Effects of Recent U.S. Supreme Court Decisions on Arbitrations and Class Action Litigation in South Carolina
The Federal Arbitration Act and arbitrability: An issue for both state and federal courts

Herron is the most recent case where the S.C. Supreme Court has addressed "arbitrability" under the Federal Arbitration Act, 9 U.S.C. 1, et seq. (FAA). The FAA provides that agreements to arbitrate involving interstate commerce are enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The question of "arbitrability" under the FAA typically involves certain "gateway matters, such as whether the parties have a valid arbitration agreement at all," Green Tree Financial Corp. v. Bazzle, 539 U.S. 444, 452 (2003) (Bazzle); "whether parties are bound by a given arbitration clause," Howsam v. Dean Witter Reynolds, 537 U.S. 79, 84 (2002); and "whether an arbitration clause in a concededly binding contract applies to a particular type of controversy." Id. Arbitrability also encompasses the question of what decisionmaker, either court or arbitrator, considers these threshold questions.

Because the FAA is binding on state courts where interstate commerce is involved, both federal and state courts routinely wrestle with the question of "arbitrability." See Munoz v. Green Tree Fin. Corp., 343 S.C. 531, 542 S.E.2d 360 (2001). Our courts look to the decisions of the U.S. Supreme Court when considering the FAA, and arbitrability determinations of the S.C. Supreme Court have reached the U.S. Supreme Court for review. See, e.g., Bazzle.

Herron, Rent-A-Center and the U.S. Supreme Court's evolving view of arbitrability

The Herron plaintiffs brought a putative class action in state court against Century BMW and other South Carolina auto dealers, alleging that the dealers charged an illegal administrative fee in violation of the South Carolina Regulation of Manufacturers, Distributors and Dealers Act, S.C. Code Ann. § 56-15-10, et seq. (Dealers Act). Century moved to compel arbitration pursuant to a contract between the parties.

The plaintiffs challenged the arbitration clause in that contract as unconscionable and placed the arbitrability of the parties' agreement before the trial court. The trial court ruled that the arbitration clause was
unconscionable and refused to compel arbitration, relying on *Simpson v. MSA of Myrtle Beach, Inc.*, 373 S.C. 14, 644 S.E.2d 663 (2007) (*Simpson*).

**Who decides arbitrability?**

The *Heron* plaintiffs' unconscionability challenge to the parties' arbitration agreement was properly addressed by the courts. Under the FAA, courts will consider "threshold" questions of "arbitrability" unless there is "clear and unmistakable evidence" that the parties intended otherwise. *AT & T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 649, (1986) (*AT&T*). However, there are two categories of cases in which the arbitrator is the appropriate decisionmaker for "gateway matters." Under the first category, and as the AT&T decision recognizes, parties can agree to submit the question of arbitrability to arbitration.

Secondly, under the rule of *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (*Prima Paint*), the issue of contract validity (as opposed to the issue of the validity of an arbitration agreement found within that contract) is for the arbitrator, not the courts. *Prima Paint's* rationale is that the FAA applies only to those agreements to arbitrate between parties, and therefore a court is empowered only to hear a "discrete challenge" to the parties' arbitration agreement. Justice Black, dissenting in *Prima Paint*, characterized the Court's holding as "fantastic" and inconsistent with the language of § 2 of the FAA. *Id.* at 407.


**Rent-A-Center: A more particular view of an "agreement to arbitrate"**

The Court almost certainly extended the reach of *Prima Paint's* "surprising result" in *Rent-A-Center*, which involved a challenge to an arbitration agreement similar to that lodged in *Heron*. Plaintiff Jackson filed a federal employment discrimination suit against Rent-A-Center. Rent-A-Center moved to dismiss and compel arbitration, and Jackson opposed same, claiming his arbitration agreement with Rent-A-Center was unconscionable under Nevada state law.

The District Court concluded that language within the agreement required that the parties "arbitrate arbitrability." Referred to as the "delegation provision," this language gave the arbitrator "exclusive authority to resolve any dispute relating to the [agreement's] enforceability ... including ... any claim that all or any part of this Agreement is void or voidable." Therefore, the agreement's language provided that the "gateway" question of contract enforceability was to be decided by the arbitrator.

