

No. 04-1264

IN THE
Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,

Petitioner,

v.

JOHN A. CARDEGNA AND DONNA REUTER,

Respondents.

**On Writ of Certiorari to the
Supreme Court of Florida**

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

Plaintiffs effectively ask this Court to overrule not just one but two landmark decisions that have governed the enforceability of arbitration agreements in this Nation for decades: (1) *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), and (2) *Southland Corp. v. Keating*, 465 U.S. 1 (1984). In *Prima Paint*, this Court held as a matter of federal substantive law that a challenge to the validity of an underlying contract is severable from a challenge to the validity of an embedded arbitration clause, and in *Southland*, this Court held that federal substantive law governing arbitrability applies in state courts. Those two precedents control the resolution of this case: under the Federal Arbitration Act (“FAA”), plaintiffs cannot avoid enforcement of their arbitration agreement in either federal or state court by challenging the underlying contract on grounds unrelated to the arbitration agreement.

Plaintiffs insist, however, that *Prima Paint*’s severability rule is not a rule of federal substantive law, but “a matter of federal court procedure ... that applies *only* in federal court proceedings.” Resp. Br. 18 (emphasis in original). Putting aside the fact that plaintiffs failed to advance this argument in their opposition to the petition for certiorari (or at any other point in these proceedings), the argument is squarely inconsistent with the FAA as interpreted in *Prima Paint*. That case specifically held that the severability of an arbitration clause is “substantive” federal law enacted under the Commerce Clause, *see* 388 U.S. at 400, 404-05, and this Court subsequently built on that holding by specifying that the substantive federal law of arbitration applies in state as well as federal court, *see Southland*, 465 U.S. at 11-12. Plaintiffs may disagree with *Prima Paint* and *Southland*, but they cannot pretend that those cases did not hold what they did.

Nor can plaintiffs sidestep *Prima Paint* by arguing that its federal severability rule does not come into play if the underlying contract is challenged as void, rather than voidable,

under state law. The whole point of the rule is that a party cannot avoid an arbitration agreement by simply challenging the underlying contract in which it is embedded. The *nature* of the challenge to the underlying contract, and the state-law severability implications of that challenge, are immaterial; what matters is that the challenge is directed at the underlying contract, as opposed to the arbitration clause itself. To say that *Prima Paint*'s federal severability rule does not come into play until *after* a court applies a state severability rule is, for all intents and purposes, to deny the federal rule. Thus, contrary to plaintiffs' assertion, the issue here is not whether to adopt a "new rule of federal contract law," Resp. Br. 9; rather, it is whether to retain an old rule of federal arbitration law.

Let there be no mistake about it: the issue here is not (as plaintiffs repeatedly assert, *see, e.g.*, Resp. Br. 1, 7, 8, 18, 19, 20, 35) whether to "extend" *Prima Paint*, but whether to gut that decision (as well as *Southland*). At bottom, plaintiffs (and their *amici*, who are more candid on this score) are arguing that those cases were wrongly decided, and that the FAA neither establishes federal substantive law nor applies in state court. Those arguments, however, are addressed to the wrong forum. If plaintiffs and their *amici* do not like these longstanding statutory precedents, upon which innumerable contracts have been based, they are free to make their case to Congress. But they have provided no reason for this Court to do their work for them.

The reason that *Prima Paint* and *Southland* have stood the test of time is no mystery: those decisions are eminently sensible. The federal severability rule prevents parties from avoiding their agreements to arbitrate by challenging their underlying contracts on grounds unrelated to arbitration, and the application of that substantive rule in state as well as federal court prevents forum shopping. In sharp contrast to the indeterminate and inconsistent approach suggested by plaintiffs,

this regime is workable and predictable—which may explain why all six federal circuits confronted with the question presented here had no trouble concluding (without dissent) that *Prima Paint*'s federal severability rule governs a challenge to an underlying contract based on illegality. This Court should decline plaintiffs' invitation to overturn this settled law.

ARGUMENT

I. *Prima Paint* Established A Substantive Rule Of Federal Law Applicable In Both Federal And State Court.

Plaintiffs argue as a threshold matter that *Prima Paint*'s federal severability rule does not apply here at all, because this case arises from state, not federal, court. *See* Resp. Br. 13-19. That argument fails on both procedural and substantive grounds.

