Professional Perspective

Drafting Subsequent Agreements to Avoid Arbitrability Litigation

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When a new contract implementing a strategic partnership or joint development is first drafted, many times the dispute resolution provision is not of primary concern. Optimism abounds for a conflict-free relationship, but a small amount of time invested to address disputes may save significant resources later.

This is particularly relevant when a relationship grows and becomes governed by multiple contracts. Multiple contracts may have varying dispute resolution provisions or arbitration agreements. If a dispute materializes, what controls? One result of this disorienting question has been a line of so-called "arbitrability" cases when arbitration agreements may control and litigation may grow uncontrollably. As observed by one court: "As always in arbitrability cases, there are disputes upon disputes, questions embedded within questions, and disputes about who should be answering those questions." *McKenzie v. Brannan*, 19 F.4th 8 (1st Cir. 2021).

This article focuses on arbitration clauses and how the question of arbitrability has been decided by the Supreme Court and the federal circuits, and particularly addressing what happens when parties have multiple contracts with inconsistent dispute resolution clauses. The developed law suggests a number of practice pointers for contract drafters, including how to reinforce prior dispute resolutions clauses or how to alter those prior clauses and replace them with a new dispute resolution mechanism.

Background

Arbitration is provided and limited by contract. The Federal Arbitration Act's operative provision provides that contractual language evidencing parties' intent to arbitrate disputes "shall be valid, irrevocable, and enforceable." The availability and scope of arbitrability is controlled by the parties' agreement, which in turn is governed by state law principles of contract formation and interpretation. Arbitration, after all, is a matter of consent.

The parties' agreement can lead to questions even before getting to the merits. "Just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, so the question 'who has the primary power to decide arbitrability' turns upon what the parties agreed about that matter." See *First Options of Chicago, Inc. v Kaplan*, 514 U.S. 938 (1995).

Thus, an arbitrator may determine gateway questions of arbitrability, "such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy." See *Henry Schein, Inc. v. Archer and White Sales, Inc.*, 139 S. Ct. 524 (2019). In *Henry Schein*, the Supreme Court cautioned that this high level of deference from the judiciary must be supported by "clear and unmistakable evidence" evident from the face of the parties' agreement.

Delegating Questions of Arbitrability

The default rule is that questions of arbitrability are for a court to resolve. See *Puleo v. Chase Bank USA, N.A.*, 605 F.3d 172 (3d Cir. 2010). Contracting parties may alter this default rule and delegate threshold questions of arbitrability to an arbitrator using a clear and unmistakable delegation clause. Sometimes called "arbitration clauses within arbitration clauses," drafters in all jurisdictions can save time by including unambiguous delegation clauses that grant arbitrators the power to arbitrate arbitrability.

For example, the Fifth Circuit in *Agere Systems v. Samsung Electronics*, 560 F.3d 337 (5th Cir. 2009), analyzed a delegation clause stating that "[i]f a dispute arises out of or relates to this Agreement, or the breach, termination, or validity thereof," an arbitrator "shall determine issues of arbitrability." When a dispute arose, Samsung sought to compel arbitration, and Agere Systems argued to the district court that it "need not determine the issue of arbitrability because [a subsequent agreement], which did not contain an arbitration clause, superseded the [earlier agreement]." The Fifth Circuit sided with Samsung, explaining that provisions in the prior arbitration agreement "explicitly confer upon an arbitrator the power of determining what 'arises out of or relates to' the [prior] agreement."

Alternatively, questions of arbitrability can be delegated by expressly incorporating arbitration rules that provide the arbitrator the power to decide issues of arbitrability. This second delegation method is more common—parties to a contract with an arbitration agreement often incorporate a preexisting code of arbitration rules, such as the American Arbitration Association's (AAA) Commercial Arbitration Rules. Virtually all courts to consider the incorporation of preexisting rules "have concluded that, in contracts between sophisticated parties, incorporation of rules with a provision on the subject is normally sufficient 'clear and unmistakable' evidence of the parties' intent to delegate [the question of] arbitrability to an arbitrator." See *ROHM Semiconductor USA, LLC v. MaxPower Semiconductor, Inc.*, 17 F.4th 1377 (Fed. Cir. 2021).

