ENFORCING AND AVOIDING ARBITRATION CLAUSES UNDER TEXAS LAW

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Scott M. McElhaney is a partner in the Litigation and Labor and Employment sections of Jackson Walker. He is Board Certified in Labor and Employment Law by the Texas Board of Legal Specialization.

As trial and appellate counsel for a variety of companies and individuals, Scott M. McElhaney works with clients to cost-effectively resolve a range of complex commercial disputes and employment matters. He regularly appears before federal and state courts and arbitrators for trials and hearings, and he has successfully handled multiple class actions at the trial and appellate level.

Mr. McElhaney has experience in contract and business tort suits, trade secret litigation, and noncompetition agreement injunction proceedings. He represents managed care organizations in a variety of commercial disputes. He is experienced in antitrust matters, and he regularly handles a wide variety of ERISA, employment discrimination and other labor claims.

Recognized by his peers in local, state, and national surveys, Mr. McElhaney has been included in *The Best Lawyers in America* under Commercial Litigation and Labor and Employment Law, named a "Texas Super Lawyer," and listed as one of the "Best Lawyers in Dallas" in *D Magazine*. Apart from his practice, Mr. McElhaney is active in the Bar and legal community. He serves as the First Vice President of the Dallas Bar Association, has chaired the DBA's Equal Access to Justice Campaign, and is a past Chair of the DBA's Business Litigation Section. Mr. McElhaney has also served on the State Bar's District 6 Grievance Committee.

Mr. McElhaney has been a Lecturer at SMU's Dedman School of Law, where he has taught Employment Law and Legal Research and Writing. He remains a frequent speaker on a variety of legal topics.

After graduating from Harvard Law School, he was a Law Clerk to Judge Irving Goldberg of the U.S. Court of Appeals for the Fifth Circuit and to Judge Barefoot Sanders of the U.S. District Court for the Northern District of Texas.

REPRESENTATIVE CASES

- Defeated motion for class certification after contested hearing in putative class arbitration before the American Arbitration Association;
- Won and successfully defended on appeal summary judgment in favor of client in workers' compensation retaliation suit;
- secured a defense verdict from a federal court jury in an age discrimination case alleging wrongful discharge;
- won and successfully defended on appeal summary judgment in favor of client on ERISA estoppel, waiver, and breach of fiduciary duty claims for $1 million in plan benefits;
- represented employer in nationwide FLSA collective action for unpaid overtime;
- as appellate counsel, obtained reversal of adverse judgment against client in sexual harassment case;
- co-counsel in obtaining permanent injunction for high tech company against defendant in trade secret misappropriation case.

AWARDS

- Listed in *The Best Lawyers in America* under Commercial Litigation (2008-2012), Labor and Employment Law (2008-2011), Litigation – ERISA and Labor & Employment (2012)
- Listed as a "Super Lawyer in Business Litigation" in *Super Lawyers, Corporate Counsel Edition*, 2008-2009
- Named a "Super Lawyer" by Thomson Reuters, 2004-2011
- Selected as a "Best Lawyer in Dallas" in *D Magazine*, July 2009, May 2011
- Selected as a "Best Lawyer in Dallas Under 40" in *D Magazine*, 2004, 2006

PUBLICATIONS/ SPEAKING ENGAGEMENTS

- "Enforcing and Avoiding Arbitration Clauses Under Texas Law" (March 19, 2012).
- "The Fair Labor Standards Act: Recent Developments and Issues of Interest" (Sept. 30, 2010).
- "Legal Counsel" in *The Professional Services Firm Bible* (John Wiley & Sons, 2005).
- "Electronic Data: Retention Policies, Spoliation, and Use in Litigation" (August 4, 2004).
- "Avoiding Punitive Damages in Employment Discrimination Cases" Jackson Walker Employer's Update (Spring 2003).
- "From Start to Finish: Procedural Issues and Practical Outcomes in Class Actions" Presented to the Texas State Bar Antitrust and Business Litigation Section Class Action Seminar (April 12, 2002).

EDUCATION

Mr. McElhaney received an A.B. degree, *summa cum laude*, in history from Dartmouth College, where he was elected to Phi Beta Kappa. He obtained his J.D. degree, *cum laude*, from Harvard Law School, where he was Managing Editor of the Harvard Civil Rights-Civil Liberties Law Review.

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I. INTRODUCTION

For a variety of reasons, many companies that face lawsuits on a regular basis have sought to replace the supposed "uncertainty" of the courthouse with the supposed "certainty and efficiency" of arbitration. Some of the asserted justifications for channeling disputes into arbitration – such as reducing the time to resolution – are laudable. Other motivations for requiring arbitration – such as a desire for secrecy – are more controversial.

Whatever the motivation for the increased use of arbitration agreements, conflicts over whether legal claims should be subject to arbitration present a rich source for dispute. These disputes often spill over into arguments about whether supposed agreements to arbitrate are enforceable. This Paper attempts to survey the current state of many such arguments. Before doing so, however, an examination of the federal and state statutes that govern arbitration agreements is necessary.

II. THE FEDERAL ARBITRATION ACT AND TEXAS ARBITRATION ACT

Courts historically resisted enforcing arbitration agreements. One explanation for this resistance is that judges perceived arbitration to be an encroachment on their power. *See*, *e.g*., *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270-71 (1995) (explaining same). Congress passed the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq*., in 1925 to reverse this sentiment and put arbitration agreements on the same footing as contracts generally. *Id.* The Texas Legislature later passed the Texas General Arbitration Act ("TAA"), Tex. Civ. Prac. & Rem. Code §171.001 *et seq*., which largely tracks the FAA, but contains certain differences relating to arbitration procedure that are beyond the scope of this Paper. In any event, the FAA remains the more frequently utilized arbitration statute because of the ease with which it can be invoked.

A. The Federal Arbitration Act.

1. Scope of the FAA: To the Furthest Reach of Congress's Commerce Power.

The explicit purpose of the Federal Arbitration Act ("FAA") is to put arbitration agreements on the same footing as contracts generally. The principal substantive section of the Act sets out this rule:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction. . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2. Thus, an agreement to arbitrate is valid under the FAA if it meets the requirements of the general contract law of a state. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *In re AdvancePCS Health L.P.*, 172 S.W.3d 603 (Tex. 2005). The United States Supreme Court has explained that the phrase "involving commerce" was enacted with an intent

"to exercise Congress's commerce power to the full." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 277 (1995).

2. Neither Employment Agreements Nor Statutory Employment Claims Are Exempt from the FAA.

For a time, confusion arose out of the fact that FAA Section 1 excludes from the Act's coverage "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." Some argued that this exemption applied to all contracts of employment, given the sweep of the Supreme Court's definition of interstate commerce. In *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001), however, the Supreme Court put this argument to rest, holding that the statutory exemption applied only to contracts of employment of workers actually engaged in the movement of goods in interstate commerce, not other employment contracts.

Ten years earlier, the Supreme Court rejected the argument that statutory discrimination claims were exempt from arbitration agreements. In *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Court held that, where there is no inherent conflict between arbitration and the underlying purposes of anti-discrimination statutes, such as was the case with the Age Discrimination in Employment Act claim at issue in that suit, the FAA required enforcement of agreements to arbitrate such claims. The *Gilmer* decision is widely viewed as being a catalyst for the growth of the use of arbitration agreements to cover employment disputes.

The Fifth Circuit has expressly held that Title VII claims, like ADEA claims, are arbitrable. *Alford v. Dean Witter Reynolds, Inc.*, 939 F.2d 229, 230 (5th Cir. 1991). More recently several cases have made clear that other employment-related claims are not immune from arbitration. *See*, *e.g.*, *Carter v. Countrywide Credit Indus., Inc*., 362 F.3d 294, 298 (5th Cir. 2004) ("We thus find unpersuasive the Carter Appellants' contention that FLSA claims are not subject to arbitration."); *Garrett v. Circuit City Stores, Inc.*, 449 F.3d 672 (5th Cir. 2006) (provisions of USERRA do not preclude enforcement of agreement to arbitrate such disputes).

Also recall that in *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247 (2009), the Supreme Court held that a provision in a collective-bargaining agreement that clearly and unmistakably requires union members to arbitrate ADEA claims is enforceable.

3. The FAA Applies in State Courts and Preempts State Law Hostile to Arbitration, but Does Not Preempt Generally Applicable Contract Law.

When it applies, the FAA governs proceedings in state courts and pre-empts state laws hostile to arbitration. *See Jack B. Anglin Co. Inc. v. Tipps*, 842 S.W.2d 266, 271 (Tex. 1992) (holding that the FAA applies in Texas state courts and preempts state laws hostile to arbitration); *In re R&R Personnel Specialists*, 146 S.W.3d 699, 703-04 (Tex. App. – Tyler 2004, orig. proceeding) (same); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (same; also holding that the California Franchise Investment Law's requirement of judicial determination of claims brought under that statute was pre-empted by the FAA). See the discussion of unconscionability below for additional discussion of this principle.

However, generally applicable state contract law remains in place:

> States may regulate contracts, including arbitration clauses, under general contract law principles, and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995); *see also Iberia Credit Bureau Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 166 (5th Cir. 2004) (noting same).

4. Remedy Under the FAA: Judicial Enforcement of Arbitration Agreements.

Section 4 of the FAA requires a court to order a party to arbitrate its claims upon a showing that an agreement to arbitrate the claims at issue exists. 9 U.S.C. § 4. Section 3 of the FAA requires a court to stay a case until arbitration has been completed. 9 U.S.C. § 3. A court does not have the discretion to delay compelling arbitration pending the completion of discovery. *In re Champion Technologies, Inc.*, 173 S.W.3d 595, 599 (Tex. App. – Eastland, orig. proceeding); *see also In re Heritage Bldg. Sys., Inc.*, 185 S.W.3d 539, 542 (Tex. App. – Beaumont 2006, orig. proceeding) (trial court had no authority to compel mediation pending a ruling on a motion to compel arbitration).

5. Invoking the FAA: Showing That the Agreement "Involves Commerce."

To invoke the FAA, an applicant for an order compelling arbitration must show that the agreement containing an arbitration clause relates to interstate commerce. *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 754 (Tex. 2001) (noting that the FAA extends to the furthest reaches of Congress's commerce power and that the issue is whether the contract "relates to interstate commerce," not whether the transaction was in interstate commerce).

This is not an onerous burden given the breadth of Congress' power to regulate interstate commerce. *See*, *e.g.*, *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 252-253 (1964) (finding Title II of the Civil Rights Act of 1964 to be a valid exercise of Congress' commerce power). Proof of practically any link to interstate commerce will suffice. *In re Nexion Health*, 173 S.W.3d 57 (Tex. 2005) (receipt and Medicare payments to pay for medical care for husband at hospital sufficient connection to interstate commerce for wife's wrongful death suit against hospital for death of husband); *In re MP Ventures of South Texas, Ltd.*, 276 S.W.3d 524, 529 (Tex. App.—San Antonio 2008, orig. proceeding) (contract to purchase and install greenhouse related to interstate commerce because materials used to construct greenhouse were transported from out of state); *American Medical Tech., Inc. v. Miller*, 149 S.W.3d 265, 269 (Tex. App. – Houston [14th Dist.] 2004, no pet.) (employment agreement calling for transfer of securities listed on NASDAQ showed contract involved commerce); *In re Tenet Healthcare Ltd.*, 84 S.W.3d 760, 765 (Tex. App. – Houston [1st Dist.] 2002, orig. proceeding) (employment agreement between distribution clerk and hospital related to interstate commerce because hospital treated out-of-state patients and received goods, services, and payments from out-of-

state entities); *Palm Harbor Homes, Inc. v. McCoy*, 944 S.W.2d 716, 719-20 (Tex. App. – Ft. Worth 1997, orig. proceeding) (FAA applied where component part of mobile home at issue was manufactured out of state).

Note – A reference to the applicability of Texas *substantive* law in a contract that contains an arbitration clause does not affect application of the FAA in assessing arbitrability. *Mesa Operating L.P. v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 243-44 (5th Cir. 1986); *McGrath v. FSI Holdings, Inc.*, 246 S.W.3d 796, 803 (Tex. App. – Dallas 2008, pet. denied); *American Medical Tech., Inc. v. Miller*, 149 S.W.2d 265, 269 (Tex. App. – Houston [14th Dist.] 2004, no pet.).

However, parties can agree to arbitrate under state arbitral rules alone. *See Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). Ultimately, a court must ascertain the intent of a choice of law clause. *See In re Olshan Found. Repair Co.*, 328 S.W.3d 883, 889 (Tex. 2010); *BDO Seidman, LLP v. J.A. Green Dev.*, 327 S.W.3d 852 (Tex. App. – Dallas 2010, no pet.).

Note – Whether the FAA bars a court from entering a preliminary injunction pending arbitration turns on whether the parties contemplated such relief pending arbitration. *See RGI, Inc. v. Tucker and Assoc., Inc.*, 858 F.2d 227, 228 (5th Cir. 1988); *Metra United Escalante, L.P. v. Lynd Co.*, 158 S.W.3d 535, 539-40 (Tex. App. – San Antonio 2004, no pet.).

