STATE BAR LITIGATION SECTION REPORT

THE ADVOCATE

Threshold Issues in Litigation

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ARBITRABILITY: THE ULTIMATE THRESHOLD ISSUE IN LITIGATION

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Introduction

In 1992, the Texas Supreme Court ushered in a new era in arbitration with its trailblazing decision in *Anglin v. Tipps*, 842 S.W.2d 266 (Tex. 1992). Sweeping away decades of legislative and judicial roadblocks to the use of arbitration embedded in the previous incarnation of Texas arbitration law, eventually codified and updated as TEX. CIV. PRAC. & REM. CODE §§171.001 *et seq.* ("TAA"), the *Anglin* Court emphasized the availability of an alternative method of dispute resolution within the ambit of the Federal Arbitration Act, 9 U.S.C. §§1 *et. seq.* ("FAA"), setting forth in broad strokes the manner in which Texas courts could address arbitrability expeditiously.

Arbitration law has evolved considerably since the *Anglin* decision, both judicially and statutorily, such that arbitrability of disputes now epitomizes the ultimate threshold issue in litigation: where will the litigation be conducted? The following discussion provides a roadmap to practitioners for navigating the labyrinthine multi-faceted components of this threshold issue.

The seminal question for a practitioner to address is whether there is an agreement to arbitrate[.]

I. Is the Dispute Arbitrable?

A. Is There An Agreement to Arbitrate?

The seminal question for a practitioner to address is whether there is an agreement to arbitrate, as arbitration cannot be ordered in the absence of such an agreement. *See Freis v. Canales*, 877 S.W.2d 283, 284 (Tex. 1994). The writing required to satisfy this criterion is usually that for any form of contract, involving such factors as a meeting of the minds, valid consideration, requisite signatures[1] and the like.

The practitioner should also be aware that in addition to a mutually signed instrument (whether physically or electronically signed), the Texas Supreme Court has also recognized the enforceability of an arbitration agreement unilaterally orchestrated. *See In Re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002); *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 849 (Tex. 2009).

B. Is the Agreement "Illusory?"

Even with a written instrument, the arbitration agreement must not be "illusory." That is, it must not allow one party to avoid its promise to arbitrate by unilaterally amending or terminating the provision altogether. *See In Re 24R, Inc.,* 324 S.W.3d 563, 567 (Tex. 2010). If a promisor retains the option to discontinue performance, then such agreement may be deemed illusory and unenforceable. *See Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d at 849; *Carey v. 24 Hour Fitness*, 669 F.3d 202 (5th Cir. 2012).

C. Conditions Precedent

Presuming the practitioner determines that an arbitration agreement exists, he or she must then pause to consider whether that agreement contains a condition precedent, such as the requirement to mediate and if so, whether such a condition has been or needs to be satisfied before the practitioner seeks to compel arbitration.

Where contractual prerequisites exist and are undisputedly not satisfied, then the party seeking to compel arbitration may not be entitled to relief. *See Southwinds Express Constr. v. D.H. Griffin of Tex., Inc.*, 513 S.W.3d 66 (Tex. App.—Houston [14th Dist.] 2016); *In re Pisces Foods, L.L.C.,* 228 S.W.3d 349 (Tex. App.—Austin 2007, orig. proceeding); *see also In re Rapid Settlements, Ltd.*, 202 S.W.3d 456 (Tex. App.—Beaumont 2006, orig. proceeding) (transfer of funds as condition precedent to enforcing arbitration agreement).

However, failing to mediate does not always disqualify a party from pursuing arbitration, absent explicit contract language to the contrary. *See In Re U.S. Home Corp.*, 236 S.W.3d 761, 764 (Tex. 2007); *LDF Constr., Inc. v. Bryan*, 324 S.W.3d 137, 147 (Tex. App. —Waco 2010, no pet.) (party initiating litigation could not avoid arbitration by relying upon opponent's failure to fulfill mediation prerequisite).

D. Challenges to Enforceability

1. Introduction

Contract defenses pose challenges to enforceability of an

arbitration agreement, "such as fraud, duress or unconscionability." *Arthur Anderson LLP v. Carlisle*, 556 U.S. 624, 630–31 (2009); *see Venture Cotton Cooperative v. Freeman*, 435 S.W.3d 222, 227 (Tex. 2014). Thus, the practitioner has to be prepared to address these potential challenges.