A. Plaintiffs Waived The Argument That *Prima Paint* Does Not Apply In State Court.

As an initial matter, plaintiffs waived the argument that *Prima Paint* does not apply in state court by failing to raise that argument in their opposition to the petition (or at any other previous stage of this litigation). The petition presented the question whether the Florida Supreme Court erred by deciding this case “consistent with the Alabama Supreme Court but in direct conflict with six federal courts of appeals.” Pet. i. If plaintiffs believed that this alleged conflict was illusory because *Prima Paint* does not apply in state court at all, they were required to say so in their opposition brief. *See, e.g.*, S. Ct. Rule 15.2; *Baldwin v. Reese*, 541 U.S. 27, 34 (2004); Robert L. Stern *et al.*, *Supreme Court Practice* § 6.37, at 450-51 (8th ed. 2002). Plaintiffs, however, said nothing of the sort; rather, they acknowledged the conflict and simply argued that the contrary federal decisions were “mistaken,” “indefensible,” and “simply wrong.” Pet. Opp. 21-22. Because plaintiffs' new argument does not relate to *this* Court's power to decide the case, and

hence is not “jurisdictional,” this Court should deem it waived. *See, e.g., South Cent. Bell Tel. Co. v. Alabama*, 526 U.S. 160, 171 (1999); *Oklahoma City v. Tuttle*, 471 U.S. 808, 816 (1985).

Plaintiffs offer three reasons why their new argument “is properly before the Court,” Resp. Br. 13-14 n.4, but none is availing. *First*, plaintiffs contend that the Florida Supreme Court “explicitly addressed” the argument. *Id.* That contention is simply untrue: the Florida court attempted to distinguish *Prima Paint* on the merits, but never suggested that the case did not apply in state court at all. *See* Pet. App. 5a-7a. *Second*, plaintiffs invoke “this Court’s traditional rule that once a federal claim is properly presented, a party can make any argument in support of that claim.” Resp. Br. 14 n.4 (internal quotation omitted). But that rule on its face does not apply here, where the disputed “federal claim” is *Buckeye*’s claim that the FAA requires arbitration of the underlying lawsuit. Instead, plaintiffs are governed by the rule that “the prevailing party . . . is entitled to defend the judgment on any ground *that it properly raised below*,” *Jones v. United States*, 527 U.S. 373, 396 (1999) (emphasis added), which does not help them because they never raised this argument below. *Third*, plaintiffs assert that their new argument is “predicate to an intelligent resolution of the question presented.” Resp. Br. 14 n.4 (internal quotation omitted). But plaintiffs’ new argument applies only to cases in state court, and the question presented here also arises in federal court, so it can be “intelligently resolved” without addressing the new argument.

B. *Prima Paint* Applies in State Court.

If this Court nonetheless exercises its discretion to reach the merits of plaintiffs’ new argument that *Prima Paint* does not apply in state court, that argument can readily be dismissed. Plaintiffs contend that *Prima Paint*’s federal severability rule is merely “a rule of *procedure* governing the allocation of authority between federal courts and arbitrators that Congress

created pursuant to its power to regulate proceedings in federal courts.” Resp. Br. 16 (emphasis added); *see also id.* at 18 (“[T]he separability rule [of *Prima Paint*] is a matter of federal court procedure.”). That contention is manifestly incorrect.

The very question presented in *Prima Paint* was whether the FAA establishes a *substantive* federal severability rule that preempts contrary state law. This Court unequivocally answered that question in the affirmative, “agree[ing]” with the Second Circuit that the severability rule is “one of ‘national substantive law’” that “governs even in the face of a contrary state rule,” 388 U.S. at 400 (and rejecting the First Circuit’s contrary view that “the question of ‘severability’ is one of state law,” *id.* at 403). Contrary to plaintiffs’ assertion, *Prima Paint* did not hold that the FAA was based on Congress’ power over the federal courts, but instead on Congress’ commerce power. *See id.* at 405 (“[I]t is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of control over interstate commerce and over admiralty.”) (internal quotation omitted).

If *Prima Paint* itself left any doubt on this score, moreover, subsequent rulings have dispelled it. In *Southland*, this Court reaffirmed *Prima Paint*’s holding that the FAA creates substantive federal law enacted under Congress’ commerce power. *See* 465 U.S. at 11 (“The [FAA] rests on the authority of Congress to enact substantive rules under the Commerce Clause.”); *id.* (“The [*Prima Paint*] Court relied for [its] holding on Congress’ broad power to fashion substantive rules under the Commerce Clause.”). Indeed, as *Southland* noted, the statutory requirement of a “contract evidencing a transaction involving commerce,” 9 U.S.C. § 2, would be inexplicable if the statute were *not* enacted under Congress’ commerce power. 465 U.S. at 14. *Southland* further made explicit “what was implicit in *Prima Paint*, *i.e.*, the substantive law the Act created [is] applicable in state and federal court.” *Id.* at 12.

And in *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995), this Court reaffirmed not only *Prima Paint*'s holding that the FAA establishes "substantive" federal law enacted under the Commerce Clause, *id.* at 271, but also *Southland*'s holding that such substantive federal law applies in both state and federal court, *see id.* at 271-72.

