

Who Decides Arbitrability: The Court or The Arbitrator?

By John V. Burch & David A. Harris June 7, 2019

When parties to a construction contract agree to arbitrate and the surety's bond incorporates that contract by reference, does a court or does the arbitrator decide whether the surety must join in arbitration? Some very recent cases have important implications for sureties facing this question, and it turns out that who decides the issue may turn on how the question is framed.

In *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524, 527, 202 L. Ed. 2d 480 (2019), the United States Supreme Court held unanimously that parties to a contract can agree that an arbitrator, rather than a court, must resolve disputes concerning the scope of an arbitration agreement. Furthermore, the Court held that incorporating by reference arbitration rules authorizing arbitrators to decide the issue of arbitrability is enough to take this issue out of the courts and into arbitration.

The underlying contract in *Henry Schein* incorporated the AAA rules, which state that the arbitrators have the power to resolve arbitrability questions. Despite this, the trial court had held that arbitrability should not be decided by the arbitrator because the demand to arbitrate the claims at issue was "wholly groundless." The trial court reasoned that if a court finds no grounds to support the application of an arbitration agreement to a specific dispute, then it is senseless to have the arbitrability issue decided by the arbitrator. This was affirmed by the Fifth Circuit.

In reversing, the Supreme Court framed the question as "Who decides the threshold arbitrability question?" The answer was that when the Federal Arbitration Act is involved, the question of who decides arbitrability is a question of contract. If the parties agree that the arbitrator rather than a court will resolve the threshold question of arbitrability, so it will be. The Court held that there is no "wholly groundless" exception, and even when the parties make the argument that there is no well-founded basis for arbitration, if the underlying contract says the arbitrator will decide that issue, it must go to that forum.

The *Henry Schein* decision should not be taken to mean that all questions of arbitrability go to the arbitrator, even where so stated in the arbitration agreement. In *Berkeley County School District v. HUB International Ltd.*, 363 F. Supp. 3d 632 (D.S.C. 2019), a school board brought an action against its CFO and insurers alleging that the insurance companies conspired with the CFO to issue excessive and duplicative insurance policies. The insurers responded asserting that agreements with the school district required arbitration. The court distinguished *Henry Schein* and held that the court would decide the arbitrability of the dispute.

How did the South Carolina District Court distinguish *Henry Schein* and find that the arbitrability question was to be decided by the court? The court found that there are two separate issues often described as a single question of "arbitrability." First, there is the question of the scope of an arbitration

agreement. This issue goes to whether a valid arbitration clause applies to a specific dispute. The court found that *Henry Schein* applied to this type of arbitrability question.

The second type of arbitrability question, according to *Berkeley County*, concerns whether the parties ever even agreed to arbitrate their dispute. In other words, is there a valid agreement to arbitrate? When this question arises, as it did in the *Berkeley County* case, the court must decide first whether or not a valid agreement to arbitrate exists.

So, how can the question be framed so that the court and not the arbitrator decides the issue of arbitrability of a dispute involving a surety?

The surety in *FCCI Ins. Co. v. Nicholas Cty. Library*, 5:18-CV-038-JMH, 2019 WL 1234319 (E.D. Ky. Mar. 15, 2019), raised the issue of whether the arbitration provisions in the construction contract applied to the surety. The question the court ultimately answered was whether the arbitration provision applied to the claims against the surety. In other words, the question was framed in terms of the scope of the arbitration agreement. The court, following *Henry Schein*, held that, because the arbitration clause said the process would be governed by AAA rules, those rules governed the threshold issue of arbitrability. Therefore, it was up to the arbitrator to determine arbitrability as to the surety, not the court.

Had the question been framed differently, would the result have changed? The *FCCI* court noted the surety contended that the arbitration clause was limited to “the parties” to the construction contract. Despite this, the court decided to analyze whether the “claims” against the surety were within the scope of the valid agreement. But the court could have framed the question differently. Since the surety argued that it was not one of the “parties” to the construction contract, the question could have very easily changed from one of scope to one of validity. In other words, the opportunity was there for the court to decide whether a valid arbitration agreement existed as to the surety. If that were the question, and not the scope of the arbitration agreement, the court may have ultimately applied the reasoning found in *Berkeley County* and decided the arbitrability question for itself.

The bottom line is that, when a surety asks a court decide whether an arbitration agreement within a construction contract applies to the claims against the surety, the more the issue is framed as one involving the existence of a valid arbitration agreement, the greater likelihood the court will decide the issue.

One final note: The court in *FCCI* said the surety was a sophisticated party and that if it did not want arbitration, that should have been stated in its bond. The court held that if the surety did not want to go to arbitration, it needed to put a different method of dispute resolution in the bond or make it clear to exclude arbitration provisions on the face of the bond.