In cases involving a single contract with an arbitration provision, the question of the scope of arbitrability and who decides that question may be relatively straight-forward. For example, in *Richardson v. Coverall N. Am., Inc.*, 811 F. App'x 100 (3d Cir. 2020), the contracting parties agreed that "all controversies, disputes or claims between [the parties] shall be submitted promptly for arbitration" and that "[a]rbitration shall be subject to . . . the then current Rules of the AAA for Commercial Arbitration." The Third Circuit found that incorporation of the AAA Rules—which state in relevant part that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction"—is "about as clear and unmistakable as language can get." Another example is *ROHM Semiconductor*, in which the Federal Circuit held that the parties' incorporation of the California Code of Civil Procedure, which in turn delegates issues of arbitrability to an arbitrator, was clear evidence of delegation.

But there are also limits to delegating questions of arbitrability. Simply presenting an argument that contract language evidences delegation does not always equate to a finding that the question of arbitrability was actually delegated by the parties. For example, in *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, 809 F.3d 746 (3d Cir. 2016), the court acknowledged that, generally, incorporation of preexisting arbitration rules is a clear and unmistakable delegation of questions of arbitrability. And yet, the *Chesapeake* court found that incorporation of the AAA Rules did "not clearly and unmistakably assign to an arbitrator" the question of arbitrability because the case was about class arbitrability, not bilateral arbitrability, and locating the provision delegating class arbitrability to an arbitrator "implicates 'a daisy-chain of cross-references'—going from the [contracts] themselves to 'the rules of the [AAA]' to the Commercial Rules and, at last, to the Supplementary Rules."

To summarize: (1) parties can delegate arbitrability directly to an arbitrator and exclude a court from that decision; (2) the parties' agreement must have clear and unmistakable evidence of the parties' intent to do so; and (3) most courts agree that incorporating arbitration rules that contemplate arbitrators arbitrating arbitrability constitutes clear and unmistakable evidence.

But the question of who decides arbitrability complicates when multiple contracts with different dispute resolution provisions are at issue. In that case, the answer to the question "who decides" depends on a number of factors, including the particular jurisdiction of the dispute.

Delegation of Arbitrability & Multiple Contracts

The question of arbitrability when multiple agreements are involved is more complex. In such cases, courts are often faced with the question of whether an arbitration agreement applies at all and who gets to decide that threshold question. The answers, unsurprisingly, depend on the specific facts and the jurisdiction.

One example is the Fifth Circuit case of *Agere Systems v. Samsung Electronics*. The dispute in *Agere* involved several contracts, the earlier one having an arbitration clause and a delegation clause stating, "[i]f a dispute arises out of or relates to this Agreement, or the breach, termination or validity thereof," an arbitrator "shall determine issues of arbitrability." The later contract did not have this language. In addressing an argument that the earlier contract was superseded by the later contract, and thus the court—instead of the arbitrator—should address the substance of the dispute, the Fifth Circuit held that the delegation clause in the earlier agreement was a clear and unmistakable delegation of questions regarding the supersession of the prior agreement—and its attendant dispute resolution provision—to the arbitrator.

But delegation clauses may only go so far. For example, in *MZM Constr. Co. v. N.J. Bldg. Laborers Statewide Benefit Funds*, 974 F.3d 386 (3d Cir. 2020), the defendants sought arbitration under a contract which contained an arbitration clause and a delegation clause stating that "[t]he Arbitrator shall have the authority to decide whether an Agreement exists, where that is in dispute." But the plaintiff disagreed, arguing that the agreement that contained the delegation clause was itself invalid. The Third Circuit held that while arbitrators may decide arbitrability when so allowed by valid contract, contract formation, unless embodied in an entirely separate arbitration agreement, is solely for courts to decide. Because contract formation was placed at issue, the arbitrability question belonged to the court.

