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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THECOURT
FIFTH JUDICIAL CIRCUIT

Alison Renee Lee, Circuit Court Judge

Appellate Court Case No. 2023-00858
Circuit Court Case No. 2022-CP-40-2586

Capella Capital, LLC, Capella Carolinas, LLC, and Michael Lindley,..... Respondents,

v.

Donivon Glassburn, ...Appellant.

INITIAL BRIEF OF APPELLANT

June 30, 2023

s/Christy Ford Allen
Christy Ford Allen, Esquire (SC Bar 15649)
John A. Massalon, Esquire (SC Bar 10279)
WILLS MASSALON & ALLEN LLC
Post Office Box 859
Charleston, South Carolina 29402
(843) 727-1144
callen@wmalawfirm.net
jmassalon@wmalawfirm.net

ATTORNEYS FOR APPELLANT

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STATEMENT OF ISSUE ON APPEAL

The issue on appeal is whether the trial court erred in denying the motion to compel arbitration.

STATEMENT OF THE CASE

This case is a business dispute between two (2) individuals. Respondent Lindley has made claims against Appellant Glassburn arising from at least two (2) limited liability company business ventures: Capella Carolina, LLC and Carolina Capital, LLC (hereinafter "LLCs") (Complaint, R. p.). In lieu of filing an Answer to Lindley's Complaint, Appellant Glassburn filed a Motion to Dismiss and Compel Arbitration which was heard by the Trial court on or about January 26, 2023. (Motion, R. p.). In opposition to the Motion to Dismiss, Respondent Lindley argued that Glassburn should be precluded or estopped from seeking to compel arbitration pursuant to the arbitration clause in the Subscription for Membership Agreements, when according to Lindley's counsel, Glassburn's position in the case is that the Subscription for Membership Agreements did not confer Lindley with fifty percent (50%) of the LLCs.

The court denied the motion to dismiss and compel on April 25, 2023. (Order Denying Motion, R. p.). Appellant filed a Motion to Alter or Amend under Rule 52(b). (Motion to Alter or Amend, R. p.). The court denied the motion on May 18, 2023. Appellant filed its Notice of Appeal on May 25, 2023. (Notice, R. p.) No Answer or other pleadings were filed.

Lindley's lawsuit purports to be a derivative action filed on his own behalf and for two LLCs. The complaint alleges breach of fiduciary duty arising from the alleged LLC membership agreements and common law governing LLCs, fraud arising from Glassburn's alleged use of the LLCs' assets and proceeds, and seeks both an accounting and receivership of the LLC businesses

and assets. (Complaint, R. p.). As the basis for his claim to be an equal co-member in the LLCs at issue, Plaintiff Lindley alleges that he and Defendant Glassburn both signed certain Subscription for [LLC] Membership Agreements, (Complaint Para. 10, R. p.) in 2014. It is these Subscription Agreements that contain the arbitration agreement at issue.

The two (2) Subscription for Membership Agreements are identical in form, other than reference to each particular LLC. Directly under the title on the first page it states, in all caps and underlined, THIS AGREEMENT IS SUBJECT TO MANDATORY ARBITRATION. The footer of the first page contains hand-written initials of the two (2) parties. The first paragraph of the second page includes the following arbitration agreement:

> Each member acknowledges that this subscription agreement shall be governed by the laws of the State of South Carolina and the Operating Agreement for [Capella Carolinas], LLC which is incorporated herein by reference, and hereby agrees to be bound by the same. Any claim or dispute arising out of or relating to this agreement, or the breach thereof shall be settled by arbitration in the State of South Carolina in accordance with the rules and regulations then applicable to the American Arbitration Association governing three-member panels. The parties hereto agree to be bound by the award in such arbitration and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof.
>
> (emphasis added)

Immediately following that paragraph there is table indicating 50/50 ownership between Lindley and Glassburn, and the parties initialed this page as well. The last page of the Subscription for Membership Agreement contains the signature page showing both Lindley's and Glassburn's handwritten signatures. Just above the signatures, the agreement states that "the undersigned agrees to be bound as a Member by the terms of the Operating Agreement of [Capella Carolinas], LLC as if the undersigned were a signatory thereof. And, finally, there are initials handwritten by both Lindley and Glassburn in the footer of page 3 of 3. (Defendant's Memorandum in Support of Motion, Ex. B, R. p.). Finally, a document entitled Operating Agreement of Capella Carolinas,

LLC was also presented to the court prior to the motion hearing. (Plaintiffs' Opposition to Motion, Ex. C, R. p.). The Capella Carolinas LLC Operating Agreement document appears to be a standard operating agreement. However, it does not include reference to arbitration, does not have an Exhibit indicating the names of members or their respective interests, and includes only one signature line and signature – that of Mr. Glassburn. (Plaintiffs' Opposition to Motion, Ex. C, R. p.).

