RENDERED: JULY 29, 2005; 2:00 p.m.
NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court of Appeals

NO. 2004-CA-001252-MR

CINCINNATI GAS AND ELECTRIC COMPANY — APPELLANT

v.

APPEAL FROM BOYD CIRCUIT COURT
HONORABLE C. DAVID HAGERMAN, JUDGE
ACTION NO. 04-CI-00227

APPALACHIAN FUELS, LLC. — APPELLEE

OPINION
REVERSING AND REMANDING

** ** ** ** **

BEFORE: DYCHE, SCHRODER, AND VANMETER, JUDGES.

SCHRODER, JUDGE: This is an appeal from an order denying appellant's motion to compel arbitration, granting appellee's motion to stay arbitration, and converting a restraining order staying arbitration deadlines into a temporary injunction. Because the issue of arbitrability in this case – whether appellant's availing itself of the self-help remedy of set-off precluded arbitration under the contract – is considered procedural as a waiver issue, the issue must be decided by the

arbitrator pursuant to the dictates of Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002). Accordingly, we reverse the lower court and remand for further proceedings consistent with this opinion.

Appellant, Cincinnati Gas & Electric Company ("CG&E"), and appellee, Appalachian Fuels, LLC ("Appalachian") entered into two three-year coal supply agreements on March 1, 2002, and April 1, 2002. The contracts required Appalachian to sell and deliver specific quantities and quality of coal to CG&E from specifically designated source mines. The quantities were measured in annual tonnage with monthly minimums. The contracts also contained a provision stating that Appalachian's obligation to deliver the coal would be excused in the event of *force majeure* conditions at those designated mines.

Appalachian's deliveries of coal were spotty throughout 2002 and stopped altogether in August of 2003. Appalachian claimed that events of *force majeure* – 1) depletion of reserves in the designated source mines and 2) the unavailability of new permits to mine the additional reserves - prevented it from making any further deliveries to CG&E. On September 24, 2003, CG&E advised Appalachian that it would begin to exercise its right to withhold monies it owed Appalachian to offset the cost of replacement coal pursuant to Sections 2.4.1 and 8.3 of the contracts. From September of 2003 to January of

2004, CG&E held back over $1,000,000 in funds owed to Appalachian, $400,000 of which it still has never paid. During this time, the parties met periodically and attempted to negotiate how to restructure the contracts to allow Appalachian to perform using different coal sources. However, a new agreement was never reached. On February 16, 2004, CG&E gave notice to Appalachian of its intent to invoke the arbitration clause (Section 11.11) of the contracts. Section 11.11 provided in pertinent part:

> If a dispute arises between the Parties relating to this Agreement, the Parties agree to use the following procedure prior to either Party pursuing other available remedies:
> (A) A meeting shall be held promptly between the Parties, attended by individuals with decision-making authority regarding the dispute, to attempt in good faith to negotiate a resolution of the dispute.
> (B) If within thirty (30) days after such meeting, the Parties have not succeeded in negotiating a resolution of the dispute, then, upon fifteen (15) days written notice to the other party, either Party may request that the matter be referred to binding arbitration before three arbitrators, one of whom shall be named by Buyer, one by Seller, and a third of whom shall be named by the two arbitrators appointed by the Buyer and Seller, respectively. (emphasis added.)

On February 20, 2004, CG&E selected its arbitrator pursuant to the above provision of the contract. On March 4, 2004, Appalachian filed its complaint in the Boyd Circuit Court requesting a stay of the arbitration sought by CG&E and seeking

judicial resolution of the parties' *force majeure* dispute. Appalachian also filed a motion for a temporary restraining order pursuant to CR 65.03 requesting a continuance of the deadline for selecting an arbitrator until the circuit court had the opportunity to rule on the motion to stay the arbitration proceedings. The court granted Appalachian's motion for a temporary restraining order. CG&E then filed a motion to dissolve the restraining order, to compel arbitration, and to stay the state court action. A hearing on the competing motions was held on May 6, 2004. On June 2, 2004, the court denied CG&E's motion to compel arbitration, granted Appalachian's motion to stay arbitration, and converted the restraining order into a temporary injunction, thereby enjoining all further arbitration deadlines. The basis of the court's ruling was that CG&E had waived the right to arbitrate the dispute when it pursued "other available remedies" by withholding funds owed to Appalachian to cover the cost of replacement coal – the self-help remedy of set-off. This appeal by CG&E followed.

CG&E's first argument is that the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq*. (2005), preempts the Kentucky Arbitration Act ("KAA"), KRS 417.045-240, and governs this case. Section 2 of the FAA, 9 U.S.C. § 2 (2005), provides in part that a written agreement to arbitrate "a contract evidencing a transaction involving commerce . . . shall be valid,

irrevocable, and enforceable." The analogous section of the KAA, KRS 417.050, provides in pertinent part:

> A written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of any contract.

