

**THE TEXAS SUPREME COURT'S APPROACH TO
ENFORCING ARBITRATION CLAUSES IN 2010**

THE 6TH ANNUAL CONSTRUCTION SYMPOSIUM

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**THE TEXAS SUPREME COURT'S
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In 2010, the Texas Supreme Court dealt with numerous issues relating to arbitration contracts and/or clauses. In three particular cases, the Court took up challenges to motions to compel arbitration that raised issues impacting the enforcement of the arbitration clause. The Court addressed whether an employer can modify the terms of an arbitration contract, interpretation of choice of law clauses in relation to arbitration clauses, and what is required to resist arbitration on economic grounds. The Court's analysis relating to these issues is discussed below in examination of the following 2010 decisions: *In re 24R, Inc.*, 324 S.W.3d 564 (Tex. 2010); *In re Odyssey Healthcare, Inc.*, 310 S.W.3d 419 (Tex. 2010); and *In re Olshan Foundation Repair Co., LLC*, ___ S.W.3d ___, 2010 WL 4910050 (Tex. 2010).

A. Can an employer retain the ability to modify the terms of an arbitration contract?

The Texas Supreme Court addressed this question in *In re 24R, Inc.*, 324 S.W.3d 564 (Tex. 2010). Frances Cabrera worked for 24R, Inc., d/b/a "The Boot Jack" as an at-will employee for 15 years. During that time, she was presented with three separate arbitration agreements in 2003, 2004 and 2005, and employees were required to sign these agreements as a condition of continued employment. Cabrera signed all three agreements. In January 2007, she alleged that she developed a medical condition requiring that she eat all meals before 6:00 p.m. The Boot Jack terminated her in spring 2007; Cabrera asserted this was done because she requested accommodations to eat meals per her doctor's directions.

After Cabrera exhausted her remedies through the Texas Workforce Commission, Cabrera sued The Boot Jack for age and disability discrimination. The Boot Jack sought to compel arbitration under the 2005 arbitration agreement. The trial court denied the motion. The court of appeals denied mandamus relief,

and the Texas Supreme Court granted it. *Id.* at 565-566.

Whether an arbitration agreement can be enforced constitutes a question of law. At-will employment will not prevent employers and employees from entering into an arbitration agreement as long as the consideration for the contract is not continued employment. The consideration for the arbitration agreement can be the mutual agreement to arbitrate. An illusory promise prevents the mutuality of the obligation and cannot be the consideration for the contract. An illusory promise is one that will not bind the promisor. An employer makes an illusory promise when it can amend the arbitration contract so as to avoid arbitration or terminate the contract. *Id.* at 566-567.

Cabrera opposed arbitration on the basis that the arbitration agreement was unenforceable because it lacked consideration; she asserted the The Boot Jack's promise to arbitrate was illusory as it retained the right to amend the agreement and was not mutually bound by it. She argued that the employee manual gave The Boot Jack the right to modify or abolish any personnel policy, including the arbitration agreement. The manual provides, "The Boot Jack reserves the right to revoke, change or supplement guidelines at any time without notice." *Id.* at 567. Cabrera interpreted this language to mean that The Boot Jack could amend or terminate the arbitration contract at any time.

The Texas Supreme Court examined the employee manual and the arbitration agreement. These were separate documents. The arbitration agreement did not mention or incorporate the employee manual by reference. If it had incorporated the employee manual, the manual would have become part of the arbitration agreement. *Id.* Further, no part of the arbitration agreement addressed the right of either party to change its terms. The Texas Supreme Court also pointed out that the employee manual expressly stated that it is not a contract and contained a disclaimer stating, "The policies and procedures in this manual are not

intended to be contractual commitments by The Boot Jack . . .” *Id.*

The employee manual did not give The Boot Jack the right to modify or abolish the terms of the arbitration agreement. The language from the manual that Cabrera relied on to argue that the arbitration agreement was illusory was not applicable. The employee manual did not form a contract between The Boot Jack and its employees. Rather, the arbitration agreement was a stand-alone contract that did not incorporate the employee manual. As a result, the arbitration agreement was an enforceable contract; the mutuality of the agreement to arbitrate between The Boot Jack and Cabrera provided the consideration for the contract. The trial court should have compelled arbitration. The Texas Supreme Court directed the trial court to vacate its prior order denying 24R’s motion to compel. *Id.* at 567-568.

