PERRY HOMES: WHEN IS THE RIGHT TO ARBITRATION WAIVED?

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I. INTRODUCTION

An arbitration clause in a contract provides for a means of alternative dispute resolution. Parties to a contract can decide that disputes that may arise will go to arbitration rather than litigation. An arbitration clause can apply to all disputes that arise under a contract or only to certain types to disputes. If another party refuses to arbitrate per the contract's terms, a party may have to go to court to enforce the arbitration clause. Federal and Texas law create a strong presumption in favor of enforcing arbitration clauses, and both provide a means for a party to compel arbitration through the courts.

The fact that there is an arbitration clause does not necessarily mean that arbitration will occur. There are inherent challenges based upon the arbitration clause itself that could present potential obstacles to arbitration, such as whether the arbitration clause is valid, whether the clause is broad or narrow and encompasses the claims at issue, whether the person who wants to arbitrate is able to enforce the clause (i.e. a non-signatory to a contract), and more. A party can also challenge the enforceability of an arbitration clause based upon the general contract law of the state. Challenges such as fraudulent inducement or unconscionability can be raised in opposition to the arbitration clause. These issues revolve around interpretation of the arbitration clause itself or actions surrounding when a party agreed to the arbitration clause.

Another type of challenge is available that does not have to do with the arbitration clause directly; rather it focuses on the actions of the party seeking to enforce an arbitration clause. Waiver of arbitration arises when a party expressly or impliedly takes action that shows or demonstrates that it prefers litigation to arbitration. There are two types of waiver: express and implied. Express waiver occurs when a party affirmatively decides or indicates that it wants to pursue the matter in a judicial forum as opposed to arbitration. *In re Citigroup Global Mkts.,* 258 S.W.3d 623, 626 (Tex. 2008). Implied waiver occurs when a party subject to or seeking to compel arbitration substantially invokes the litigation process and causes prejudice to the other party. *Id.* at 626; *Perry Homes,* 258 S.W.3d at 589-590. Generally for implied waiver, the subject party's actions and statements will be reviewed. *See In re Citigroup Global Mkts.,* 258 S.W.3d at 626.

The difficult question becomes what level of conduct will impliedly waive one's right to seek arbitration. A clear standard is waiver occurs when a party is allowed "to conduct full discovery, file motions going to the merits and seek arbitration only on the eve of trial." *In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759, 764 (Tex. 2006). But what about in the numerous cases where the party's actions do not rise to that level of invoking the judicial process? Further, what actions will cause the other party to suffer prejudice? The Texas Supreme Court analyzed Texas law and explained what constitutes an implied waiver of arbitration in detail in *Perry Homes v. Cull*, 258 S.W.3d 580 (Tex. 2007). The issues addressed in *Perry Homes*, the factors applied, and the subsequent interpretation of *Perry Homes* will be addressed in this article.

II. THE TEXAS SUPREME COURT'S DECISION IN *PERRY HOMES V. CULL*

A. Who Decides the Question of Whether Arbitration Was Waived?

Issues relating to arbitration in the case must be distinguished between substantive arbitrability and procedural arbitrability issues. Substantive arbitrability encompasses "gateway" arbitration issues that a court must decide, such as whether a dispute is encompassed by an agreement to arbitrate. *In re Neutral Posture Inc.*, 135 S.W.3d 725, 728 (Tex.App.-Houston [1st Dist.] 2003, orig. proceeding); *Valero Energy Corp. v. Teco Pipeline Co.*, 2 S.W.3d 576, 583 (Tex.App.-Houston [14th Dist.] 1999, no pet.). Procedural arbitrability issues are for the arbitrator to decide and encompass those questions that grow out of the dispute and relate to the final disposition. Determining whether conditions precedent to arbitration were complied with constitutes an example of a procedural arbitrabililty issue, i.e. notice and time limits. *In re Neutral Posture Inc.*, 135 S.W.3d at 728; *Valero Energy Corp.*, 2 S.W.3d at 583.

