



ARBITRATION: CHALLENGES TO A MOTION TO COMPEL

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What Is Arbitration?

Do You Have a Choice?

- Parties to a contract with an arbitration clause do not have to arbitrate if both parties agree to proceed with litigation.
- If only one party wants to arbitrate and the dispute is subject to the arbitration agreement, the willing party can compel the other party to arbitrate.
- There is a strong presumption in favor of arbitration under Federal and Texas law.

Basic Arbitration Clause

- Basic arbitration clause from the AAA:
- Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Construction Industry Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

Federal Arbitration Act or Texas' General Arbitration Act?

Federal Arbitration Act (“FAA”), 9 U.S.C. 1 *et. seq.*

- “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

FEDERAL ARBITRATION ACT

- Under the FAA, a court must compel arbitration if a party shows that there is an enforceable arbitration clause encompassing the dispute. 9 U.S.C. § 4.
- The litigation must be stayed until the arbitration is completed. 9 U.S.C. § 3

Texas General Arbitration Act ("TAA"), TEX. CIV. PRAC. & REM. CODE § 171.001 *et. seq*

- (a) A written agreement to arbitrate is valid and enforceable if the agreement is to arbitrate a controversy that:
 - (1) exists at the time of the agreement; or
 - (2) arises between the parties after the date of the agreement.

Tex. Civ. Prac. & Rem. Code § 171.021(a).

- When arbitration is ordered, the court must stay the litigation. Tex. Civ. Prac. & Rem. Code § 171.025

Does the FAA or TAA Apply?

- The arbitration clause can specify whether the FAA or TAA will apply.
- Contract may contain a choice of law clause. *See e.g. ASW Allstate Painting & Constr. v. Lexington Ins. Co.*, 188 F.3d 307 (5th Cir. 1999) (TAA applied when choice of law clause specified Texas law).
- If the arbitration clause does not specify, both could 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).

Can a Party Be Compelled to Arbitrate?

■ Two Questions:

1. Did the parties agree to arbitrate?
2. Does the arbitration clause encompass the dispute?

Did the Parties Agree to Arbitrate?

- Examine the arbitration clause. Did the parties form a valid agreement to arbitrate?
 - Question of law for the court.
 - Apply ordinary contract principles.
 - Examine the entire writing to harmonize and give effect to all provisions of the contract.
- What is beyond the trial court's discretion: determining what the law is and applying the law to the facts.

Southern Green Builders, LP v. Cleveland, 558 S.W.3d 251, 255 (Tex.App.—Houston [14th Dist.] 2018).

Valid Arbitration Clause

- A party who has the opportunity to read and arbitration agreement and signs it is charged with knowing its contents. *EZ Pawn v. Mancias*, 934 S.W.2d 87, 90 (Tex. 1996).
- Presumption favoring arbitration does not arise until after the court determines that a valid arbitration agreement exists. *In re Morgan Stanley & Co., Inc.*, 293 S.W.3d 182, 185 (Tex. 2009).

Does the Arbitration Clause Encompass the Dispute?

- Who decides the question of arbitrability?
- Question of law unless the contract delegates this power to the arbitrator.
- If the contract contains a delegation clause, then the court must determine if the delegation clause is valid.

See RSL Funding, LLC v. Newsome, No. 16-0998, 62 Tex. Sup. Ct. J. 253, ____ S.W.3d ____, 2018 WL 6711316 (Tex. Dec. 21, 2018).

DELEGATION CLAUSES

Texas Supreme Court

- *RSL Funding, LLC v. Newsome*, No. 16-0998, ____ S.W.3d ____, 2018 WL 6711316 (Tex. Dec. 21, 2018).
- Contract to transfer a payee's structured-settlement-payment to another party in exchange for payment of \$53,000.00 was approved by a court. The payment was never made. The original payee, Newsome, filed a petition that sought enforcement of the original order or, in the alternative, to vacate the original order.

RSL Funding, LLC v. Newsome

- The transfer contract contained an arbitration clause:

Disputes under this Agreement of any nature whatsoever ... shall be resolved through demand by any interested party to arbitrate the dispute.... **The parties hereto agree that the issue of arbitrability shall likewise be decided by the arbitrator, and not by any other person. That is, the question of whether a dispute itself is subject to arbitration shall be decided solely by the arbitrator and not, for example by any court.**

RSL Funding, LLC v. Newsome

- The trial court denied the motion to compel arbitration filed by RSL Funding.
- The Court of Appeals determined that the facts of the dispute allowed it to disregard the parties' agreement. It determined that the nature of the case made the matter non-arbitrable.
- Should the Court of Appeals have decided the issue of arbitrability?