Because *Southland* and *Allied-Bruce* leave no doubt that the FAA's substantive provisions apply in state as well as federal court, plaintiffs try to circumvent those cases by arguing that *Prima Paint*'s federal severability rule is not substantive at all. According to plaintiffs, "*Prima Paint*'s holding was grounded in the language of 9 U.S.C. § 4," which they claim is merely a procedural provision governing the enforcement of arbitration agreements in federal court. Resp. Br. 6. That argument is not only incorrect but perverse, since (as noted above) the very foundation for *Southland*'s holding that the FAA's substantive provisions apply in state court was *Prima Paint*'s antecedent holding that the FAA created substantive federal law (specifically, a severability rule) in the first place.

Thus, even assuming that plaintiffs are correct in arguing that § 4 of the FAA does not apply of its own force in state court—an issue this Court expressly left open in *Southland*, *see* 465 U.S. at 16 n.10—that argument misses the point. This case is not about the arguably procedural provisions of § 4, but about the indisputably substantive provisions of § 2. Statutes must be read as a whole, and FAA § 4 gives meaning to FAA § 2. *See, e.g., Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 201 (1956) (FAA sections "are integral parts of a whole" that must be read together); *cf. Prima Paint*, 388 U.S. at 400 ("The key statutory provisions are §§ 2, 3, and 4 of the [FAA]."). Although § 2 on its face focuses on the enforceability of the arbitration "provision" itself, and thus suggests that this issue is distinct from the enforceability of the underlying "contract," that section itself did not expressly answer the severability

question presented in *Prima Paint*. Not surprisingly, the Court thus turned for guidance to the other sections of the statute. Because § 4 orders a federal court to compel arbitration once the “the making of *the agreement for arbitration* or the failure to comply therewith is not in issue,” 9 U.S.C. § 4 (emphasis added), it logically follows that the “grounds as exist at law or in equity for the revocation of any contract,” 9 U.S.C. § 2, which a court may consider before enforcing the arbitration agreement, are limited to grounds involving the arbitration agreement itself (as opposed to the underlying contract).

Indeed, plaintiffs’ argument that *Prima Paint*’s severability rule is “procedural” rather than “substantive” in nature turns those terms upside down. Whether a particular contractual provision is severable from the underlying contract has nothing to do with judicial “procedure,” and everything to do with “substance.” That is why *Prima Paint*’s rule preempts contrary state substantive law, *see* 388 U.S. at 402-04, and why that rule applies in state as well as federal court (as the court below assumed and many state courts have recognized, *see, e.g., Eddings v. Southern Orthopedic & Musculoskeletal Assocs., P.A.*, 555 S.E.2d 649, 655 (N.C. App. 2001), *rev’d on other grounds*, 569 S.E.2d 645 (N.C. 2002); *Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 604 So. 2d 332, 336-37 (Ala. 1991)). Plaintiffs tellingly do not cite a single decision under the FAA holding that *Prima Paint* does not apply in state court.

As a policy matter, of course, the foregoing conclusion is eminently sensible, since there would be little to recommend a rule that treated arbitration clauses as severable in federal court but not in state court (particularly since parties have no way of knowing *ex ante* if an eventual dispute will wind up in federal or state court). Under plaintiffs’ regime, an arbitration agreement would be enforced in a diversity case filed in or removed to federal court, but not in the state court across the street. Such a rule would only encourage the very forum-

shopping and gamesmanship that this Court rejected in *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78-79 (1938), by holding that federal courts sitting in diversity should not apply different substantive law than state courts. Indeed, this compelling consideration underlies *Southland*, which recognized that it would be most odd to think that Congress exercised its powers under the Commerce Clause to create federal substantive arbitrability law, but then limited such law to the federal courts. 465 U.S. at 15-16; *see also Allied-Bruce*, 513 U.S. at 272; *cf. Prima Paint*, 388 U.S. at 424-25 (Black, J., dissenting); *Bernhardt*, 350 U.S. at 203-04.

Several of plaintiffs' *amici* are candid enough to admit that their real grievance is not with the application of *Prima Paint per se* in state court, but with the application of *any* provision of the FAA in state court. In their view, both *Southland* and *Allied-Bruce* (not to mention *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003); *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996); *Volt Info. Scis., Inc. v. Board of Trs. of the Leland Stanford Jr. Univ.*, 489 U.S. 468 (1989); and *Perry v. Thomas*, 482 U.S. 483 (1987), all of which applied the substantive provisions of the FAA in cases arising from state court), should be overruled. This Court can readily dispose of that argument.

As an initial matter, the *Southland* line of cases flows inexorably from *Prima Paint's* holding that the FAA established substantive federal law enacted under the commerce power. Indeed, in light of *Prima Paint*, most state courts recognized even *before Southland* that the FAA applies in state court. *See, e.g., Burke Cty. Pub. Schs. Bd. of Ed. v. Shaver P'ship*, 279 S.E.2d 816, 824 & n.15 (N.C. 1981) (collecting cases); *cf. Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 407 (2d Cir. 1959) (FAA's substantive severability rule applies in both federal and state court), *cert. granted*, 362 U.S. 909, *cert. dismissed*, 364 U.S. 801 (1960).