Based on this record and the argument of counsel, the trial court denied the motion to compel arbitration holding that the claims being made in the Complaint did not arise under the Subscription for Membership Agreements, which contained the arbitration language. The court's order also appears to rely on the fact that the Operating Agreement submitted does not contain a separate arbitration clause as supporting the conclusion that the claims by Lindley were not arbitrable.

STANDARD OF REVIEW

"Due to the strong South Carolina and federal policy favoring arbitration, arbitration agreements are presumed valid." *Doe v. TCSC, LLC*, 430 S.C. 602, 607 (S.C. Ct. App. 2020) (citing *Cape Romain Contractors, Inc. v. Wando E., LLC*, 405 S.C. 115, 125, 747 S.E.2d 461, 466 (2013). "An appeal from the denial of a motion to compel arbitration is subject to *de novo* review." *New Hope Missionary Baptist Church v. Paragon Builders*, 379 S.C. 620, 625, 667 S.E.2d 1, 3 (Ct. App. 2008). Under this standard of review, the appellate court will not reverse factual findings of the trial court that are reasonably supported by the record. *Lampo v. Amedisys Holding, LLC*, 437 S.C. 236, 241, 877 S.E.2d 486, 489 (Ct. App. 2022).

ARGUMENT

1. THE COURT ERRED IN CONCLUDING THAT THE CLAIMS BEING MADE WERE NOT ARBITRABLE UNDER THE ARBITRATION CLAUSE IN THE SUBSCRIPTION FOR MEMBERSHIP AGREEMENTS

The consideration of an arbitration agreement's scope is evaluated under the "federal substantive law of arbitrability." *Wilson v. Willis*, 426 S.C. 326, 335, 827 S.E.2d 167, 172 (2019) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc*., 473 U.S. 614, 626, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985)). The presumption in favor of arbitration applies to the scope of an arbitration agreement. *Id*. at 337, 827 S.E.2d at 173.[1]

In determining whether a claim is covered by the arbitration agreement or is arbitrable, the court or arbitrator's function is to determine whether a claim has a "significant relationship to the . . . agreement" containing the arbitration clause. *Am. Recovery Corp. v. Computerized Thermal Imaging, Inc.*, 96 F.3d 88, 93 (4th Cir. 1996), *Davis v. ISCO Indus., Inc.*, 434 S.C. 488, 496, 864 S.E.2d 391, 395 (Ct. App. 2021) (quoting *Zabinski v. Bright Acres Assocs*., 346 S.C. 580, 596-97, 553 S.E.2d 110, 118 (2001)). In *Zabinski*, the Supreme Court found "any claim pursuant to the partnership agreement is arbitrable" because the arbitration agreement provided "'any controversy or claim arising out of the partnership agreement' should be settled by arbitration.'" 346 S.C. at

[1] In light of this court's very recent case of *Hicks Unlimited, Inc. v. Unifirst, Corp.*, __S.E.2d __, 2023 S.C Lexis 124, 2023 WL 3987465 (June 14, 2023), which was not issued at the time of the trial court's order in this case, the undersigned wishes to point out that the allegations of the Lindley Complaint, unlike that in *Hicks Unlimited*, contain direct references to interstate commerce: Lindley is a citizen of Texas, and Glassburn a citizen of South Carolina. (Complaint at Para. 3-4, R. p.); additional LLCs were formed [by Lindley and Glassburn] in SC, Texas, Alabama, and Colorado which reflected Lindley and Glassburn as 50/50 owners. (Complaint at Para. 8, R. p.). At no time has Respondent Lindley objected to the application of the Federal Arbitration Act, 9 U.S.C. § 1 et seq., (FAA) or case law interpreting it to this case. (Transcript at p. 8, R. p.).

597, 553 S.E.2d at 119. The court determined "any tort claims between the partners that relate to the partnership agreement are arbitrable." *Id*.

