Is the “Clear and Unmistakable” Hurdle for Delegation of Arbitrability Issues to an Arbitrator Uniform or Variable?

The United States Supreme Court established that questions of arbitrability are presumptively for a court unless the parties clearly and unmistakably manifest their intention (i.e., agreement) that such issues should be determined by an arbitrator in the first instance. See First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 944 (1995); see also Opalinski v. Robert Half Int’l Inc., 761 F. 3d 326, 335 (3d Cir. 2014). But is the “clear and unmistakable” standard uniform in all circumstances or variable?

For example, should a court adjudicate what is “clear and unmistakable” one way when the alleged delegation agreement is between “sophisticated” parties (e.g., commercial entities) and another way when at least one of the parties is “unsophisticated” (e.g., a non-executive employee or a consumer)? And should the “clear and unmistakable” hurdle be raised or lowered depending upon the arbitrability issue in question – e.g., (a) claim or subject matter arbitrability vs. (b) party arbitrability vs. (c) class arbitrability?

Party “Sophistication”

The Third Circuit Court of Appeals recently held (i) that a plain delegation is “clear and unmistakable” independent of the “sophistication” of the parties, and (ii) that the incorporation by reference of the Commercial Arbitration Rules (“CAR”) of the American Arbitration Association (“AAA”), which included its Rule 7(a) concerning the power of an arbitrator to rule on his/her own jurisdiction, was “about as clear and unmistakable as language can get.” See Richardson v. Coverall N. Am., Inc., 2020 U.S. App. LEXIS 13568 (3d Cir. April 28, 2020) at *5. The latter holding was a particularly enthusiastic endorsement of what is by now a common holding in the federal circuits. See id. at *5n.2.

The former holding was more novel. As is common, in Richardson, an agreement to delegate was not set out expressly in the principal contract document, but was arguably manifested by the incorporation by reference in the principal arbitration agreement of institutional arbitration rules that empower an arbitrator to adjudicate his/her own jurisdiction. The implicit question was whether an “unsophisticated party” -- however that term is defined -- should be bound by a term that is merely incorporated by reference in the principal text of a contract, rather than expressly set out in that principal text.

One of the objects of the Federal Arbitration Act (“FAA”), 9 U.S.C. §§ 1, et seq., was that an arbitration agreement should in general be treated the same as any other contract. As such, the interpretation of an arbitration agreement is principally governed by state contract and related law principles, as the Third Circuit acknowledged, see id. at *4, citing Jaludi v. CitiGroup, 933 F.3d 246, 254-55 (3d Cir. 2019).

The Richardson case concerned two franchisees of commercial cleaning service company Coverall North America, Inc. (“CNA”). They had acquired their respective franchises from Sujol LLC, the CNA “master franchisee” for the territory that included New Jersey, wherein the claimants seemed to have been domiciled. When disputes arose, the two franchisees commenced a putative class action in New Jersey state court, alleging that they were actually employees of Sujol and CNA under New Jersey law, and that the defendants had violated the New Jersey Wage Payment Law by “misclassifying [plaintiffs] as independent contractors, charging them for a job, and taking unlawful deductions from their wages.” 2020 U.S. App. LEXIS 13568 at *3. CNA and Sujol removed the case to federal court and moved under FAA § 3 to stay the proceedings in favor of arbitration. See id.

The District Court declined to send the arbitrability issue to an arbitrator based on its finding that the
incorporation by reference of the AAA CAR did “did not satisfy the clarity needed for delegation, at least with an ‘unsophisticated party’.”  See id.  On appeal under FAA § 16(a)(1)(A), the Third Circuit reversed in that regard and remanded.

The pertinent arbitration agreement with Sujol covered “all controversies, disputes or claims” between Sujol and the franchisee, and provided that any such arbitration be conducted in accordance with the then current Commercial Arbitration Rules of the AAA.  See id. at *4-*5.  Among those rules is the well-known provision – AAA CAR 7(a) – for the arbitrator’s authority to “rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counter-claim.”  See id.

The Court of Appeals assumed for purposes of argument that one of the plaintiffs (Silva) “lacked” sophistication.  Id. at *5 n. 3.  Nonetheless, it considered the agreement in question to be sufficiently clear for it to find an intent to delegate arbitrability issues to an arbitrator.  Thus the incorporation by reference in the principal arbitration agreement text of terms to be found in another text that is clearly referenced would generally bind even an “unsophisticated” party, at least under governing New Jersey state contract law.  (Could there be exceptions due to some other muddling of the arbitration agreement?  The Court did not rule that out.  See id. at *5n.2.)

We will see in time whether this sort of ruling holds up in other federal circuits.  Inasmuch as state law has a substantial place in the analysis, it is unsurprising that there has been inconsistency in that regard to date in the courts generally.

“Class Arbitration”

Another possible variable in connection with the delegation hurdle is the nature of the arbitrability question.  For example, the incorporation by reference of AAA arbitration rules seems to have been viewed differently vis-à-vis the “clear and unmistakable” hurdle when the delegation of “class arbitrability” is in issue.  The Third Circuit Court of Appeals itself noted, for example, that in  Chesapeake Appalachia, LLC v. Scout Petroleum, LLC, 809 F.3d 746 (3d Cir. 2016), it held that “the mere incorporation of unspecified AAA rules did not demonstrate an intent to delegate arbitrability in a class action.”  See id. at *5 n. 2.  Perhaps this variability concerning the delegation hurdle reflects the notable recent emphasis by SCOTUS of the considerable differences from conventional bilateral arbitration that the “class arbitration” construct presents.

[1] And how do we determine whether a party is “sophisticated” or “unsophisticated”?

Authors