2. Unconscionability Issues

The Texas Supreme Court has held that a contract of adhesion is not automatically unconscionable and has also held that arbitration agreements are not *per se* unconscionable. *In Re U.S. Home Corp.*, 236 S.W.3d 761, 764 (Tex. 2007). Yet an arbitration agreement can be challenged premised upon principles of unconscionability (both procedural and substantive).[2]

a. Procedural Unconscionability

Procedural unconscionability is defined as "pertaining to the circumstances surrounding a contract's adoption, including" (1) the entire atmosphere in which the agreement was made; (2) alternatives, if any, available to the parties at the time the contract was made; and (3) the non-bargaining ability of one party. *See Royston, Rayzor*, 467 S.W.3d at 499; *Ridge Nat. Res., L.L.C. v. Double Eagle Royalty, L.P.*, 564 S.W.3d 105, 132 (Tex. App.—El Paso 2018); *Delfingen US-Texas, L.P. v. Valenzuela*, 407 S.W.3d 791, 797–98 (Tex. App.—El Paso 2013, no pet.) (agreement not enforced).

b. Substantive Unconscionability

Substantive unconscionability is defined as a contractual challenge "referring to the fairness of the arbitration provision itself." *See Freeman*, 435 S.W.3d at 227. An arbitration agreement involving statutory claims is substantively unconscionable if it waives a party's statutory rights and remedies. *See In Re Poly-America, L.P.*, 262 S.W.3d 337, 349, 352 (Tex. 2008) (waiver of Workers' Compensation Act remedies substantively unconscionable); *Bonded Builders Home Warranty Assoc. of Tex., Inc. v. Smith*, 488 S.W.3d 468, 476–77 (Tex. App.—Dallas 2016).

3. Other Applicable Contract Defenses

There may also be other applicable contract defenses to the enforceability of an arbitration agreement, such as forgery, fraudulent inducement of arbitration, and legal or mental incapacity to execute an agreement. *See Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444 (2006) (issue of "illegality" of arbitration agreement); *In Re Morgan Stanley & Co.*, 293 S.W.3d 182, 189 (Tex. 2009) (issue of mental capacity of signatory); *In re RLS Legal Solutions, L.L.C.*, 221 S.W.3d 629 (Tex. 2007) (claim of duress); *Pak Foods v. Garcia*, 433 S.W.3d 171, 175–76 (Tex. App.—Houston [14th Dist.] 2014, *pet. dism'd*) (agreement signed by minor); *Am. Med. Techs., Inc. v. Miller*, 149 S.W.3d 265, 273 (Tex. App.—Houston [14th Dist.] 2004) (issue of fraudulent inducement).

E. Scope of Agreement

A practitioner must be prepared to address not only validity and enforceability, but also whether the dispute is within the scope of the agreement, *see In Re Rubiola*, 334 S.W.3d at 225–26, a burden imposed upon the party opposing arbitration. *See Prudential Sec., Inc. v. Marshall*, 909 S.W.2d 896, 900 (Tex. 1995). In a dispute involving arbitrable and non-arbitrable claims, the TAA authorizes abating trial of the later claim pending conclusion of the arbitration of the former claim. *See* TAA §171.025. *Anglin* recognizes that in certain circumstances, existing claims can be sufficiently factually intertwined so as to be subject to arbitration, even if one such claim is outside the scope of the arbitration clause. *See Anglin*, 824 S.W.2d at 271; *BBVA Compass Inv. Solutions, Inc. v. Brooks*, 456 S.W.3d 711, 720–21 (Tex. App.—Ft. Worth 2015).

Additionally, an agreement may contain an arbitration clause that is (for whatever reason) restricted in scope. *See, e.g., Alliance Family of Cos. v. Nevarez*, --- S.W.3d ---, 2019 WL 1486911, at *6–7 (Tex. App.—Dallas 2019) ("non-disclosure agreement" could not form basis for compelled arbitration where claims were unrelated to the NDA).

II. Who Decides Arbitrability?

A. Introduction

The next threshold issue for the practitioner to address is the appropriate forum for deciding arbitrability. Three years after *Anglin*, the United States Supreme Court, in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), pronounced the guidelines for resolving this "gateway" question, determined by whether parties, by "clear and unmistakable evidence," designate the arbitrator to decide arbitrability. 514 U.S. at 944–45; *see Henry Schein, Inc. v. Archer White & Sales, Inc.*, 139 U.S. 524 (2019) ("*Henry Schein I*").