In the case of waiver of arbitration, the examination focuses on a party's conduct in

court. "Contracting parties would expect the court to decide whether one party's conduct before the court waived the right to arbitrate." *Perry Homes*, 258 S.W.3d at 588 *quoting Tristar Fin. Ins. Agency, Inc. v. Equicredit Corp. of Am.*, 97 F. Appx. 462, 464 (5th Cir. 2004). Further, the issue of waiver affects only the enforcement of the arbitration clause rather than the entire contract, further suggesting waiver is an issue for a court to address. *Perry Homes*, 258 S.W.3d at 589. Due to these and other factors, the Texas Supreme Court determined that waiver of arbitration constitutes a question for the court rather than the arbitrator to decide. *Id.*

B. Establishing Waiver of Arbitration

In order to establish an implied waiver of arbitration, a party asserting the defense must show that the party seeking to compel arbitration substantially invoked the judicial process to the challenger's detriment or prejudice. *Id.* at 589-590. In deciding if the judicial process has been substantially invoked, courts must examine waiver of arbitration on a case-by-case basis and look at the totality-of-the-circumstances. *Id.* at 591. Substantially invoking the judicial process is not enough by itself to establish waiver of arbitration. A challenger must also show that it has suffered prejudice as a result. *Id.* at 593-594. The question with waiver of arbitration "is not so much when waiver occurs as when a party can no longer take it back." *Id.* at 595. The case for waiver must be strong as there is a strong presumption against waiver of arbitration, creating a difficult burden for the challenger. *See id.* at 590.

1. What Constitutes Substantially Invoking the Judicial Process?

No set formula exists for determining when a party has substantially invoked the judicial process. The Texas Supreme Court made clear before *Perry Homes* that a party substantially invokes the judicial process when that party is allowed "to conduct full discovery, file motions going to the merits, and seek arbitration only on the eve of trial." *In re Vesta Ins. Group, Inc.*, 192 S.W.3d at 764. However, even less action could meet the standard. The strong presumption against arbitration will weigh in favor of finding that a party did not waive its right to arbitration. In the past, the Texas Supreme Court examined waiver of arbitration numerous times, and never found that a party had waived its right to arbitration.

In *Perry Homes v. Cull*, the Texas Supreme Court set forth examples of actions from past cases that failed to qualify as substantially invoking the judicial process. The examples given are:

> Filing suit;
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> Moving to dismiss a claim for lack of standing;
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> Moving to set aside a default judgment and requesting a new trial;
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> Opposing a trial setting and seeking to move the litigation to federal court;
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> Moving to strike an intervention and opposing discovery;
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> Sending 18 interrogatories and 19 requests for production;
>
> Requesting an initial round of discovery, noticing (but not taking) a single deposition and agreeing to a trial resetting; and
>
> Seeking initial discovery, taking four depositions, and moving for dismissal based on standing.

Perry Homes, 258 S.W.3d at 590 (citations omitted).

Even with the examples available to demonstrate what will not constitute substantial invocation of the judicial process, guidance is still needed as to what conduct or combination of acts will rise to that level. The Texas Supreme Court looked at factors that federal courts utilize in applying a totality-of-the-circumstances test on a case-by-case basis. The factors include:

> Whether the movant was plaintiff (who chose to file in court) or defendant (who merely responded);
>
> How long the movant delayed before seeking arbitration;
>
> Whether the movant knew of the arbitration clause all along;
>
> How much pretrial activity related to the merits rather than arbitrability or jurisdiction;

How much time and expense has been incurred in litigation;

Whether the movant sought or opposed arbitration earlier in the case;

Whether the movant filed affirmative claims or dispositive motions;

What discovery would be unavailable in arbitration;

Whether activity in court would be duplicated in arbitration; and

Whether the case was to be tried.

Id. at 591 (citations omitted). These factors were not present in every case, and every factor is not required for waiver to be found. In the federal cases, waiver could be found based on only a few factors being present or even only one factor being present. *Id.* at 591.

