Litigation

The Splintered Opinion in *Green Tree*: A Roadmap Through Arbitration Federalism*

*by Lori Singer Meyer**

In *Green Tree v. Bazzle*,[1] a case decided in June, 2003, the United States Supreme Court faced the question: does the Federal Arbitration Act[2] (FAA) prohibit imposing class proceedings on an arbitration agreement that is silent on the topic of class-wide arbitration? Petitioners wanted the Court to rule that the FAA preempts South Carolina state law allowing a court or arbitrator to impose class proceedings on an arbitration. However, the Court declined to reach a majority decision. Instead, the Court reached a judgment in the case and issued a highly splintered decision: an opinion and a concurrence in the judgment only and two dissents.

Essentially, the opinions provide the justices' respective approaches to arbitration federalism in the face of silence in an arbitration agreement. According to Justice Thomas, the FAA does not apply to state proceedings on arbitration; hence, the Court has nothing to say about the question asked. According to Stevens, federal law does not come into play until one of the parties raises an issue that must be addressed by federal law. Because the question asked in the case is purely one of contract interpretation, which a state court can decide, Stevens would leave the lower court result alone. Stevens believes that simply asking if the FAA has anything to say about a question does not give the Court *carte blanche* to dig for a deeper conceptual framework where the FAA may be implicated. Rehnquist, on the other hand, believes that the general framework of the FAA requires that the parties to an arbitration agreement affirmatively consent to not only the class action, but any litigation management tool. Therefore, it is impermissible for a court or arbitrator to impose on an arbitration proceeding any procedures other than those explicitly mentioned in the terms of the agreement. Finally, Breyer believes that federal law requires submitting the question asked in *Green Tree* to an arbitrator picked by the putative class representative and Green Tree, since the parties agreed to let an arbitrator decide all questions arising from the agreement.

In order to give a sense of the size of the set of litigation management mechanisms that a party might want to be read into an arbitration agreement, at oral argument Justice Breyer raised the perhaps ridiculous example of whether a court or arbitrator could insist that the parties litigate in a coal mine without any oxygen simply because an arbitration agreement does not mention the coal mine.[3] It is hard to believe that silence in an arbitration agreement could be read as authorizing the use of this requirement if requested by one of the parties. But beyond the class action, is it hard to believe that a party would want a protective order issued for trade secrets? An arbitration agreement might not mention such an order and neither does the FAA. The variations on the theme of what a party might want imposed on an arbitration proceeding are endless.

Noticeably absent from petitioner's question asked in *Green Tree* is *who* would be prohibited from imposing class proceedings on an arbitration agreement that is silent about them. Hence, the final result from the justices' different approaches to arbitration federalism is the answer to the question, *who* will be deciding whether the FAA preempts state law when an arbitration agreement says nothing. Would it be an arbitrator or would it be the state court? Green Tree Financial would have preferred never to even get to that question. However, since the Court by and large has decided in *Green Tree* that class proceedings are not *in toto* prohibited in the face of silence under the FAA, but that a court or arbitrator must decide the issue on a case by case basis, the question *who* decides has now become the next important and very practical concern for litigants. For the time being, the lower courts will struggle with this issue.

This essay breaks into four sections; *Green Tree's* History, Certiorari Review, The Preemptive Force of the FAA, and *Who* Decides. It ends with a brief conclusion.

***Green Tree*'s History**

Green Tree originated in the South Carolina state court system. Though there was a dispute over whether the FAA applied to the arbitration clause, the Supreme Court of South Carolina found that it wasn't necessary to resolve that issue because it held as a matter of state law that silence in an arbitration agreement could be interpreted to permit class arbitration. Hence, even if the FAA had preemptive force, the contract would be interpreted as a matter of state law by the arbitrator or the court. The FAA has nothing to say when a contract is interpreted.

In *Green Tree,* Green Tree Financial Corp. entered into lending agreements with respondents Bazzle and Lackey. The lending documents included an arbitration clause that did not mention class arbitration. Each respondent sought relief as the respective representative of a class in the South Carolina state court. The gravamen of the respondents' complaint was that Green Tree had failed to provide a required South Carolina consumer loan notice provision.

