RECENT DEVELOPMENTS

Buckeye Check Cashing, Inc. v. Cardegna[*]

I. INTRODUCTION

In a decision that lends further credence to the old adage that consumers should always beware of the small print, the United States Supreme Court recently held that when a challenge is brought against the validity of an entire contract, and not specifically its arbitration clause, the challenge will be heard by an arbitrator and not a state or federal judge.[1] In arriving at its ruling, the Court reaffirmed three holdings from *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*[2] and *Southland Corp. v. Keating*[3] as follows: (1) an arbitration clause is severable from the rest of a contract under federal arbitration law; (2) an arbitrator first hears challenges to a contract's validity unless the arbitration clause itself is challenged; and (3) federal arbitration law applies in federal and state courts.[4]

The immediate impact of *Buckeye Check Cashing* is that both state and federal courts are on notice that the Federal Arbitration Act requires that challenges to the validity of an entire contract, regardless of the underlying legal basis for the challenge, are to be heard by an arbitrator and not a court.

II. FACTS AND PROCEDURAL HISTORY

In *Buckeye Check Cashing*, respondents John Cardegna and Donna Reuter conducted several deferred-payment transactions with petitioner Buckeye Check Cashing in which they were given cash in return for a personal check written in the amount of the cash received plus a finance charge.[5] For each deferred-payment transaction that the respondents concluded, they signed a "Deferred Deposit and Disclosure Agreement" (Agreement) that contained two provisions regarding arbitration.[6] The first provision stated that by signing the Agreement, the respondents agreed that "either you or we or third-parties involved can choose to have [a] dispute [arising out of the Agreement or related instruments] resolved by binding

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[*] Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct. 1204 (2006).

[1] *Id.* at 1210.

[2] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

[3] Southland Corp. v. Keating, 465 U.S. 1 (1984).

[4] *Buckeye Check Cashing*, 126 S. Ct. at 1209.

[5] *Id.* at 1207.

[6] *Id.*

arbitration[.]"[7] The second provision explained that "[a]ny claim, dispute, or controversy . . . arising from or relating to this Agreement . . . or the validity, enforceability, or scope of this Arbitration Provision or the entire agreement (collectively 'Claim'), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration[.]"[8] In addition, the second provision specified that the Agreement "shall be governed by the Federal Arbitration Act ('FAA'), 9 U.S.C. Sections 1–16."[9]

Cardegna and Reuter brought a putative class action lawsuit against Buckeye Check Cashing claiming that the deferred-payment check cashing transactions were in actuality usurious loans that violated various Florida statutes.[10] At the trial court, defendant Buckeye Check Cashing filed an application to compel arbitration and to stay the court proceedings in accordance with the arbitration provisions in the Agreement signed by plaintiffs.[11] In response, the plaintiffs filed a memorandum in opposition to the motion to compel arbitration claiming that the court should not enforce the arbitration agreement because it was part of an illegal usurious contract that was void *ab initio*.[12] The trial court denied Buckeye Check Cashing's motion to compel arbitration, relying on two Florida appellate cases: *Party Yards, Inc. v. Templeton*[13] and *FastFunding v. Betts*.[14]

After the denial of its motion to compel, Buckeye Check Cashing appealed to the District Court of Appeals of Florida for the Fourth District claiming that the trial court erred by not construing the FAA in accordance with *Prima Paint* and its progeny.[15] The appellate court agreed with Buckeye Check Cashing and held that because the Agreement was to be construed in accordance with the FAA, the rule from *Prima Paint* was to be applied, meaning that "only where the attack is specifically and exclusively directed toward the arbitration clause or a separate agreement to arbitrate may the court try the issue before submitting the balance of the controversy to

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[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *See* Buckeye Check Cashing, Inc. v. Cardegna, 824 So. 2d 228, 229 (Fla. Dist. Ct. App. 2002).

[11] *See id.* In its opinion, the Court of Appeals of Florida, Fourth District summarizes the trial court's handling of the case. *Id.*

[12] *Id.*

[13] Party Yards, Inc. v. Templeton, 751 So. 2d 121 (Fla. Dist. Ct. App. 2000).

[14] FastFunding v. Betts, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000).