RSL Funding, LLC v. Newsome

- Default Rule: Arbitrability is a threshold matter for the court to decide.
- A contract that requires the issue of arbitrability to be decided by the arbitrator, not the court, is valid and must be treated like any other arbitration agreement.

RSL Funding, LLC v. Newsome

- “When faced with such an agreement, courts have no discretion but to compel arbitration unless the clause’s validity is challenged on legal or public policy grounds. So the proper procedure is for a court to first determine if there is a binding arbitration agreement that delegates arbitrability to the arbitrator. If there is such an agreement, the court must then compel arbitration so the arbitrator may decide gateway issues the parties have agreed to arbitrate.”

RSL Funding, LLC, No. 16-0998, 2018 WL 6711316 , *3 (citations omitted).

RSL Funding, LLC v. Newsome

- Was there a valid agreement to arbitrate?
- Three ways to challenge the validity of an arbitration clause: : “(1) challenging the validity of the contract as a whole; (2) challenging the validity of the arbitration provision specifically; and (3) challenging whether an agreement exists at all.” *RSL Funding, LLC*, No. 16-0998, 2018 WL 6711316 , *6.
- Contract formation defenses are to be decided by a court. *See* 9 U.S.C. § 4; TEX. CIV. PRACT. & REM. CODE § 171.021(b).

RSL Funding, LLC v. Newsome

- Newsome challenged the entire transfer agreement. He argued that the transfer agreement never came into existence or was not enforceable because the court's approval orders were void.
- *Prima Paint* separability doctrine: the arbitrator decides any challenge to the enforceability of an existing contract.

RSL Funding, LLC v. Newsome

- Issue: does the challenge go to the contract's formation or to its enforcement?
- Newsome's voidness argument may provide a basis for revoking the agreement; however, it does not mean the contract was never formed.
- Voidness on public policy grounds is a defense to a contract's enforcement, not its formation.
- Under the doctrine of separability, this is an issue for the arbitrator to decide.

“Wholly Groundless” Exception

- “Wholly Groundless” Exception:

“The wholly groundless exception is a doctrine applied by some federal appellate courts to deny arbitration even in the face of an arbitral delegation clause. Under the wholly groundless exception, the court may decline to enforce an arbitral delegation clause when no reasonable argument exists that the parties intended the arbitration clause to apply to the claim before it.”

RSL Funding, LLC, No. 16-0998, 2018 WL 6711316 , *5.

- The Texas Supreme Court determined the validity of the wholly groundless exception was not properly before it.

“Wholly Groundless” Exception

- Disagreement amongst Federal Courts of Appeals over whether this exception is consistent with the FAA.
- The United States Supreme Court decided the issue in *Henry Schein, Inc. v. Archer and White Sales, Inc.*, No. 17-1272, ___ U.S. ___, ___ S.Ct. ___, ___ L.Ed.2d ___, 2019 WL 122165 (U.S. 2019).

Henry Schein, Inc. v. Archer and White Sales, Inc.

- Distribution agreement between Archer and White and Henry Schein, Inc. contained an arbitration clause:

“Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief . . .), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA) . . .”

Henry Schein, Inc. v. Archer and White Sales, Inc.

- Archer and White filed a petition alleging violating of federal and state antitrust law and seeking monetary damages and injunctive relief.
- Henry Schein, Inc. moved to compel arbitration arguing the incorporation of the AAA's rules meant the parties incorporated a delegation provision into their contract.
 - Issues of arbitrability should be decided by an arbitrator.
- Archer and White asserted the “wholly groundless” exception arguing the question of arbitrability should be decided by an arbitrator as it sought injunctive relief in its petition.

Henry Schein, Inc. v. Archer and White Sales, Inc.

- The district court agreed with Archer and White holding Henry Schein, Inc.'s argument was wholly groundless. The Fifth Circuit affirmed.
- U.S. Supreme Court rejected the wholly groundless exception finding it was inconsistent with the text of the FAA and the Court's own precedent.

Henry Schein, Inc. v. Archer and White Sales

- “The ‘wholly groundless’ exception to arbitrability is inconsistent with the Federal Arbitration Act and this Court’s precedent. Under the Act, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms. The parties to such a contract may agree to have an arbitrator decide not only the merits of a particular dispute, but also ‘gateway’ questions of ‘arbitrability.’ ‘Therefore, when the parties’ contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless. That conclusion follows also from this Court’s precedent.”