6. Invoking the FAA: Agreement of the Parties May Also Be Sufficient.

An agreement between the parties may also be sufficient to invoke the FAA. *In re Pham*, 314 S.W.3d 520 (Tex. App. – Houston [1st Dist.] 2010, orig. proceeding) (collecting cases); *Roy v. Ladyman*, 318 S.W.3d 502 (Tex. App. – Dallas 2010, no pet.); *In re HEB Grocery Co.*, 299 S.W.3d 393, 397 (Tex. App. – Corpus Christi, 2009, orig. proceeding); *In re ReadyOne Indus., Inc.*, 294 S.W.3d 764, 769 (Tex. App. – El Paso 2009, orig. proceeding); *In re Kellogg Brown & Root*, 80 S.W.3d 611, 617 (Tex. App. – Houston [1st Dist.] 2002, orig. proceeding) (when "the parties agree to arbitrate under the FAA, they are not required to establish that the transaction at issue involves or affects interstate commerce"); *but see In re FirstMerit Bank*, 52 S.W.3d 749, 754 (Tex. 2001) (examining whether transaction at issue related to interstate commerce even though agreement stated the parties agreement that the FAA applied).

Note – If an arbitration agreement does not specify whether the Texas General Arbitration Act or the Federal Arbitration Act applies, then both laws may apply (if the dispute involves interstate commerce). *In re Devon Energy Corp.*, 332 S.W.3d 543, 547 (Tex. App. – Houston [1st Dist.] 2009, orig. proceeding). One court has held that if an arbitration agreement refers to the Texas General Arbitration Act alone, then it is deemed to exclude the FAA, and motions to compel arbitration are deemed to arise under the Texas statute. *Atlas Gulf-Coast, Inc. v. Stanford*, 299 S.W.3d 356, 358 (Tex. App. – Houston [14th Dist.] 2009, orig. proceeding).

B. The General Texas Arbitration Act.

1. Scope of the TAA.

In 1965, the Texas Legislature passed its own arbitration act. The Texas General Arbitration Act ("TAA") tracks the relevant substantive parts of the FAA. *See* Tex. Civ. Prac. & Rem. Code § 171.001 (noting that a "written agreement to arbitrate is valid and enforceable" and may be avoided "only on a ground that exists at law or in equity for the revocation of a contract").

2. Exceptions to the TAA's Coverage.

The TAA excludes from its coverage several types of claims, including collective bargaining agreements and claims for workers' compensation benefits. *See* Tex. Civ. Prac. & Rem. Code § 171.002(a). However, the FAA does not contain such exceptions, and whenever the FAA applies, the Supremacy Clause ensures that it will trump the TAA. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984); *Miller v. Public Storage Management, Inc.*, 121 F.3d 215, 219 (5th Cir. 1997); *In re Nexion Health*, 173 S.W.3d 67 (Tex. 2005).

3. Remedy Under the TAA: Judicial Enforcement of Arbitration Agreements.

Like the FAA, the TAA requires a court to order parties to arbitrate their claims upon a showing that an agreement to arbitrate the claims exists and is enforceable. *See* Tex. Civ. Prac. & Rem. Code § 171.021. As with the FAA, a trial court has no discretion to refuse to order arbitration. *See In re MHI Partnership, Ltd.*, 7 S.W.3d 918, 923 (Tex. App. – Houston [1st Dist.] 1999, orig. proceeding) (trial court had no authority to defer ruling on motion to compel arbitration pending completion of discovery); *cf. In re Houston Pipe Line Co.*, 311 S.W.3d 449 (Tex. 2009) (pre-arbitration discovery is expressly authorized under the TAA when a trial court cannot fairly and properly make its decision on the motion to compel arbitration because it lacks sufficient information regarding the scope of an arbitration provision or other issues of arbitrability). Also like the FAA, the proper procedure after entry of an order referring a dispute to arbitration is to stay the case. Tex. Civ. Prac. & Rem. Code § 171.025.

4. Parties May Agree to Appellate Review

Under the FAA, the grounds for vacating an arbitration award are "exclusive" and cannot be supplemented by an arbitration agreement to allow for more plenary appellate review. *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 578 (2008). In contrast, the Supreme Court of Texas has held that – because arbitrators derive their powers from the parties' contract – an arbitration agreement that provides that an arbitrator does not have the authority (a) to render a decision that contains reversible error or (b) to apply a cause of action or remedy not provided for by law may be enforced, and is not preempted by the FAA. In effect, this holding allows parties to contract for appellate review of arbitral decision. *See Nafta Traders, Inc. v. Quinn*, 339 S.W. 3d 84 (Tex. 2011).

III. ENFORCING AND AVOIDING ARBITRATION AGREEMENTS

To determine whether a dispute is subject to arbitration, one must analyze two questions: *first*, whether a valid agreement to arbitrate exists and *second*, whether the dispute in question falls within the scope of that arbitration agreement. *Carey v. 24 Hour Fitness, USA, Inc.*, No. 10-20845, __F.3d __ (5th Cir. 2012); *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 737 (Tex. 2005).

Note that these issues go to the substantive questions of whether there is an agreement to arbitrate the dispute at issue and whether that agreement is valid and enforceable. Procedural questions affecting whether arbitration should go forward – such as compliance with notice, time limits, and similar prerequisites to compelling arbitration – are questions for an arbitrator to decide. *Howsam v. Dean Witter Reynolds Inc.*, 537 U.S. 79, 83-85 (2002).

However, as discussed below, the Supreme Court has explained that parties may agree to arbitrate "gateway" issues of arbitrability – i.e., issues such as whether parties have agreed to arbitrate or whether their agreement covers a particular controversy. The only caveat is that parties must clearly and unmistakably agree to delegate such gateway issues to an arbitrator. *Rent-A-Center West, Inc. v. Jackson*, 130 S. Ct. 2772, 2777-78 (2010). Texas courts have reached the same result. *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 61 (Tex. 2008); *McGehee v. Bowman*, 339 S.W.3d 820 (Tex. App. – Dallas 2011, n.p.h.); *Haddock v. Quinn*, 287 S.W.3d 158 (Tex. App. – Fort Worth 2009, no pet.) (waiver by litigation conduct can, upon agreement of the parties, be decided by an arbitrator). But keep in mind that the *validity* of such an agreement to arbitrate (whether it is legally binding, as opposed to whether it was in fact agreed to) is an issue that a court must address. *Rent-a-Center*, 130 S. Ct. at 2778.

A. Issues Surrounding the Creation and Validity of a Purported Agreement to Arbitrate.

As noted above, whether a valid agreement to arbitrate exists depends on whether the parties entered into an arbitration agreement and whether the arbitration agreement is enforceable under generally applicable state contract law. Issues related to whether a binding contract to arbitrate has been formed and, if so, whether there are any viable defenses to the enforcement of the arbitration agreement frequently arise under this inquiry and are generally determined by state contract law. *In re Dillard Dep't Stores, Inc.*, 186 S.W.3d 514, 515 (Tex. 2006). Of course, under basic contract law, it generally does not matter if a person does not realize that he or she is agreeing to arbitrate his or her claims. "Absent fraud, misrepresentation, or deceit, a party is bound by the terms of the contract he signed, regardless of whether he read it or thought it had different terms." *In re McKinney*, 167 S.W.3d 833 (Tex. 2005).

Before proceeding, recall that, as explained in more detail below, a challenge to the validity of a contract *as a whole*, and not specifically to *an arbitration clause* within it, must go to the arbitrator, not to a court. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006); *In re Labatt Food Service, L.P.*, 279 S.W.3d 640, 648 (Tex. 2009).

Also note that the often invoked "policy in favor of arbitration agreements" does not apply when a court is examining the threshold question of whether an arbitration agreement exists. *Granite Rock Co. v. Int'l Brotherhood of Teamsters*, 130 S. Ct. 2847 (2010); *Morrison v.*

Amway Corp., 517 F.3d 248, 254 (5th Cir. 2008); *In re Morgan Stanley & Co.*, 293 S.W.3d 182, 185 (Tex. 2009). The policy favoring arbitration only applies to questions surrounding the scope of a clause that is found to exist. *See infra.*

1. Is There an Agreement to Arbitrate?

Before a party to a dispute can attempt to compel arbitration, there must be a valid agreement to arbitrate. Applying generally applicable contract analyses, several recent cases highlight what is and what is not necessary and what is and is not sufficient to create a binding contract to arbitrate a dispute.

a. There Must Be an Agreement *To Arbitrate*.

Preliminarily, there must be an agreement *to arbitrate* – i.e., to submit a dispute to something courts recognize as arbitration. A Texas court has recently held that a policy requiring that employment disputes be submitted to a pool of "arbitrators" that consisted solely of the employer's employees was not an arbitration mechanism because the parties could not select their own arbitrators, as the definition of arbitration requires. *In re Phelps Dodge Magnet Wire Co.*, 225 S.W.3d 599 (Tex. App. – El Paso 2005, orig. proceeding). However, the mere fact that the adjective "binding" does not accompany the word "arbitration" in an arbitration agreement does not make the agreement invalid. *Nabors Drilling USA, LP v. Carpenter*, 198 S.W.3d 240, 247 (Tex. App. – San Antonio 2006, orig. proceeding).

b. There is No Specific Requirement That the Agreement be Signed.

There is no specific requirement that an arbitration agreement be signed, so long as it is written and agreed to by the parties. *See* 9 U.S.C. § 3; Tex. Civ. Prac. & Rem. Code § 171.001(a); *In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 606 (Tex. 2005). An exception exists under the TAA for contracts of less than $50,000 and for personal injury claims. Tex. Civ. Prac. & Rem. Code § 171.002, but these requirements can be preempted by the FAA, when it applies. *See In re AdvancePCS Health L.P.*, 172 S.W.3d at 606 n.5; *In re MPVentures*, 276 S.W.3d 524 (Tex. App. – San Antonio 2008, orig. proceeding).

c. Arbitration Agreements Need Not Appear in Any Particular Place.

There is no requirement that an arbitration clause appear in each contract that may be covered by an agreement to arbitrate. If the parties agree to arbitrate a given dispute, it does not matter where that agreement is written. *See In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 606 (Tex. 2005). Similarly, arbitration agreements may be incorporated by reference to other documents. *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 781 (Tex. 2006); *In re Bank One N.A.*, 216 S.W.3d 825 (Tex. 2007).

d. Enforceability Through Mutuality of Obligation.

Proving that an agreement to arbitrate is enforceable can be accomplished by showing mutuality of obligation. If two parties agree to submit their disputes with the other to arbitration, courts typically find that the agreement to arbitrate is enforceable. If one side does not actually

obligate itself to arbitrate, and there is no other consideration, courts typically find that that party has not promised to do anything and thus refuse to enforce the purported arbitration agreement.

Hence, in *In re 24R, Inc., et al.*, 324 S.W.3d 564 (Tex. 2010), the Supreme Court found that where the employer and employee both promised to arbitrate claims against the other and where those promises could not unilaterally be rescinded by either party, there was sufficient consideration to support the arbitration agreement. *See also In re Polymerica, LLC*, 296 S.W.3d 74, 76 (Tex. 2009) (per curiam); *In re Dillard Dep't Stores, Inc.*, 186 S.W.3d 514, 516 (Tex. 2006) (similar); *In re Champion Tech., Inc.*, 222 S.W.3d 127 (Tex. App. – Eastland 2006) (orig. proceeding). *In re HEB Grocery Co., L.P.*, 299 S.W. 3d 393, 399 (Tex. App. – Corpus Christi 2009, orig. proceeding).

However, in *Labor Ready Central III, L.P. v. Gonzalez*, 64 S.W.3d 519 (Tex. App. – Corpus Christi 2001, orig. proceeding), the Corpus Christi court of appeals found that where an employer required employees to submit their claims to arbitration, but accepted no such limitation itself, the employer "gave no consideration for the purported arbitration agreement. Because there [was] no mutuality of obligation, no enforceable arbitration agreement exist[ed]." *Id*. at 524. The same result applies where a company can unilaterally amend its obligations under an arbitration agreement at any time. In that case, even a promise to arbitrate is illusory. *Morrison v. Amway Corp.*, 517 F.3d 248, 257 (5th Cir. 2008); *In re C&H News Co.*, 133 S.W.3d 642 (Tex. App. – Corpus Christi 2003, orig. proceeding) (same). Likewise, if a promise to arbitrate is subject to change and the promise is silent as to whether such a change may only be retroactive, then the promise is deemed to be illusory. *Carey v. 24 Hour Fitness USA, Inc.*, No. 10-20845, __F.3d __ (5th Cir. 2012).

In *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d. 223 (Tex. 2003), the Texas Supreme Court synthesized these competing strands and explained that an employer's promise to be bound by the result of an arbitration is illusory if the employer reserves an unqualified right to modify or terminate its promise to abide by an arbitration decision such that a decision to do so could operate retroactively as well as prospectively. In effect, such a case simply presents a straightforward application of basic contract principles. *See* 1 Williston on Contracts § 43, at 140 (3d ed.) ("Where a promisor retains an unlimited right to decide later the nature and extent of his performance, the promise is too indefinite for legal enforcement."). The Court found the agreement at issue to be ambiguous as to whether the reservation of the right to change the employment agreement at issue applied to the arbitration provision. The Court thus remanded the case for further proceedings. However, in *In re Odyssey Healthcare, Inc.*, 310 S.W. 3d 419, 421, 424 (Tex. 2010), the Supreme Court held that an arbitration clause in a workers' compensation plan was not illusory where, although the employer reserved the right to amend, modify, or terminate the plan at any time, the plan also provided no such change affected an injury that occurred before the date of the change.