The Texas Supreme Court agreed with the federal courts' approach and adopted their test. The Court held that "waiver must be decided on a case-by-case basis, and that courts should look to the totality of the circumstances." *Id.* The Texas Supreme Court has considered factors similar to those examined by the federal courts:

When the movant knew of the arbitration clause;

How much discovery has been conducted;

Who initiated it;

Whether it related to the merits rather than arbitrability or standing;

How much of it would be useful in arbitration; and

Whether the movant sought judgment on the merits.

Id. at 591-592. These are the factors to be considered in examining the conduct of the party seeking to compel arbitration.

Substantial invocation of the judicial process includes the entire process and not just seeking judgment on the merits. An examination of the totality-of-the-circumstances on a case-by-case basis is required as what is substantial in one case may only be preliminary in another. *Id.* at 592-593. "[A] party who enjoys substantial direct benefits by gaining an advantage in the pretrial litigation should be barred from turning around and seeking arbitration with the spoils." *Id.* at 593.

2. Is a Showing of Prejudice Required?

Waiver of arbitration will not be found based solely on substantial invocation of the judicial process; the challenger must also have suffered prejudice as a result of the opposing party's actions. Prior to *Perry Homes*, the Texas Supreme Court found that prejudice was a requirement of waiver of arbitration in at least eight cases. *Id.* at 593-594. Likewise, federal courts also favor requiring a finding of prejudice. Ten of the twelve regional circuit courts require a showing of prejudice, and the remaining two consider it a factor. *Id.* at 594. The Court decided to adopt the prejudice requirement as the second part of the test for waiver in *Perry Homes*. *Id.* at 595.

The Court explained what type of prejudice must result from the opposing party's substantial invocation of the judicial process. Under the Federal Arbitration Act, prejudice relates to inherent unfairness in a party taking advantage of the litigation process and then shifting to the arbitration process for its own advantage. The unfairness applies in terms of delay, expense or damage to the challenger's position when a party forces the challenger to litigate issues and then seeks arbitration on the same issues. *Id.* at 597. For this second element of the waiver test, the Court examines the fact that prejudice resulted, not the extent of the prejudice suffered. *Id.* at 599-600.[i]

Like the first element of waiver, a court must consider all of the circumstances in a case in order to determine if the challenger suffered prejudice. Prejudice should be easier to establish against a party who initially opposed arbitration and later reversed its position. The failure to demand arbitration does not automatically mean a party waives that right, but the failure to do so does impact on the question of prejudice and can be a factor considered, along with other considerations, as to whether waiver occurred. The failure of a party to demand arbitration and/or initially opposing arbitration while engaging in pretrial activity that is consistent with going to trial, as opposed to arbitration, lessens the burden a challenger faces when asserting waiver of arbitration

occurred. Likewise, if a timely demand for arbitration is made, the burden one faces in establishing prejudice increases. The challenger then is on notice that arbitration may occur and has the opportunity to avoid compromising its position with respect to arbitrable and non-arbitrable claims. *Id.* at 600.

C. Applying the Test to the Facts in *Perry Homes v. Cull*

In 1996, the Culls bought a house from Perry Homes and a warranty from Home Owners Multiple Equity, Inc. and Warranty Underwriters Insurance Company. The house subsequently suffered structural defects and drainage problems over the next several years. The Culls sued the warranty companies and Perry Homes. The warranty agreement contained an arbitration clause, and the warranty companies immediately requested arbitration. The Culls opposed arbitration, and no ruling was ever issued. In addition the Culls began seeking extensive discovery. After the majority of the discovery was completed and the case set for trial, the Culls attempted to compel arbitration under the warranty agreement 14 months into the litigation. The trial court granted the motion four days before trial stating the Defendants had not shown that they suffered prejudice due to the Culls' litigation conduct. *Id.* at 584-585.

