Carve-Outs and Injunctive Relief in Arbitration Cases

By: Mitchell L. Lathrop

Mitchell Lathrop is a lawyer licensed to practice law in California, New York and the District of Columbia. He spent 45 years in trial courts around the country as counsel for insurers and brokers. Today he restricts his practice to mediation, arbitration, and expert consulting and testimony in causes involving insurance (including brokers and agents), reinsurance, and lawyer's professional responsibility.

THE dual issues of arbitrability and who decides the validity of an arbitration provision continue to be disparate and unsettled,[1] particularly where parties modify otherwise commonplace arbitration agreements by adding carveouts. Even where an arbitration agreement provides otherwise clear and unmistakable evidence of the parties intent to delegate decisions of arbitrability to the arbitrator, a carveout provision may upend the enforceability of the arbitration provision.

The decisions of the United States Supreme Court following the enactment of the Federal Arbitration Act ("FAA")[2] in 1947 make clear that federal courts must respect and enforce arbitration

[1] *See*, *e.g.*, J2 Res., LLC v. Wood River Pipe Lines, LLC, 2020 U.S. Dist. LEXIS 130594 (S.D. Tex. July 23, 2020); Fedor v. United Healthcare, Inc., 976 F.3d 1100 (10th Cir. 2020); Citizens of Humanity, LLC v. Applied Underwriters Captive Risk Assur. Co., 299 Neb. 545, 909 N.W.2d 614 (Neb. 2018); Presbyterian Healthcare Servs. v. Goldman, Sachs & Co., 122 F. Supp.3d 1157 (D. N.M. 2015); Peabody Holding Co., LLC v. UMW, 665 F.3d 96 (4th Cir. 2012); Momot v. Mastro, 652 F.3d 982 (9th Cir. 2011); Parrish v. Valero Retail Holdings, Inc., 727 F. Supp.2d 1266 (D. N.M. 2010); Sadler v. Green Tree Servicing, LLC, 466 F.3d 623 (8th Cir. 2006); Oil, Chem., & Atomic Workers Int'l Union v. Conoco, Inc., 241 F.3d 1299 (10th Cir. 2001); Riley Mfg. Co. v. Anchor Glass Container Corp., 157 F.3d 775 (10th Cir. 1998); Abram Landau Real Estate v. Bevona, 123 F.3d 69 (2d Cir. 1997); Avedon Eng'g, Inc. v. Seatex, 126 F.3d 1279 (10th Cir. 1997); Securities Serv. Network v. Cromwell, 1995 U.S. App. LEXIS 22540 (6th Cir. Aug. 1, 1995).

[2] 9 U.S.C. § 1, *et seq*.

provisions in accord with the explicit provisions of the FAA that an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[3] Over the years, the high court has dealt with multiple issues touching on the FAA and arbitration provisions in contracts subject to the FAA such as collective bargaining agreements,[4] labor laws,[5] claims of fraud,[6] debt collection,[7] arbitrator disclosure and misconduct,[8] judicial authority and discretion,[9] and FAA pre-emption of state laws.[10] The Court also decided issues relating to the arbitrability of securities law claims,[11] even when coupled with state law pendent claims,[12] antitrust claims,[13] and even discrimination claims.[14] As the Court pointed out:

> In many cases over many years, this Court has heard and rejected efforts to conjure conflicts between the Arbitration Act and other federal statutes. In fact, this Court has rejected *every* such effort to date (save one temporary exception since overruled),

[3] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967); Scherk v. Alberto-Culver Co., 417 U.S. 506, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974).

[4] United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960); Hines v. Anchor Motor Freight, Inc., 424 U.S. 554, 96 S. Ct. 1048, 47 L. Ed. 2d 231 (1976); AT&T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986); United Paperworkers International Union v. Misco, Inc., 484 U.S. 29, 108 S. Ct. 364, 98 L. Ed. 2d 286 (1987); Eastern Associated Coal Corporation v. United Mine Workers of America, District 17, 531 U.S. 57, 121 S. Ct. 462, 148 L. Ed. 2d 354 (2000); Granite Rock Co. v. International Brotherhood of Teamsters, 130 S. Ct. 2847, 177 L. Ed. 2d 567 (2010).