B. Proving "Clear and Unmistakable Evidence"

The "clear and unmistakable evidence" needed to satisfy the *First Options* standard comes in different forms. *See Petrofac, Incorporated v. DynMcDermott Petrol. Oper. Co.,* 687 F.3d 671 (5th Cir. 2012) (adoption of American Arbitration Association ("AAA") Rules of Arbitration, including Rule that allows arbitrator to rule on his or her own jurisdiction (e.g., AAA Commercial Rule 7)[3]; *IHS Acquisition No. 131, Inc. v. Iturralde*, 387 S.W.3d 785 (Tex. App.—El Paso 2013); *Berry Y & V Fabricators, LLC v. Bambace,* 604 S.W.3d 482, 486–87 (Tex. App.—Houston [14th Dist.], 2021); *but see Lucchese Boot Co. v. Solano*, 473 S.W.3d 404,

412–14 (Tex. App.—El Paso 2015, no pet.); *Boss Corp. Inc. v. Donegal, Inc.*, 370 S.W.3d 68, 76 (Tex. App.—Houston [14th Dist.] 2012, no pet.); *Friedman & Feiger, LLP v. Massey*, —S.W.3d— 2019 WL 3269325, at *21 (Tex. App.—Ft. Worth, Jul. 18, 2019).

C. Procedure When Clear and Unmistakable Evidence Lacking

If "clear and unmistakable evidence" is lacking, the practitioner will travel the following path of gateway evaluation: to a court to assess "gateway" issues about contract formation and validity of an agreement to arbitrate, *see Rent-A-Center W., Inc. v. Jackson*, 561 U.S. 63, 71 (2010) (FAA); *In Re Morgan Stanley & Co., Inc.*, 293 S.W.3d 182, 187–88 (Tex. 2009); *RSL Funding, LLC v. Newsome*, 569 S.W.3d 116, 120 (Tex. 2018) (TAA); and to an arbitral tribunal to resolve contract validity issues and substantive disputes. *See Prima Paint Corp. v. Flood & Conklin Mfg., Co.,* 388 U.S. 395, 403–04 (1967) (FAA); *Morgan Stanley,* 293 S.W.3d at 187–88.

D. Current Controversy Over Delegation of Authority

1. Federal Law on Delegation of Authority

The law on what constitutes "clear and unmistakable evidence" of delegation of authority is in a state of flux, focusing upon two issues: what specific language qualifies contractually as "clear and unmistakable evidence" under *First Options*?; and who has to sign an agreement to permit delegation of gateway issues to an arbitrator?

This controversy has evolved into two separate concerns: impact of "carve out" language upon contract provisions suggesting delegation of arbitrability to an arbitrator; and delegation against a non-signatory.

It appeared that the U.S. Supreme Court would resolve these questions in the aftermath of *Henry Schein I*. On remand of that case, the Fifth Circuit held that even with an incorporation of AAA Rules in the agreement, the parties did not satisfy the clear and unmistakable evidence test because the contract contained an "injunctive relief carve out." *See* 935 F.3d 274, 282–83 (5th Cir. 2019). The court further stated that in the absence of such a carve-out, incorporation of the AAA's rules would have constituted sufficient evidence of intent to arbitrate arbitrability. *Id.* at 281–82.

These rulings triggered a return trip to the Supreme Court, focused upon two controversies:

(a) Whether the injunctive relief clause neutralized delegation of arbitrability to the arbitrator; and

(b) Whether incorporation of AAA Commercial Rule 7 qualified as sufficient evidence of delegation?

The U.S. Supreme Court granted certiorari on the first question, *see Henry Schein II*, 141 U.S. 107, and conducted oral argument, but then dismissed the writ in *Henry Schein II* as improvidently granted. *See* 141 U.S. 656 (Jan. 25, 2021).

Accordingly, these issues remain unresolved at the federal level.

2. Texas Law on Delegation of Authority

Texas courts have been divided concerning what constitutes delegation. The Texas Supreme Court, in *Jody James Farms, Inc. v. The Altman Group, Inc.*, 547 S.W.3d 624 (Tex. 2018), initiated its review of delegation by acknowledging that arbitrability as a gateway matter is "ordinarily committed to the trial court and controlled by state law." *Id.* at 631. But the Court also recognized that parties do possess the power to agree to arbitrate arbitrability and acknowledged the existence and limits of *First Options*. *Id.* (citing *First Options*, 514 U.S. at 943).