[15] *Id.* at 229–30.

arbitration[.]"[16] As the appellees claimed that the whole contract was illegal and therefore void *ab initio*, and because they did not specifically challenge the arbitration provision,[17] the Fourth District reversed the trial court's order denying the motion to compel arbitration and remanded the case.[18]

In response to the reversal of the trial court's order, Cardegna and Reuter appealed to the Florida Supreme Court claiming that the Fourth District's holding was in direct conflict with the Fifth District's holding in *FastFunding v. Betts*.[19] The facts of *FastFunding* are similar to those in *Buckeye Check Cashing* as plaintiff Betts brought suit claiming that check cashing loans charged usurious interest rates in violation of Florida law and defendant FastFunding subsequently moved to compel arbitration.[20] *FastFunding* held that if a contract is in violation of Florida's usuary statutes, it is illegal and therefore, the plaintiff is not required to perform under the contract and does not have to submit the dispute to arbitration.[21] Prior to *FastFunding*, the Fifth District held in *Party Yards, Inc. v. Templeton* that "[w]here the facts alleged by the plaintiff are sufficient to put the making of a lawful agreement at issue, the trial court must determine the validity of the agreement before compelling a party to submit to arbitration."[22]

The Florida Supreme Court determined that the rationale behind the Supreme Court's decision in *Prima Paint* did not apply to the facts of *Buckeye Check Cashing*.[23] For the Florida Supreme Court, the crucial difference was that in *Prima Paint*, the alleged fraud in the inducement would render the contract voidable, whereas the contract in *Buckeye Check Cashing* would be entirely void if it violated Florida's usury laws. As a result of the void contract, the arbitration clause would be nullified as well.[24] Ultimately, the Florida Supreme Court held that when a plaintiff sufficiently alleges that a contract violates the state's usury laws, the trial court and not

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[16] *Id.* at 230 (quoting Manning v. Interfuture Trading, Inc., 578 So. 2d 842, 843 (Fla. Dist. Ct. App. 1991)).

[17] *See id.* at 229 (noting that while appellees asserted that the arbitration clause was unconscionable, they did not properly raise the issue before the trial court and, thus, the issue was not considered by the Fourth District.).

[18] *Id.* at 232.

[19] Cardegna v. Buckeye Check Cashing, Inc., 894 So. 2d 860, 862 (Fla. 2005).

[20] *Id.* (citing FastFunding v. Betts, 758 So. 2d 1143, 1143–44 (Fla. Dist. Ct. App. 2000)).

[21] *Id.*

[22] Party Yards, Inc. v. Templeton, 751 So. 2d 121, 124 (Fla. Dist. Ct. App. 2000).

[23] *Buckeye Check Cashing*, 894 So. 2d at 863.

[24] *Id.*

an arbitrator must initially determine whether the contract is legal before a party can be required to submit to arbitration under the provisions of the contract.[25] In reversing the Fourth District and remanding the case for further proceedings in line with its opinion, the Florida Supreme Court noted that an arbitration provision was not severable from a contract found illegal under state law.[26] In its opinion, the court distinguished its ruling from a recent Eleventh Circuit holding[27] by explaining that *Bess* was "expressly resolved under federal law principles" before a federal court while its *Buckeye Check Cashing* holding was based on considerations of Florida law.[28]

Buckeye Check Cashing appealed from the Florida Supreme Court's ruling and the United States Supreme Court granted certiorari[29] to resolve the issue of "whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality."[30]

III. THE COURT'S HOLDING AND REASONING

The Supreme Court held that "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator."[31] In arriving at its holding, the Court reiterated rules from earlier cases that an arbitration clause is severable from the rest of a contract and federal arbitration law applies in state courts as well as federal courts.[32]

A. *Challenges to the Validity of the Contract as a Whole Must Be Heard by Arbitrators*

The arbitration provisions of the Agreement at issue stated that the Agreement was to be governed by the FAA.[33] Section 2 of the FAA provides that an arbitration provision is "'valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any

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[25] *Id.* at 865.

[26] *Id.* at 864.

[27] *See* Bess v. Check Express, 294 F.3d 1298 (11th Cir. 2002).

[28] *Buckeye Check Cashing, Inc.*, 894 So. 2d at 864.