The Texas Supreme Court has also noted that where an arbitration clause is part of an underlying contract that is supported by consideration, the rest of the parties' agreement can provide the consideration for a promise by one party to arbitrate. *In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 607 (Tex. 2005); *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 676 (Tex. 2006).

e. In the Employment Context, Promulgation of an Arbitration Policy Coupled With Continued Employment Can Be Sufficient to Create a Binding Agreement.

The Texas Supreme Court has held that an employer's promulgation of a policy requiring arbitration of disputes between the employer and employee, coupled with the employee's continued work for the company was sufficient to create an enforceable agreement to arbitrate disputes covered by the policy.

In *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002), Halliburton notified employees that it was adopting a "dispute resolution program." Under the program, binding arbitration was required to resolve disputes between the company and its employees. The notice of this program provided that any employee who continued to work after a given date would be deemed to have accepted the new program. Changes to the arbitration policy could only be made prospectively and with notice to the employees. James Myers, an at-will employee, was later demoted and sued Halliburton, claiming that his demotion was caused by race and age discrimination. The Texas Supreme Court found that the dispute was arbitrable. Relying on *Hathaway v. General Mills, Inc.*, 711 S.W.2d 227 (Tex. 1986), the court held that an employer may change the terms of an at-will employment relationship without further consideration if the employee has notice of the change and accepts the change by continuing employment after receiving notice. The consideration given by Halliburton was not illusory, even in the context of at-will employment, because even termination of an employee's employment would not defeat Halliburton's obligation to arbitrate disputes already in existence. *See also In re Dillard Dep't Stores, Inc.*, 181 S.W.3d 370 (Tex. 2006) (same); *see D.R. Horton, Inc. v. Brooks*, 207 S.W.3d 862 (Tex. App. – Houston [14th Dist.] 2006, no pet.). Note, though that where there is a promise that is otherwise illusory because it may be modified, notice and acceptance by an employee will not make the enforceable simply because it has been accepted. *Carey v. 24 Hour Fitness, USA, Inc.,* No. 10-20845, __F.3d __ (5th Cir. 2012); *Weekly Homes, LP v. Rao*, 336 S.W.3d 413 (Tex. App. – Dallas 2011, pet. denied).

More recent cases have made it clear that the employer must show that the employee received unequivocal notice of the arbitration policy. *In re Dillard Dep't Stores, Inc.*, 181 S.W.3d 370 (Tex. 2006); *Sporran Kbusco, Inc v. Cerda*, 227 S.W.3d 288 (Tex. App. – San Antonio 2007, pet. denied); *see also Campbell v. General Dynamics Gov't Systems Corp.*, 407 F.3d 546 (1st Cir. 2005) (new arbitration policy promulgated by e-mail sent from CEO was ineffective to notify employee of policy to arbitrate future disputes with the company where employee did not read e-mail and court found that the e-mail at issue insufficiently communicated the importance of the information conveyed because the e-mail did not specifically explain that the arbitration policy was binding or that the employee would not have a judicial forum; court also noted that although e-mail could be an appropriate method of communicating an arbitration policy, e-mail features such as the "accept" feature could have been used to show that employees read and understood the policy). However, receipt by an employee of a summary of an arbitration agreement has been held to be sufficient notice. *In re Dallas Peterbilt, Ltd., L.L.P.*, 196 S.W.3d 161 (Tex. 2006).

f. The Party Enforcing the Agreement Must Have the Right to Do So.

In a case that reminds attorneys to dot their "i"s and cross their "t"s, the First Court of Appeals held in *Mohamed v. AutoNation USA Corp*., 89 S.W.3d 830, 835-37 (Tex. App. – Houston [1st Dist.] 2002, orig. proceeding), that a company that claimed it had purchased an employer failed to prove that it had done so such that it could assert the employer's rights under an arbitration agreement. The plaintiff the case, Mohamed, worked for a car dealership that had required him to sign an arbitration agreement covering employment disputes. AutoNation purchased the auto dealership. Mohamed later sued, asserting discrimination on the basis of race and national origin. AutoNation moved to compel arbitration, but Mohamed argued that the arbitration agreement he signed was with his prior employer. The court of appeals held that AutoNation did not prove that it was a proper party to the arbitration agreement.

In another recent case that reminds the parties to comply with the formalities of contract formation, the El Paso Court of Appeals held that a district court did not abuse its discretion when it refused an employer's request to enforce an arbitration agreement that the employee, but not the employer, had signed. The court explained that since the issue of whether a written contract must be signed in order to be binding is a question of the parties intent, and since the contract at issue in that case provided that it could not be modified unless the modification was signed by the parties, the trial court could have concluded that the employer did not establish the existence of an agreement to arbitrate. *In re Bunzl USA, Inc.*, 155 S.W.3d 202 (Tex. App. – El Paso 2004, orig. proceeding); *but see In re Citgo Petrol. Co.*, 248 S.W.3d 769 (Tex. App. – Beaumont 2008, orig. proceeding) (approving of district court's finding that employer's conduct showed that it had agreed to arbitration clause, although agreement not signed).

g. Other Factors Relating to Creation of an Arbitration Agreement.

Of course, there can be many other factors that can determine whether an arbitration agreement was ever concluded, such as whether an agent had the authority to commit a principal to arbitrate and whether the signor had the capacity to assent to the agreement. *See In re Morgan Stanley & Co.*, 293 S.W.3d 182 (Tex. 2009) (issue of party's mental capacity to assent to contract); *American Med. Tech., Inc. v. Miller*, 149 S.W.3d 265 (Tex. App. – Houston [14th Dist.] 2004, no pet.) (issue of agent's authority); *In re Mexican Restaurants*, 2004 WL 2850151 (Tex. App. – Eastland 2004, orig. proceeding) (issue of child's capacity to consent); *In re SSP Partners*, 241 S.W.3d 162 (Tex. App. – Corpus Christi 2007, orig. proceeding) (issue of parent's authority to bind children); *see also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444 n.l (2006) (noting same).

2. Is the Arbitration Agreement Subject to Generally Applicable State Law Defenses?

A court may refuse to enforce an arbitration clause without violating the FAA if the arbitration clause is unenforceable under generally applicable state law contract defenses. *Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681, 686-87 (1996). However, the Supreme Court has cautioned that in considering whether an "agreement to arbitrate is unenforceable, [courts] are [to be] mindful of the FAA's purpose to 'reverse the longstanding judicial hostility to arbitration agreements . . . and to place arbitration agreements upon the same footing as other contracts.'" *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 89-90 (2000) (noting that the

Court has "rejected generalized attacks on arbitration that rest on 'suspicion of arbitration as a method of weakening the protections afforded in the law to would-be complainants'") (citation omitted).

a. Burden of Persuasion Rests With the Party Opposing Arbitration.

The Texas Supreme Court has explained that "the burden of proving a defense to arbitration is on the party opposing arbitration." *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749 (Tex. 2001). This is not surprising; the defenses typically asserted are in essence affirmative defenses to the enforcement of an agreement to arbitrate. *See In re AdvancePCS Health L.P.*, 172 S.W.3d 603 (Tex. 2005).

b. Attacks on the Enforceability of a Contract as a Whole Are for the Arbitrator.

In 1967, the United States Supreme Court held that if there is an agreement between the parties containing an arbitration clause that requires arbitration of any dispute "arising out of or relating to the agreement" and a party opposing arbitration contends that the agreement as a whole was procured by fraud (as opposed to the arbitration clause alone being procured by fraud), then the question of whether the agreement was fraudulently induced is for the arbitrator, not the courts, to decide. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967). In *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), the Supreme Court reaffirmed its *Prima Paint* holding, explaining that that case established that, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract and that, unless a party's challenge is to the arbitration clause at issue itself, the issue of a broader contract's validity is considered by the arbitrator in the first instance. The Texas Supreme Court recognized this rule in *In re J.D. Edwards World Solutions Co.*, 87 S.W.3d 546, 551 (Tex. 2002). Thus, state law defenses to the enforcement of an agreement that contains an arbitration clause "must specifically relate to the [arbitration clause] itself, not the contract as a whole." *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 756 (Tex. 2001).

It is important to distinguish between two different principles which can appear to be in tension in certain cases. Where a party resisting arbitration argues that it never entered into an agreement – because, for example, it did not sign the agreement – or whether any agreement was even concluded – because, for example a party did not have the legal capacity to consent – a court must first determine whether there is an agreement to arbitrate before a dispute can be sent to arbitration. *See In re Morgan Stanley & Co.*, 293 S.W.3d 182, 190 (Tex. 2009) (trial court, rather than arbitrator, had authority to determine whether party lacked mental capacity to assent to contract which contained arbitration provision). On the other hand, if parties have entered into an agreement that contains an arbitration clause, an argument that the entire agreement is not enforceable is for the arbitrator. *See Will-Drill Resources, Inc. v. Samson Resources Co.*, 352 F.3d 211 (5th Cir. 2003) (same); *see also American Medical Tech., Inc. v. Miller*, 149 S.W.3d 265 (Tex. App. – Houston [14th Dist.] 2004, no pet.) (same).

Note – Do not be fooled by what the Texas Supreme Court admitted was a hiccup in its explanation of the law in the late 1990's. In *In re Oakwood Mobile Homes, Inc.*, 987 S.W.3d 571 (Tex. 1999), the Texas Supreme Court erroneously stated that the alleged substantive unconscionability of an arbitration clause cannot be asserted to the court as a reason not to

compel arbitration, but had to be submitted to the arbitrator. In *In re Halliburton Co.*, the court explained that the statement in *Oakwood Mobile Homes* was dicta and was incorrect. The *Halliburton* court "clarif[ied] that courts may consider both procedural and substantive unconscionability of an arbitration clause in evaluating the validity of an arbitration provision." *In re Halliburton Co.*, 80 S.W.3d 566, 572 (Tex. 2002).

c. Material Breach of the Arbitration Agreement.

A material breach of an arbitration agreement by the party attempting to enforce that agreement can justify a refusal to compel arbitration. A good example of such a situation occurred in *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999). Hooters required its restaurant employees to sign arbitration agreements. Under those agreements, Hooters had the obligation to promulgate adequate rules for arbitration. The Fourth Circuit found that the rules Hooters promulgated were entirely one-sided and were calculated to produce biased proceedings. For example, the rules required the employee to provide, at the outset, information describing "the nature of the claim" and "the specific acts or omissions which are the basis of the claim," while Hooters had no such information disclosure requirement. The employee also had to provide a list of all fact witnesses with a brief summary of the facts known by each; Hooters had no such obligation. Perhaps most egregiously, the employee could only select an arbitrator from a company-approved list. Hooters was allowed to expand the scope of the arbitration to any matter, regardless of whether it related to the employee's claim, but the employee could only raise matters included in the notice of claim. The rules also gave the company the right to move for a summary decision and the right to bring suit in court to vacate or modify an arbitral award while the employee had no such rights. Finally, the company had the right to cancel the agreement to arbitrate upon 30 days notice, and also had the right to modify the rules whenever it wished, without any notice. The Fourth Circuit found that Hooters had materially breached its obligations under the arbitration agreement and thus held that the food server plaintiffs were excused from their obligation to arbitrate their claims. *Id.* at 940-41; *see also Walker v. Ryan's Family Steak Houses, Inc.*, 400 F.3d. 370 (6th Cir. 2005) (following *Hooters* in case in which defendant selected an arbitration provider for which it supplied 42% of the provider's business).

The material breach principle was also applied in *Brown v. Dillard's Inc.*, 430 F.3d 1004 (9th Cir. 2005). There, Dillard's required Brown to agree to arbitrate any employment-related claims she had. After she was fired, Brown filed a notice of intent to arbitrate her wrongful discharge claims. Dillard's refused to participate in arbitration proceedings. Brown then sued Dillard's in court. When Dillard's attempted to compel arbitration, the Ninth Circuit held that the company could not do so because it was in material breach of the arbitration agreement by failing to arbitrate earlier.

Texas courts have faced analogous cases. In *Tri-Star Petrol. Co. v. Tipperary Corp.*, 107 S.W.3d 607 (Tex. App. – El Paso 2003, pet. denied), the court found that a party exercised undue influence over an accounting firm that had been hired under an arbitration agreement to perform an accounting of production on a natural gas project. The court found that the party's interference constituted a material breach of the arbitration agreement sufficient to justify (1) vacation of the arbitration award based on the accounting and (2) a refusal to order re-arbitration.

d. Waiver of the Right to Compel Arbitration.