When faced with the question of whether disputes arising under one agreement can be encompassed by an arbitration clause in a second agreement, the court determine whether the dispute "significantly relates" to the agreement containing the arbitration clause. *See Gen. Elec. Capital Corp. v. Union Corp. Fin. Grp. Inc*., 142 F. App'x 150, 152 (4th Cir. 2005). In *American Recovery*, the parties entered into an overarching contract which contained an arbitration clause, 96 F.3d at 90, and a separate, non-compete agreement which did not. Id. When a dispute arose under the non-compete agreement, the court held that the dispute should be arbitrated because "the test for an arbitration clause of this breadth is not whether a claim arose under one agreement or another, but whether a significant relationship exists between the claim and the agreement containing the arbitration clause." *Id*. at 94.

Here, Lindley and Glassburn have two overarching Subscription for Membership Agreements with a broad arbitration clause, *supra* at 2. The language in the Subscription for Membership Agreements expressly incorporates the LLC Operating Agreement into that agreement, and the arbitration clause broadly extends to such disputes which "arise out of or relate to this agreement or the breach thereof." Lindley's Complaint directly relies on the Subscription for Membership Agreement in support of his claim of status as co-member in the LLCs. (Complaint Para. 10, R. p.). The claims for a receivership, conversion, fraud, breach of fiduciary duty, and breach of duty warranting disassociation all arise from the relationship allegedly created and documented by the Subscription Agreements.

The trial court appears to have accepted Lindley's arguments that the arbitration clause in the Subscription for Membership Agreements did not apply to their claims, and that arbitration

should be denied based, in part, on an Operating Agreement for Capella Carolinas, LLC which does not contain an arbitration clause. The court's reliance on the absence of an arbitration clause in one Operating Agreement document (not signed by both parties) does not reasonably support the finding that Lindley's claims were not subject to the arbitration agreement in the Subscription for Membership Agreement. Furthermore, a statement in a brief submitted by Glassburn in support of the motion that he was denying all allegations (even before any responsive pleading) is not evidence. *See Hicks Unlimited, Inc. v. Unifirst, Corp.*, __S.E.2d __, 2023 S.C Lexis 124, 2023 WL 3987465, *10-11 (June 14, 2023). The evidence before the trial court --- the Complaint, two Subscription for [LLC] Membership Agreements, and one Operating Agreement -- support only one conclusion: that Lindley's claims "significantly relate" to the Subscription Agreement and the respective LLC membership duties that those Subscription Agreements incorporated.

2. THE COURT ERRED IN CONCLUDING THERE WAS NO VALID AGREEMENT TO ARBITRATE

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406 (1967), the Supreme Court held that to avoid arbitration, a party must assert a contractual defense to the arbitration agreement itself, and not to the contract as a whole. Thus, for example, a party must allege that the *arbitration agreement* is unconscionable, not that the *entire contract* is unconscionable. *Doe v. TCSC, LLC*, 430 S.C. 602, (S.C. Ct. App. 2020). It is well settled that "arbitration clauses are separable from the contracts in which they are imbedded." *Hous. Auth. of Columbia v. Cornerstone Hous., LLC*, 356 S.C. 328, 338, 588 S.E.2d 617, 622 (Ct. App. 2003) (quoting *Jackson Mills Inc. v. BT Cap. Corp.*, 312 S.C. 400, 403, 440 S.E.2d 877, 879 (1994)). "The issue of [the arbitration clause's] validity is distinct from the substantive validity of the contract as a whole." *Id*. (alteration in original) (quoting *Munoz v. Green Tree Fin. Corp.*, 343 S.C. 531, 540, 542 S.E.2d 360, 364 (2001)). *See also Smith v. D.R. Horton, Inc.*, 417 S.C. 42, 48,

790 S.E.2d 1, 4 (2016) (noting the "*Prima Paint* doctrine" required that "in conducting an unconscionability inquiry, courts may only consider the provisions of the arbitration agreement itself, and not those of the whole contract").

The trial court did not make an express finding as to the validity of the arbitration clause. Lindley did not submit any affidavit or evidence that he denies signing the Subscription Agreement containing the arbitration agreement. Lindley does not allege fraud in the inducement of the Subscription for Membership Agreement or its arbitration clause. Instead, Lindley's claims seek to benefit from his status as a member of the LLCs at issue and alleges that status is derived directly from the Subscription for Membership Agreements. (Complaint Para. 10, R. p.).

