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Separability Saved: US Supreme Court Eliminates Threat to International Arbitration

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I. Introduction

On February 21, 2006, in the case of *Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, the Supreme Court of the United States eliminated a serious threat to international arbitration by an overwhelming majority of 7-1, re-affirming that the doctrine of separability applies in the United States.[1]

The separability doctrine provides that an arbitration agreement contained in a contract is separable from the rest of the contract, thus requiring that attacks on the validity of the contract as a whole go to arbitration rather than to court. In other words, the arbitral tribunal—not the court—has jurisdiction to determine questions regarding the validity of a contract containing an arbitration agreement.

The US Supreme Court established this doctrine almost 40 years ago in the landmark 1967 decision in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*[2] However, in a 2005 decision, the Florida Supreme Court chose to ignore the doctrine, holding that an attack on the validity of a contract containing an arbitration clause was properly brought before the court and not the arbitrator.[3] The US Supreme Court's reversal of this Florida Supreme Court decision protects one of the important principles underlying the success of international arbitration involving American parties or taking place in the United States.

II. History of the Case

The plaintiffs, Cardegna and others, had cashed cheques at Buckeye Check Cashing. Buckeye provided the plaintiffs with cash in exchange for the cheques and a small finance charge. Each transaction was recorded by way of written contract containing an arbitration clause.

The plaintiffs brought a class action against Buckeye in a Florida state court claiming that the contracts provided for the charging of usurious interest rates and violated Florida lending and consumer-protection laws. Buckeye, relying on the arbitration clause in the contracts, moved to compel arbitration to resolve the dispute.

The case made its way to the Florida Supreme Court, which held that a court rather than an arbitrator should determine whether a contract that contains an arbitration clause is void for illegality. The Florida Supreme Court held that Florida state law did not allow parts of an illegal and void contract to be severable. The Court reasoned that, because it was alleged that the contracts with Buckeye were criminal and illegal, it could not enforce the arbitration clause because the contract might later be found to be unlawful.

Buckeye appealed to the US Supreme Court and argued that an arbitrator rather than a court should determine whether the contract was illegal. The plaintiffs sought confirmation of the Florida Supreme Court decision, and argued that the outcome they sought would not undermine the widespread enforcement of arbitration agreements.[4]

III. *Buckeye* Decision

In an eight-page decision written by Justice Scalia for a seven-member majority, the US Supreme Court reversed the decision of the Florida Supreme Court and held that a challenge to the validity of a contract as a whole where that contract contains an arbitration clause—irrespective of whether an action is brought in a United States state or federal court—must be decided by an arbitrator, not by a court.

In its decision, the US Supreme Court relied on two important precedents.

First, it relied on its 1967 landmark precedent in *Prima Paint* where it established the doctrine of separability of an arbitration clause from the rest of the contract in which it is contained.[5] The US Supreme Court said that *Prima Paint* established that "*as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract*," and that "*the issue of the contract's validity is considered by the arbitrator in the first instance*," except where "*the challenge is to the arbitration clause itself.*"[6]

Second, it relied on its 1984 decision in *Southland Corp.* v. *Keating*[7] where it held that the US Federal Arbitration Act ("FAA") "*create[d] a body of federal substantive law*" applicable before US state courts as well as federal courts.[8]

Applying this case law, the US Supreme Court held in *Buckeye* that the arbitration clause in each of the contracts at issue was enforceable separately from the remainder of the contract and that since the plaintiffs had challenged the contract as a whole rather than just its arbitration clause, an arbitrator, not a court, had to consider whether the contract was void for illegality. The lone dissenting judge, Justice Thomas, wrote a one paragraph dissent. Justice Thomas considered that the FAA should not apply to US state court proceedings and, on this basis alone, would have upheld the Florida Supreme Court decision.[9]

Accordingly, the *Buckeye* decision confirms that the separability doctrine applies throughout the United States. The US Supreme Court stated that the severability doctrine established in *Prima Paint* means that US law is in favour of enforcing arbitration agreements, even if the contract in which such an agreement is found is later determined by an arbitrator to be void.[10]

In its submissions, the plaintiffs had argued for an interpretation of the FAA that would avoid the application of *Prima Paint*. They argued that the decision in that case was based on paragraphs 3 and 4 of the FAA—procedural provisions that had only been applied in federal courts—rather than on paragraph 2—the FAA's main substantive provision that had been applied in state courts as well as federal courts. In essence, the plaintiffs argued that *Prima Paint*'s interpretation of the FAA created nothing more than a federal court rule of procedure.[11]

In *Buckeye*, the US Supreme Court ruled that (1) such a view of the FAA was inconsistent with its decision in *Southland* that the FAA did not apply solely to federal court disputes, and (2) the application in *Prima Paint* of paragraph 2 of the FAA was a matter of federal substantive law not limited to the jurisdiction of federal courts. Although *Prima Paint* turned primarily on paragraph 4 of the FAA, *Buckeye* held that the severability rule was derived from paragraph 2, which it described as "*embody[ing] the national policy in favour of arbitration.*"[12] The US Supreme Court held that the severability rule guarantees respect of "*the FAA's substantive command*" contained in paragraph 2 "*that arbitration agreements be treated like all other contracts.*" Thus, the severability doctrine is directly applicable in state court proceedings.[13]

The US Supreme Court also ruled that the distinction drawn by the Florida Supreme Court between void and voidable contracts—with arbitration clauses in the former not capable of being severed under Florida law—was not relevant and did not preclude the severability doctrine, particularly in light of the facts in both *Prima Paint* and *Southland*. Accordingly, state law cannot operate to exclude the operation of the severability doctrine.[14]

These two principles—that the severability doctrine applies in state courts and that state laws cannot operate to preclude the doctrine's operation—reinforce each other and are a clear endorsement of the severability doctrine in US law, as well as a guarantee of its application in state and federal courts throughout the United States.