A party seeking to enforce an arbitration agreement can also lose the right to do so by waiver. However, the Texas Supreme Court has explained that there is a "strong presumption against waiver" and that courts "will not find that a party has waived its right to enforce an arbitration clause by merely taking part in litigation unless it has substantially invoked the judicial process to the opponent's detriment." *In re Service Corp. Int'l*, 85 S.W.3d 171 (2002). A "party does not waive a right to arbitration by mere delay; instead, the party urging waiver must establish that any delay resulted in prejudice." *Id.*; *see also In re Fleetwood Homes of Texas, L.P.* , 257 S.W.3d 692 (Tex. 2008) (delay alone insufficient); *In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759, 763 (Tex. 2006) (same).

A party does not necessarily substantially invoke the judicial process by taking pre-trial actions in a suit brought against that party. Thus, filing a motion to transfer venue, mediating a case, engaging in written discovery, and conducting depositions (at least where such discovery was available in the arbitration or irrelevant to the arbitrable claims) has been held to be insufficient to waive the right to compel arbitration. *Granite Constr. Co. v. Beaty*, 130 S.W.3d 362 (Tex. App. – Beaumont 2004, no pet.); *see also In re MacGregor (FIN) Oy*, 126 S.W.3d 177, 184 (Tex. App. – Houston [1st Dist.] 2003) (no waiver where party seeking to compel arbitration sought interim injunctive relief in court), *vacated on other grounds sub nom. In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005); *Wee Tots Pediatrics, P.A. v. Morohunfola*, 268 S.W.3d 784 (Tex. App. – Fort Worth 2008, no pet.) (seeking discovery on claims not subject to arbitration does not constitute waiver); *cf. In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759, 764 (Tex. 2006) (declining to find waiver on facts of the case, even though party seeking to compel arbitration had engaged in discovery and filed a motion to dismiss for lack of standing).

Substantially invoking the judicial process can occur "when the proponent of arbitration actively tried, but failed, to achieve a satisfactory result in litigation before turning to arbitration," such as by moving for summary judgment or seeking final resolution of the dispute. *Williams Indus. Inc. v. Earth Development Sys. Corp.*, 110 S.W.3d 131, 139-40 (Tex. App. – Houston [1st Dist.] 2003, no pet.). Indeed, in *Petroleum Pipe Americas Corp. v. Jindal Saw, Ltd.*, 575 F.3d 476 (5th Cir. 2009), the Fifth Circuit held that the defendant had substantially invoked the judicial process by waiting to move to arbitrate until after the trial court made pronouncements in a pretrial hearing that it favored the plaintiff's interpretation of a contract at issue in the case. *Id*. at 482. Similarly, the Dallas Court of Appeals held that a law firm had substantially invoked the litigation process by filing a suit to collect unpaid fees, obtaining a default judgment, attempting to collect, and resisting a bill of review. The firm was held to have waived the right to compel arbitration when the client appeared and filed a counterclaim. *Holmes Woods & Diggs v. Gentry*, 333 S.W.3d 650 (Tex. App. – Dallas 2009, no pet.). The Fifth Circuit has also held that filing suit in itself subsantially invokes the judicial process. *Nicholas v. KBR, Inc.*, 565 F.3d 904 (5th Cir. 2009).

However, seeking to vacate a default judgment does not substantially invoke the judicial process, *In re Bank One N.A.*, 216 S.W.3d 825 (Tex. 2007), nor does requesting a transfer of a case to the federal MDL panel. *In re Citigroup Global Mkts, Inc.*, 258 S.W.3d 623 (Tex. 2008); *cf. In re Automated Collection Techs, Inc.*, 156 S.W.3d 557 (Tex. 2004) (filing counterclaims and serving discovery did not waive right to invoke forum-selection clause).

Actual prejudice includes such things as (1) the movant's access to information that is not discoverable in arbitration and (2) the opponent's incurring costs and fees due to the movant's actions or delay. *Southwind Group, Inc. v. Landwehr*, 188 S.W.3d 730, 737 (Tex. App. – Eastland 2006, orig. proceeding). Thus in *Republic Ins. Co. v. Paico Receivables, LLC*, 383 F.3d 341 (5th Cir. 2004), the Fifth Circuit found that an insurance company had waived its right to arbitration by litigating in the district court, seeking summary judgment, and waiting until days before trial to seek to compel arbitration. *Id*. at 344-47 (also holding that no waiver clause did not overcome the district court's authority to find waiver); *see Okorafor v. Uncle Sam & Assoc., Inc.*, 295 S.W.3d 27, 41 (Tex. App – Houston [1st Dist.] 2009, no pet.) (property owner prejudiced contractor by pursuing an aggressive litigation strategy and abruptly switching to an arbitration strategy to seek an advantage, thereby waiving any right to arbitrate). Without a showing of prejudice, however, a court should not find waiver. *Texas Residential Mortgage, L.P. v. Portman*, 152 S.W.2d 861 (Tex. App. – Dallas 2005, no pet.). *See Northwest Constr. Co., Inc. v. The Oak Partners, L.P.*, 248 S.W.3d 837 (Tex. App. – Fort Worth 2008, pet. denied) for a case finding both substantial invocation of the judicial process and prejudice to the other party.

The foregoing will inform the reader's evaluation of *Perry Homes v. Cull*, 258 S.W.3d 580 (Tex. 2008), in which the Supreme Court found that the plaintiffs – who had admittedly initially opposed arbitration, engaged in 14 months of discovery, and then sought arbitration on the eve of trial – had waived their right to arbitrate. The Court has little trouble finding that the plaintiffs had substantially invoked the judicial process. The Court's finding of prejudice was that it was unfair to Perry Homes to allow the plaintiffs to get discovery under one set of rules, but then be forced to try the case in arbitration, where the right to appeal was limited. *Id.* at 597.

e. Condition Precedent to Arbitration

In some situations, the failure of a condition precedent to an arbitration demand can provide a defense to a motion to compel arbitration. Although procedural issues relating to whether an arbitration should go forward (such as timeliness) are generally for an arbitrator to decide, *Howsam v. Dean Witter Reynolds Inc.*, 537 U.S. 79, 83-85 (2002), some courts have held that where there are contractual prerequisites to invoking an arbitration agreement and it is undisputed that those prerequisites have not been met, then the party seeking an order compelling arbitration is not entitled to relief. *See In re Pisces Foods, L.L.C.,* 228 S.W.3d 349 (Tex. App. – Austin 2007, orig. proceeding) (request for mandamus denied where arbitration agreement required mediation as prerequisite to arbitration and it was undisputed that no party had sought or refused to mediate dispute); *see also In re Rapid Settlements, Ltd.*, 202 S.W.3d 456 (Tex. App. – Beaumont 2006, orig. proceeding) (where court order approving transfer of funds was condition precedent to enforcement of arbitration agreement, arbitration could not proceed before such an order was entered). However, if a prerequisite to arbitration (such as a mediation requirement) exists, and where one party initiates litigation without complying, and the other party seeks to compel arbitration without complying either, courts have held that the party that initiated litigation cannot avoid arbitration by noting that his opponent failed to fulfill the prerequisite as well. *LDF Constr., Inc. v. Bryan*, 324 S.W.3d 137, 147 (Tex. App. – Waco 2010, no pet.).

f. Arbitration Agreements Procured by Duress.

Any generally applicable state law defense to the enforcement of a contract can be used to avoid enforcement of an arbitration clause. Thus, an arbitration agreement procured by duress may provide a valid defense to enforcement of an arbitration clause, but any such defense must involve duress related to the arbitration clause itself, not duress to sign the entire agreement (though such an argument may be presented to the arbitrator). *In re RLS Legal Solutions, L.L.C.*, 221 S.W. 3d 629 (Tex. 2007).

g. Unconscionability of an Arbitration Agreement.

Unconscionability is probably the most litigated defense to the enforcement of arbitration clauses. Of course only generally applicable unconscionability standards can be employed to deem an arbitration agreement unconscionable. If state laws or cases stand as an obstacle to the accomplishment and execution of the purposes of the FAA or otherwise apply different rules for arbitration clauses, then those rules cannot be given effect under the FAA. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011); *Iberia Credit Bureau v. Cingular Wireless LLC*, 379 F.3d 159, 164 (5th Cir. 2004).

i. There is No Good Definition of Unconscionability.

There is no precise definition on unconscionability. Generally, the test is whether the clause at issue is so one-sided as to be unenforceable, judged in the light of the general commercial background and the needs of the parties in the circumstances existing at the time the contract was made. *In re Poly-America L.P.*, 262 S.W.3d 337 (Tex. 2008); *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 678 (Tex. 2006); *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 757 (Tex. 2001). Texas law recognizes, however, that courts should not lightly invalidate contractual arrangements on unconscionability grounds. *Wade v. Austin*, 524 S.W.2d 79, 86 (Tex. Civ. App. – Texarkana 1975, no writ) ("It has accordingly been said that, almost without limitation, what the parties agree upon is valid, the parties are bound by the agreement they have made, and the fact that a bargain is a hard one does not entitle a party to be relieved therefrom if he assumed it fairly and voluntarily"); *see also Bartley v. National Union Fire Ins. Co.*, 824 F. Supp. 624, 635 (N.D. Tex. 1992) (noting same).

ii. Procedural v. Substantive Unconscionability.

In any unconscionability inquiry, courts focus on two aspects of contract formation. *First*, courts examine whether the party resisting enforcement of the contract was faced with an absence of meaningful choice. This is often called "procedural unconscionability." Procedural unconscionability has also been said to concern the use of fine print, convoluted language, lack of understanding by one of the contacting parties, and an inequality in bargaining power. *Second*, courts look at whether the terms of the contract are unreasonably favorable to the other party. This is often termed "substantive unconscionability." *In re Olshan Found. Repair Co.*, 328 S.W.3d 883, 892 (Tex. 2010); *In re Halliburton Co.*, 80 S.W.3d 566, 571 (Tex. 2002); *Pony Express Courier Corp. v. Morris*, 921 S.W.2d 817 (Tex. App. – San Antonio 1996, no writ) (procedural unconscionability "is concerned with assent and focuses on the facts surrounding the bargaining process"; substantive unconscionability "is concerned with the fairness of the

resulting agreement" and the "legitimate commercial reasons justifying the inclusion of the [challenged] terms).

iii. The Showing Required to Prove Unconscionability.

Under Texas law, a party attempting to avoid a contract on unconscionability grounds "bears the burden of proving both procedural and substantive unconscionability." *In re Turner Bros. Trucking Co., Inc.*, 8 S.W.3d 370, 376-77 (Tex. App. – Texarkana 1999, orig. proceeding); *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294 (5th Cir. 2004) (similar). Successful unconscionability claims present both procedural and substantive difficulties, but it may be most accurate to think of the required showing as a sliding scale: the more of one that is present, the less of the other is required. *See* 15 Williston on Contracts § 1763A, at 226-27 (3d ed.) (noting same).

(A) Procedural Unconscionability.

Claiming that an agreement is a contract of adhesion is alone insufficient to prove procedural unconscionability under Texas law. The Texas Supreme Court has held that "adhesion contracts are not automatically unconscionable." *In re AdvancePCS Health L.P.,* 172 S.W.3d 603(Tex. 2005); *In re Olshan Found. Repair Co.*, 328 S.W. 3d 883, 892 (Tex. 2010) (same); *see also In re Halliburton Co.*, 80 S.W.3d 566, 572 (Tex. 2002) (noting that employers may make a "take-it-or-leave-it" offer to at will employees). The United States Supreme Court has expressed a similar sentiment. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991) ("[M]ere inequality in bargaining power is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context").

Other cases highlight the difficulty in establishing procedural unconscionability in any context in Texas. In *Fleetwood Enterprises, Inc. v. Gaskamp*, 280 F.3d 1069, 1077 (5th Cir. 2002), the Fifth Circuit noted that "[t]he only cases under Texas law in which an agreement was found procedurally unconscionable involve situations in which one of the parties appears to have been incapable of understanding the agreement." Texas courts have found that no procedural unconscionability was present where the relevant terms of the agreement were conspicuously noted and there was no evidence plaintiff was unaware of them when he signed agreement. *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 679 (Tex. 2006); *In re H.E. Butt Grocery Co.*, 17 S.W.3d 360, 371-72 (Tex. App. – Houston [14th Dist.] 2000, orig. proceeding).

The law is not the same nationwide; California is a notable exception. Under that state's law, a "stark inequality of bargaining power" between a prospective employee and an employer which prevents the employee from enjoying a "meaningful opportunity to negotiate" has been found to render an arbitration agreement "procedurally oppressive." *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1171 (9th Cir. 2003); *see Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 301 n.5 (5th Cir. 2004) (noting the difference between California and Texas unconscionability law).

(B) Substantive Unconscionability.

A number of facets of arbitration agreements have been subject to challenges on substantive unconscionability grounds. Since unconscionability is an imprecise, "know it when

you see it" inquiry, some of the cases described below find one factor insufficient in itself to make an arbitration agreement unconscionable, but other courts find that, when combined with others, that factor is sufficient to justify a finding of unenforceability. In the end, whether an arbitration clause is unconscionable will turn on the facts of each case and the receptivity of the court hearing the argument.