The class action has been a tool of particular interest during the past decade to consumer lenders and consumers alike. Judge Richard Posner could not have better described why lenders have adopted arbitration agreements to take their disputes out of the courts where class actions clearly are permissible. In the majority opinion in *In the Matter of Rhone-Poulenc Rorer Incorporated*,[4] the Seventh Circuit issued a mandamus order decertifying a class (the appellate court could not yet rule on the appeal of the certification order). Posner wrote

> [consider]the sheer *magnitude* of the risk to which the class action, in contrast to the individual actions pending or likely, exposes them. Consider the situation that would obtain if the class had not been certified. The defendants would be facing 300 suits....Three hundred is not a trivial number of lawsuits. The potential damages in each one are great. But the defendants have won twelve of the first thirteen, and, if this is a representative sample, they are likely to win most of the remaining ones as well....These are guesses, of course, but they are at once conservative and usable for the limited purpose of comparing the situation that will face the defendants if the class certification stands. All of a sudden they will face thousands of plaintiffs...They might, therefore, easily be facing $25 billion in potential liability (conceivably more), and with it bankruptcy. They may not wish to roll these dice. That is putting it mildly. They will be under intense pressure to settle... Judge Friendly, who was not given to hyperbole, called settlements induced by a small probability of an immense judgment in a class action "blackmail settlements."[5]

However, consumers feel it is an abrogation of a right to pursue a class action if they can not pursue class proceedings in the arbitral forum. Hence, there has been a considerable amount of litigation in the lower courts over whether consumers can proceed as a class under an arbitration agreement that does not mention class proceedings.

In the *Bazzle* case, the trial court certified a class action and then ordered the dispute resolved by arbitration. In *Lackey*, Green Tree sought to compel arbitration; then, when the case went to arbitration, the arbitrator (the same arbitrator as in the Bazzle case) decided the arbitration should proceed as a class proceeding.

In both the *Bazzle* and *Lackey* cases, the arbitrator awarded the class damages and attorneys' fees. The class damages in *Bazzle* were approximately 11 million dollars and the damages in *Lackey* were approximately nine million dollars. The two classes together consisted of more than 3700 individuals and the total award including attorneys' fees was approximately 27 million dollars. The trial court confirmed the awards and Green Tree appealed both cases, claiming, among other things, that class arbitration was legally impermissible under the FAA. The Supreme Court of South Carolina withdrew the cases from the lower appellate court, assumed jurisdiction, and consolidated the proceedings. In its decision, the Supreme Court concluded that the arbitration agreement was silent on the issue of class proceedings. It further concluded that

> ...whether section 4 of the FAA applies in state court is debatable. Section 4 provides, '[a] party aggrieved by the alleged failure ... of another to arbitrate under a written agreement for arbitration may petition a *United States district court* ....'
>
> In any case, this Court can rely on independent state grounds to permit class-wide arbitration, in the trial court's discretion, where the agreement is silent. First, under general principles of contract interpretation, we construe Green Tree's omission of any reference to class actions against them. 'As a matter of pure contract interpretation it is striking, and rather odd, that so many courts have interpreted silence in arbitration agreements to foreclose rather than to permit arbitral class actions.' [6]

Hence, the Supreme Court of South Carolina found the trial court had correctly decided that the arbitrator did not act in manifest disregard of the law when he permitted class arbitration to proceed under the arbitration agreement.

Certiorari Review

Green Tree sought *certiorari* review of the Supreme Court of South Carolina's decision in the United States Supreme Court. Green Tree argued that the Supreme Court of South Carolina's decision violated the FAA, which requires that arbitration agreements be enforced in accordance with their terms, and that silence in an agreement must be read under the FAA as prohibiting class arbitration. In other words, that the FAA preempts state law that would allow an alternative result. The Court granted *certiorari* to resolve a conflict among the state and federal courts on the issue. The Seventh Circuit, Eighth Circuit and Alabama Supreme Court had held that courts have no authority to order class-action arbitration where an arbitration agreement does not expressly provide for it. The California and South Carolina state courts had held that the FAA does not preempt class-wide arbitration if it is permissible under state law.

