) for antitrust violations. The basis for the motion to compel was an arbitration agreement between the parties that mandated the use of arbitration except in "actions seeking injunctive relief." Archer argued that the case could not be arbitrated because the plaintiff sought, in part, injunctive relief. The Fifth Circuit conceded that the parties had delegated the question of arbitrability to the arbitrator, but the court nonetheless concluded that the claim of arbitrability was "wholly groundless" because the underlying case involved an action "seeking injunctive relief." The court concluded that because the "plain meaning" of this clause precluded arbitrability, the court did not have to send it to an arbitrator to decide this gateway question.

Henry Schein argues in its brief to the Supreme Court that the Fifth Circuit's approach conflicts with the plain text of the FAA. Specifically, the petitioner argues that where the parties delegate authority to decide an issue to an arbitrator, the court cannot look at the substance of the underlying claim, even if the claim "appears to be frivolous." According to Henry Schein, the Court has consistently applied this rule in arbitration of merits questions, and the logic of *Rent-A-Center* requires the same logic that is applied to the merits of an agreement to be applied to delegation clauses, as *Rent-A-Center* held that a delegation clause is simply "an agreement to arbitrate threshold issues." In opposition, Archer makes two primary arguments. First, Archer argues that it would be absurd to read the FAA to require courts to allow a pointless detour to arbitration, inflicting "terrible waste and inefficiency." Second, Archer argues that the FAA's purpose is to enforce the parties' contractual intent, and presumably no party would ever intend their contracts to permit wasteful detours in non-arbitrable matters.

Both Henry Schein and Archer argue that negative practical consequences will flow from a contrary decision. Henry Schein argues that the "wholly groundless" exception will undermine the "emphatic federal policy in favor" of arbitration and will move the courts toward taking even arguable cases out of arbitration. In turn, Archer argues that the "wholly groundless" exception is a "useful check in rare cases" and that, historically, it has not hampered arbitration in those jurisdictions in which it has been applied. The Court is likely to issue a decision in *Henry Schein* in 2019.

Lamps Plus, Inc. v. Varela. On the same day the Court is to hear argument in *Henry Schein*, the Supreme Court is also scheduled to hear oral argument in *Lamps Plus, Inc. v. Varela*. *Lamps Plus* involves the question of when a court must find that parties agreed to engage in "class arbitration" when the arbitration agreement does not explicitly specify the availability of classwide treatment. In 2016, petitioner Lamps Plus was the victim of a successful "phishing" attack, involving a major leak of employee personal information. Respondent Varela, an employee of Lamps Plus, was one of those who had his information leaked, and he filed suit on behalf of himself and all similarly situated Lamps Plus employees against his employer. Varela's employment contract, however, contained an arbitration clause. Lamps Plus therefore moved under the FAA to compel bilateral (non-class) arbitration. The district court sent the case to arbitration but ordered class-wide arbitration, rather than bilateral arbitration, despite the fact that the agreement did not specify the availability of classwide treatment. In an unpublished memorandum, the Ninth Circuit affirmed, concluding that because Lamps Plus had drafted the employment agreement, ambiguities in the contract should be interpreted in Varela's favor.

Lamps Plus argues in its Supreme Court brief that the Court's recent FAA decisions in *Stolt-Nielsen v. Animalfeeds International Corp.*, *AT&T Mobility LLC v. Concepcion*, and last term's *Epic Systems Corp. v. Lewis* all require that the case be sent to bilateral arbitration. According to Lamps Plus, these cases stand for the proposition that bilateral proceedings are a "fundamental attribute" of arbitration, and courts may not infer a willingness to agree to class arbitration from the silence in the parties' agreement. With these cases as the background, Lamps Plus asserts that the Ninth Circuit erred by holding that the parties

agreed to classwide treatment despite the silence in their agreement. In particular, Lamps Plus cites *Epic Systems*, where the Court explicitly stated that "courts may not allow a contract defense to reshape traditional individualized arbitration by mandating classwide arbitration procedures without the parties' consent." In light of this and other language in similar cases casting arbitration as defaulting to a bilateral process, Lamps Plus maintains that parties who are silent on the availability of classwide treatment should not lose out on individualized arbitration and be compelled to class arbitration. In response, Varela makes two arguments. First, Varela argues that the Court lacks jurisdiction because the FAA only provides for jurisdiction in appeals over orders denying arbitration. According to Varela, because the district court here actually ordered arbitration, albeit classwide arbitration rather than the bilateral arbitration that Lamps Plus requested, there should be no jurisdiction over the appeal. Second, Varela argues that, assuming jurisdiction exists, the practice of construing ambiguities in a contract against its drafter is a well settled principle of California contract interpretation, and the FAA requires that contracts to arbitrate be interpreted consistent with such generally applicable state law principles. The Supreme Court is likely to issue a decision in *Lamps Plus* in 2019.

Significance for Congress. Regardless of how the Court decides these three cases, the FAA is likely to be a significant issue in the courts and for Congress. The fact that the Supreme Court is deciding three cases involving the FAA in the first month of its October 2018 term, two of which involve circuit splits, is indicative of the importance and divisiveness of the FAA throughout the federal court system. However, Congress has also been involved in this area. The FAA is a federal statute, and as such, the Court's decisions involving the FAA are subject to Congress's revision. Accordingly, several bills have been introduced that would work changes both great and small in the FAA regime, for example, by carving out certain areas from the FAA's reach, or by changing the procedures that would apply in arbitration. With the Court taking an increasing interest in the FAA, the interests of legislators, businesses, and litigators in this area may likewise increase in the future.

Author Information

Wilson C. Freeman
Legislative Attorney

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