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COMMENTARY

Third Circuit Rules that Courts, not Arbitration Panels, Have Final Word on Class Action Arbitrability

In Brief

The history and proceedings of the Third Circuit's recent decision in *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, No. 15-1275, 2016 U.S. App. LEXIS 42 (3d Cir. Jan. 5, 2016), are a precautionary tale suggesting that companies should expressly state key "rules of their game" in arbitration provisions. This includes whether claims such as class actions are subject to arbitration and, in the event of a dispute, where the issue of arbitrability will be determined.

Contracts containing agreements to arbitrate often provide for arbitration pursuant to the rules of an arbitration service provider such as the American Arbitration Association ("AAA"). It is not unusual, however, for such clauses to incorporate little (or no) detail regarding the arbitration process, decision-makers on disputed jurisdictional issues, or the availability of class, collective or other group claims. In just such a context, on January 5, 2016, the United States Court of Appeals for the Third Circuit held that it was for a court—not an arbitration panel—to decide whether classwide arbitration could proceed in an oil and gas royalty dispute. But before the Third Circuit ruled, another federal district court interpreted the exact same clause otherwise, as did an arbitration panel of three retired federal judges.

The Procedural History

In *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, No. 15-1275, 2016 U.S. App. LEXIS 42 (3d Cir. Jan. 5, 2016), plaintiff Scout Petroleum ("Scout") brought suit against Chesapeake Appalachia, LLC ("Chesapeake") alleging that Chesapeake underpaid royalties under lease agreements. Scout brought its claims as a class-wide arbitration action before a AAA panel, based upon the following arbitration provision contained in the leases at issue:

> **ARBITRATION**. In the event of a disagreement between Lessor and Lessee concerning this Lease, performance thereunder, or damages caused by Lessee's operations, the resolution of all such disputes shall be determined by arbitration in accordance with the rules of the American Arbitration Association.

Chesapeake Appalachia, 2016 U.S. App. LEXIS 42 at *3.

Chesapeake then filed a declaratory judgment action to stop the class arbitration in federal court, arguing that it had not consented to class arbitration. *Id.* at *9. While the federal action was pending, the arbitration panel—consisting of three retired federal judges—examined the arbitration agreement and ruled that "'the arbitration contract in this case clearly and unmistakably authorizes [the panel] to make the decision about arbitrability.'" *Id.* at *10. The panel thus concluded, based on the clause's incorporation of the AAA rules, that the panel was empowered to determine whether class arbitration was available per the terms of Chesapeake's leases. The panel ultimately decided that class arbitration was appropriate. *Id.* But Chesapeake then sought and received an order from the federal district court vacating the arbitrators' ruling. The court held that the arbitrators lacked authority to decide whether class arbitration was appropriate. *Id.* at *11.

The very next day, however, another judge in the same district entered an opinion concerning the same arbitration language in a different oil and gas lease and reached the opposite result. That judge concluded, as the AAA arbitration panel had, that the arbitration agreement clearly authorized the arbitrators, not the court, to resolve the question of arbitrability of the class claims.[1] Just a few months later, judges in two other cases filed in a neighboring state's federal district court—again addressing the same arbitration language in other oil and gas leases—agreed with the first federal court. They reserved the question of classwide arbitrability to the court.[2]

The Third Circuit's Decision

In the wake of these conflicting results, Scout sought appellate review of the district court's original decision in *Chesapeake Appalachia*, asking that the court defer to the arbitration panel's decision regarding arbitrability. On appeal, the Third Circuit reaffirmed *Opalinski v. Robert Half Int'l, Inc.*, 761 F.3d 326 (3d Cir. 2014), a recent opinion in which the court had assessed whether it is courts or arbitrators who appropriately address "question[s] of arbitrability," i.e., the "narrow range of gateway issues" respecting matters as fundamental as whether the parties have actually agreed to arbitrate. *Chesapeake Appalachia*, 2016 U.S. App. LEXIS 42 at *22-23. The court held that "the availability of class arbitration is a 'question of arbitrability' for a court to decide unless the parties unmistakably provide otherwise." *Id.* at *26 (citing *Opalinski*, 761 F.3d at 335-36).