[5] Perry v. Thomas, 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed.2d 426 (1987).

[6] *Prima Paint,* 388 U.S. 395.

[7] Green Tree Financial Corp. v. Bazzle, 539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003); Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006); Vaden v. Discover Bank, 556 U.S. 49, 129 S. Ct. 1262, 173 L. Ed. 2d 206 (2009).

[8] Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 89 S. Ct. 337, 21 L. Ed. 2d 301 (1968).

[9] Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983).

[10] Southland Corp. v Keating, 465 U.S. 1, 79 L. Ed. 2d 1, 104 S. Ct. 852 (1984); Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996); Preston v. Ferrer, 552 U.S. 346, 128 S. Ct. 978, 169 L. Ed. 2d 917 (2008).

[11] Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987).

[12] Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985).

[13] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985).

[14] Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991).

> with statutes ranging from the *Sherman* and *Clayton Acts* to the *Age Discrimination in Employment Act*, the *Credit Repair Organizations Act*, the *Securities Act of 1933*, the *Securities Exchange Act of 1934*, and the *Racketeer Influenced and Corrupt Organizations Act*.[15]

Courts and arbitrators must address two threshold questions before compelling arbitration: (1) is there a valid agreement to arbitrate, and (2) is the dispute covered by the arbitration provision?[16] Once those two questions have been answered in the affirmative, the next issue which is likely to arise in many cases is: who decides arbitrability, the arbitrator or the court? The general rule is that when an arbitration provision or the rules of an arbitration provider provide that the arbitrator will determine arbitrability, that decision is left to the arbitrator except in cases where a party challenges the validity of the arbitration provision itself. When a party challenges the validity of the arbitration provision, the court must decide arbitrability. In *First Options of Chicago, Inc. v. Kaplan*,[17] the Supreme Court held that if the parties agree to submit the question of who has the primary power to decide arbitrability to the arbitrator, the court should defer to the arbitrator's arbitrability decision, but if not, the court should decide the question independently. *First Options* involved several related disputes between First Options of Chicago, a firm that cleared stock trades on the Philadelphia Stock Exchange, and three adverse parties: Manuel Kaplan; his wife, Carol Kaplan; and his wholly owned investment company, MK Investments, Inc. (MKI). First Options was the clearing house for MKI trades. The parties entered into a 1988 workout agreement which was memorialized in four separate documents which governed resolution of debts to First Options that MKI and the Kaplans incurred as a result of the October 1987 stock market crash. In 1989, MKI lost an additional $1.5 million, whereupon First Options took control of, and liquidated, certain MKI assets; demanded immediate payment of the entire MKI debt; and insisted that the Kaplans were personally obligated to pay any deficiency. First Options demanded arbitration by a

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[15] Epic Systems Corp. v. Lewis, _ U.S. _, 138 S. Ct. 1612, 1627, 200 L. Ed. 2d 889, 905-906 (2018).

[16] *AT&T Technologies*, 475 U.S. at 648-649; Schnabel v. Trilegiant Corp., 697 F.3d 110, 118 (2d Cir. 2012); Starke v. Squaretrade, Inc., 913 F.3d 279 (2d Cir. 2019); Gannon v. Circuit City Stores, Inc., 262 F.3d 677, 680 (8th Cir. 2001).

[17] 514 U.S. 938, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995).

panel of the Philadelphia Stock Exchange.

MKI signed the only workout document of the four that contained an arbitration clause. The Kaplans, however, had not signed that document. They denied that their disagreement with First Options was arbitrable and filed written objections with the arbitration tribunal. The arbitrators nevertheless decided that they had the power to rule on the merits of the parties' dispute and ruled in favor of First Options. The Kaplans petitioned for vacatur of the arbitration award, while First Options petitioned to confirm. The court confirmed the award and the Kaplans appealed. The Third Circuit agreed with the Kaplans and reversed confirmation of the award.[18]

The Supreme Court issued certiorari to review two specific issues: (1) the standard of review applied to a court's decision to confirm or vacate an arbitrator's award, and (2) who, the court or the arbitrator, has the primary authority to decide whether a party has agreed to arbitrate. As to the second issue, the high court made clear that "the question 'who has the primary power to decide arbitrability' turns upon what the parties agreed about *that* matter."[19] In other words, if the parties expressly gave the arbitrability decision to the arbitrator, then the arbitrator would decide. Otherwise it would be up to the court.[20]

The standard of review of an arbitrator's decision as articulated in *First Options* is that normally applied to all appellate review of lower court decisions. "[C]ourts grant arbitrators considerable leeway when reviewing most arbitration decisions; but that fact does not mean that appellate courts should give *extra* leeway to district courts that uphold arbitrators."[21] At the same time, however, Sections 10 and 11 of the FAA set forth the exclusive categories for vacating or modifying an arbitral award.