Cost of Arbitration – A popular argument against the enforcement of arbitration agreements has been that the cost associated with arbitrating a claim makes resort to arbitration unaffordable for individual litigants. Courts and commentators have struggled to define appropriate boundaries for the allocation of expenses associated with arbitration proceedings. *See generally* Matthew T. Ballenger, *The Price of Justice: The Role of Cost Allocation in the Employment Arbitration Fairness Analysis*, 18 Lab. Law 485 (2002). Most courts have made it clear, though, that specific facts, not generalized complaints, are necessary to establish a claim that the cost of arbitration renders an arbitration agreement unenforceable.

The seminal case in this area is *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79 (2000). There, the United States Supreme Court noted that "[i]t may well be that the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating [her] rights in the arbitral forum." *Id.* at 90. However, the Court held that the mere "'risk' that [a plaintiff] will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement." *Id*. at 91. Where "a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs." *Id*. at 92.

In *Green Tree*, the plaintiff had "failed to support [her] assertion" that "[a]rbitration costs are high, and that she did not have the resources to arbitrate." *Id.* at 90 n.6. The Court explained that the plaintiff's "discussion of costs relied entirely on unfounded assumptions" because, among other things, she did not show that "she would be charged the filing fee or arbitrator's fee that she identified." *Id*. The Court also rejected the plaintiff's attempt to show that arbitration costs were prohibitive by "list[ing] fees incurred in cases involving other arbitrations" because such information did not "afford a sufficient basis for concluding that [the plaintiff] would in fact have incurred substantial costs in the event her claim went to arbitration." *Id*.

Since *Green Tree v. Randolph*, several federal courts of appeals have addressed the issue of arbitration costs in the context of arbitration of employment disputes. These cases take somewhat differing approaches to the showing required to invalidate an arbitration agreement on cost-of-arbitration grounds.

The Ninth Circuit has taken the most aggressive stance. In *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003), the court held Circuit City's employment dispute arbitration agreement was substantively unconscionable where the agreement (1) required each party to pay half of all costs of arbitration (including the arbitrator's fees and expenses, filing and administrative fees, court reporter fees, and room rental) and (2) provided for the possibility that a losing employee could be saddled with all of the costs of arbitration was substantively unconscionable. *Id.* at 1178. The court simply rejected the argument that, without hard estimates, the cost issue was too speculative. *Cf. Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 91 (2000).

In *Blair v. Scott Specialty Gases*, 283 F.3d 595 (3d Cir. 2002), the Third Circuit found that cost splitting was potentially impermissible, but required a specific showing of harm. The court held that an arbitration agreement that followed the default AAA rule that the parties to an arbitration would pay the arbitrator's compensation equally could be unconscionable because it prevented a claimant from "effectively [] vindicat[ing his or her] statutory cause of action in the arbitral forum. *Id.* at 605. The court wrote that such a requirement could "undermine Congress's intent" in enacting civil rights statutes if it prevented "employees who are seeking to vindicate statutory rights from gaining access to a judicial forum and then require[d] them to pay for a judge in court." *Id.* at 606. The court thus remanded the case for further proceedings regarding the claimant's ability to pay.

The Third Circuit's a more particularized showing requirement appears to be the one followed by most courts, although other courts take slightly differing approaches. *See*, *e.g.*, *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549 (4th Cir. 2001); *Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003) (en banc).

The Fifth Circuit has addressed a few cases in which plaintiffs have sought the invalidation of arbitration agreement on costs grounds. In the first case it faced, the facts for invalidation were not compelling. In *Williams v. Cigna Financial Advisors, Inc.*, 197 F.3d 752 (5th Cir. 1999), a claimant brought a post-arbitration action to set aside an arbitrator's decision. The claimant asserted that being required to pay half of the arbitration costs (about $3,000) was against public policy. Noting that the claimant's income at the time of the arbitration was over $100,000, the Fifth Circuit rejected this claim, reasoning that the claimant failed to show that that sum prevented him from having a full opportunity to vindicate his claim. *Id.* at 763. (In *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294 (5th Cir. 2004), the Fifth Circuit confronted, but (as will be discussed below) did not discuss in detail the underlying merits of another case presenting this issue.) Recently, the Circuit rejected the claim that an arbitration agreement was unconscionable on costs grounds where the arbitration would have cost almost $30,000 and where the plaintiff was destitute at the time of the lawsuit. The Court explained that there was no evidence of the plaintiffs financial condition at the time the arbitration agreement was made, which was the relevant time under the applicable Georgia state law. *Overstreet v. Contigroup Cos., Inc.*, 462 F.3d 409 (5th Cir. 2006).

In 2001, the Texas Supreme Court adopted the *Green Tree* analysis and recognized "that *some* specific information of future costs is required." *In re FirstMerit Bank*, 52 S.W.3d 749, 756 (Tex. 2001). In the *FirstMerit Bank* case, the Texas Supreme Court reached a conclusion analogous to the one reached in *Green Tree*. The Court explained that the plaintiffs "provided no evidence that the AAA would actually charge" the filing and hearing fees plaintiffs identified and further noted that "the most recent AAA commercial arbitration rules provide that 'the AAA may, in the event of extreme hardship on the part of any party, defer or reduce the administrative fees.'" *FirstMerit Bank*, 52 S.W.3d at 757. The Court concluded that "without any specific information on what the costs will be," the plaintiffs' evidence was "not evidence of unconscionability." *Id*.

Since *FirstMerit Bank*, the Texas Supreme Court has decided a few cases presenting an argument for the invalidation of an arbitration agreement on cost grounds, but has not granted relief to a challenger. In *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002) the court held that an arbitration agreement covering employment disputes was not unconscionable where the

employer agreed to pay expenses of arbitration other than a $50 filing fee and provided up to $2,500 to for employee to consult with an attorney. In *In re Poly-America L.P.*, 262 S.W.3d 337 (Tex. 2008), the Court discounted evidence that a fee-splitting provision in an arbitration agreement would have precluded the assertion of the claim because, among other things, the arbitrator could adjust the cost provision).

Most recently, the Supreme Court clarified that a party seeking to avoid arbitration on cost grounds must show that arbitration is not an adequate and accessible substitute to litigation, and if the total cost of arbitration is comparable to the total cost of litigation, then the arbitral forum is equally accessible. *In re Olshan Found. Repair Co.,* 328 S.W.3d 883, 894 (Tex. 2010). A plaintiff must prove the likely cost of arbitration, and plaintiff may have to show that requests for fee waivers have been denied. *Id.*; *see also TMI, Inc. v. Brooks*, 225 S.W.3d 783 (Tex. App. – Houston [14th Dist.] 2007) (orig. proceeding) (holding that evidence of AAA costs did not show substantive unconscionability where matter could have been arbitrated without AAA involvement); *Aspen Tech. v. Shasha*, 253 S.W.3d 857 (Tex. App. – Houston [14th Dist.] 2008, orig. proceeding) (same, while discounting more specific evidence of costs).

– Remedy for Unreasonable Costs – Reformation and Enforcement – If a party to an arbitration agreement shows that the cost of arbitration is too high to allow her to effectively vindicate her rights, a court must still decide whether to invalidate the entire agreement or to reform and enforce the agreement. This decision could turn on whether a severability clause appears in the arbitration agreement. Even in the absence of such a clause, courts have begun to excise offensive parts of arbitration agreements and then compel arbitration. *See Spinetti v. Service Corp. Int'l*, 324 F.3d 212 (3d Cir. 2003) (affirming order enforcing arbitration agreement after striking clauses (1) requiring parties to pay their own attorney's fees, regardless of the outcome of the arbitration, and (2) requiring the parties to split the arbitrator's fees from employment dispute arbitration agreement); *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294 (5th Cir. 2004) (similar); *see also Hadnot v. Bay Ltd.*, 344 F.3d 474 (5th Cir. 2003) (affirming district court's decision to sever punitive damages prohibition and enforce arbitration agreement over employee's argument that entire arbitration agreement was unenforceable).

Not all cases, however, follow this path. *See Iberia Credit Bureau, Inc. v. Cingular Wireless, LLC*, 379 F.3d 159, 171 (5th Cir. 2004) (noting that arbitration agreement that was unconscionable because it was one sided could not be reformed).

– Possible Exception – Offering to Pay an Opponent's Arbitration Costs – Faced with a substantial showing that the cost of arbitrating a dispute would be prohibitive, some parties that seek to enforce arbitration agreements have successfully avoided invalidation by offering to cover any arbitration filing and administrative fees, and arbitrator's fees associated with an arbitration of the opponent's claims. In *Large v. Conseco Fin. Serv., Inc.*, 292 F.3d 49, 51 & 56-57 (1st Cir. 2002), a defendant offered to pay arbitration costs after filing a motion to compel arbitration but before the district court's ruling. The court of appeals then held that defendant's "offer to pay the costs of arbitration and to hold the arbitration in the Larges' home state of Rhode Island mooted the issue of arbitration costs." Following *Large*, the Fifth Circuit and other circuits have reached the same result in similar circumstances. *See Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294 (5th Cir. 2004); *Livingston v. Associates Fin., Inc.*, 339 F.3d 553, 557 (7th Cir. 2003).

Insufficient Remedies – Insufficient remedies can also lead courts to refuse to enforce arbitration agreements.

In *Paladino v. Avnet Computer Tech., Inc*., 134 F.3d 1054 (11th Cir. 1998), the Eleventh Circuit affirmed a district court's order refusing to compel arbitration of plaintiff's Title VII claim. The arbitration agreement stated that "the arbitrator is authorized to award damages for breach of contract only, and shall have no authority whatsoever to make an award of other damages." The agreement was unenforceable because it did not allow the arbitrator to award damages available under Title VII.

Likewise in *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003), the Ninth Circuit found substantively unconscionable an employment dispute arbitration agreement that provided for the remedies offered by Title VII, but limited back pay to one year, front pay to two years, and punitive damages to the greater of $5,000 or the sum or a claimant's front pay and back pay. *Id.* at 1178-79.

The Texas Supreme Court found that a prohibition of an award of punitive damages where such damages were available under the statutory claim asserted was unconscionable, but then severed that clause and enforced the arbitration agreement. *In re Poly-America L.P.*, 262 S.W.3d 337 (Tex. 2008). The Fifth Circuit has also impliedly held that a prohibition on the award of punitive damages in an employer-employee arbitration agreement was unconscionable. *Hadnot v. Bay Ltd.*, 344 F.3d 474 (5th Cir. 2003) (affirming district court's decision to sever punitive damages prohibition and enforce arbitration agreement over employee's argument that entire arbitration agreement was unenforceable); *but see Investment Partners L.P. v. Glamour Shots Licensing, Inc*., 298 F.3d 314, 318 n.1 (5th Cir. 2002) (dicta in footnote stating that provisions in arbitration agreements that prohibit punitive damages are generally enforceable).

Limited Statute of Limitations – Contractual statutes of limitations that limit what claims can be brought in arbitration more than would be limited in court have been found to be unconscionable.

For example, in *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003), the Ninth Circuit found that a one year contractual statute of limitations in an agreement to arbitrate employment disputes that deprived claimants of the benefits of the continuing violation doctrine was unconscionable. *Id.* at 1175; *see also Alexander v. Anthony Int'l. L.P.*, 341 F.3d 256 (3d Cir. 2003) (same for 30 day statute of limitations); *but see In re Poly-America L.P.*, 262 S.W.3d 337 (Tex. 2008) (shortening limitations period for wrongful discharge claim from two years to one year not evidence of unconscionability where claimant filed claim within one year).

Precluding Class Actions – A fertile source of controversy in recent years has been whether arbitration agreements that prohibit individuals from bringing or participating in class actions are unconscionable. There are, however, distinct issues that should be separated. These include (1) whether, as a matter of state law, a class action prohibition is unconscionable and (2) whether a state law rule that finds class action prohibitions to be unconscionable is consistent with the FAA. Both issues are discussed below. A separate set of issues – whether an arbitration agreement permits class arbitration and who decides whether class arbitration is permitted (a court or an arbitrator) – is also discussed below.

– Cases Finding that Preclusion of Class Claims is Acceptable – Courts that enforce arbitration agreements that prohibit class actions typically reject arguments that class action prohibitions in arbitration agreements are per se unconscionable and explain that, if a party's basic *substantive* rights remain available in arbitration, the unavailability of a *procedural* device such as a class action is not grounds on which to conclude that an arbitration agreement is unenforceable.

A leading early decision on the issue is *Johnson v. West Suburban Bank,* 225 F.3d 366 (3d Cir. 2000). In that case, the plaintiff brought class claims under the Truth in Lending Act ("TILA") and Electronic Fund Transfer Act ("EFTA") against a bank from which he obtained a short-term loan. When the bank moved to compel arbitration of his claims, Johnson argued that his right to bring a class action trumped his agreement to arbitrate his claims. The Third Circuit rejected this argument, holding that "neither [the TILA nor EFTA] grants potential plaintiffs any substantive right that cannot be vindicated in an arbitral forum. While it may be true that the benefits of proceeding as a class are unavailable in arbitration . . . the right [to proceed as a class] is merely a procedural one . . . that may be waived by agreeing to an arbitration clause." *Id*. at 369. The court concluded that "[w]hatever the benefits of class actions, the FAA '*requires* piecemeal resolution when necessary to give effect to an arbitration agreement.'" *Id*. at 375 (emphasis in original; quotation omitted)

This reasoning has been followed by federal courts that have interpreted Texas law. *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 301 (5th Cir. 2004); *Marsh v. First USA Bank, N.A*., 103 F. Supp. 2d 909, 923 (N.D. Tex. 2000) (enforcing arbitration clause in purported class action and rejecting argument that plaintiffs were "entitled as a matter of right to proceed as a class").[1] A claimant thus may not avoid arbitration simply by asserting class claims in court.