The court next turned to the specific lease agreements at issue to determine if the parties had "unmistakably" given authority to a panel of arbitrators to decide whether class arbitration was available. *Chesapeake Appalachia*, 2016 U.S. App. LEXIS 42 at *28. Scout argued that reference to the AAA's rules in the lease agreements incorporated all of the AAA's standards, including the Commercial Arbitration Rules and the Supplementary Rules for Class Arbitration, which purport to allow an arbitrator to determine whether the parties have agreed to class arbitration. *Id.* at *35-37. The court disagreed, finding mere reference to the AAA's rules insufficient to constitute the "clear and unmistakable evidence" required to pass authority from the court to the panel of arbitrators. *Id.* at *37-38. The court acknowledged that no "special 'incantation'" is required to give the arbitrator control over questions of arbitrability, *id.* at *29-30, but it deemed the incorporation of the AAA's many rules by reference insufficient to overcome the heavy presumption in the Third Circuit in favor of judicial decision on classwide arbitrability:

> We … agree with Chesapeake that this case implicates "a daisy-chain of cross-references"—going from the Leases themselves to "the rules of the American Arbitration Association" to the Commercial Rules and, at last, to the Supplementary Rules. Having examined the various AAA rules, we believe that the Leases still fail to satisfy the onerous burden of undoing the presumption in favor of judicial resolution of the question of class arbitrability.

Id. at *37-38.

The Third Circuit then affirmed the district court's order vacating the arbitrators' decision as to the availability of class arbitration based upon the fact that the parties had not given the arbitrators the authority to make that decision. *Id.* at *51. The court's opinion was limited to the "who decides" inquiry; the court did not conduct its own assessment of the parties' agreement respecting class arbitration, presumably leaving that decision to the district court. *See id.* at *34.

Contrast to Bilateral Arbitration Provisions

With its holding in *Chesapeake Appalachia*, the Third Circuit joins the Sixth Circuit as the only federal appellate courts to consider and decide the impact of references to general arbitration rules on the question of who decides whether the parties have agreed to classwide arbitration. *Id.* at *17. While "'[v]irtually every circuit to have considered the issue'" in the bilateral arbitration context has held that incorporation of the AAA's rules by reference constitutes "clear and unmistakable evidence that the parties agreed to arbitrate arbitrability,"[3] only the Third and Sixth Circuits have assessed whether the same standard applies to the availability of *classwide* arbitration. *Chesapeake Appalachia* and its counterparts in the Sixth Circuit[4] have both said no: While incorporating the AAA's rules into a contract gives an arbitrator the authority to determine whether the parties have agreed to bilateral arbitration, a general reference to the AAA rules is *not* sufficient to allow an arbitrator to determine whether the parties have agreed to *classwide* arbitration. Other Courts of Appeal have not yet spoken on the issue.

Conclusion

Chesapeake Appalachia serves as notice of potential pitfalls to parties who do not memorialize their expectations for arbitration. Simple reference to the AAA's—or another entity's—rules may have unintended consequences if, and when, those rules are amended, edited, or otherwise changed between the contract's execution and the date of arbitration. Further, referring to the AAA's rules generally may not suffice to identify the particular AAA rules under which the parties have agreed to arbitrate or to incorporate all of the AAA's provisions on jurisdictional issues and, for example, the availability or waiver of class action arbitration.

Parties seeking certainty should consider incorporating express language identifying particular rules under which claims are to be decided, what types of disputes are covered by the agreement to arbitrate, and where jurisdiction lies for the determination of arbitrability itself. Thoughtful drafting can avoid potentially costly uncertainty as to what will be arbitrated—and who will make that determination—if a dispute should arise.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

1 *See Chesapeake Appalachia, LLC v. Burkett*, Civ. Action No. 3:13-3073, 2014 U.S. Dist. LEXIS 148442 (M.D. Pa. Oct. 17, 2014).

2 *See Chesapeake Appalachia, LLC v. Suppa*, 91 F. Supp. 3d 853 (N.D. W. Va. 2015); *Bird v. Turner*, Civ. Action No. 5:14-97, 2015 U.S. Dist. LEXIS 116057 (N.D. W. Va. Sept. 1, 2015).

3 *See, e.g.*, *Oracle Am., Inc. v. Myriad Grp. A.G.*, 724 F.3d 1069, 1074 (9th Cir. 2013); *Petrofac, Inc. v. DynMcDermott Petrol. Operations Co.*, 687 F.3d 671, 675 (5th Cir. 2012); *Fallo v. High-Tech Inst.*, 559 F.3d 874, 878 (8th Cir. 2009); *Qualcomm Inc. v. Nokia Corp.*, 466 F.3d 1366, 1373 (Fed. Cir. 2006); *Terminex Int'l Co. v. Palmer Ranch Ltd. P'ship*, 432 F.3d 1327, 1332 (11th Cir. 2005); *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208 (2d Cir. 2005).

4 *Huffman v. Hilltop Cos., LLC*, 747 F.3d 391 (6th Cir. 2014), and *Reed Elsevier, Inc. v. Crockett*, 734 F.3d 594 (6th Cir. 2013).