IV. Significance of Buckeye to International Arbitration

The status of arbitration agreements under US law would have been thrown into question had the Florida Supreme Court decision been left standing. The US Supreme Court decision in *Buckeye* is important in confirming the uniform operation of this area of the law in the United States and the "safety" of entering into an arbitration agreement with an American party or which designates a place of arbitration in the United States.

First, as indicated above, *Buckeye* ensures that the separability doctrine applies in all US courts, unaffected by the operation of inconsistent state laws. This ensures that the doctrine will be uniformly applied across the United States. Parties are thus guaranteed a measure of consistency in conducting arbitration on American soil. In particular, the predictability of the arbitration process (especially from a cost perspective) is enhanced given that parties will be able to engage in arbitration in the United States without fear of suddenly finding their dispute in court instead of arbitration because of a state law regarding the validity of the contract at issue. Indeed, had the Florida Supreme Court decision not been reversed, there would have been the risk in the United States that a party could move a dispute into the courts that was supposed to be arbitrated simply by making an attack on the validity of the contract. This would have affected the confidence of non-American parties in entering into arbitration agreements with American parties and in choosing a place of arbitration in the United States.

Second, by ruling that challenges to the validity of a contract as a whole must be referred to arbitration where there is an arbitration agreement, the US Supreme Court has limited the scope for a court to intervene unnecessarily. This ensures that the contractually-enshrined, voluntary choice of parties to resort to arbitration in the event of a dispute is respected. To force parties to enter into court litigation where they have chosen arbitration in their contract would go against the very *raison d'être* of the arbitration clause and would weaken the "finality" of choosing arbitration as a dispute resolution mechanism.

Third, by overturning the decision of the Florida Supreme Court, the US Supreme Court has averted a widespread reconsideration of the current formulation of arbitration clauses in existing contracts. In *Buckeye*, the arbitration clause was worded very broadly, indicating that Buckeye and the plaintiffs shared a common wish to send any dispute to arbitration. Moreover, the arbitration clause specifically referred to the FAA. In the circumstances, for a court to decide whether the contract in question was invalid would have been inconsistent with the clear wording of the arbitration clause, which conveyed the obvious intention of the parties to resort to arbitration to resolve differences between them. Had the Florida Supreme Court decision stood, drafters of arbitration clauses would have had to consider "going back to the drawing board" in an attempt to make such clauses even more explicit in order to avoid a *Buckeye* situation.

In sum, the *Buckeye* decision is consistent with the pro-arbitration aims of the FAA that the US Supreme Court itself highlighted in its analysis. Perhaps more importantly, though, *Buckeye* avoids damage to the reputation of the United States as a "safe" host of international arbitration. This is critical given the importance of the United States and American parties to international commerce.

Finally, *Buckeye* is consistent with current international arbitration case law and doctrine. It is well-established that arbitrators are able to, and should, rule on their own jurisdiction, rather than leave that task to national courts (commonly-known as the "competence-competence" principle). In *Buckeye*, the very legality (and thus validity) of the contract in question was being challenged. As one of the authors has recently written, the widely accepted view in international arbitration today is that an arbitral tribunal should not refuse jurisdiction over a dispute simply because of allegations of illegality, such as fraud, corruption, bribery, or money laundering.[15]

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1 *Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

2 *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 US 395 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D388%2BU%252ES%252E%2B%2B395

3 *See* the October 2005 issue of *Mealey's International Arbitration Report* at pp. 25-26 ("Separability Principle Doesn't Apply to Florida Contract Case") and pp. 31-54 ("'Separability,' 'Illegality,' and Federalism: The *Cardegna* Case in the Supreme Court" by Professor Rau).

4 *See* the October 2005 issue of *Mealey's International Arbitration Report* at p. 26 ("Separability Principle Doesn't Apply to Florida Contract Case").

5 *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 US 395 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D388%2BU%252ES%252E%2B%2B395

6 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1208-1209 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

7 *Southland Corp.* v. *Keating*, 465 US 1 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D465%2BU%252ES%252E%2B%2B1

8 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1208-1209 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

9 *Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1211 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

10 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1210 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

11 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1209-210 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

12 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1207 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

13 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1209-1210 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

14 *See Buckeye Check Cashing, Inc.* v. *John Cardegna et al.*, 126 S. Ct. 1204, 1209 and 1210 <http://www3.lexis.com/LENS/EndUser?Action=CITE_RET&redirUrl=http%3A%2F%2Fwww.lexis.com%2Fresearch%2Fxlink%3Fcanceldest%3Dform%26keyenum%3D25270%26keytnum%3D0%26searchtype%3Dget%26search%3D126%2BS%252E%2BCt%252E%2B%2B1204

15 *See* Andrew de Lotbinière McDougall, "International Arbitration and Money Laundering," 20, American University International Law Review, 1021, 2005 at pp. 1039-1042 and 1052.