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[18] Kaplan v. First Options, 19 F.3d 1503 (3d Cir. 1994).

[19] *First Options,* 514 U.S. at 943-944. (emphasis in original). *See also AT&T Technologies*, 475 U.S. at 656 ("The question whether the parties have submitted a particular dispute to arbitration, *i.e.*, the "*question of arbitrability*," is "an issue for judicial determination. Unless the parties clearly and unmistakably provide otherwise") (emphasis in original).

[20] *See*, *e.g*., Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002).

[21] *First Options,* 514 U.S. at 948 (emphasis in original).

Many current arbitration provisions provide for administration of an arbitration by an arbitral provider such as the American Arbitration Association ("AAA"),[22] or prescribe that the arbitration will proceed according to a specific set of rules.[23] Where the arbitration agreement incorporates the rules of an arbitral provider into an arbitration agreement, the rules will govern both the procedure to be followed and the authority of the arbitrator. As the Third Circuit said in *Richardson v. Coverall N. America, Inc.*,[24] "the incorporation of the AAA Rules in [Plaintiff's] arbitration clause constitutes clear and unmistakable evidence that the parties agreed to delegate arbitrability."[25]

While most provisions in an arbitration agreement will be upheld by the court, that is not universally true. For example, the standards for judicial review of an arbitration award cannot be extended even by agreement of the parties.[26] What about provisions which carve out the authority of the arbitrator, or put another way, can a carveout provision in an arbitration agreement negate an otherwise clear and unmistakable delegation of arbitrability to an arbitrator? Enter the long and tortured history of *Archer & White Sales, Inc. v. Henry Schein, Inc.*

Archer & White Sales, Inc. ("Archer") is a distributor of dental equipment which competes directly against Henry Schein, Inc. ("Schein"). Archer alleged Schein to be the biggest distributor in the country. Danaher Corporation ("Danaher"), the biggest manufacturer of dental equipment in the country, acquired all of its former smaller competitors in the dental equipment manufacturing field. In 2013 Archer sued Schein,[27] alleging that Schein and Danaher conspired with Danaher, its subsidiaries, and one unnamed large distributor to restrict Archer's access to the market because Archer was to selling equipment to dentists at discounted prices. Schein moved to stay the litigation and compel

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[22] There are, of course, many arbitration providers, among the more well-known being the Judicial Arbitration and Mediation Services, Inc. ("JAMS") and the National Arbitration Forum ("NAF").

[23] *See*, *e.g.*, AAA Commercial Rules, JAMS Comprehensive Arbitration Rules & Procedures.

[24] 811 Fed. Appx. 100 (3d Cir. 2020).

[25] *See also* Petrofac, Inc. v. DynMcDermott Petroleum Operations Co., 687 F.3d 671, 675 (5th Cir. 2012); Archer & White Sales, Inc. v. Henry Schein, Inc., 878 F.3d 488, 493 (5th Cir. 2017).

[26] *See* Hall Street Associates, L.L.C., v. Mattel, Inc., 552 U.S. 576, 128 S. Ct. 1396, 170 L. Ed. 2d 254 (2008) (FAA will not permit arbitration agreement to expand judicial review following the arbitration).

[27] Multiple defendants were parties to the litigation. This article focuses only on Schein.

arbitration in accordance with an arbitration agreement in its distributor agreement with Archer. The arbitration provision read:

> 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 Pelton & Crane), 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.

Schein asserted that Archer was bound by the arbitration clause and that the doctrine of equitable estoppel allowed even those defendants who were not parties to any contract with Archer containing an arbitration clause to demand arbitration.