The Preemptive Force of the FAA

To the author of this essay, it seems obvious that lenders such as Green Tree Financial Corp. will include a "no class arbitration" clause in arbitration agreements from now on. Hence, a majority decision on the question before the Court likely would have been of limited value. However, there are other litigation management tools than the class action that a litigant might want to import into an arbitration that an arbitration agreement does not mention. A broader treatment

of what the FAA prohibits state law from imposing on silence could be quite valuable. This the Court provides.

It is interesting to consider in some depth the four opinions in *Green Tree.*

In his dissent, Justice Thomas writes that he does not believe that the FAA pertains to state proceedings. Hence, he would have left the South Carolina courts to decide as a matter of state law whether class proceedings might be imposed upon the arbitration agreement.

In a concurrence in the judgment, Justice Stevens follows Thomas to some extent. Stevens does not believe federal law has anything to say about the question presented to the Court. If a party had challenged who should decide the question, then Stevens allows that FAA concerns would be invoked. However, since no one has, the lower court ruling should be left undisturbed, even though Stevens believes that in the first instance the contract should have been interpreted by the arbitrator and not the court.

Unlike Thomas and Stevens, the remaining justices believe that the FAA governs the question asked in *Green Tree*. However, the justices split in their view of exactly what that governance means. Because they split on how to conceptualize the FAA's governance of the question asked in the case, the two camps reach different answers to the question of *who* should decide whether a party is prohibited from imposing class proceedings on an arbitration agreement.

Chief Justice Rehnquist's dissent adopts Green Tree's argument that (1) the cornerstone of the FAA is that parties must consent to be bound by an arbitration agreement; therefore, (2) when an arbitration agreement does not mention class arbitration, a party can not affirmatively consent to class proceedings; therefore, (3) the trial court must act as a gatekeeper protecting the bargain consented to between parties. Hence, Rehnquist reaches the conclusion that as a matter of federal law the trial court is the institution that must decide whether a plaintiff may represent a class (or any litigation device) under an arbitration agreement that does not mention it.

On the other hand, Justice Breyer, who delivers the judgment of the Court, counters Rehnquist's reading of the law. Breyer writes that first and foremost it is the *arbitrator* who must decide the question of whether an arbitration agreement forbids class arbitration. The parties clearly consented to this one arbitrator, and now he should interpret the agreement. Breyer believes that the issue in *Green Tree* is a matter of contract interpretation - to reach this conclusion, Breyer relies on *Howsam v. Dean Witter Reynolds*, *Inc.*[7] where the Court had decided that the arbitrator should determine a certain procedural gateway matter.

Hence, Thomas' reading of federalism would leave the state courts to determine whether any legal mechanism could be imposed on an arbitration proceeding. Stevens would also let state courts decide unless a direct question was asked that implicated the FAA. Rehnquist would submit the question to the state trial court for an initial determination of whether the parties had consented to be bound by a particular procedure that was not mentioned in their arbitration agreement; Breyer would submit the question to the arbitrator picked by the parties as a matter for the arbitrator to decide under all relevant law.

***Who* Decides**

Two of the opinions in *Green Tree*, those authored by Rehnquist and Breyer respectively, accept that the FAA preempts state law governing the question asked and center on *who* would decide what federal law mandates. As a practical matter, litigants will be concerned about who the decision-maker will be of whether a litigation tool such as the class action may be used in an arbitration in the face of silence in the arbitration agreement.

An arbitrator's decision is given considerable deference by the courts, as can be seen in the Supreme Court of South Carolina's ruling that the arbitrator in *Green Tree* did not act in manifest disregard of the law when he permitted class arbitration to proceed. A trial court deciding whether the parties consented to use of a particular management tool in arbitration typically will be reviewed *de novo*. As Green Tree argued at oral argument,

> ...The problem is, why would we make a judgment at the outset of this process that says, we are going to enter into the most informal decision-making process with no right to judicial review and with $27 million dollars at stake.... No one would... It would be madness.[8]

Hence, even though Green Tree's claim that it would pick different arbitrators for each of thousands of arbitrations might raise eyebrows, the fact that Green Tree would not consent to arbitrate its disputes if it arbitrates in a class proceeding makes wholesale sense.