The Culls substantially invoked the judicial process before filing their motion to compel. The trial court's file reflected some of the actions taken by the Culls including their initial 79 page objection to the original arbitration request; five motions to compel, with 76 requests for production of documents attached; Perry Homes' two motions for protective orders regarding the Culls noticing six designees for deposition on nine issues and with an attachment requesting 67 categories of documents; and three notices of deposition for Defendants' experts with 24 categories of document requests. In addition, the Culls took ten depositions. *Id.* at 595-596.

While the Culls conducted discovery on nearly all merits of the case, the totality-of-the-circumstances test examines more than just what discovery occurred. The Culls opposed the warranty companies' request for arbitration with a 79 page response objecting to arbitration wherein they argued about the AAA's competence, fees and other issues. *Id.* at 596. Further, they moved to compel arbitration late in the litigation. They filed their motion to compel at the same time that Perry Homes filed a motion to continue the trial, seeking a ten week extension to finish expert depositions. It is not known if the case would have gone to trial on the trial date. However, at that time the motion to compel was filed, discovery was almost complete. *Id.*

The rule that one cannot wait until "the eve of trial" to seek arbitration applies not just before trial but is also a rule of proportion. The Culls first opposed arbitration and then 14 months after filing suit sought to compel arbitration, right before the trial setting. They justified their reversal by stating they wanted to avoid the delays of an appeal. However, the arbitration served to delay adjudication on the merits. Trial would have occurred in a few days or weeks; instead, the arbitration did not occur until nearly ten months later. Arbitration did not serve to reduce the delay of the litigation. Further, arbitration could limit pretrial discovery, but the Culls had 14 months of extensive discovery through the litigation before seeking arbitration. *Id.* at 596. All these actions together constitute substantial invocation of the judicial process.

The Culls' actions prejudiced the Defendants, establishing the second element of the waiver test. No disputes exist between the parties over the discovery conducted or which pleadings were filed. *Id.* at 599. Basically, the Culls opposed arbitration, engaged in significant discovery and then sought to compel arbitration. Further, they waited to seek arbitration until trial was imminent. Proof of the undisputed facts at the hearing was unnecessary as it would have only lengthened the hearing and increased its costs. In such a situation, where the evidence is largely undisputed, "[r]eferral to arbitration should be decided summarily with the evidence limited to disputed facts." *Id.* at 599. In this case, the Culls were able to have the court order discovery and then limit the Defendants' rights to appellate review. "Such manipulation of litigation for one party's advantage and another's detriment is precisely the kind of

inherent unfairness that constitutes prejudice under federal and state law." *Id.* at 597.

The Culls waived their right to arbitration. The level of discovery that occurred and the actions they took in court amounted to them substantially invoking the judicial process. Further, the Defendants suffered prejudice as a result of their actions. Both requirements were met for waiver of arbitration based on the totality-of-the-circumstances.

D. Standard of Review

The Texas Supreme Court determined that a trial court's decision on waiver of arbitration should be reviewed applying the abuse-of-discretion standard. The Court determined waiver constituted a question of law for the court under a proper abuse-of-discretion standard, and trial courts do not receive deference on questions of law. Appellate courts should defer to the trial court on factual findings that are supported by evidence.[ii] *Id.* at 598. In the test for waiver of arbitration, the trial court makes a decision based upon the totality-of-the circumstances. "[A] totality-of-the-circumstances test presumes a multitude of potential factors and a balancing of evidence on either side; if appellate courts must affirm every time there is some factor that was not negated or some evidence on either side, then no ruling based on the totality-of-the-circumstances could ever be reversed." *Id.*

In the case of *Perry Homes v. Cull*, the parties agreed on the factual evidence. No dispute existed that the Culls originally opposed arbitration, that they conducted extensive discovery on the merits, and that they sought arbitration on the eve of trial. The question that remained was whether such conduct constituted prejudice. As here, when there is no factual dispute, only conclusions remain as to whether a party's trial conduct constitutes prejudice. *Id.* at 598.