Turning to what satisfies the delegation test, the *Jody James* Court then focused upon whether the parties' incorporation of the AAA Rules evinced such evidence of delegation. *Id.* at 631. Acknowledging that this type of deference might be appropriate in a situation involving *signatories* to an arbitration agreement, which it declined to decide, the Court nevertheless held that such deference is inapplicable when a dispute arises between a signatory and a non-signatory, irrespective of whether the signatory is the one resisting arbitration, because one of the parties has never formally agreed to arbitrate. *Id.* at 632. It thus rejected delegation in the absence of a valid agreement to do so. *Id.*[4]

III. Judicial Determination of Arbitrability

Presuming the arbitration agreement does not delegate arbitrability to an arbitrator, a practitioner's next threshold consideration is the process by which a court decides arbitrability.

A. Proper Venue For Determining Arbitrability

In doing so, the practitioner must initially be mindful of venue, such that if the arbitration agreement specifies venue, that provision has to be honored. *See In Re Sosa*, 370 S.W.3d 79 (Tex. App.—Houston [14th Dist.] 2012) (agreement specifying Houston as location for arbitration overrode right of defendant to seek venue elsewhere on basis that injunctive relief was sought).[5]

B. Nature of Hearing on Arbitrability

One credo of *Anglin* was the need for courts to determine arbitrability by "summary proceeding," *Anglin, supra,* 824

S.W.2d at 269, an issue which takes primacy over consideration of the merits. *E.g.*, *Kelly v. Hinson*, 387 S.W.3d 906 (Tex. App.—Ft. Worth 2012).

The "summary proceeding" label does not connote a proceeding congruent with that utilized in summary-judgment practice. As the *Anglin* Court recognized, a trial court could summarily resolve arbitrability relying upon undisputed facts derived from affidavits, pleadings, etc., but if material facts were controverted, the court would be obliged to conduct an evidentiary hearing to determine those. *Anglin*, 824 S.W.2d at 269.

When the trial court conducts such an evidentiary hearing, a reviewing court is obliged to defer to the trial court's factual determinations if they are supported by evidence; nevertheless, the trial court's legal determinations are reviewed *de novo. Wagner v. Apache Corp.*, — S.W.3d —, Nos. 19-0243 & 19-0244, 2021 WL 1323413, at *3 (Tex. Apr. 9, 2021) (quoting *Henry v. Cash Biz, LP*, 551 S.W.3d 111, 115 (Tex. 2018)).

C. Preparing For the Hearing on Arbitrability

Given the malleable nature of such a summary proceeding, the practitioner should be aware that parties are statutorily entitled to conduct pre-hearing discovery. *See* TAA §§171.086(4) and (6). Pre-hearing discovery is appropriate if the court "cannot fairly and properly make its decision on the motion to compel because it lacks sufficient information regarding the scope of an arbitration provision or other issues of arbitrability." *See In Re Copart*, 619 S.W.3d 710, 714 (Tex. 2021) citing *In Re Houston Pipe Line Co.*, 311 S.W.3d 449, 451 (Tex. 2009).

Despite this statutory command, the *Copart* Court also emphasized that the right to conduct pre-hearing discovery was not unbridled, ruling that pre-hearing discovery was not justified where the discovery proponent's proffer contained only conclusory assertions regarding validity of an arbitration agreement and failed specifically to dispute the authenticity of the agreement or plaintiff's signature on it. *Id.* at 715–16. In the absence of such a demonstration, a trial court abuses its discretion by ordering such discovery. *Id.* at 716.

D. Timetable for a Hearing on Arbitrability: Waiver of Right To Arbitrate

There is a strong presumption against waiver of the right to seek to compel arbitration. *See Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (interpreting FAA); *In re Poly-Am., L.P.*, 262 S.W.3d 337, 348 (Tex. 2008) (interpreting TAA). However, practitioners must be mindful that the passage of time combined with the "substantial invoking of the judicial process to the detriment or prejudice of the challenger" can constitute a waiver of the right to compel arbitration. *See Perry Homes v. Cull*, 258 S.W.3d 580, 589–90 (Tex. 2007).

IV. Initiating Judicial Review of Arbitrability

A. FAA vs. TAA – Preemption

The validity of an arbitration agreement also depends upon a court's underlying statutory authority. Both the FAA and the TAA can apply to an arbitration agreement. The FAA generally applies to arbitration agreements involving interstate commerce, and additionally, parties can specify reliance upon the FAA, even in the absence of interstate commerce. *In Re Olshan Foundation Repair Co., LLC*, 328 S.W.3d 883, 893 (Tex. 2010).

Thus, if the FAA applies, it preempts otherwise applicable state law, including the TAA, *Southland Corp. v. Keating*, 465 U.S. 1, 14–16 (1984), when state law "refuse[s] to enforce an arbitration agreement that the FAA would enforce." *See Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995); *Nitro-Lift Technologies, L.L.C. v. Howard*, 568 U.S. 17 (2012); *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 780 (Tex. 2006) (orig. proceeding).