In another differing example, *McKenzie v. Brannan*, 19 F.4th 8 (1st Cir. 2021), the court found that a contract delegating arbitrability issues to an arbitrator cannot provide clear and unmistakable evidence of the parties' intent if the same contract was alleged by one party to be superseded by a later agreement. In so holding, the court relied on the presumption that "courts hold the decision-making power when it comes to whether parties are bound by an arbitration clause."

The Third Circuit recently addressed the issue of arbitrability in the context of multiple contracts in *Field Intel. Inc. v. Xylem Dewatering Sols. Inc.*, 49 F.4th 351 (3d Cir. 2022). The parties in the litigation had two contracts that each set forth differing procedures for dispute resolution. The first contract, ratified in 2013, contained an arbitration provision; the second contract, ratified in 2017, did not include an arbitration provision and instead designated a specific forum for any potential litigation. Following a decision by Xylem to terminate its business relationship with Field Intelligence, Field Intelligence filed suit in federal court alleging a breach of their second agreement.

Xylem, believing that Field Intelligence's lawsuit implicated the first contract, filed an arbitration demand, and moved to stay the federal litigation pending the outcome of the arbitration. The district court denied the motion to stay and instead enjoined the arbitration, holding that the federal question of arbitrability, based on the interplay of the two contracts, was for it to decide, and then resolving the state question of whether the second contract superseded the first contract in favor of Field Intelligence. Xylem appealed.

The Third Circuit divided its analysis into two sub-questions: (1) Arbitrability: who should decide whether the second contract replaced the first, a court or an arbitrator? and (2) Supersession: if a court should decide, does the second contract in fact supersede the first contract? On the first question, the Third Circuit held that a court must decide the gateway question of arbitrability. Like the dispute in *MZM*, the Third Circuit decided that Field Intelligence's argument was that the parties intended to extinguish the prior agreement, thus placing the parties' mutual assent to arbitrate directly at issue. On the second question, the Third Circuit went on to find that the second contract did not supersede the first contract because the contracts addressed different subject matter and there was no express language in the second contract indicating the parties' alleged cancellation of the first contract.

This holding is instructive for several reasons. By examining the language in each contract, and—equally importantly, by examining the language that is absent from each contract—drafters can better position their clients to achieve their strategic goals to either preserve or terminate arbitration clauses when negotiating subsequent contracts.

Practice Pointers for Contract Drafting

Depending on a client's strategic position, practitioners may find themselves negotiating a subsequent agreement and desiring to either preserve and buttress an arbitration provision or terminate an arbitration provision and ensure that disputes play out in court. In either position, practitioners should be mindful of the following practice pointers for drafting.

Explicitly Reference & Address How Prior Agreements Should Be Treated

Ambiguity across multiple agreements can lead to extended litigation about arbitrability, instead of getting to the merits. Regardless of whether the end result is ratifying an existing arbitration agreement in a subsequent agreement or terminating a dispute resolution mechanism from a prior agreement, consider stating how that prior dispute resolution mechanism should be treated going forward.

For example, in *Xylem*, Field Intelligence argued the 2017 agreement was intended to extinguish the arbitration provision in the 2013 contract. The 2013 contract had a provision stating it "may be modified or waived only by an express amendment and waiver in writing signed by the Parties." In holding that the 2017 contract did not supersede the 2013 contract, the court held "if [the parties] meant to supersede that contract and its arbitration obligation, we would expect to see some specific language to that effect in the 2017 agreement."

Thus, whether the goal is to preserve or terminate and replace, contract drafters should consider explicitly referencing a prior agreement that is affected by a later agreement. Contract drafters can use the "whereas" clauses of the subsequent agreement as a place to explicitly reference and explain how prior agreements should be treated. Furthermore, if a drafter's goal is to terminate and replace, the drafter should consider making the new dispute resolution clause retroactive. On the other hand, if a drafter's goal is to preserve, the drafter should expressly recognize the continued applicability of the prior dispute resolution clause.