III. TEXAS CASE LAW SINCE *PERRY HOMES V. CULL*

Since *Perry Homes v. Cull*, the cases continue to demonstrate the strong presumption against waiver of arbitration, and courts balance the factors set forth in the decision as the totality-of-the-circumstances is examined. As addressed, each waiver of arbitration challenge must be examined separately on a case-by-case basis. Without both elements of the test, waiver of arbitration will not be found. In addition, the Supreme Court has gone even further in defining waiver by addressing the difficulty in establishing express waiver.

A. Texas Supreme Court

In two cases since the *Perry Homes v. Cull* decision, the Texas Supreme Court has provided additional clarification on express and implied waiver of arbitration. Attempts by challengers to show statements in briefs or communications amounted to express waiver failed, and the standard for implied waiver of arbitration remains high. In both subsequent opinions, the Court summarized the *Perry Homes* test for waiver of arbitration as follows:

> "[A] party waives an arbitration clause by substantially invoking the judicial process to the other party's detriment or prejudice." [*Perry Homes,* 258 S.W.3d at 589-590]. Waiver is a legal question for the court based on the totality of the circumstances, and asks whether a party has substantially invoked the judicial process to an opponent's detriment, the latter term meaning inherent unfairness caused by "a party's attempt to have it both ways by switching between litigation and arbitration to its own advantage." [*Id.* at 597].

In re Citigroup Global Mkts., Inc., 258 S.W.3d 623, 625 (Tex. 2008); *In re Fleetwood Homes of Tex., L.P.*, 257 S.W.3d 692, 694 (Tex. 2008).

In the case of *In re Fleetwood Homes of Tex., L.P.*, 257 S.W.3d 692 (Tex. 2008), the Court addressed the issues of express waiver and evidence of prejudice. Gulf filed suit in October 2005, and Fleetwood answered and demanded arbitration under their contract. However, Fleetwood did not compel arbitration until July 2006. Gulf opposed the arbitration and argued

that Fleetwood had expressly waived its right to arbitration. *Id.* at 693-694. Gulf asserted that Fleetwood expressly waived the right to arbitration based on e-mails from Fleetwood's counsel regarding a proposed trial setting, including the final e-mail that proposed setting trial in March. *Id.* at 694. The Court concluded that the e-mails did not rise to the level of an express waiver of arbitration. Specifically, nothing in the final e-mail expressly waived arbitration or revoked the arbitration demand previously set forth in Fleetwood's answer to the petition. *Id.*

As there was no express waiver, the Court continued its examination to determine if Fleetwood had impliedly waived its right to arbitration by waiting eight months before seeking to compel arbitration, discussing a trial setting and participating in limited discovery. The Court did not address the first element of the waiver test, whether Fleetwood had substantially invoked the judicial process. Instead, it focused on the fact that there was insufficient evidence to support a finding of prejudice. Gulf offered no explanation as to how it suffered prejudice, particularly due to the e-mails. Outside of the e-mails, there were few other factors that weighed in Gulf's favor for establishing the fact of prejudice. Fleetwood had only noticed one deposition, which it later cancelled, and served one set of written discovery (the day before it filed its motion to compel). Further, Fleetwood did not file any dispositive motions or delay its motion to compel until the eve of trial. These actions were not enough to overcome the presumption against waiver. *Id.* at 694-695.

Express waiver was also relied upon by the challenger in *In re Citigroup Global Mkts., Inc.*, 258 S.W.3d 623 (Tex. 2008). The Nickells sued Citigroup in state court, and Citigroup removed the case to federal court. Thereafter, the Nickells moved to remand the case, and Citigroup moved for transfer to a federal multidistrict litigation ("MDL") court. Citigroup also moved to stay the federal litigation pending the MDL panel's decision and also specifically reserved its right to pursue arbitration. Ultimately, the Nickells remanded the case from the MDL panel back to state court when Citigroup gave up the jurisdictional battle, which had lasted seven months. Citigroup filed a motion to compel arbitration once back in state court. *Id.* at 625. The trial court denied the motion, and the court of appeals agreed on the basis that Citigroup had expressly waived its right to arbitration based upon statements in its previous motions which suggested that it was transferring the case for the purposes of litigation. *Id.* at 625-626.