The Magistrate Judge analyzed the motion and issued an order compelling arbitration and staying the case pending completion of the arbitration.[28] He opined that the arbitration clause had to be read "against the background of the strong public policy in favor of arbitration expressed in the FAA." In granting the motion to compel arbitration, the Magistrate Judge pointed out:

> The Court has no hesitation in concluding that this lawsuit is a dispute "related" to the distributor agreement. After all, the very rights that Archer claims the Defendants conspired to defeat were created by the distributor agreement and others like it that the record suggests have similar arbitration clauses. . . . The fact that Archer was an authorized dealer for the equipment at issue is essential to its claims. However, the exception carved out for actions seeking injunctive relief is problematic to the motions to compel arbitration. On the most superficial level, this lawsuit is clearly an action seeking injunctive relief since it *does* seek that relief. On the other hand, it does not seek *only* injunctive

[28]Archer & White Sales, Inc. v. Henry Schein, Inc., 2013 U.S. Dist. LEXIS 201338 (E.D. Tex. May 28, 2013).

> relief, and the Court is persuaded that damages . . . are the predominant relief sought. The incorporation of the rules of the AAA provides the answer to this problem, as those rules very clearly state that the question of the arbitrability of a dispute is referred to the arbitrator under the AAA rules.[29]

That was but the beginning. Ruling on an objection of the Magistrate Judge's decision, the district court conducted much the same analysis as the Magistrate Judge but reached a different conclusion on the essential issue of the carve-out for injunctive relief. In reversing the Magistrate Judge's decision, the district court ruled "the phrase 'except actions seeking injunctive relief' is clear on its face—any action seeking injunctive relief is excluded from mandatory arbitration. Plaintiff's action seeks injunctive relief. Applying the plain meaning of the clause, Plaintiff's action is excluded from mandatory arbitration."[30]

Schein moved the stay the litigation pending appeal, but the court denied the motion.[31] In denying the stay motion, the court, in essence, found that Schein had little chance of prevailing on the merits; there was no irreparable injury to Schein by proceeding with the litigation; and further delay would injure other parties to the case. Schein then moved to transfer the case to a different division of the court, but that too was unsuccessful.[32] When the case reached the Fifth Circuit, the appellate court, ruling on the motion to compel arbitration *de novo*, affirmed the district court's decision.[33]

The U.S. Supreme Court obviously had some difficulty with the proceedings below, because it granted Schein's application for a stay granted pending the filing and disposition of a petition for a writ of

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[29]Id. at *5-*6.

[30]Archer & White Sales, Inc. v. Henry Schein, Inc., 2016 U.S. Dist. LEXIS 169245 at *12 (E.D. Tex. Dec. 7, 2016).

[31]Archer & White Sales, Inc. v. Henry Schein, Inc., 2017 U.S. Dist. LEXIS 22796 (E.D. Tex. Feb. 17, 2017).

[32]Archer & White Sales, Inc. v. Henry Schein, Inc., 2017 U.S. Dist. LEXIS 117380 (E.D. Tex. July 26, 2017) (Schein has not satisfied its "significant burden" to show that transfer to the Sherman Division is clearly more convenient).

[33]Archer & White Sales, Inc. v. Henry Schein, Inc., 878 F.3d 488 (5th Cir. 2017).

certiorari,[34] granted certiortari,[35] and allowed Schein to file part of its appendix under seal.[36] In an opinion authored by Justice Kavanaugh, the high court reversed the Fifth Circuit and struck down the claim that the "wholly groundless" exception to arbitrability is consistent with the FAA.[37] The Court explained:

> Even when the parties' contract delegates the threshold arbitrability question to an arbitrator, the Fifth Circuit and some other Courts of Appeals have determined that the court rather than an arbitrator should decide the threshold arbitrability question if, under the contract, the argument for arbitration is wholly groundless. Those courts have reasoned that the "wholly groundless" exception enables courts to block frivolous attempts to transfer disputes from the court system to arbitration. We conclude that the "wholly groundless" exception is inconsistent with the text of the [FAA] and with our precedent.[38]

The Court emphasized that "[w]hen the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract."[39]