Id., ___ U.S. at ___, ___ S.Ct. ___, slip op. at 1 (citations omitted).

NON-SIGNATORIES AND ARBITRATION CLAUSES

Non-Signatories to an Arbitration Agreement

- Generally, non-signatories to an arbitration agreement cannot be forced to arbitrate and cannot force a party to an arbitration agreement to arbitrate.

Exceptions

- Six scenarios where a non-signatory may be required to arbitrate:
 1. Incorporation by reference;
 2. Assumption;
 3. Agency;
 4. Alter ego;
 5. Equitable estoppel; and
 6. Third-Party Beneficiary.

Jody James Farms, JV v. Altman Group, Inc.

- *Jody James Farms, JV v. Altman Group, Inc.*, 547 S.W.3d 624 (Tex. 2018).
- Issue: can an arbitrator determine whether a non-signatory can compel a non-signatory to arbitrate?

Jody James Farms, JV v. Altman Group, Inc.

- Jody James Farms, JV purchased a Crop Revenue Coverage Insurance Policy from Rain & Hail, LLC, through the Altman Group, an independent insurance agency. The policy contained an arbitration clause. Altman Group was not expressly named in the policy and did not sign the policy.
- The carrier denied coverage for a claim. One basis for the denial was failure to provide notice. Jody James Farms asserted it had promptly called its agent at Altman Group to report the loss.

Jody James Farms, JV v. Altman Group, Inc.

- The arbitrator found in favor of the carrier.
- Jody James Farms then sued Altman Group and its agent. The trial court granted the agency's motion to compel arbitration. At arbitration, Jody James Farms continued to assert its right to proceed against the agency in court. The arbitrator determined the agency could compel arbitration and ruled on the merits of the dispute in favor of the agency.

Jody James Farms, JV v. Altman Group, Inc.

- The agency asked the trial court to confirm and enforce the arbitrator's award, and Jody James Farms requested that the award be vacated arguing no valid arbitration agreement exists between the parties. The trial court confirmed the award and denied Jody James Farms' motion.
- The Court of Appeals affirmed.

Jody James Farms, JV v. Altman Group, Inc.

- The arbitration clause incorporated the AAA's rules. Texas courts have differed on whether the incorporation of the AAA's rules evidence a clear intent for the arbitrator to decide the issue of arbitrability.
- When the dispute arises between a signatory to the contract and a non-signatory, questions pertaining to the existence of an arbitration agreement with a non-signatory are to be decided by the court, not the arbitrator.

Jody James Farms, JV v. Altman Group, Inc.

- A valid arbitration agreement exists between Jody James Farms and the carrier. The dispute with the agency does not arise from a disagreement between the carrier and Jody James Farms. The arbitration clause does not require that Jody James Farms arbitrate this disagreement.
- Examined some of the exceptions for when a non-signatory can be compelled to arbitrate.

Jody James Farms, JV v. Altman Group, Inc.

- Incorporation by reference: the arbitration clause did not incorporate any other disagreements (i.e. such as a disagreement between Jody James Farms and the Agency).
- Agency: an agent of a signatory can sometimes invoke an arbitration clause against another signatory. Here: the agency was an insurance agency, but the carrier did not exercise control over it. Agency cannot be the basis to compel arbitration.

Jody James Farms, JV v. Altman Group, Inc.

- Third-Party Beneficiary: a third-party beneficiary can enforce an arbitration clause as long as the signatories intended to secure a benefit to that third party and entered into the contract directly for the third party's benefit. The benefit must be direct, not incidental, and must be clearly set forth in the contract.
- Here: the agency was not a third-party beneficiary of the policy. The contract did not directly benefit the agency. At most, the agency received indirect and incidental benefits.

Jody James Farms, JV v. Altman Group, Inc.

- Direct-Benefits Estoppel: a signatory cannot seek to hold a non-signatory liable under a contract that contains an arbitration clause while simultaneously asserting the provision cannot be enforced by the non-signatory.
- Not applicable. Jody James Farms' claims against the agency are independent of the insurance policy. Its claims are based on the agency's tort and DTPA duties, which are generally non-contract obligations.

Waiver of Arbitration: Express and Implied

Waiver of Arbitration

- Parties subject to an arbitration clause can choose to arbitrate rather than litigate. If a party initiates or participates in litigation, how far can one proceed in the litigation process before the right to arbitrate the dispute is waived?
- Texas has a strong presumption against waiver of arbitration, but it is not irrebuttable.