B. Moving to Compel Arbitration

The TAA specifies the procedure by which a party can seek to compel arbitration of a dispute. *See* TAA §171.021. The FAA procedure is identified in 9 U.S.C. §§3 and 4, including conducting a summary trial on the issue of arbitrability if arbitrability is at issue in the case.[6]

C. Demonstrating Subject Matter Jurisdiction in Federal Court

To compel arbitration in federal court, the practitioner must bear one fundamental point in mind: the significance of subject-matter jurisdiction, a clause absent from the FAA. The practitioner must thus be prepared to demonstrate the existence of such jurisdiction.

Demonstrating federal subject-matter jurisdiction involves utilizing the complicated legal analysis adopted in *Vaden v. Discovery Bank*, 556 U.S. 49 (2009). Under *Vaden*, when a party seeks to compel arbitration in federal court, the district court is required to "look through" the complaint to determine if subject-matter jurisdiction exists as to the underlying controversy, that is, whether (irrespective of any

arbitration clause) the claims are "predicated on an action that 'arises under' federal law." 556 U.S. at 61. In prescribing this analytical framework, the *Vaden* Court also indicated that the "look through" process must focus exclusively on the well-pleaded claims in the complaint, rather than actual or hypothetical contents of a counterclaim. *See Polyflow, L.L.C. v. Specialty RTP, L.L.C.*, 993 F.3d 295 (5th Cir. 2021) (jurisdiction proper where arbitration dispute focuses upon at least three federal statutory claims). The practitioner must also bear in mind that this demonstration of jurisdiction carries with it the companion juridical considerations of standing, mootness, and ripeness. *See Lower Colorado River Auth. v. Papalote Creek II, L.L.C.*, 858 F.3d 916, 923 (5th Cir. 2017).[7]

V. Appealability

Finally, a practitioner must prepare a strategy for the review of the question of arbitrability if a trial court denies a motion to compel. *Anglin* emphasized the primacy of arbitrability, even if that meant halting the case at the trial court pending such a determination. The FAA and the TAA now explicitly authorize appellate jurisdiction over the interlocutory appeal of an order denying a motion to compel arbitration. *See* 9 U.S.C. §16; TAA §171.098. These statutes further authorize an interlocutory appeal of an order that confirms or denies confirmation of an arbitration award, or the modification or correction of such an award.

VI. Conclusion

Practitioners confronting the question of arbitration at the threshold of litigation can follow these guidelines to navigate the labyrinth of arbitrability.

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[1] In *Aerotek, Inc. v. Boyd*, 624 S.W.3d 199 (Tex. 2021), the Texas Supreme Court interpreted the Texas Uniform Electronic Transactions Act, TEX. BUS. & COMM. CODE ch. 322, to permit endorsement of an arbitration agreement by "electronic" signatures.

[2] Procedural unconscionability is decided by a court, while substantive unconscionability is decided by an arbitrator, *see In Re Halliburton Co.*, 80 S.W.3d at 571; further, if the arbitration proponent demonstrates the existence of an arbitration agreement, the burden shifts to the party advocating the defense of unconscionability. *See Royston, Rayzor, Vickery & Williams, LLP v. Lopez*, 467 S.W.3d 494, 499 (Tex. 2015).

[3] AAA Commercial Rule 7 states: "The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim."

[4] At least one subsequent ruling has distinguished *Jody James* in a case where a non-signatory sought to compel a signatory to arbitrate, holding that the non-signatory's invocation of the agreement impelled incorporation of the agreement's terms, including the language authorizing delegation of arbitrability to an arbitrator. *See Ruff v. Ruff*, ---S.W.3d---, 2020 WL 4592794, at *9 (Tex. App.—Dallas Aug. 11, 2020, pet. denied).

[5] The practitioner must also be aware that conduct by the parties can modify a contractual venue choice. *See In Re Lopez*, 372 S.W.3d 174 (Tex. 2012).

[6] FAA Section 4 includes the unique provision authorizing a jury trial of the issue of arbitrability.

[7] Note one idiosyncrasy in the FAA, Section 1's limitation on scope. *See New Prime, Inc. v. Oliveira*, 139 U.S. 532 (2019) (Section 1 specifically excludes certain classes of claims, including contracts of employment of certain transportation workers, seamen, or railroad workers). Evaluation of a Section 1 exclusion is a gateway issue for a court to decide. *Id.* at 537.

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