With apologies to the great Winston Churchill, that may have been the end of the beginning, but it was not the beginning of the end. The Fifth Circuit on remand held that the district court correctly determined that the case was not subject to the arbitration clause.[40] Although the Fifth Circuit conceded that the parties had clearly and unmistakably delegated at least some questions of arbitrability to the arbitrator,[41] it nevertheless decided that the court must make the arbitrability determination itself, holding that the presence of a carve-out provision in the agreement negated the otherwise clear and unmistakable evidence of the

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[34] Henry Schein, Inc. v. Archer & White Sales, Inc., 200 L. Ed. 2d 331 (2018).
[35] Henry Schein, Inc. v. Archer & White Sales, Inc., 138 S. Ct. 2678, 201 L. Ed. 2d 1071 (2018).
[36] Henry Schein, Inc. v. Archer & White Sales, Inc., 139 S. Ct. 305, 202 L. Ed. 2d 15 (2018).
[37] Henry Schein, Inc. v. Archer & White Sales, Inc., _ U.S. _, 139 S. Ct. 524, 202 L. Ed. 2d 480 (2019).
[38] *Id*., 139 S. Ct. at 529.
[39] *Id*., 139 S. Ct. at 531.
[40] Archer & White Sales, Inc. v. Henry Schein, Inc., 935 F.3d 274 (5th Cir. 2019).
[41] *See Petrofac*, 687 F.3d at 675 ("We agree with most of our sister circuits that the express adoption of these [AAA] rules presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability.").

parties' intent to delegate arbitrability.[42]

Once again the Supreme Court issued a stay of the proceedings in the district court pending the timely filing and disposition of a petition for a writ of certiorari.[43] Certiorari was again granted[44] and the parties were permitted to file the joint appendix under seal with redacted copies for the public record.[45] Virtual oral argument was held on December 8, 2020. The single issue, as framed by the high court, was "[w]hether 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."[46]

Viewing the case with the benefit of hindsight, the district court had three possible options when considering Schein's motion to compel arbitration: (1) deny the motion and continue with the litigation in court; (2) grant the motion and send everything, including arbitrability and the injunction issue, to arbitration; or (3) bifurcate the matter while retaining jurisdiction over the claim for injunctive relief and sending everything else to arbitration, with arbitrability to be determined by the arbitrators.

To deny the motion and continue with the litigation in court would clearly have contravened the intent of the parties when they entered into the initial contract with an arbitration provision for resolving disputes. Similarly, to send everything to arbitration would usurp the jurisdiction of the court with respect to the injunction carve out and impermissibly delegate to arbitrators an issue over which they had no legitimate jurisdiction.[47] Bifurcation would seem to be the only correct solution, with the court retaining jurisdiction over the claims for injunctive relief. A carefully reasoned award by the arbitrators could either moot the injunction claim or give the court invaluable assistance in deciding it.

Arbitration clauses must be clear and unmistakable if they are to be enforced by the courts.[48] To avoid unnecessary and costly litigation and overall confusion, practitioners should use standard arbitration provisions without attempting to insert carve-out

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[42] *Archer & White Sales, Inc*., 935 F.3d at 283.
[43] Henry Schein, Inc. v. Archer & White Sales, Inc., 140 S. Ct. 951, 205 L. Ed. 2d 532 (2020).
[44] Henry Schein, Inc. v. Archer & White Sales, Inc., 207 L. Ed. 2d 1050 (2020).
[45] Henry Schein, Inc. v. Archer & White Sales, Inc., 2020 U.S. LEXIS 4160 (U.S. Oct. 5, 2020).
[46] *See* https://www.supremecourt.gov/qp/19-00963qp.pdf (last accessed Dec. 15, 2020).
[47] *See*, *e.g*., Ruhrgas AG v. Marathon Oil Co., 526 U.S. 574, 119 S. Ct. 1563, 143 L. Ed. 2d 760 (1999).
[48] *See*, *e.g*., *In re* CenturyLink Sales Practices & Secs. Litig., 2020 U.S. Dist. LEXIS 227550 (D. Minn. Dec. 4, 2020).

provisions. The standard arbitration clauses of the principal arbitration organizations[49] are available online.

[49] While there may be others, AAA, ICDR, JAMS and LCIA are generally the most well recognized arbitral providers.