Texas courts of appeals have joined this line of reasoning. In *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190 (Tex. App. – Houston [14th Dist.] 2003, no pet.), the court rejected the contention "that enforcement of the arbitration provision is substantively unconscionable because prohibiting class treatment of small-damage consumer claims is fundamentally unfair." The court explained:

> If we enforce the arbitration clause, Leroy argues that consumers like her will be discouraged from seeking legal redress on an individual basis, while businesses like AutoNation will be encouraged to engage in illegal conduct because they will not have to be concerned about potential class actions. This assumes that the right to proceed on a class-wide basis supersedes a contracting party's right to arbitrate under the FAA. However, the primary purpose of the FAA is to overcome courts' refusals to enforce agreements to arbitrate and to ensure that private agreements to arbitrate are enforced according to their terms. The Texas Supreme Court has . . . stressed that "[p]rocedural devices," such as Rule 42's provision for class actions, "may 'not be construed to enlarge or diminish any substantive rights or

[1] The *Marsh* court observed that the federal Rules Enabling Act – which provides that the rules of procedure "shall not abridge, enlarge or modify any substantive right" – counseled against any finding that the class action procedure could be deemed to be a substantive right that could not be waived. The Texas Government Code similarly provides that the Texas Supreme Court's rules of civil procedure may not "abridge, enlarge or modify the substantive rights of a litigant." Tex. Gov't Code § 22.004(a).

> obligations of any parties to any civil action.'" Accordingly, there is no entitlement to proceed as a class action.

Id. (citations omitted).

– Cases Finding that Preclusion of Class Claims is Unacceptable – Courts from some other states, mostly (but not exclusively in California) have taken a diametrically opposing view of attempts to preclude class actions. Most of these cases have arisen in the context of consumer disputes. Some courts, however, have addressed the issues in employment disputes.

Ingle v. Circuit City Stores, Inc., 328 F.3d 1165 (9th Cir. 2003), found that, under California law, a class action prohibition in an employment dispute arbitration agreement was substantively unconscionable. *Id.* at 1175-76. The court relied on a California decision that described a similar bar to be effectively one-sided (because the company in that case effectively would never have occasion to bring a class action) and an impermissible attempt "to create for itself virtual immunity from class or representative actions despite their potential merit, while suffering no similar detriment to its own rights." *Id.*; *see also Ting v. AT&T*, 319 F.3d 1126, 1150 (9th Cir. 2003) (same in consumer case).

Synthesizing this line of cases, the California Supreme Court held that class action waivers are effectively per se unconscionable where they arise in adhesion contracts, the amount of damages for any claimant is small, and there is an allegation that the class action prohibition is part of a scheme to defraud. *Discover Bank v. Superior Court of Los Angeles*, 113 P.3d 1100 (Cal. 2005). Other courts had reached similar results. For example, the Third Circuit held that New Jersey state law renders class action waivers unconscionable where they involve claims of "low monetary value." *Homa v. Am. Express Co.*, 558 F.3d 225, 232-33 (3rd Cir. 2009).

The United States Supreme Court, however, recently held that California's *Discover Bank* rule was impermissible under the FAA. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). Invoking the principle that state law rules may not either expressly disfavor arbitration agreements or "stand as an obstacle to the accomplishment and execution of the full purposes and objectives" of the Act, the Court held the *Discover Bank* rule violated that principle because the FAA allowed the parties to agree limit the subjects of arbitration, select the rules of arbitration, and (most importantly for the case at hand) limit with whom they would arbitrate.

The *AT&T Mobility* case does not necessarily close the door to an unconscionability objection to a class action prohibition in an arbitration agreement.

As one court has recently explained that *AT&T Mobility* did not "require that all class-action waivers be deemed per se enforceable." *In re American Express Merchants' Litigation*, No. 06-1871, ___ F.3d ___ (2d Cir. 2012). In the *Amex* case, the Second Circuit noted the requirement that litigants be able to effectively vindicate their claims in an arbitral forum, *see Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) ("So long as the prospective litigant *effectively may vindicate its statutory cause of action in the arbitral forum*, the [federal substantive] statute will continue to serve both its remedial and deterrent function") (emphasis added), and then held that a class action prohibition may be held to be unconscionable if the plaintiff shows that it would be unable to vindicate its statutory rights in a

bilateral arbitration. In *Amex*, the plaintiff brought an antitrust claim and showed, through expert testimony, that asserting its claim on an individual basis would be cost-prohibitive. The court agreed that unless the plaintiff could join others, it would effectively be precluded from vindicating its rights, thus rendering the class action prohibition unconscionable. (Moreover, because the court could not order class arbitration (because there was no agreement for class arbitration), it is likely that class adjudication will be the result.)

The First Circuit employed the same reasoning and reached the same result in *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006). That court held that Comcast could not enforce the class action waiver provision of arbitration agreements that it had with its Boston area subscribers where certain subscribers brought antitrust claims against The plaintiffs' evidence showed that putative class members stood to recover between a few hundred and a few thousand dollars (even after trebling) and that, by contrast, expert fees could reach into the hundreds of thousands of dollars, while attorney's fees could run into the millions of dollars. Based on this evidence, the court concluded that such large costs could preclude the effective vindication of the plaintiff's federal statutory claims. *Id.* at 60-61.

The *Kristian* court distinguished cases such as *Johnson v. West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000), which had held class action waivers to be acceptable in Truth in Lending Act ("TILA") cases where attorney's fees were available to prevailing plaintiffs. The *Kristian* court first stated that the undisputed evidence presented by the plaintiffs showed (1) that the antitrust claims at issue were much more factually complex than the factual questions posed by TILA cases, where the issue is simply whether the terms of the loan at issue violated the law and (2) that the factual complexity of the *Kristian* claims made those claims expensive to prosecute because of the expert and attorney's fees. Those factors led the court to agree with the plaintiffs that, without a class mechanism, the plaintiffs would be effectively precluded from asserting their claims. The potential availability of attorney's fees in antitrust cases did not solve the problem, because the high opportunity cost in attorney time and uncertainty of outcome in many antitrust cases rendered it unlikely that a rational attorney would expend the resources necessary to recover on only a few individual cases. *Id.* at 70-71. Finally, the court rejected the contention that the possibility of government enforcement could compensate for the absence of private enforcement because that contention was contrary to Congress' intent – which was to have both private and government enforcement. *Id.* at 71.[2]

Also note that the NLRB has recently held that that class action waivers violate Section 7 of the National Labor Relations Act ("NLRA") because they inhibit an employee's right to engage in "concerted activities for the purpose of collective bargaining or other mutual aid or protection..." *D.R. Horton Inc*., 357 N.L.R.B. 184 (2012). D.R. Horton had a practice of requiring its employees to sign an arbitration agreement and class action waiver. The NLRB stated that the NLRA and the Norris-LaGuardia Act of 1932 protect employees' ability to participate in class actions as a form of "concerted activity" and that just as the substantive right to engage in concerted activity allows unionized and non-unionized employees to join together in

[2] This analysis parallels the Supreme Court's decision in *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79 (2000), where the Court noted that "[i]t may well be that the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating [her] rights in the arbitral forum," *id.* at 90, and held that a party could "invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive" by "showing the likelihood of incurring such costs." *Id*. at 92.

strikes or mutual aid, it also allows them to bring court or arbitration claims as class actions. The NLRB noted that *Concepcion* involved conflict between FAA and state law – which was governed by the Supremacy Clause – while whereas in this particular employment context, two federal statutes conflict and thus, the ultimate decision could differ. The ultimate impact of the NLRB's decision on class action litigation remains unclear. *See also Chen-Oster v. Goldman, Sachs & Co*., 785 F.Supp.2d 394, 406 (S.D.N.Y. 2011) (noting that because a pattern or practice claim under Title VII can only be brought in the context of a class action, employee's claim cannot be committed to arbitration lest employee be deprived of her substantive rights).

Note – A separate but fertile set of issues is whether an arbitration agreement permits class arbitration and who decides whether class arbitration is permitted (a court or an arbitrator). In *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010), the Supreme Court held that arbitrators exceed their powers if they impose class arbitration on parties who did not agree to class arbitration. In that case, the arbitration agreement was stipulated to be silent (i.e., there was no agreement) as to whether class arbitration was permitted. The Court held that, in that case, the defendant did not agree to arbitrate with a class of plaintiffs. The Court also wrote that an implicit agreement to authorize class arbitration is not a term that an arbitrator may infer *solely* from the fact that the parties agreed to arbitrate, because class arbitration changes the nature of arbitration to such a degree that it cannot be presumed that the parties agreed to it. Because, according to the Court, the arbitrators based their decision on public policy considerations, and not applicable rules of law, the Court held that the arbitrators had exceeded their powers and that their decision had to be vacated.

Some courts have read *Stolt-Nielsen* rather narrowly. For example, in *Jock v. Sterling Jewelers Inc.*, 646 F.3d 113 (2d Cir. 2011), the Second Circuit confronted a situation in which an arbitrator had read an arbitration agreement that did not address the availability of class arbitration to allow class arbitration. (The arbitrator said she refused to imply a term that would prohibit class arbitration, which in fairness to the arbitrator was consistent with law existing at the time.) The district court held that the arbitrator's reasoning conflicted with *Stolt-Neilsen* and vacated the arbitration decision that allowed class arbitration. Stating that the *Stolt-Nielsen* decision did not foreclose the possibility that parties may reach an implicit agreement to authorize class arbitration, the Second Circuit held that the district court improperly decided whether arbitrator's decision was correct, instead of whether the arbitrator exceeded her authority. Because the arbitrator did not exceed her authority in deciding whether class arbitration was available, the Second Circuit held that the arbitrator's decision had to stand since she applied state law and the terms of the agreement to reach her conclusion. The Fifth Circuit recently heard argument in a similar case. *See Reed v. Florida Metro. Univ.*, No. 11-50509 (5th Cir.).

The *Stolt-Neilsen* court also explained that what was commonly believed to be the holding of *Green Tree Fin. Co. v. Bazzle*, 539 U.S. 444, 123 S. Ct. 2402 (2003) – i.e., that arbitrators generally decide in the first instance whether class arbitration is permitted – was not a holding from the case. A four-justice plurality reached that conclusion, but Justice Stevens (who provided the fifth vote for the result in the case) did not address that issue.

Complicating matters, though, the Texas Supreme Court adopted the reasoning of the *Bazzle* plurality in *In re Wood*, 140 S.W.3d 367, 368 (Tex. 2004), so Texas courts should follow that holding. Note, however, that one Texas court of appeals has held that where an arbitration

agreement expressly noted that a court is to rule on disputes about the validity, effect or enforceability of a class action prohibition, courts and not arbitrators are to rule. *NCP Finance Ltd. Partnership v. Escatiola*, 350 S.W. 3d 152 (Tex. App. – San Antonio 2011, n.p.h.).

Similarly, the Fifth Circuit has adopted the *Green Tree* plurality reasoning as circuit precedent. *Pedcor Mgmt. Co., Inc. v. Nations Personnel of Texas, Inc.*, 343 F.3d 355 (5th Cir. 2003) (vacating order that certified class of plaintiffs and referred dispute to arbitration so that arbitrator could decide in the first instance whether arbitration was permitted or forbidden).

Filing Fee – Employment dispute arbitration agreements that require a filing fee to be paid to the employer and that do not account for possible indigence have been held to be unconscionable. *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1177 (9th Cir. 2003).

Secrecy of Outcome – In *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), the Ninth Circuit also held that a secrecy provision in an AT&T customer service agreement that contained an arbitration clause was substantively unconscionable. The court reasoned that only AT&T would gain access to precedent and that the unavailability of arbitral decisions could prevent potential plaintiffs from obtaining the information needed to build a case of intentional misconduct. *Id.* at 1151-52. The Fifth Circuit, however, rejected this reasoning in a case under Louisiana law. *Iberia Credit Bureau v. Cingular Wireless, LLC*, 379 F.3d 159, 175-76 (5th Cir. 2004).

Limited Discovery – In *In re Poly-America L.P.*, 262 S.W.3d 337 (Tex. 2008), the Texas Supreme Court held that limiting discovery to one deposition per side, 25 interrogatories, and 25 requests for production did not, in the context of that case, render the arbitration agreement at issue substantively unconscionable. *But see Walker v. Ryan's Family Steak Houses, Inc.*, 400 F. 3d 370 (6th Cir. 2005) (limiting discovery to at most one deposition created impermissible unfairness to the plaintiffs).

Waiver of Jury – Courts have by and large rejected arguments that a person's agreement to arbitrate impermissibly waives a right to a jury trial.