The Court of Appeals for the Ninth Circuit reversed. *Jackson v. Rent-A-Center*, 581 F.3d 912 (9th Cir. 2009). While acknowledging that the "delegation provision" in the agreement "assigns the arbitrability determination to the arbitrator," the Ninth Circuit Court of Appeals reasoned that an unconscionability challenge to an arbitration agreement subsumes and incorporates a challenge to the "agreement to arbitrate arbitrability" "where ... a party challenges an arbitration agreement as unconscionable, and thus asserts that he could not meaningfully assent to the agreement, the threshold question of unconscionability is for the court." In other words, if a party cannot "meaningfully assent" to an arbitration agreement, then that party cannot "meaningfully assent" to a delegation provision found within that agreement. The Ninth Circuit's reasoning is strikingly similar to that employed by the S.C. Supreme Court in *Simpson*, rejecting a claim that a delegation provision required an arbitrator to determine...
whether an arbitration agreement is unconscionable.

**Herron, Shady Grove and state statutes addressing class actions**

The **Herron** plaintiffs sought to maintain a class action against various auto dealers to recover administrative fees that plaintiffs asserted were charged illegally. The arbitration agreement between the parties included a provision whereby the plaintiffs waived their right to bring or participate in a class action. While reversing the trial court’s determination that the arbitration clause was unconscionable, the S.C. Supreme Court found the ban on class actions unenforceable on public policy grounds because the Dealers Act (whose purpose is consumer protection) expressly provided plaintiffs with the right of class relief. Accordingly, any contract prohibiting those class actions is unenforceable.

The **Herron** analysis—applying South Carolina’s legislatively expressed public policy favoring class action litigation—would presumably prohibit class actions where the General Assembly has expressed that public policy. After all, South Carolina has many statutes, particularly consumer protection statutes, that explicitly prohibit the use of class actions. (See, e.g., S.C. Code Ann. §§ 37-23-50; 37-23-70; 37-5-108; 37-5-202; 37-10-105; and 40-39-160). **Shady Grove** casts some doubt on that proposition.

**Shady Grove: Federal Rule 23 overrides state law prohibition on class actions**

Petitioner filed a putative federal class action under the Class Action Fairness Act, Pub. L. No. 109-2, 28 U.S.C. 1711, et seq., (CAFA) in New York to recover from Allstate statutory interest allowed under a New York law. The District Court dismissed the action after concluding it lacked jurisdiction because N.Y. Civ. Prac. Law Ann. §901(b) explicitly bars claimants from pursuing a class action to recover a “penalty” such as statutory interest. However, the Court ultimately reversed in a plurality decision, reasoning that Fed.R. Civ. P.
Rule 23 and §901(b) conflicted and that Rule 23 allowed the petitioner to pursue a federal class action despite New York's prohibition.

Rule 23 defines when a federal class action "may be maintained." The Court found that Rule 23 "unambiguously authorizes any plaintiff, in any federal proceeding, to maintain a class action if the Rule's prerequisites are met." "Shady Grove, 130 S.Ct. at 1442. Since §901(b) provides that claims "may not be maintained as a class action," a majority of the Court found that Rule 23 and §901(b) inherently conflicted.

The Court considered Rule 23 in light of the Rules Enabling Act, 28 U.S.C. § 2072(b). The Rules Enabling Act limits the Federal Rules by stating that "such rules shall not abridge, enlarge or modify any substantive right." The plurality held that the Court must look to the federal rule and determine whether it regulates procedure ("the manner and means by which litigants' rights are 'enforced'") and is valid, or substance ("the rules of decision by which [the] court will adjudicate [those] rights") and is invalid. The plurality adopted a bright-line rule by analyzing the federal rule rather than the specific state provision, finding that Rule 23 does not violate the Rules Enabling Act:

A class action, no less than traditional joinder (of which it is a species), merely enables a federal court to adjudicate claims of multiple parties at once, instead of in separate suits. And like traditional joinder, it leaves the parties' legal rights and duties intact and the rules of decision unchanged.

Shady Grove, 130 S.Ct. at 1442. Notably, Justice Stevens' concurrence argues that the Court must instead look to the state law, and not the federal rule, to determine whether a substantive right is affected—a view that requires courts to make a case-by-case determination.

**Shady Grove and Herron: When South Carolina's public policy matters**

The Dealers Act provision considered in Herron would not run afoul of Rule 23, FRCP like the New York statute did in Shady Grove, because that statute specifically authorizes class actions, while the New York statute in Shady Grove expressly forbids class actions. However, Shady Grove may limit Herron and the reach of South Carolina's public policy expressed in statutes prohibiting class actions. For litigants in state court seeking class action litigation where the legislature has expressly forbidden same, it appears the rationale of Herron will control. However, in light of Shady Grove, it is doubtful that those same class action prohibitions enacted by the General Assembly are enforceable in actions brought in federal court under CAFA and Federal Rule 23. Accordingly, Shady Grove may open the door to class action litigation in federal court under CAFA in spite of South Carolina's clearly expressed public policy to the contrary.

