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Emma Kline

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SUPREME COURT OF APPEALS OF WEST VIRGINIA TAKES MERITORIOUS CLAIMS
BACK HOME TO THE PLACE THEY BELONG

By
Emma Kline*

I. INTRODUCTION

In *State ex rel. TD Ameritrade, Inc. v. Kaufman*, the Supreme Court of Appeals of West Virginia concluded that the Circuit Court of Kanawha County exceeded its authority when it ruled on the merits of an issue that ultimately was referred to arbitration.¹ The Supreme Court of Appeals concluded that when a trial court is required to rule on a motion to compel arbitration pursuant to the Federal Arbitration Act (“FAA”), the trial court is limited to determining the threshold issues of: 1) whether a valid arbitration agreement exists between the parties; and 2) “whether the claims averred by the plaintiff fall within the substantive scope of that arbitration agreement.”²

II. BACKGROUND

In *Ameritrade*, Dan Salamie, appellee, filed a civil action against Bruce Conrad, an independent financial advisor, and Ameritrade, a New York discount brokerage firm (together, “appellants”).³ Salamie alleged that he sustained financial loss when Conrad disregarded specific instructions concerning Salamie’s investment holdings in four Ameritrade accounts.⁴ Salamie also asserted that Ameritrade was vicariously liable for Conrad’s actions, as Conrad was a registered representative of Ameritrade.⁵ After Salamie served his first discovery requests on

* Emma Kline is a 2012 Juris Doctor candidate at the Pennsylvania State University Dickinson School of Law.

¹ *State ex rel. TD Ameritrade, Inc., v. Kaufman*, 692 S.E.2d 293, 294 (W. Va. 2010).

² *Id.* at 298.

³ *Id.* at 295.

⁴ *Id.*

⁵ *Id.*

Ameritrade, Ameritrade filed a motion for protective order and also informed the trial court that it intended to file a motion to compel arbitration.⁶ In its motion, Ameritrade requested that the trial court dismiss Salamie's litigation claim, or else stay the litigation pending the outcome of the arbitral decision.⁷ Before the trial court decided the issue to compel arbitration, the parties met to attempt settlement negotiations.⁸ Salamie said that he would submit to arbitration if Ameritrade would stipulate that Conrad was "subject to its 'control'" under federal securities law; doing so would indicate that Ameritrade was vicariously liable for Conrad's actions.⁹ Ameritrade refused to stipulate.¹⁰

Salamie then filed a motion for partial summary judgment.¹¹ Although he agreed to participate in arbitration, Salamie "requested a ruling from the trial court as part of the referral on whether Conrad was a 'controlled person' under federal law for purposes of establishing vicarious liability against Ameritrade."¹² The trial court granted Ameritrade's motion to compel arbitration, but also approved Salamie's motion for partial summary judgment.¹³ In addition to determining that Ameritrade was responsible for "monitoring" Salamie's account and for complying with certain New York Stock Exchange Rules, the circuit court also held that, pursuant to 15 U.S.C. §78(t), Conrad was a "controlled person," making Ameritrade vicariously liable for his actions.¹⁴ The trial court also ordered the arbitrator to follow the aforementioned determinations.¹⁵ Ameritrade subsequently filed a rule to show cause to prohibit enforcement of the trial court's

⁶ *Ameritrade*, 692 S.E.2d at 295.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Ameritrade*, 692 S.E.2d at 295.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at 295-96.

¹⁵ *Id.* at 296.

determinations that “address[ed] the merits of matters that were referred to arbitration for resolution.”¹⁶