However, as it is likely that "no class arbitration" clauses will be added to Green Tree's arbitration agreements from now on, the class action point is somewhat moot. But, take for example whether there can be arbitration at the bottom of a coal mine without any oxygen. Under Breyer's opinion, it would be up to an arbitrator to interpret the arbitration agreement according to state law to determine if the parties wanted to do that. Would the arbitrator have freedom to order the arbitration to proceed if state law didn't prohibit arbitrating in a coal mine? And if he did, under the FAA and state law, would such an order be read by a reviewing court as a manifest disregard of the law? Or just a bad idea? Or perhaps would a court be able to find silence on a topic in an agreement that a party wants to use to be, say, unconscionable? Or some similar state law defense to a contract? Under *Perry v. Thomas,*[9]

> ...state law, whether of legislative or judicial origin, is applicable...*if* that law arose to govern issues concerning validity, revocability and enforceability generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with th[e] requirement of Section 2 [of the FAA]...[10]

A defense of unconscionability to silence which means in effect a requirement to arbitrate in a coal mine without oxygen does not seem a defense that would be raised solely to an arbitration agreement, but rather to *any* agreement about dispute resolution.

It seems likely that a court would be able to find unconscionable an arbitrator's decision that required in the face of silence in the agreement that the parties must arbitrate and suffocate. But, consider the requirement that protective orders be issued for trade secrets? A court reviewing an arbitration agreement on that would be hard pressed to find that an unconscionable requirement for the parties, even though a court in the first instance may not have found that the parties actually consented to this requirement.

Justice Thomas would let the state courts hash out all these issues for themselves, without having the FAA hanging over their shoulders. In *Green Tree*, Stevens would leave the issue for the state courts since the FAA was not directly implicated in the question asked. Stevens and Breyer, however, believe the arbitrator in the first instance should decide what silence in an arbitration agreement prohibits. Therefore, the courts would be able to review silence in arbitration agreements only for whether an arbitrator acted in manifest disregard of the law or would be able to review the agreement itself as being unconscionable or a like defense to the agreement's enforceability. Rehnquist would mandate that the court in the first instance review whether the parties actually consented to having a particular litigation management tool imposed on the arbitration agreement. This decision would be reviewable *de novo* by a higher court. For Stevens and Breyer's approach, if a trial court found that an agreement was unconscionable or that an arbitrator acted in manifest disregard of the law, the appellate court would also review the court's decision *de novo*. But the appellate court would have no access to review an arbitrator's decision that was not in manifest disregard of the law, say interpreting silence in an agreement to permit an arbitrator issuing protective orders for trade secrets.

Conclusion

In sum, the justices' differing views on arbitration federalism lead, in the final result, to differing answers of *who* should decide whether a litigation tool can be prohibited by the FAA. As a practical matter, litigants will be greatly concerned with whether an arbitrator or a court will be deciding key questions about how a case may be managed because of the reviewability of that decision for error by a higher court. Five justices of the court seem to believe that it is up to the arbitrator to decide whether silence in an arbitration agreement prohibits importing a litigation management tool into an arbitration proceeding; hence, these justices would leave as unassailable by courts litigation devices that it would not seem in manifest disregard of the law for parties to use. Four justices would have a court review an arbitration agreement in the first instance for whether parties consented to the use of a litigation tool. Perhaps this breakdown signals how the justices will rule in an appropriate case in the future.

* Lori Singer Meyer is a graduate of the University of Chicago Law School, former law clerk to Judge Paul Cassell of the District Court of Utah and slated to clerk for Judge Diarmuid O'Scannlain of the Ninth Circuit Court of Appeals in 2004-2005.

Footnotes

* *See* Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 Fla. L. Rev. 175 (2002).

[1] 123 S.Ct. 2402 (2003).

[2] 9 U.S.C. Section 1, *et seq.*

[3] Oral argument transcript at 34-36.

[4] 51 F.3d 1293 (7th Cir. 1995).

[5] *Id.* at 1297-1298.

[6] *Bazzle v. Green Tree Financial Corp.*, 569 S.E.2d 349, 359-360 (S.C. 2002).

[7] 537 U.S. 79 (2002).

[8] Transcript at 29.

[9] 482 U.S. 483 (1987).

[10] *Id.* at 492, n. 9.