In one case, the Fourth Circuit succinctly explained that the "loss of the right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate." *Sydnor v. Conseco Fin. Servs. Corp.*, 252 F.3d 302, 307 (4th Cir. 2001). Closer to home, in *American Heritage Life Ins. Co. v. Orr*, 294 F.3d 702, 710-11 (5th Cir. 2002), the Fifth Circuit described an argument that enforcement of an arbitration agreement would deprive the plaintiffs of their constitutional right to a jury trial as "without foundation," observing that "by agreeing to arbitration [plaintiffs] have necessarily waived the following: (1) their right to a judicial forum, and (2) their corresponding right to a jury trial." *Id*. Texas state courts have reached the same conclusion. *Henry v. Gonzalez*, 18 S.W.3d 684, 691 (Tex. App. – San Antonio 2000, pet. dism'd by agr.) (same); *but see Kloss v. Edward D. Jones & Co.*, 54 P.3d 1, 11 (Mont. 2002) (concurring opinion signed by majority of justices stating that mandatory arbitration interferes with the right to trial by jury and any waiver of that right must be knowing, intelligent, and voluntary).

Note also the distinct but related issue of whether contractual jury waivers are enforceable. The Supreme Court of Texas has held that they are. *In re Prudential Ins. Co.*, 148 S.W.3d 124 (Tex. 2004) (enforcing contractual jury waiver); *see also In re Frank Kent Motor Co.*, No. 10-0687, ___ S.W.3d ___ (Tex. 2012) (jury waiver not procured by coercion because at

will employee was threatened with termination if he did not agree to jury waiver); *but see Grafton Partners L.P. v. Superior Court of Alameda Co.*, 116 P.3d 479 (Cal. 2005) (finding pre-dispute contractual jury waiver unenforceable under California statute regulating methods for waiving jury trials); *BankSouth, N.A. v. Howard*, 444 S.E.2d 799 (Ga. 1994) (also invalidating a contractual jury waiver).

One Sided Obligation to Arbitrate – In cases where a binding agreement has been formed, but the terms of that agreement only require one side to arbitrate – such as an employee alone in an agreement with her employer to arbitrate employment disputes – the absence of an obligation of the other party to arbitrate has been found to render the arbitration agreement substantively unconscionable.

Thus in *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003), the Ninth Circuit found that Circuit City's arbitration agreement was substantively unconscionable because it lacked "the 'modicum of bilaterality'" that California requires to be enforceable. *Id.* at 1173. The Fifth Circuit confronted a similar situation under Louisiana law in *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 169 n.10 (5th Cir. 2004). However, in *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 678 (Tex. 2006), the Supreme Court of Texas held that the right of a third party beneficiary of an arbitration agreement to opt out of arbitration did not render the agreement unconscionable.

Timing of Implementation of Agreement – The United States District Court for the Southern District of Texas confronted a case in which an employer implemented an arbitration policy which provided that continued employment demonstrated agreement to the policy. However, the arbitration requirement was implemented after an employee had filed a change of discrimination with the EEOC (which alleged discriminatory failure to promote and harassment), but before he filed suit. Judge Kent held that enforcing the arbitration agreement in those circumstances would be unconscionable. The employee had limited alternatives to accepting the arbitration requirement, and the Judge found that allowing the employer to bind the employee to the arbitration requirement "after he had essentially initiated his lawsuit . . . was fundamentally and manifestly unfair and contrary to public policy." *Wilcox v. Valero Refining Co.*, 256 F. Supp. 2d 687 (S.D. Tex. 2003). More recently, a Texas court of appeals construed an arbitration policy promulgated after an employee's claim accrued that did not specifically include pre-existing claims not to reach such claims. The court also noted that, even if the agreement reached such claims, the agreement could be unconscionable. *In re Brookshire Bros., Ltd.*, 198 S.W.3d 381 (Tex. App. – Texarkana 2006, orig. proceeding).

Small Print – Small print alone will not render an arbitration agreement unenforceable since the FAA prohibits states from requiring such agreements to be set out with special prominence. *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 172 (5th Cir. 2004).

B. Issues Surrounding Whether a Dispute Falls Within the Scope of an Arbitration Agreement.

Once a court concludes that a valid agreement to arbitrate exists, the court must then conclude that the dispute at issue falls within the scope of the agreement to arbitrate. Although

this inquiry turns on the dispute at issue and the language of each arbitration agreement, certain generalizations can be made.

1. The Presumption in Favor of Finding Disputes to be Covered.

Texas and federal courts have repeatedly recognized that the FAA evinces "an 'emphatic federal policy in favor of arbitral dispute resolution.'" *In re American Homestar of Lancaster, Inc.*, 50 S.W.3d 480, 484 (Tex. 2001) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 473 U.S. 614, 631 (1985)); *Safer v. Nelson Financial Group Inc.*, 422 F.3d 289 (5th Cir. 2005). This "emphatic federal policy" creates a strong presumption that motions to compel arbitration should be granted. As the Texas Supreme Court has held, "[t]he policy in favor of enforcing arbitration agreements is so compelling that a court should not deny arbitration *unless it can be said with positive assurance* that an arbitration clause is *not* susceptible of an interpretation which could cover the dispute at issue." *Prudential Securities, Inc. v. Marshall*, 909 S.W.2d 896, 899 (Tex. 1999) (emphasis in original) (citation omitted); *In re Rubiola*, 334 S.W.3d 220, 225 (Tex. 2011) (quoting same); *In re First Texas Homes, Inc.*, 120 S.W.3d 868 (Tex. 2003) (agreement to arbitrate "all disputes" covered all claims, even those arising after execution of arbitration agreement); *see also Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) ("any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or like defense to arbitrability"); *Fleetwood Enters. Inc. v. Gaskamp*, 280 F.3d 1069, 1073 (5th Cir. 2002) ("ambiguities [are] resolved in favor of arbitration").

2. Arbitration Will be Ordered Even if Piecemeal Litigation Results.

The parties must arbitrate any claims that fall within the scope of the arbitration agreement, even when other claims in a suit are nonarbitral and piecemeal litigation would result. *KPMG LLP v. Cocchi,* No. 10-1521, 565 U.S. __ (2011); *Helena Chem. v. Wilkins*, 18 S.W.3d 744, 750 (Tex. App. – San Antonio 2000), *aff'd*, 47 S.W.3d 486 (Tex. 2001); *see also Wee Tots Pediatrics, P.A. v. Morohunfola*, 268 S.W.3d 784 (Tex. App. – Fort Worth 2008, no pet.) (same).

3. An Opponent of Arbitration Has the Burden to Show No Coverage.

Texas courts have explained that parties seeking to avoid arbitration have the burden "to show that [their] claims [fall] outside of the scope of the arbitration agreement." *Prudential Securities, Inc. v. Marshall*, 909 S.W.2d 896, 900 (Tex. 1999); *Cantella & Co., Inc. v. Goodwin*, 924 S.W.2d 943, 944 (Tex. 1996) (same).

4. Focus of Inquiry is on Allegations of the Complaint and the Language of the Arbitration Clause.

To determine whether a claim is covered by an arbitration agreement, courts are to "focus on the factual allegations of the complaint." *Prudential Securities, Inc. v. Marshall*, 909 S.W.2d 896, 900 (Tex. 1999) (holding that defamation claims premised on allegations that defendants said plaintiffs were dishonest and thieves fell within scope of arbitration agreement covering claims arising out of plaintiffs' employment or termination of employment); *In re Rubiola*, 334 S.W.3d 220, 225 (Tex. 2011) (same); *In re Dillard Dep't Stores, Inc.*, 186 S.W.3d 514, 516

(Tex. 2006) (defamation claims covered by agreement requiring arbitration of claims for "personal injuries arising from termination").

5. The Effect of "Broad" Arbitration Clauses.

When the arbitration clause at issue requires arbitration of disputes using phrases such as "any claims," "arising out of," "relating to," and "in connection with," courts characterize such clauses "as broad arbitration clauses capable of expansive reach." *Pennzoil Explor. & Prod. Co. v. Ramco Energy Ltd.*, 139 F.3d 1061, 1067 (5th Cir. 1998) (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 397-98 (1967)).

Such "broad" arbitration clauses "are not limited to claims that literally 'arise under the contract,' but rather embrace *all disputes between the parties having a significant relationship* to the contract regardless of the label attached to the dispute." *Id*. at 1067 (emphasis added). The Fifth Circuit has explained that when parties agree to an arbitration clause covering "[a]ny dispute . . . arising out of or in connection with or relating to this Agreement," they "intend the clause to reach *all aspects of the relationship*." *Nauru Phosphate Royalties, Inc. v. Drago Daic Interests, Inc.*, 138 F.3d 160, 164-65 (5th Cir. 1998) (emphasis added). Courts have similarly noted that when examining arbitrability under a "broad" arbitration clause, claims that "touch matters" enumerated by the clause are arbitrable. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625-26 n.13 (1985); *McReynolds v. Elston*, 222 S.W.3d 731 (Tex. App. – Houston [14th Dist.] 2007, no pet.); *Kirby Highland Lakes Surgery Center, L.L.P. v. Kirby*, 183 S.W.3d 891 (Tex. App. – Austin 2006, no pet.) (extensively discussing same); *see In re Swift Transp. Co., Inc.,* 279 S.W.3d 403, 408 (Tex. App. – Dallas 2009, orig. proceeding) (holding that agreement to arbitrate disputes "arising out of or relating to the relationship created by the Agreement" includes within its scope plaintiff's tort claims).

Thus, in *Pennzoil Exploration*, the Fifth Circuit rejected a claim that an arbitration clause in a joint operating agreement ("JOA") did not reach a dispute arising under a subsequent letter agreement between the parties. The court held that the claim based on the letter agreement was subject to the JOA's arbitration clause because it "related to" the JOA. *Pennzoil Exploration*, 139 F.3d at 1067. "Bearing in mind the strong federal policy in favor of arbitration," the court held that the claim "related to" the JOA because the dispute "flow[ed] from a series of interrelated agreements all of which centered around the [same] overriding goal." *Id.* at 1068. Although the court noted that "the dispute may not 'arise under' the JOA," the "interrelatedness and interdependency" of the JOA and the letter agreement made the claim "'relate to' the JOA and therefore fall[] within the JOA's broad arbitration provision." *Id*. at 1069.

However, the reach of a broad arbitration clause is not limitless. In *Loy v. Harter*, 128 S.W.3d 397 (Tex. App. – Texarkana 2004, pet. denied), a Texas court of appeals found that a party's claim against an individual for breach of his fiduciary duty as a director of a corporation did not fall within the scope of a broad arbitration clause contained in the individual's contract of employment with the corporation. *Id.* at 402-405; *see also In re Great Western Drilling Ltd.*, 211 S.W.3d 828 (Tex. App. – Eastland 2006). Similarly, the Fifth Circuit has found that broad "arising out of or relating to" language can be limited by other language in the arbitration agreement. *Tittle v. Enron Corp.*, 463 F.3d 410 (5th Cir. 2006).

6. Claims that Are Intertwined With Causes of Action That Are Subject to Arbitration Are Themselves Arbitrable.

Claims asserted in a lawsuit are also subject to arbitration if they are "factually intertwined" with, "touch on," have a "significant relationship with," or are "inextricably enmeshed" with claims that are subject to arbitration.

In *Jack B. Anglin Co. Inc. v. Tipps*, 842 S.W.2d 266, 270-71 (Tex. 1992), the Texas Supreme Court held that DTPA claims arising out of alleged misrepresentations regarding the quality of defendants' services and material used in its work were subject to arbitration because the basis for those claims was "factually intertwined" with plaintiff's breach of contract claim, which was subject to arbitration.

Similarly, *Gerwell v. Moran*, 10 S.W.3d 28 (Tex. App. – San Antonio 1999, no writ) held that "[a]s long as the asserted claims '*touch upon matters covered by the [arbitration] agreement*, the claims are subject to arbitration.'" *Id*. at 31 (emphasis in original). The court found that the plaintiff's claims for breach of contract, breach of fiduciary duty, fraud, and unjust enrichment based on contract in which he agreed to assign his interest in partnership to other partners were subject to arbitration because the underlying partnership agreement contained arbitration clause; the court noted that "but for [the partnership agreement, plaintiff] would not have had a partnership interest to assign." *Id*.

More recently, in *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190 (Tex. App. – Houston [14th Dist.] 2003, no pet.), the court summarized that Texas law provides that "if the facts alleged 'touch matters,' have a 'significant relationship' to, are 'inextricably enmeshed' with, or are 'factually intertwined' with the contract that is subject to the arbitration agreement, the claim will be arbitrable. However, if the facts alleged are completely independent of the contract and the claim could be maintained without reference to the contract, the claim is not subject to arbitration." *Id*. at 195; *see also In re Sun Communications, Inc.,* 86 S.W.3d 313, 319 (Tex. App. – Austin 2002, orig. proceeding) (plaintiff's breach of fiduciary duty claims that were based "on alleged deficiencies in the reports [plaintiff] was supposed to have received under the contract" that contained arbitration clause were "inextricably intertwined with the contract" and were thus subject to arbitration) (emphasis in original).