Citigroup's statements in its motions to transfer did not rise to the level of express waiver of arbitration. The fact that Citigroup sought the transfers does not evidence that it had abandoned arbitration. Citigroup had reserved its right to request arbitration and so informed the Nickells. Statements in the transfer pleadings pertaining to potential savings in discovery, witness convenience and so on were required by statute, 28 U.S.C. § 1407(a), to justify transfer to the MDL court. The Texas Supreme Court interpreted the statements on avoiding duplication of discovery as showing an effort to avoid litigation activity as opposed to duplicating it. Further, transfer to the MDL court was not inconsistent with arbitration as consolidated actions can be arbitrated too. *Id.* at 626.

The Court then examined whether Citigroup's actions amounted to implied waiver of arbitration. Citigroup's only litigation conduct consisted of the transfer pleadings that it filed, and the pleadings did not go to the merits of the case. These pleadings constitute factors to consider in the totality-of-the-circumstances test. Outside of the transfer pleadings, Citigroup never sent or responded to any discovery, never filed any other motions relating to the merits and engaged in no other litigation conduct before asking for arbitration. The statements made in the transfer pleadings about what discovery could be saved if the case were before the MDL court fail to rise to the level of substantial invocation of the judicial process. *Id.* As a result, Citigroup did not waive its right to arbitration either expressly or impliedly.

B. Texas Courts of Appeal

Four cases from Texas Courts of Appeal analyzing waiver of arbitration in light of *Perry Homes v. Cull* demonstrate the continuing difficulty in establishing implied

waiver of arbitration. Both parts of the totality-of-the-circumstances test remain important and must be established by the challenger. In only one of the four cases was waiver of arbitration found.

One definitive action by a party will not constitute waiver or establish the first element of waiver. In the case of *In re H&R Block Financial Advisors, Inc.*, 262 S.W.3d 896 (Tex.App.—Houston [14th Dist.] 2008, pet. granted), H&R Block moved to compel arbitration and later filed for summary judgment; Krynik argued the motion for summary judgment amounted to waiver of arbitration. H&R Block had originally raised arbitration as an affirmative defense. Two weeks after answering, H&R Block moved to dismiss the lawsuit and compel arbitration. In response, Krynik argued that his father had signed the agreement containing the arbitration clause, making Krynik a non-signatory. Based upon this admission, H&R Block moved for summary judgment arguing that Krynik was disavowing the contractual claims and the remaining claims were time barred. It is this motion for summary judgment that Krynik relies on to establish waiver of arbitration. *Id.* at 898-899. Applying the test and factors from *Perry Homes*, the Court disagreed with Krynik's waiver argument. The Court interpreted the motion for summary judgment as being presented as an alternative to the arbitration demand, and the motion was filed only after Krynik claimed he was not a party to the contract. As a result, H&R Block did not substantially invoke the litigation process. *Id.* at 902.

What occurs if a party engages in discovery before moving for summary judgment? Can waiver be established then? In *Bison Building Materials, Ltd. v. Sambrano*, 2008 Tex. App. LEXIS 4844 (Tex.App.—Houston [1st Dist.] 2008, orig. proc.) (mem. op.), the Court interpreted the test for waiver based upon *In re Citigroup Global Mkts., Inc.*, 258 S.W.3d 623 (Tex. 2008) as requiring a party to pursue the litigation process, change its strategy and pursue arbitration, and do so in an "inherently unfair manner that worked to its own advantage and to [the challenger's] prejudice or detriment." *Bison Building Materials, Ltd.*, 2008 Tex. App. LEXIS 4844, *40. In *Bison*, Plaintiff asserted that Bison waived its right to arbitration based on its litigation conduct: waiting to compel arbitration until seven months after the original petition had been filed and four months before the trial date; serving depositions on written questions to Plaintiff relating to her treatment and expenses; and seeking summary judgment on the basis that Plaintiff had waived any litigation premised on her injuries. *Id.* at 2008 Tex. App. LEXIS 4844, *41-*42. Despite these actions, the Court concluded that Bison did not substantially invoke the judicial process after balancing the factors. The Court determined that Bison did not seek to compel arbitration on the eve of trial. In the motion for summary judgment, Bison did not seek judgment on the merits of Plaintiff's claim; instead, the motion was aimed at avoiding litigation. Further, the two depositions that occurred were taken by Plaintiff, not Bison. Finally, the written discovery that Bison did conduct would be necessary whether the claims were tried in court or before an arbitrator. *Id.* at 2008 Tex. App. LEXIS 4844, *46-*51.