The lower court did not state which law it applied in deciding this case. It has been held that the FAA governs issues of arbitrability in state and federal courts if the case involves interstate commerce. Saneii v. Robards, 289 F.Supp.2d 855 (W.D. Ky. 2003); 9 U.S.C. § 1 (2005). Here the parties agree that the contracts at issue involve interstate commerce because they provide for the sale and delivery of coal mined in West Virginia and Kentucky to Ohio. Hence the FAA would be applicable and would preempt the KAA. See Fazio v. Lehman Brothers, Inc., 340 F.3d 386 (6th Cir. 2003).

CG&E next argues that the FAA mandates that the arbitrator decide whether the case is subject to arbitration under the facts of this case, citing 9 U.S.C. § 3 (2005) and Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002). 9 U.S.C. § 3 (2005) provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending,

> upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

In Howsam, the question before the Supreme Court was whether the lower court or the arbitrator should decide if arbitration was time-barred under the NASD arbitration time limit rule. The Supreme Court held that such gateway procedural questions are for the arbitrator, not the courts:

> "'[P]rocedural' questions which grow out of the dispute and bear on its final disposition" are presumptively *not* for the judge, but for an arbitrator, to decide. John Wiley [& Sons, Inc. v. Livingston, 376 U.S. 543,] 557, 84 S. Ct. 909, [11 L Ed.2d 898 (1964)] . . . So, too, the presumption is that the arbitrator should decide "allegation[s] of waiver, delay, or a like defense to arbitrability." Moses H. Cone Memorial Hospital [v. Mercury Construction Corp., 460 U.S. 1,] 24-25, 103 S. Ct. 927[, 74 L. Ed.2d 765 (1983)]. Indeed, the Revised Uniform Arbitration Act of 2000 (RUAA), seeking to "incorporate the holdings of the vast majority of state courts and the law that has developed under [Federal Arbitration Act]," states that an "arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled." RUAA § 6(c), and comment 2, 7 U.L.A. 12-13 (Supp.2002). And the comments add that "in the absence of an agreement to the contrary, issues of substantive arbitrability . . . are for a court to decide and issues of procedural arbitrability, *i.e.*, whether prerequisites

> such as *time limits*, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide." Id., § 6, comment 2, 7 U.L.A., at 13 (emphasis added).

Howsam, 537 U.S. at 84-85, 123 S. Ct. at 592.

It is CG&E's position that whether or not it pursued "other available remedies" under the contracts by withholding funds owed to Appalachian was a procedural issue to be decided by the arbitrator and not the court. Conversely, Appalachian maintains that such was a substantive question of arbitrability to be decided by the court. Appalachian correctly points out that the Court in Howsam did not overrule its earlier holding in AT & T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986), that the underlying issue of whether the parties have submitted a particular issue for arbitration is a substantive issue for the courts to decide.

The lower court in this case adjudged that the issue was a substantive one for the court to decide. Because the court's ruling did not include any factual findings, but was based solely on the interpretation of law and of the contracts, our review of the ruling will be *de novo*. Conseco Finance Servicing Corp. v. Wilder, 47 S.W.3d 335, 340 (Ky.App. 2001).

In our view, there is no question that the parties agreed under the terms of the contracts to arbitrate the type of dispute underlying this case – whether Appalachian was excused from performing due to *force majeure*. Under the language of Section 11.11 of the contracts, the arbitration provision clearly applies to any dispute between the parties "relating this Agreement." Sections 2.4.1, 2.4.2, and 9.1 of the contracts provide that the duty to perform shall be excused by *force majeure,* and the definition of *force majeure* is set forth in Section 9.2.

The only question regarding arbitration in this case is whether CG&E pursued "other available remedies" prior to invoking the arbitration clause when it set off the cost difference of replacement coal against the amounts it owed Appalachian under the contracts. From our reading of Section 11.11 of the contracts, pursuing other available remedies would clearly waive the right to invoke the arbitration clause. See Conseco Finance Servicing Corp. v. Wilder, 47 S.W.3d at 344-345.[1] As stated above, under Howsam, that would be considered a procedural issue to be decided by the arbitrator, not the courts. Accordingly, the order denying the motion to compel arbitration, granting the motion to stay the arbitration, and

[1] In Wilder, this Court made a determination of waiver relative to an arbitration clause. However, there was no challenge to such court determination in that case, and Wilder was decided in 2001, prior to the United States Supreme Court's decision in Howsam.

converting the restraining order into a temporary injunction staying all arbitration deadlines is reversed, and the cause remanded for further proceedings consistent with this opinion.

ALL CONCUR.

BRIEF AND ORAL ARGUMENT FOR APPELLANT:	BRIEF AND ORAL ARGUMENT FOR APPELLEE:
Janice Lee Murray Huntington, West Virginia	Barry D. Hunter Lexington, Kentucky