[29] *See* Buckeye Check Cashing, Inc. v. Cardegna, 545 U.S. 1127 (2005).

[30] *Buckeye Check Cashing, Inc.*, 126 S. Ct. at 1207.

[31] *Id.* at 1210.

[32] *See id.* at 1209.

[33] *See id.* at 1207.

contract.'"[34] In examining this section, Justice Scalia determined that there were two types of legal or equitable challenges to the validity of arbitration agreements: those that specifically challenge the validity of an arbitration provision or an agreement to arbitrate, and those that challenge the contract as a whole, either on grounds affecting the entire agreement or by claiming that one illegal contract provision renders the whole instrument invalid.[35] In *Prima Paint*, the Supreme Court had previously considered which types of challenges to a contract could be considered by an arbitrator and which had to be heard by a federal court.[36] Justice Scalia looked to this case to determine the forum for hearing the challenge to the Agreement brought by the respondents.[37]

Prima Paint turned on the Court's reading of Section 4 of the FAA, the pertinent part of which provides that: "[U]pon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement[.]"[38] The Court read Section 4 to mean that federal courts could hear claims that an agreement to an arbitration clause was fraudulently induced, but that "the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally."[39] Respondents Cardegna and Reuter claimed that the entire Agreement concluded with Buckeye Check Cashing was illegal for being in violation of Florida's usury laws, and they did not specifically challenge the arbitration provisions of the contract.[40] Consequently, the Court found that the arbitration provisions of the Agreement are "enforceable apart from the remainder of the contract" and that respondents' challenge "should therefore be considered by an arbitrator, not a court."[41]

Respondents also argued that Section 2 of the FAA could not apply to the Agreement at issue because the statute governs arbitration agreements arising out of "a contract."[42] They reasoned that if the deferred-payment arrangements violated the Florida usury laws, the Agreement was void *ab*

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[34] *Id.* at 1208.

[35] *Id.*

[36] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 403–404 (1967).

[37] *Buckeye Check Cashing, Inc.*, 126 S. Ct. at 1208.

[38] *Id.* at 1208 n.2.

[39] *Id.* (quoting *Prima Paint Corp.*, 388 U.S. at 403–04).

[40] *Id.* at 1209.

[41] *Id.*

[42] *Id.* at 1210.

initio and then there was no contract.[43] A similar line of reasoning was employed by Justice Black in his *Prima Paint* dissent, but the *Buckeye Check Cashing* Court read Section 2 to cover contracts that an arbitrator could find to be invalid or illegal.[44] The reasoning of the Justices in the majority was that the term "contract" in the statute was intended to be read broadly and they believed that the use of the phrase "any contract" in the last sentence was intended to encompass putative contracts.[45] Otherwise, only arbitration provisions that were found to be voidable, but not void, could be challenged.[46]

B. *An Arbitration Clause is Severable from the Remainder of a Contract*

One of the consequences of the *Prima Paint* opinion was the establishment of a "rule of severability," meaning that arbitration clauses can be considered separately from the contracts within which they are contained.[47] The Second Circuit Court of Appeals had explained the effect of such a rule to be that "where no claim is made that the fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud."[48]

In the *Buckeye Check Cashing* opinion, the Court describes the *Prima Paint* rule of severability as a "matter of substantive federal arbitration law."[49] The Court rejected the Florida Supreme Court's contention that an arbitration clause could not be severed from a contract found to be illegal under Florida law.[50] Justice Scalia dismissed outright the Florida court's reliance on the distinction between contracts that are void and those that are voidable saying that the *Prima Paint* Court reached its conclusion through the application of the federal rule of severability and "*without discussing* whether the challenge at issue would have rendered the contract void or

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[43] *Buckeye Check Cashing, Inc.*, 126 S. Ct. at 1210.

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *See* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 403–404 (1967).

[48] *Id.* at 402.

[49] *Buckeye Check Cashing, Inc.*, 126 S. Ct. at 1209.

[50] *See id.*

voidable."[51] Thus, applying the rule of severability, even if the challenge to the contract could result in the entire instrument being void, unless the arbitration provision or circumstances surrounding its conclusion are contested, in the first instance an arbitrator and not a court will hear the challenge.