Even if there had been substantial invocation of the judicial process, Plaintiff still could not have met the second element of prejudice for waiver of arbitration. Plaintiff had disputed whether she needed to demonstrate that she had suffered prejudice. She did not claim to be prejudiced by Bison's actions at the hearing or in her objection to arbitration. As a result, she did not establish this second required element. *Id.* at 2008 Tex. App. LEXIS 4844, *51-*52.

Actions that show a party actually trying to avoid litigation weigh in favor of a party attempting to compel arbitration. A party taking steps to resolve a case and primarily invoking the litigation process for non-arbitrable claims will not satisfy the first part of the waiver test from *Perry Homes.* In *Wee Tots Pediatrics, P.A. v. Morohunfola*, 268 S.W.3d 784 (Tex.App.—Fort Worth 2008, no pet.), the Court applied the test from *Perry Homes* when Wee Tots sought to compel arbitration and was accused of waiving its right to arbitrate. In that case, Wee Tots sent discovery prior to moving to compel arbitration and filed for summary

judgment but only on a non-arbitrable claim. Further, mediation had occurred, and Wee Tots explained that it had wanted to wait to compel arbitration until after mediation occurred. In the totality-of-the-circumstances, Wee Tots did not substantially invoke the litigation process. Arbitration should have been compelled. *Id.*

Early steps in the process that are aimed at avoiding litigation will likely not support waiver, but numerous actions taken over months during litigation can be enough for waiver. A party's active participation, particularly in discovery, prior to asking for arbitration can be fatal. In *Citizens National Bank v. Bryce*, 2008 Tex.App. LEXIS 8313 (Tex.App.—Tyler 2008, orig. proc.) (mem. op.), the *Perry Homes* test and factors were applied to assess whether a Bank had waived its right to arbitration. *Id.* at 2008 Tex.App. LEXIS 8313, *10-*14. The Bryce Plaintiffs sued on May 19, 2005 and produced a copy of the partnership agreement containing the arbitration clause to the Bank in November 2005. The Bank filed its motion to compel on January 12, 2007, or 20 months after suit was filed. The record does not show when the Bank became aware of the arbitration clause. *Id.* at 2008 Tex.App. LEXIS 8313, *14-*15. During the intervening time period, the Bank served requests for disclosures, three requests for production, three sets of interrogatories, filed three motions to compel, and took 13 oral depositions and two depositions on written questions. The discovery all related to the merits of the lawsuit, and it appears that discovery was nearly complete when the Bank sought arbitration. In addition to discovery, the Bank designated its expert witnesses and filed numerous other pleadings, including a motion for summary judgment, subject to its motion to compel arbitration, that addressed all of Plaintiffs' claims except for one category. *Id.* at 2008 Tex.App. LEXIS 8313, *15-*17. All this activity meant that the Bank had substantially invoked the judicial process. *Id.* at 2008 Tex.App. LEXIS 8313, *17.