Lindley does not assert the arbitration agreement itself is unconscionable. These are not consumer or adhesion contracts. The agreements were entered into by two adults in sophisticated business ventures for the purposes described by Lindley as "to among other business, purchase commercial real estate properties and commercial retain centers, develop commercial retain centers, purchase partnership interests in other real estate developments, purchase and service ATM machines, purchase and operate bingo video equipment manufacturers, and invest alongside other investment companies in opportunistic real estate and business opportunities," (Complaint Para 5 as to Capella Capital, LLC, R. p.), and "to purchase 100% of the stock and membership interests in twelve (12) South Carolina entities/corporations which closed on May 1, 2013 to continue the operation of various charitable bingo facilities," (Complaint Para. 6, R. p.) as to Capella Carolinas, LLC.

Lindley presents no contractual defense to the formation or contractual validity of the arbitration clause in the Subscription Agreements. Instead, Lindley relies upon *Granite Rock Co. v. Int'l Bhd. Of Teamsters*, 561 U.S. 287 (2010) in support of the argument that Glassburn's alleged

position that the Subscription for Membership Agreement is not determinative of Lindley's ownership (Glassburn filed no answer) somehow estops (or operates as a waiver) Glassburn from seeking to enforce the arbitration agreement in the Subscription for Membership Agreement. *Granite Rock Co*. involved a dispute over the ratification date, and therefore, formation of a collective bargaining agreement containing an arbitration clause which applied to disputes "arising under" the agreement. *Id*. at 289. And, notwithstanding Lindley's reliance on Glassburn's alleged position that the Subscription for Membership Agreement did not award Lindley 50% of the companies, Lindley does not challenge the formation of the Subscription for Membership Agreement itself. He does not deny he signed the agreement, nor present evidence to challenge the formation or validity of the Subscription for Membership Agreement. If there are disputes over the meaning and effect of the Subscription for Membership Agreements on the parties' relationship and financial interest, those are substantive matters for the arbitrator.

Lastly, the trial court order references the fact that an Operating Agreement of Capella Carolinas, LLC presented contained no arbitration clause and contained only one signature line – that of Glassburn. Those facts, however, do not address the validity of the arbitration clause found in the Subscription for Membership Agreement. Furthermore, it is well established that the absence of a written Operating Agreement is not fatal to the company's formation, existence or operation. S.C. Code Ann. §33-44-103(a) (2021) (if there is no written Operating Agreement, the South Carolina Limited Liability Company Act provides the default terms).

There are simply no facts on which the court could have relied upon to conclude there was no valid agreement to arbitrate.

3. THE COURT ERRED IN NOT ADDRESSING WHETHER THE PARTIES AGREED TO DELEGATE QUESTION OF ARBITRABILITY TO THE ARBITRATOR PRIOR TO

DETERMINING WHETHER THE ARBITRATION AGREEMENT APPLIED TO THE CLAIMS

The trial court's order denied the arbitration motion by concluding that the arbitration agreement signed between the parties in two "Subscription for [LLC] Membership" agreements did not apply to the claims being made in this case. The court made no other factual findings as to the question of whether the parties made a valid arbitration agreement.

"The question of the arbitrability of a claim is an issue for judicial determination, unless the parties provide otherwise." *Zabinski v. Bright Acres Assocs*., 346 S.C. 580, 596, 553 S.E.2d 110, 118 (2001). The United States Supreme Court in *Henry Shein, Inc. v. Archer and White Sales, Inc*., __U.S. __, 139 S. Ct. 524, 529, 202 L.Ed.2d 480, 487 (2019) recently held that a court may not decide whether an arbitration agreement applies to the particular dispute if the parties "clearly and unmistakably" delegated the question to an arbitrator, even if the court believes that the argument for arbitrability is "wholly groundless." This further narrowed the instances where a court can make an arbitrability-type determination. In *Simply Wireless, Inc. v. T-Mobile US, Inc.*, 877 F.3d 522, 528-29 (4th Cir. 2017) (reversed on different grounds in *Henry Shein, Inc. v. Archer & White Sales, Inc*., 139 S.Ct. 524, 529-30 (2019)), the Fourth Circuit held that when parties to a contract "delegate questions of arbitrability to an arbitrator, then that incorporation constitutes the parties' clear and unmistakable intent to let an arbitrator determine the scope of arbitrability" and the case is sent to arbitration for all arbitrability disputes." *See also Doe v. TCSC, LLC*, 430 S.C. 602, 608, 846 S.E.2d 874, 877 (Ct. App. 2020) (the parties may, of course, delegate these gateway issues such as validity and arbitrability to an arbitrator as long as there is "clear and unmistakable" evidence of such delegation).