B. Apply the Texas Arbitration Act or the Federal Arbitration Act?

A common question that arises is whether the Texas Arbitration Act (“TAA”) or the Federal Arbitration Act (“FAA”) should be applied to an arbitration agreement. The FAA will apply to contracts involving interstate commerce. When there is a conflict between the FAA and TAA, the FAA will preempt the TAA. *See In re Olshan Foundation Repair Co., LLC*, ___ S.W.3d ___, 2010 WL 4910050, *3 (Tex. 2010). Parties can contract as to which statute will govern. For example, if they select the FAA, it will be applied to the arbitration agreement even if the contract does not involve interstate commerce. The way the parties draft the contract and its choice of law provision can greatly affect which statute will control; this was the central issue in *In re Olshan Foundation Repair Co., LLC*, ___ S.W.3d ___, 2010 WL 4910050 (Tex. 2010).

Four contracts were at issue in *In re Olshan Foundation Repair Co., LLC*. Olshan Foundation Repair had contracted with four separate parties to make foundation repairs. All four parties later sued Olshan over the work it performed on their houses. The plaintiffs were represented by the same attorney and used the

same expert. The plaintiffs signed nearly identical contracts when contracting with Olshan, and each contract contained an arbitration clause. The arbitration clause in Olshan’s contracts with the Kilpatricks, Tisdales, and Tingdales stated that disputes would be resolved through arbitration “pursuant to the arbitration laws in your state.” The contract with the Waggoners also provided that disputes would be resolved through arbitration, but it contained the phrase “pursuant to the Texas General Arbitration Act.” *Id.*, 2010 WL 4910050, *2.

Olshan sought to compel arbitration against all four families under the FAA. The homeowners sought to avoid arbitration by arguing that the TAA controlled and that the arbitration clause was unenforceable under the TAA. Tex. Civ. Prac. & Rem. Code §171(a)(2) requires that all arbitration agreements in service contracts under \$50,000 be signed by all parties and their attorneys. The work Olshan performed for each homeowner was less than \$50,000. The homeowners asserted that their attorney had not signed the contracts and that the contracts’ arbitration clause was enforceable as a result. Olshan argued that the FAA preempted the TAA’s exemption and that the arbitration clauses were enforceable. *Id.*, 2010 WL 4910050, *2-*3.

If the FAA applied to the arbitration clauses at issue, then it would preempt the TAA’s exemption. 9 U.S.C. §2; *Olshan Foundation Repair*, 2010 WL 4910050, *3. The FAA is intended to ensure that private agreements to arbitrate are enforced according to the parties’ agreement. However, it does not prevent the parties from contracting as to how the agreement will be enforced. *Id.*, 2010 WL 4910050, *3-*4.

The Texas Supreme Court addressed application of a general choice-of-law provision to an arbitration clause in *In re L & L Kempwood Associates, LP*, 9 S.W.3d 125 (Tex. 1999) (per curiam). In that case, the choice-of-law provision provided that the contract would be governed by “the law of the place where the Project is located,” and the project was located in Houston. The Court held that this choice-of-

law provision did not preclude application of the FAA as the FAA was part of the law of where the project was located. *Id.* at 127-128. The law of Texas includes federal law. Thus to exclude the FAA, the parties would have had to specifically excluded the FAA or federal law. *Id.*

The Court applied the analysis of *L & L Kempwood Associates* to the arbitration provisions at issue in *Olshan Foundation Repair*. Under the foregoing analysis, the contracts stating that arbitration would occur pursuant to “the arbitration laws in your state” were subject to the FAA as this language included federal law. As a result, the FAA preempted the application of TRCP §171(a)(2). *Olshan Foundation Repair*, 2010 WL 4910050, *5.