The question remains whether the Bank's extensive discovery and the numerous pleadings resulted in prejudice to Plaintiffs. The Bank argued that Plaintiffs introduced no evidence of prejudice at the hearing on the motion to compel, including no evidence of work done, time spent or costs incurred; instead they relied upon the arguments of counsel. However, as the Court pointed out, *Perry Homes* focuses on proof of fact of prejudice as opposed to the extent of prejudice suffered. Despite this, the Bank's point that the discovery taken in the case would be useful in arbitration was accurate and weighed in the Bank's favor. It is unknown, however, what discovery an arbitrator would allow given an arbitrator's nearly unbridled discretion regarding discovery. *Id.* at 2008 Tex.App. LEXIS 8313, *20-*23. Another factor to consider is that the motion to compel was filed only eight weeks before trial; thus, it was filed on the eve of trial. *Id.* at 2008 Tex.App. LEXIS 8313, *18. Finally, after the Bank had taken its final deposition, Plaintiffs still needed some depositions. The Bank offered to present its witnesses for deposition in exchange for the agreement that Plaintiffs would not claim these depositions were evidence of waiver of arbitration. *Id.* at 2008 Tex.App. LEXIS 8313, *24. "Under *Perry Homes*, the trial court properly interpreted the Bank's actions as manipulation of the litigation for its advantage and the Bryce Plaintiffs' detriment." *Id.* at 2008 Tex.App. LEXIS 8313, *25. As a result, Plaintiffs established prejudice and met both elements in the test for waiver of arbitration.

IV. CONCLUSION

The Texas Supreme Court's decision in *Perry Homes v. Cull* and subsequent Texas case law demonstrate that a finding of waiver of arbitration will be a rare event. The presumption against finding waiver of arbitration remains strong. For implied waiver of arbitration, a challenger must show that a party substantially invoked the litigation process as opposed to taking steps to avoid litigation, promoting settlement, or undertaking discovery that would also be allowed in arbitration. If any of these other explanations are available, the factors will likely tip more in favor of finding a party did not substantially invoke the litigation process. Even if the first element of the waiver test is met, the challenger needs to establish that it suffered prejudice by demonstrating that the party moving for arbitration attempted to take advantage of both the judicial process and

arbitration to the challenger's detriment. As addressed in *Perry Homes*, the focus will be on the fact of prejudice rather than on the extent of prejudice suffered. However, a challenger should not ignore this element and presume that no evidence is required. To be safe, a challenger should address how it suffered prejudice in order to support this second element. As shown by the cases discussed above, balancing the factors under the totality-of-the circumstances will likely result in a finding that a party did not waive its right to arbitration.

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[i] In his dissent, Justice Phil Johnson addresses that he would require proof that the challenger suffered detriment. *Perry Homes*, 258 S.W.3d at 603. The trial court had concluded that the Defendants had not proven that they suffered prejudice. *Id.* at 604-606. The trial court could also have weighed, as a factor against prejudice, a provision in the contract that required a party that initiated litigation to reimburse the other party's costs and expenses in seeking dismissal of said litigation. In fact, Justice Johnson would have expanded the clause to require reimbursement of all litigation costs and expenses. *Id.* at 606. While the Defendants' claimed prejudice, there is no evidence in the record that they suffered prejudice or that the Culls gained an unfair advantage. *Id.* at 607-608.

[ii] Justice Phil Johnson's dissent sets forth his disagreement with the Majority's abuse of discretion standard. In his view, an abuse of discretion standard applies where a trial court possesses the discretion to make determinations based upon factual determinations. "The test for abuse of discretion is not whether, in the opinion of the reviewing court, the trial court's ruling was proper, but whether the trial court acted without reference to guiding rules and principles." *Perry Homes*, 258 S.W.3d at 602. A trial court's decision on waiver should only be reversed if the decision is arbitrary or unreasonable. As long is there is evidence supporting the trial court's determination, then the decision should be upheld and the trial court did not abuse its discretion. *Id.*

Justice Don Willett agrees in his dissent that the abuse of discretion standard goes too far; he would impose the same standard as Justice Johnson, asking whether the trial court acted arbitrarily or disregarded all guiding standards in reaching its decision. While he admits that it was a close call in ruling that Perry Homes did not show that it suffered prejudice, the trial court did not abuse its discretion in compelling arbitration. *Id.* at 612-613.