In creating a "new" federal court forum for certain class action disputes and establishing a different diversity standard in 28 U.S.C. § 1332(d)(2), presumably members of Congress did not intend CAFA (and Federal Rule 23) to allow a cause of action to proceed as a class action in federal court even if explicitly prohibited by state law. Shady Grove may do just that.

**The Herron result, Stolt-Nielsen and the "sound of silence"**

The S.C. Supreme Court determined that the prohibition against class actions found in the Herron parties' arbitration agreement was unenforceable because it conflicted with clear language in the Dealers Act allowing class actions. Because the arbitration agreement contained a severance clause ("[i]f any part of this Agreement shall be deemed or found unenforceable for any reason, the remainder of the Agreement shall remain enforceable"), the class action prohibition would be removed, and the case would proceed in arbitration.

However, the S.C. Supreme Court declined to compel the action to arbitration based upon a state-ment by counsel for Century BMW at oral argument that the respondents did not "wish to invoke the severance clause" and the underlying proposition that severance is predicated on the intent of the parties. Herron, 693 S.E.2d 394, 400.

This result appears curious initially in view of the fact that the severance clause in the agreement was hardly ambiguous regarding the parties' intent. See Schulmeyer v. State Farm Fire & Cas. Co., 353 S.C. 491, 495, 579 S.E.2d 132, 134 (2003) ("[i]f the contract's language is clear and unambiguous, the language alone determines the contract's force and effect.").

The Supreme Court's ruling becomes clearer in view of what the respondents intended to avoid: not the severance clause per se, but its effect—class-action arbitration. But with the class-action prohibition struck from the agreement, no language remained demonstrating the parties' intent with respect to class actions in arbitration. In particular, no remaining language precluded class arbitration. A similar "silence" in an agreement with respect to class arbitration had in the past formed a basis for the S.C. Supreme Court to compel class arbitration. Bazzle v. Green Tree Financial Corp., 351 S.C. 244, 266, 569 S.E.2d 349, 360 (2002) (Green Tree Financial). As described below, Stolt-Nielsen construed "silence" in a different way, and its rationale provides support for the Herron result.

**Stolt-Nielsen: Background and "Bazzle bafflement"**

The Court considered whether an arbitration agreement allowed a case to proceed as a class action in arbitration, despite any clear language to that effect in that agreement. The parties agreed to submit the question of whether the action could proceed on a class basis to an arbitration panel. The parties further stipulated that the arbitration clause was "silent" with respect to class arbitration. The arbitration panel concluded that the arbitration clause allowed for class arbitration. Following appellate proceedings in federal district court and the Second
Circuit Court of Appeals, the Court granted certiorari.

Stolt-Nielsen discusses the 2003 Bazzle opinion at length, so some brief background is helpful. Bazzle arrived at the Court following the S.C. Supreme Court Green Tree Financial decision holding that “class-wide arbitration may be ordered when the arbitration agreement is silent if it would serve efficiency and equity, and would not result in prejudice.” Green Tree Financial, 351 S.C. at 266, 569 S.E. 2d at 360. The Court vacated the S.C. Supreme Court decision, with four justices reasoning that the arbitrator (not the court) should have interpreted the arbitration agreements in question, and Justice Stevens concurring in the result but not the rationale.

In the Stolt-Nielsen opinion, Justice Scalia disabused the parties and the arbitration panel (and a great many practitioners) of the proposition that Bazzle 1) requires an arbitrator to determine the issue of whether a contract permits class arbitration; and 2) established a rule to be applied in deciding whether class arbitration is permitted. Neither of those issues commanded a majority opinion in Bazzle, only a plurality. (Note that the Bazzle plurality determined that the question of whether an arbitration agreement forbids class arbitration was not one of the “gateway matters” that a court should decide.)

Since the parties had not raised the “arbitrating arbitrability” issue, Justice Scalia turned to the question of class arbitration. Because arbitration under the FAA is a matter of “consent” and “the intentions of the parties,” the Court reasoned that a party could not be compelled to class arbitration absent “a contractual basis for concluding that the parties agreed to do so.” Stolt-Nielsen, 130 S. Ct. at 1775.

The arbitration panel had rendered its determination based upon the premise that the parties did not “intend[] to preclude arbitration.” Accordingly, the agreement to conduct class arbitration, while not explicitly spelled out in the agree-