Respondents Cardegna and Reuter argued that the rule of severability did not apply in state courts as *Prima Paint* examined only Sections 3–4 of the FAA, and not Section 2, the provision of the FAA that has been applied in state court.[52] The Court quickly dispensed with this argument saying that while Sections 3 and 4 were crucial to the holding in *Prima Paint*, the severability rule really emerged from Section 2, the provision of the FAA that gives arbitration agreements the same status as other contracts.[53]

C. *Federal Arbitration Law Applies in Federal and State Courts*

From *Prima Paint* up until the time of the *Buckeye Check Cashing* decision, there has been some confusion surrounding the issue of applying state law in cases involving challenges to contracts containing arbitration provisions.[54] Indeed, in the lone dissent in this case, Justice Thomas argued that the FAA does not apply to state court proceedings.[55] The Florida Supreme Court refused to invoke *Prima Paint's* rule of severability on the grounds that the contract law and public policy of the state would not permit the enforcement of the arbitration clause of an illegal contract.[56] However, Justice Scalia stated on behalf of the majority that "we cannot accept the Florida Supreme Court's conclusion that enforceability of the arbitration agreement should turn on 'Florida public policy and contract law.'"[57]

In order to support its assertion that Florida law was not controlling, the Court looked to its prior opinion in *Southland* which held that the FAA "'create[d] a body of federal substantive law'" that is "'applicable in state

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[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *See, e.g.*, Cardegna v. Buckeye Check Cashing, Inc., 894 So. 2d 860, 866 (Fla. 2005) (Bell, J., specially concurring) (stating that "I do not believe the FAA was intended to preempt a state's generally applicable consumer protection laws").

[55] *Buckeye Check Cashing*, 126 S. Ct. at 1211.

[56] *See Buckeye Check Cashing*, 894 So.2d at 864.

[57] *Buckeye Check Cashing*, 126 S. Ct. at 1209 (citing *Buckeye Check Cashing*, 894 So. 2d at 864).

and federal court.'"[58] Some, including Justice O'Connor, saw the FAA as a statute that was procedural only and thus not applicable in state courts.[59] However, the *Southland* Court conducted a review of prior cases, including *Prima Paint*, in order to arrive at the determination that the FAA applied in state court proceedings.[60] Section 2 of the FAA specifies that the Act applies to contracts involving commerce.[61] For the majority in that case, it was crucial that Congress, in enacting the FAA, relied upon its powers under the Commerce Clause, a necessary invocation of authority if "it intended the Act to apply in state courts."[62] They reasoned that if Congress had only intended for the FAA to apply in federal court, then there would be no need to invoke the Commerce Clause as Congress is free to establish rules for the federal courts.[63]

IV. THE IMPACT OF *BUCKEYE CHECK CASHING*

The probable long-term effect of *Buckeye Check Cashing* is that an increasing number of business-consumer disputes, even those stemming from allegedly void or illegal contracts, will be resolved in arbitration. From a litigation standpoint, arbitration practitioners have predicted that "parties to an arbitration agreement who prefer litigation may still resist arbitration by challenging the arbitration provision rather than the contract as a whole, leaving courts to wrestle with artful pleading issues."[64]

Along with *Prima Paint* and *Southland*, *Buckeye Check Cashing* can be seen as "reaffirm[ing] a strong federal policy favoring enforcement of

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[58] *Id.* (citing Southland Corp. v. Keating, 465 U.S. 1, 12 (1984)).

[59] *See Southland*, 465 U.S. at 31 (O'Connor, J., dissenting). Justice O'Connor expressed the opinion that "Section 2, like the rest of the FAA, should have no application whatsoever in state courts." *Id.*

[60] *Id.* at 10–15.

[61] *See* 9 U.S.C. § 2 (2006).

[62] *Southland*, 465 U.S. at 14.

[63] *See id.* at 14–15.