Courts have also compelled arbitration of disputes arising out of contracts that do not contain arbitration clauses but were part of a transaction that involved other contracts that did contain arbitration clauses. *See Leroy*, 105 S.W.3d 190 n.2 (finding a claim arising out of an agreement that did not itself contain an arbitration clause by noting "the well-settled principle of Texas contract law that '[when] several instruments, executed contemporaneously or at different times, pertain to the same transaction, they will be read together although they do not expressly refer to each other.'") (quoting *Fort Worth Indep. School Dist. v. Fort Worth*, 22 S.W.3d 831, 840 (Tex. 2000)); *see also Safer v. Nelson Financial Group Inc.*, 422 F.3d 289 (5th Cir. 2005) (noting same).

7. Arbitration Cannot Be Avoided by Recasting Claims.

Parties to an arbitration agreement cannot avoid arbitration simply by casting their claims in tort rather than contract. *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524, 526 (5th

Cir. 2000); *Brown v. Anderson*, 102 S.W.3d 245 (Tex. App. – Beaumont 2003, pet. denied) (same).

8. Enforcement of Arbitration Clauses in Cases Involving Non-Parties.

Although arbitration is generally a matter of contract between the particular signatories to an agreement, there are situations in which courts will compel arbitration where the dispute is not solely between the parties that entered into a contract with an arbitration clause. *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624 (2009) (wherever relevant state law makes a contract to arbitrate enforceable by a nonsignatory, that person is entitled to seek to compel arbitration). Whether one of these situations exists is in the first instance a question for a court, not an arbitrator, because it goes to whether there is, in effect, an agreement to arbitrate. *Roe v. Ladyman*, 318 S.W.3d 502, 515 (Tex. App. – Dallas 2010, no pet.).

Courts have recognized a variety of theories under which a non-signatory to a contract that contains an arbitration clause can be compelled to arbitrate. These include (1) incorporation by reference, (2) assumption, (3) agency, (4) veil-piercing/alter ego, (5) estoppel, and (6) third-party beneficiary. *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005); *Bridas S.A.P.I.C. v. Government of Turkmenistan*, 345 F.3d 347, 355-56 (5th Cir. 2003); *see also In re Labatt Food Service, L.P.*, 279 S.W.3d 640, 642-43 (Tex. 2009) (derivative nature of wrongful death beneficiaries' claims generally binds their claims to be arbitrated where decedent entered into contractual agreement to arbitrate); *In re Golden Peanut Company,* 298 S.W.3d 629 (Tex. 2009) (same); *In re Rubiola*, 334 S.W3d 220 (Tex. 2011) (non-signatory who nonetheless had right under arbitration agreement to compel arbitration could do so). Estoppel theories have received the most attention in recent years.

To understand these cases it is useful to distinguish between (a) cases in which signatories to an arbitration agreement bring claims against defendant non-signatories and (b) cases in which non-signatories bring claims against defendant signatories.

a. Cases Involving Signatories to an Arbitration Agreement Bringing Claims Against Defendant Non-Signatories.

Among the cases in which signatories to an arbitration agreement bring claims against defendant non-signatories, one can further divide the cases into (i) those in which defendant non-signatories seek to compel arbitration of claims asserted against them and (ii) those in which the signatories seek to compel arbitration of claims that they assert against defendant non-signatories.

Motions to Compel Brought by Defendant Non-Signatories. In the first situation – cases in which defendant non-signatories seek to compel arbitration of the claims asserted against them – principles of equitable estoppel have been used to force the signatory to arbitrate the claims they assert. Traditionally, equitable estoppel doctrine has allowed non-signatories to compel arbitration in two circumstances:

First, the doctrine has been applied when a signatory to an arbitration agreement raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and a signatory. However, in *In re Merrill Lynch Trust Co. FSB*, 235 S.W.3d 185 (Tex. 2007),

the Texas Supreme Court refused to compel a signatory to arbitration when non-signatories claimed substantially interdependent and concerted misconduct required arbitration. The Texas Supreme Court recognized that the theory of concerted-misconduct estoppel is "far from well-settled in the federal courts." *Id.* at 10. Further, the Texas Supreme Court reasoned that nothing in contract law allows concerted misconduct to bind a non-party to a contract. *Id.* at 13. "As other contracts do not become binding on nonparties due to concerted misconduct, allowing arbitration contracts to become binding on that basis would make them easier to enforce than other contracts, contrary to the Arbitration Act's purpose." *Id.* Due to a lack of governing contract law and the conflict in federal arbitration law, the Texas Supreme Court elected against requiring the signatory plaintiffs to arbitrate their claims against the non-signatory defendants. *Id; see also In re Merrill Lynch Trust Co. FSB*, No. 235 S.W. 3d 217 (Tex. 2007) (holding same).

Second, the doctrine has been applied when the nature of the underlying claims requires the signatory to rely on the terms of the written agreement containing the arbitration clause in asserting the signatory's claims against the non-signatory. *Grigson v. Creative Artists Agency, L.L.C.*, 210 F.3d 524, 527 (5th Cir. 2000); *Hill v. G.E. Power Sys., Inc.*, 282 F.3d 343 (5th Cir. 2002) (emphasizing that, for equitable estoppel to apply, the non-signatory must rely on the terms of the underlying contract; it is insufficient that the dispute merely relate to the underlying contract); *Meyer v. WMCO-GP, L.L.C.*, 211 S.W.3d 302 (Tex. 2007). In *Grigson*, the Fifth Circuit approved a district court's application of equitable estoppel to require a signatory to an agreement containing an arbitration clause to arbitrate its claims against non-signatories because the signatory's claims sought to hold the non-signatories liable pursuant to duties imposed by the agreement that contained the arbitration clause. The court reasoned that to refuse to require arbitration impermissibly would have allowed the signatory plaintiff to "have it both ways" – i.e., rely upon one part of a contract but avoid the arbitration clause in that same contract. *Grigson*, 210 F.3d at 528; *see also In re H&R Block Fin. Advisors, Inc.*, 235 S.W.3d 177 (Tex. 2007) (same).

This situation has led to interesting results in some employment disputes. For example, in *In re Eagle Global Logistics, LP*, 89 S.W.3d 761 (Tex. App.—Houston [1st Dist.] 2002, orig. proceeding), an employee and an employer signed an agreement that contained, among other things, an arbitration clause covering any legal dispute related to the employment arrangement. The employee quit and began working for a competitor. When the employer sued the employee (to enforce a non-competition agreement and to pursue various tort theories) and competitor (under various tort theories), the competitor moved to compel arbitration and succeeded, even though it was not a signatory to the arbitration agreement. The court explained that the competitor was entitled to compel arbitration under the doctrine of equitable estoppel because the employer's claims against the employee and competitor were intertwined with and dependent upon the employer's employment agreement with the employee. *Id.* at 764.

Texas courts have refused to compel arbitration in the opposite situation – i.e., a situation where a plaintiff non-signatory who claims to have received the direct benefits of a contract that contains an arbitration clause and who asserts claims against a defendant-signatory. In that situation, courts have held that the defendant has done nothing that would estop it from denying that there is no arbitration agreement with the plaintiff non-signatory. *VanZanten v. Energy Transfer Partners*, 320 S.W.3d 845 (Tex. App. – Houston [1st Dist.] 2010, no pet.).

The Supreme Court of Texas has recently extended the doctrine of equitable estoppel to require a signatory to an arbitration agreement to arbitrate claims against non-signatories who become agents or affiliates of a signatory in suits for tortious interference with the contract that contains an arbitration agreement. In *In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759 (Tex. 2006), the Texas Supreme Court held that, although in general a signatory need not arbitrate a claim if liability against the non-signatory defendant arises from general obligations imposed by law (as opposed to liability arising from a contract that contains an arbitration clause), and although liability for tortious interference derives from general legal obligations, a signatory will nevertheless be compelled to arbitrate tortious interference claims against a non-signatory defendant where the non-signatory is an agent or affiliate of a signatory.

In re Vesta, is analogous to, but goes beyond, some previous Texas cases. For example, in *McMillan v. Computer Translation Sys. & Support, Inc.*, 66 S.W.3d 477, 482 (Tex. App. – Dallas 2001, no pet.), the Dallas Court of Appeals held that "[w]hen the principal is bound under the terms of a valid arbitration clause, its agents, employees, and representatives are covered by that agreement." *McMillan*, 66 S.W.3d at 481. The *McMillan* court noted other "cases in which nonsignatory defendants have received the benefit of an arbitration agreement [where] the plaintiffs sued individuals who were working on behalf of the signatory principals on matters covered by the agreements." *Id.* Where "the individuals' allegedly wrongful acts related to their behavior as agents of the signatory company, and those acts were within the scope of the claims covered by the arbitration provisions for which the principal signatory company would be liable," *id.*, the claims asserted against the individuals were subject to arbitration.

However, in *Westmoreland v. Sadoux*, 299 F.3d 462 (5th Cir. 2002), the Fifth Circuit took issue with the broad reasoning of the cases on which the *McMillan* court had relied, explaining that agents or employees of a signatory to an arbitration agreement cannot invoke the arbitration clause "unless the parties intended to bring them into the arbitral tent." *Id.* at 466. In *Westmoreland*, the Fifth Circuit thus held that where the plaintiff sued two agents of a company for defrauding him into selling his shares in the company, the agents could not invoke the arbitration agreement that existed between the plaintiff and the company because the agreement contained no suggestion that the agreement was intended to cover such acts of the agents. *Id.*

The Supreme Court of Texas has explained that where a non-signatory seeks to compel a plaintiff-signatory to arbitrate its claims, but the claims derive from general obligations of law and not the contract containing an arbitration clause, there is no basis to compel arbitration, because the plaintiff is not relying on the contract to support its claims. *In re Morgan Stanley & Co., Inc.,* 293 S.W.3d 182, 184 n.2 (Tex. 2009).

Motions to Compel Brought by Signatories. In the second situation – cases in which signatories seek to compel arbitration of the claims they assert against non-signatories – the same theories by which a party can seek to compel arbitration are theoretically available; however, principles of estoppel have not been as successful. *See Bridas S.A.P.I.C.*, 345 F.3d at 355-56 (rejecting application of estoppel asserted by signatory to require non-signatory to arbitrate claims asserted by signatory); *see also In re Merrill Lynch, Pierce, Fenner & Smith*, 195 S.W.3d 807 (Tex. App. – Dallas 2006, orig. proceeding).

b. Cases Involving Non-Signatories Bringing Claims Against Defendant Signatories.

Among the cases in which non-signatories to an arbitration agreement bring claims against defendant signatories, one most frequently encounters disputes in which the defendant signatory seeks to require the non-signatory to arbitrate its claims against the signatory. Several recent cases illustrate this situation.

In *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005), the Supreme Court of Texas confronted a case in which Kellogg Brown & Root, Inc. ("KBR") sued two other companies – Unidynamics and MacGregor – under quantum meruit and breach of contract theories. The dispute arose out of a construction project in which MacGregor subcontracted work to Unidynamics, which in turn subcontracted work to KBR. The MacGregor-Unidynamics contract had an arbitration clause, but the Unidynamics-KBR contract did not. When KBR sued, Unidynamics and MacGregor sought to compel arbitration. The Court held that KBR could not be compelled to arbitrate its claims against the defendants. The Court noted that KBR's claims in a sense related to the MacGregor-Unidynamics contract because the KBR contract would not exist but for the preexisting MacGregor-Unidynamics contract; however, that relationship was not sufficient to require arbitration. The Court explained that "a non-signatory should be compelled to arbitrate a claim only if it seeks, through the claim, to derive direct benefit from the contract containing the arbitration provision." *Id.* at 741. Because KBR's claims did not seek direct benefits from the MacGregor-Unidynamics contract, KBR's claims were not subject to arbitration.

Another case from the Supreme Court of Texas shows a situation under which the Supreme Court will compel arbitration of claims brought by non-signatories. In *In re Weekley Homes, L.P.*, 180 S.W.3d 127 (Tex. 2005), the daughter of a man who purchased a house from Weekley Homes sued Weekley for the asthma that she developed after living in the house. The house purchase agreement that the father signed contained an arbitration agreement. The Supreme Court held that Weekley was entitled to enforce the arbitration clause against the daughter (a) because the daughter had "exercised contractual rights" under her father's agreement by, for example, demanding that repairs be done and that she be reimbursed for costs she personally incurred in connection with having the repairs done and (b) because the daughter had "equitable entitlement to other contractual rights" under the agreement because ownership of the house had been transferred to a trust of which she was the sole beneficiary. *Id*. at 132-34. The Court held that the daughter's exercise of rights under and her entitlement to benefits of the contract prevented her from avoiding the arbitration clause. *Id.* at 134; *see also Stanford Dev. Corp. v. Stanford Condo. Owners Ass'n*, 285 S.W.3d 45, 51 (Tex. App. – Houston [1st Dist.] 2009, no pet.) (subsequent purchasers of condominiums were bound by arbitration provisions in earnest money contracts between original condominium owners and condominium developer in condominium owners' association's action against developer; even though subsequent purchasers were non-signatories, they consented to association bringing action on their behalf by virtue of their membership in association, and association was bound by arbitration provisions).