The trial court in this case failed to address whether the arbitration clause clearly delegated the issue of arbitrability to the arbitrator prior to determining that the arbitration agreement in the Subscription for Membership Agreements did not apply to Lindley's claims.

4. THE COURT ERRED IN NOT RECOGNIZING THAT THE ARBITRATION AGREEMENT'S INCORPORATION OF THE "RULES AND REGULATIONS OF THE AMERICAN ARBITRATION ASSOCIATION" IS CLEAR AND UNMISTAKABLE EVIDENCE OF AN AGREEMENT TO SEND ISSUES OF ARBITRABILITY TO THE ARBITRATOR

While not addressed by South Carolina courts, most federal appellate circuits have held that an agreement that clearly adopts the American Arbitration Association ("AAA") Rules [or other commercial arbitral rules] is clear and unmistakable evidence of an agreement to send issues of arbitrability to the arbitrator. *Brennan v. Opus Bank*, 796 F.3d 1125, 1128-30 (9th Cir. 2015) (gathering other cases from First, Second, Fifth, Eighth, Federal, Eleventh, and D.C. Circuit Courts of Appeal holding that incorporation of arbitral rules such as the AAA, JAMS and UNCITRAL rules constitutes clear and unmistakable evidence that contracting parties agreed to arbitrate arbitrability). The Fourth Circuit joined the majority of circuit courts who have held that the express incorporation of arbitral rules such as AAA and JAMS, wherein the arbitrator is granted the authority to rule on issue of arbitrability, is sufficiently clear and unmistakable evidence that the parties intended the arbitrator to decide arbitrability in *Simply Wireless, Inc. v. T-Mobile US, Inc*., 877 F.3d 522, 527 (4th Cir. 2017) (JAMS Rules). *See also Ward v. Discover Bank*, ___F.Supp.3d___, 2020 US Dist. Lexis 69976,*8-9 (D.S.C. 2020) (holding that by incorporating the AAA and JAMS rules, the parties agreed that disputes over interpretation of the scope of the arbitration clauses are to be determined by the arbitrator).

In *Henry Shein*, the Supreme Court passed up the opportunity to rule on whether the arbitration clause's incorporation of the AAA's arbitral rules indicate sufficient evidence that the

parties delegated issues of arbitrability to the arbitrator, leaving in place the majority of Circuit Court precedent. Instead of addressing the arbitral rules delegation, the Court remanded the case back to the Fifth Circuit Court of Appeals with instruction to determine first whether the arbitration clause "clearly and unmistakably" delegated arbitrability to the arbitrator. 139 S.Ct. at 531, 202 L.Ed.2d at 489. The claims in *Henry Shein* were seeking injunctive relief, and the plain language of the arbitration agreement in that case excluded actions seeking injunctive relief. *See Archer & White Sales, Inc. v. Henry Shein, Inc.*, 935 F.3d 274, 281 (5th Cir. 2019). On remand, the Fifth Circuit, therefore, held that "the most natural reading of the arbitration clause at issue here states that any dispute, except actions seeking injunctive relief, shall be resolved in arbitration in accordance with the AAA rules. The plain language incorporates the AAA rules – and therefore delegates arbitrability – for all disputes except those under the carve-out." *Id.*

In this case, it is undisputed that the parties' arbitration agreements expressly adopted the AAA rules. The agreement language, *supra* p. 2, does not contain any carve-out language. In this instance, the court should have taken judicial notice that the AAA Rules, like many other commercial arbitration rules, delegate the issue of arbitrability to the arbitrator. AAA Rule R-7(a) states that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objects with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim, without any need to refer such matters first to a court." AAA Commercial Arbitration Rules. *See* https://www.adr.org/sites/default/files/CommercialRules_Web_0.pdf (June 29, 2023).

Had the trial court found that the parties to the arbitration agreement expressly and clearly agreed to delegate issues of arbitrability to the arbitrator no further rulings would have been necessary.

CONCLUSION

Appellant respectfully requests an order reversing the decision of the trial court and compelling this matter to arbitration pursuant to the parties' agreement.

Respectfully submitted,

s/Christy Ford Allen
Christy Ford Allen, Esquire (SC Bar 15649)
John A. Massalon, Esquire (SC Bar 10279)
WILLS MASSALON & ALLEN LLC
Post Office Box 859
Charleston, South Carolina 29402
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callen@wmalawfirm.net
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