[64] Joy M. Soloway & Kevin O'Gorman, *Who Decides Challenges to a Contract—Arbitrators or The Courts? The United States Supreme Court Revisits and Reaffirms* Prima Paint, FULBRIGHT & JAWORSKI L.L.P. APPELLATE & ARBITRATION ALERT, *available at* http://www.fulbright.com/images/publications/Appellate%20and%20ADR%20Update%20-%20Prima%20Paint%20-%20February%202006.pdf (last visited Jan. 22, 2007).

arbitration agreements."[65] At oral argument, Justice Breyer commented that businesses across the world have come to rely on arbitration as a dispute settlement mechanism.[66] He suggested that deciding in favor of the Respondents would result in "throw[ing] a large section of th[e]se [arbitration] contracts back into the laws of the 50 States and arbitration will be seriously injured as the commercial community has come to rely on it."[67] Instead, the Court's decision reaffirming that the FAA applies in state court proceedings provides arbitration proceedings in the United States with a further degree of uniformity.

Federal courts of appeals and district courts have treated *Buckeye Check Cashing* as clarification of *Prima Paint*'s command that challenges to the validity of a contract, outside of challenges brought against the arbitration clause, should be heard by an arbitrator and not a court.[68] A district court in Colorado distinguished *Buckeye Check Cashing* from the facts at issue in the case before it where the plaintiff challenged the validity of a binding alternative dispute resolution program.[69] The court held that because the program concerned only alternative dispute resolution, the arbitration issue was effectively already severed and the court was thus the proper body to determine the validity of the program.[70] In addition, state courts have taken notice that the FAA applies to their consideration of challenges to contracts.[71]

The Missouri Supreme Court distinguished *Buckeye Check Cashing* and found that it did not apply in a case where the enforcement of an arbitration clause in a contract of adhesion was at issue.[72] Given that an arbitration

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[65] Sarah Rudolph Cole, *Buckeye Check Cashing Supreme Court Decision Offers Solace to Business Using Arbitration Agreements*, MAYHEW-HITE REPORT, *available at* http://moritzlaw.osu.edu/jdr/mayhew-hite/vol4iss3/lead.html (last visited Jan. 22, 2006).

[66] Transcript of Oral Argument at 29, Buckeye Check Cashing, Inc. v. Cardegna, 126 S. Ct. 1204 (2005) (No. 04-1264).

[67] *Id.*

[68] *See, e.g.*, Abdouljaami v. Legalmatch.com, Inc., No. 05 Civ. 9464, 2006 U.S. Dist. LEXIS 26327, at *13 (S.D.N.Y. Apr. 24, 2006).

[69] *See* Crawford v. United Servs. Auto. Ass'n. Ins., No. 06-cv-00380-EWN-BNB, 2006 U.S. Dist. LEXIS 46433, at *18–19 (D. Colo. July 7, 2006).

[70] *Id.* at *19.

[71] *See* Higgins v. Superior Court, 140 Cal. App. 4th 1238, 1249 (Cal. Ct. App. 2006) (noting that "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause, must go the arbitrator") (quoting *Buckeye Check Cashing*, 126 S. Ct. at 1209–10).

[72] *See* State ex rel. Vincent v. Schneider, 194 S.W.3d 853, 857 (Mo. 2006).

clause was being challenged, the court determined that it was the proper body to review the clause.[73]

Businesses like Buckeye Check Cashing that systematically include arbitration provisions in the contracts they conclude with consumers will have been extremely satisfied with the Supreme Court's opinion. In many ways, the decision can be seen as benefiting business interests to the detriment of the consumer. The vast majority of service contracts contain a binding arbitration clause,[74] and only the most well-informed consumers will understand the significance of agreeing to submit a contractual dispute to arbitration. Indeed, when writing about this case, Professor Sarah Cole commented that "it would be fiction to imagine that the consumers either knew about the arbitration clause or intended to agree to it."[75] Likewise, it would be a fiction to assume that the majority of consumers are aware of the Court's ruling in this case, but it will certainly loom large in the background of any commercial transactions they undertake.

Philip Morrow

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[73] *Id.* at 857.

[74] *See, e.g.*, Elizabeth G. Thornburg, *Contracting with Tortfeasors: Mandatory Arbitration Clauses and Personal Injury Claims*, 67 LAW & CONTEMP. PROBS. 253, 254 (2004) (noting that "[a]rbitration clauses appear in contracts for employment, for the sale of goods, and for the provision of services).

[75] Cole, *supra* note 64.