III. DISCUSSION

In reviewing the lower court’s ruling, the Supreme Court of Appeals of West Virginia focused on whether “the lower tribunal’s order [was] clearly erroneous as a matter of law.”¹⁷ On appeal, Ameritrade primarily contended that the trial court was *not* permitted to address the merits of the underlying controversy, namely whether Conrad was subject to Ameritrade’s control pursuant to the Securities Exchange Act.¹⁸ Ameritrade believed that the trial court “exceeded the scope of its legitimate powers” in determining that Conrad was in fact subject to Ameritrade’s control.¹⁹ Conversely, Salamie maintained that the trial court’s rulings were “prophylactic,” and that without a determination of whether Conrad was a “controlled person,” no contract requiring arbitration would exist.²⁰ Important to note is that the parties were not in dispute regarding the arbitration provisions in each investment account, nor were they concerned about the applicability of the FAA; the parties only contested whether the trial court had the authority to address matters aside from the issue of arbitrability.²¹ The Supreme Court ultimately sided with Ameritrade, and explained that “in deciding whether the parties have agreed to submit a particular grievance to arbitration, *a court is not to rule on the potential merits of the underlying claim.*”²²

¹⁶ *Ameritrade*, 692 S.E.2d at 296.

¹⁷ *Id.*

¹⁸ *Id.* (citing 15 U.S.C. §78(t)).

¹⁹ *Id.*

²⁰ *Id.* at n.10.

²¹ *Ameritrade*, 692 S.E.2d at 297.

²² *Id.* at 296 (citing *AT&T Techs., Inc. v. Commc’ns Workers*, 475 U.S. 643, 649 (1986)) (emphasis added).

The Supreme Court of West Virginia relied on established federal law, which recognizes that courts are not permitted to review the merits of a grievance, including whether equity is present in the particular claim, or whether language is present in the agreement tending to support a party's claim.²³ Ameritrade recognized, and the Supreme Court agreed, that when the trial court inquired as to whether Conrad was a "controlled person" it "ventured outside the limitations of its constrained inquiry and improperly considered and ruled upon the merits of the case."²⁴ Contrary to "black letter law" regarding separability, which reserves to courts the right to evaluate challenges to arbitration agreements and to arbitrators the right to evaluate the contract as a whole, Salamie believed that the trial court's rulings as to Conrad's "controlled person" status were permissible.²⁵ Though the court explained that one of the only exceptions to the separability rule exists where the arbitration agreement was acquired by adhesion; a court may evaluate the merits of a claim asserting that a party was coerced via fraud, duress, or unconscionability.²⁶

Although Salamie was able to convince the trial court to rule on whether Conrad was a "controlled person," "this foray into matters reserved for arbitral resolution was clearly improper."²⁷ The Supreme Court of Appeals of West Virginia concluded that where a court is asked to rule on a motion to compel arbitration pursuant to the FAA, the trial court may *only* decide the threshold issues of: 1) whether a valid arbitration agreement exists, and 2) "whether the claims averred by the plaintiff fall within the substantive scope of that arbitration agreement."²⁸ The trial court here expressly exceeded its authority, and violated the doctrine of separability.²⁹

²³ *Id.* at 297 (citing *United Steelworkers v. American Mfg. Co.*, 363 U.S. 564, 568 (1960)).

²⁴ *Id.*

²⁵ *Id.* at 298.

²⁶ *Ameritrade*, 692 S.E.2d at 298 fn.9 (citing *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 637 (4th Cir 2002)).

²⁷ *Id.*

²⁸ *Id.* at 298.

²⁹ *Id.*

IV. SIGNIFICANCE

In deciding that the arbitrator in *Ameritrade* exceeded his authority, the Supreme Court of Appeals of West Virginia aligned itself with other jurisdictions that have adhered to the doctrine of separability, which stipulates that courts are to decide only issues concerning the validity of an arbitration agreement, and the arbitrability of the claims between two parties. The Supreme Court of Appeals of West Virginia has established not only its support for the federal policy favoring arbitration, but also the idea that arbitration is premised in contract. Parties in West Virginia now have the opportunity to contract for their desired arbitral proceedings, and courts likely will enforce these contractual arrangements. This indispensable decision will encourage the West Virginia court system to enforce arbitration agreements and awards, and ultimately indicates the Supreme Court of Appeals of West Virginia's movement towards the federal policy in favor of arbitration.

This decision also implicates the issue of excess judicial authority. By requiring the arbitrator to disregard the Circuit Court's holding pertaining to Conrad's "controlled person" status, the Supreme Court of Appeals of West Virginia established its deference to arbitrators and their authority to decide the substantive matters at issue.