In contrast, the Waggoners’ contract required that arbitration would be governed by the Texas General Arbitration Act. Their contract specifically chose Texas’ substantive law and the TAA. While the FAA is part of Texas’ arbitration laws and can apply to arbitrations occurring in Texas, the FAA is not part of the TAA. The parties decided that only the TAA should govern their arbitration. As a result, TRCP §171(a)(2) applied to the Waggoners’ contract with Olshan and Olshan was prevented from compelling arbitration against the Waggoners as their attorney had not signed the contract. *Olshan Foundation Repair*, 2010 WL 4910050, *5-*6.

C. Can the cost of arbitration prevent the enforcement of an arbitration clause?

Many times a party opposing arbitration will argue that the arbitration clause is unconscionable because the arbitration will cost too much. This is an actual argument that can be raised; however, key evidence of the potential costs will be required. The burden on the party raising this argument is quite high.

Section 2 of the FAA provides that arbitration agreements “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. An

arbitration clause is interpreted and enforced according to the general contract law of the applicable state. *See Perry v. Thomas*, 482 U.S. 483, 493, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987); *In re Poly-America, LP*, 262 S.W.3d 337, 347 (Tex. 2008). In Texas, unconscionable contracts are unenforceable. *Id.* at 348.

There are two types of unconscionability in Texas with regards to arbitration contracts: substantive unconscionability and procedural unconscionability. “Substantive unconscionability refers to the fairness of the arbitration provision itself, whereas procedural unconscionability refers to the circumstances surrounding the adoption of the arbitration provision.” *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 677 (Tex. 2006). In 2010, the Texas Supreme Court addressed the issue of substantive unconscionability with regards to the cost of arbitration in *In re Odyssey Healthcare, Inc.*, 310 S.W.3d 419 (Tex. 2010) and *In re Olshan Foundation Repair Co., LLC*, ___ S.W.3d ___, 2010 WL 4910050 (Tex. 2010). In both cases, the parties challenging enforcement of the arbitration clauses argued that the clauses were substantively unconscionable due to the substantial expense that would be incurred if the parties were forced to arbitrate rather than proceed with litigation.

To establish that it would be unconscionable to arbitrate due to the cost that would have to be incurred, the party raising the challenge must come forward with evidence of the cost of the arbitration. “[W]hen a party contests arbitration due to substantial expense, that party bears the burden of proving the likelihood of incurring such costs, and must provide some specific information concerning those future costs.” *Odyssey Healthcare*, 310 S.W.3d at 422. The court analyzing whether the arbitration clause is unconscionable examines whether the arbitration costs would preclude a litigant from effectively litigating the issues, vindicating that litigant’s legal rights, and/or from bringing valid claims. *See id.*, 2010 WL 4910050, *7. However, these considerations need to be balanced against the fact that Texas and federal law strongly favor arbitration and declaring the agreement unconscionable based

on cost is relying on the risk that the costs will be incurred. *Id.* “[T]he crucial inquiry is whether the arbitral forum in a particular case is an adequate and accessible substitute to litigation, a forum where the litigant can effectively vindicate his or her rights.” *Id.*, 2010 WL 4910050, *9.