Don't Overleverage Merger or Forum-Selection Clauses

Generic merger clauses, while common across all sorts of contracts, are not without their limits. In general, a merger clause is "designed to do nothing more than prevent any unincorporated side agreements previously negotiated by the parties during the pre-contract negotiation stage from becoming enforceable provisions," it "does not function as a 'radical . . . retroactive renegotiation of . . . earlier agreements." Portillo v. Nat'l Freight, Inc. et al., C.A. No. 15-cv-7908-JHR-KMW, 2021 BL 299613 (D.N.J. Aug. 9, 2021). Therefore, unless a new agreement completely overlaps with an earlier agreement, drafters should not expect to rely on a merger clause in the new agreement to alter the dispute resolution terms of the previous agreement.

If contract drafters intend for a later agreement to replace an earlier agreement—and cancel an earlier dispute resolution provision—the relationship of these agreements may also be addressed within the merger clause. But, again, the language used should be explicit. For example, in the *Xylem* case, Field Intelligence relied on the 2017 contract's merger clause to support its supersession argument. The merger clause said "[t]his Agreement constitutes the entire agreement between the parties with respect to its subject matter, and supersedes any and all prior or contemporaneous understandings or agreements whether written or oral." The court found in favor of Xylem, however, because the agreement only superseded previous agreements that were "with respect to its subject matter." Even though there was some overlap in the terms of the two agreements, the court held that the 2013 and 2017 agreements were not a perfect match for subject matter. Thus, under judicial scrutiny, the merger clause did not do all the work that Field Intelligence relied on it to do.

Similarly, drafters should not assume that forum selection clauses in subsequent agreements will terminate preexisting arbitration provisions in prior agreements. So long as the prior and subsequent agreements can stand together—i.e., they do not plainly contradict one another, thus lacking evidence of the parties' intent to replace the prior with the subsequent—then parties can—and routinely do—create a patchwork of contractual rights where certain subjects must go to arbitration while others must go to court.

Thus, if drafters seek to terminate prior dispute resolution language, they should not assume that including either a merger or forum-selection clause will do this. Instead, drafters should remove the guesswork and explicitly address how the earlier dispute resolution agreement should be treated.

If You Use a Delegation Clause, Know & Address the Limits

As explained above, contract drafters can use a delegation clause to expressly delegate the arbitrability question directly to an arbitrator. And contract drafters can achieve this delegation by clearly incorporating preexisting Rules, such as the AAA rules, that earmark questions of arbitrability for arbitrators themselves. But drafters beware. For some jurisdictions, such as the Third Circuit, if the opposing party puts contract formation or the parties' mutual assent to the delegation clause or incorporation of Rules directly at issue, then a court may override an arbitrators' jurisdiction. See *MZM Constr.*, 974 F.3d 386 (3d Cir. 2020); *Xylem*, 49 F.4th 351 (3d Cir. 2022)

Contract drafters can address and prevent this issue by using language that intentionally addresses the scope of power delegated to the arbitrator. Such express language has been at least upheld by the Fifth and Seventh Circuits. See *Agere Systems*, 560 F.3d 337 (5th Cir. 2009); *Air Line Pilots Ass'n, Int'l v. Midwest Express Airlines, Inc.*, 279 F.3d 553 (7th Cir. 2002). In those cases, the delegation clauses that specifically delegated questions of supersession were found to be clear and unambiguous.

Thus, contract drafters could consider including an entirely separate provision that clearly and unmistakably delegates questions of validity and mutual assent to an arbitrator. Remember, arbitration is a creature of contract and nearly all aspects of arbitration can be delegated. For contract drafters, achieving delegation is a matter of avoiding ambiguity and including clear and unmistakable evidence that both parties have consented.

Conclusion

Whatever their client's strategic goals may be, drafters may find themselves either seeking to terminate or preserve arbitration rights when negotiating and ratifying subsequent agreements. Drafters should be intentional and use unambiguous language to achieve those goals. Drafters should be mindful of the bounds that delegation clauses may reach, for they can be powerful tools. Finally, drafters should not leave anything to chance—or boilerplate—by overleveraging merger or forum-selection clauses. Instead, they should draft clear and obvious language to achieve their client's goals.