The Texas Supreme Court adopted a burden-shifting test applied by the U.S. Supreme Court in *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92, 121 S.Ct. 513, 148 L.Ed.2d 373 (2000). The party seeking “to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive . . . bears the burden of showing the likelihood of incurring such costs.” *Olshan Foundation Repair Co.*, 2010 WL 4910050, *9 quoting *Green Tree*, 531 U.S. at 92, 121 S.Ct. 513. Once that burden is met, the burden then shifts to the party seeking to compel arbitration to come forth with rebuttal evidence. *Olshan Foundation Repair Co.*, 2010 WL 4910050, *9 quoting *Green Tree*, 531 U.S. at 92, 121 S.Ct. 513. The party opposing arbitration must come forth with specific evidence of the costs that will be incurred in arbitration through the use of invoices, expert testimony, reliable cost estimates and so on. The evidence must show that the party would encounter excessive costs in arbitration. Evidence that only speculates at the cost of the arbitration will not be sufficient. *Olshan Foundation Repair Co.*, 2010 WL 4910050, *9-*10. See also *Odyssey Healthcare*, 310 S.W.3d at 422-423.

Each case must be assessed on a case-by-case basis, and the court will examine the economic factors at issue. As the Texas Supreme Court explained:

If the total cost of the arbitration is comparable to the total cost of litigation, the arbitral forum is equally accessible. Thus a comparison of the total costs of the two forums is the most important factor in determining whether the arbitral forum is an adequate and accessible substitute to litigation. Other

factors include the actual cost of arbitration compared to the total amount of damages the claimant is seeking and the claimant’s overall ability to pay the arbitration fees and costs. These factors may also show arbitration to be an inadequate and inaccessible forum for the particular claimants to vindicate their rights. However, these considerations are less relevant if litigation costs more than arbitration.

Olshan Foundation Repair Co., 2010 WL 4910050, *9.

The plaintiffs in *Olshan Foundation Repair Co.* and *Odyssey Healthcare* failed to show that it would be substantively unconscionable for them to have to arbitrate under the arbitration clauses in their contracts. In both cases, the plaintiffs failed to submit evidence of the costs they would incur in arbitration. In *Olshan Foundation Repair Co.*, the plaintiffs only provided two invoices from the AAA for arbitrations in two other cases that showed the costs faced by the claimants in those arbitrations. However, the *Olshan* plaintiffs did not provide evidence to show that their claims were similar, compare these invoices to the costs of litigation, or address their ability to pay the costs. The damages at issue in the AAA arbitrations were different than those faced by the *Olshan* plaintiffs. Further, there was no evidence submitted that the *Olshan* plaintiffs had attempted to reduce the arbitration costs, such as requesting fee waivers, asking for pro bono arbitrators or seeking to reduce the panel to one arbitrator. *Olshan Foundation Repair Co.*, 2010 WL 4910050, *10-*12.

Similarly in *Odyssey Healthcare*, the plaintiff failed to produce evidence of specific costs that would likely be incurred. She made conclusory assertions relating to the costs of witnesses and medical experts and the arbitration being held in Dallas when she was from El Paso. However, the agreement only required that the arbitrator be selected from a

Dallas panel and not that the arbitration occur in Dallas. *Odyssey Healthcare*, 310 S.W.3d at 422-423. Further, the arbitrator could have assessed “whether the cost provision in this case will hinder effective vindication of [the employee’s] statutory rights and, if so, . . . modify the contract’s terms accordingly.” *Id.* at 423 quoting *Poly-America*, 262 S.W.3d at 357.

D. Conclusion

Parties continue to attempt to avoid arbitration when a dispute develops and they have previously agreed to arbitration. However, as shown by the foregoing 2010 Texas Supreme Court decisions, the party resisting the

arbitration will most likely not succeed. Each case faces must overcome Texas and federal law’s strong preference for arbitration and the willingness of Texas courts to enforce arbitration clauses. Whether the challenge is that a contract did not exist, is based on a legal argument under a state statute, or the cost of the arbitration is too high, a party will face many large obstacles in attempting to avoid arbitration. In the end, the arbitration clause will most likely be enforced against the signatories to the contract. The foregoing 2010 opinions are consistent with the Texas Supreme Court’s prior interpretation and enforcement of arbitration clauses.