Express Waiver of Arbitration

- Express waiver: a party must expressly waive arbitration or revoke the arbitration demand.
- Requesting a trial continuance and then agreeing to a new trial did not expressly waive a party's arbitration rights.

G.T. Leach Builders, LLC v. Sapphire V.P., LP, 458 S.W.3d 502, 511. (Tex. 2015)

Implied Waiver of Arbitration

- “A party asserting implied waiver as a defense to arbitration has the burden to prove that (1) the other party has ‘substantially invoked the judicial process,’ which is conduct inconsistent with a claimed right to compel arbitration, and (2) the inconsistent conduct has caused it to suffer detriment or prejudice. Because the law favors and encourages arbitration, ‘this hurdle is a high one.’”

G.T. Leach Builders, LLC v. Sapphire V.P., LP, 458 S.W.3d 502, 511-12. (Tex. 2015) (citations omitted).

Implied Waiver: First Part of the Test

- Has the party substantially invoked the litigation process?
- Question of law for the court.
- Decide on a case-by-case basis, and courts should look to the totality of the circumstances.

Perry Homes v. Cull, 258 S.W.3d 580, 588-92 (Tex. 2008).

Substantially Invoking the Litigation Process: *Perry Homes'* Factors

- How long the party moving to compel arbitration waited to do so;
- The reasons for the movant's delay;
- Whether and when the movant knew of the arbitration agreement during the period of delay;
- How much discovery the movant conducted before moving to compel arbitration, and whether that discovery related to the merits;
- Whether the movant requested the court to dispose of claims on the merits;

Substantially Invoke the Litigation Process: *Perry Homes*' Factors

- Whether the movant asserted affirmative claims for relief in court;
- The extent of the movant's engagement in pretrial matters related to the merits (as opposed to matters related to arbitrability or jurisdiction);
- The amount of time and expense the parties have committed to the litigation;
- Whether the discovery conducted would be unavailable or useful in arbitration;
- Whether activity in court would be duplicated in arbitration; and
- When the case was to be tried.

Perry Homes v. Cull: Example of Substantially Invoking the Litigation Process

- Seeking to compel arbitration four days before trial.
- Originally objecting to arbitration and then seeking to compel arbitration 14 months later.
- Propounding discovery.
- Filing five motions to compel.
- Ten Depositions
 - Noticing the depositions of six designees of Perry Homes on nine issues and including an attachment with 57 categories of documents.
 - Noticing the depositions of three of Perry Homes' experts and requesting 24 categories of documents from each.

Implied Waiver: Second Part of the Test

- Second part of the test: The party arguing waiver must show that it suffered prejudice.
- “[P]rejudice refers to the inherent unfairness in terms of delay, expense, or damage to a party’s legal position that occurs when the party’s opponent forces it to litigate an issue and later seeks to arbitrate that same issue.”
- “[A] party should not be allowed purposefully and unjustifiably to manipulate the exercise of its arbitral rights simply to gain an unfair tactical advantage over the opposing party”.

Perry Homes v. Cull, 258 S.W.3d 580, 597 (Tex. 2008).

G.T. Leach Builders, LLC v. Sapphire V.P., LP, 458 S.W.3d 502 (Tex. 2015)

- GT Leach, the general contractor, sought to compel arbitration after participating in the lawsuit initiated by Sapphire, the developer of the project at issue.
- GT Leach did not substantially invoke the litigation process to Sapphire's detriment.
- May 2011 – May 2012: GT Leach filed counterclaims, filed motions for relief, and participated in pretrial discovery. Merely taking part in litigation is not enough.
- “A party's litigation conduct aimed at defending itself and minimizing its litigation expenses, rather than at taking advantage of the judicial forum, does not amount to substantial invocation of the judicial process.” *Id. at* 513.

G.T. Leach Builders, LLC v. Sapphire V.P., LP: Analysis of the Factors

- GT Leach was sued by Sapphire.
- GT Leach filed a motion to transfer venue to defend Sapphire's claims in a single venue.
- GT Leach filed counterclaims, but these were defensive in nature and did not seek affirmative relief.
- GT Leach did seek summary judgment or dismissal of Sapphire's claims on the merits.
 - Seeking disposition on the merits is a key factor.
- GT Leach designated experts and responsible third parties. These actions were defensive in nature and necessary to preserve its rights .

G.T. Leach Builders, LLC v. Sapphire V.P., LP: Analysis of the Factors

- GT Leach served requests for disclosure as part of its answer and responded to discovery propounded by other parties.
 - Responding to discovery is not waiver.
- GT Leach filed a motion to quash.
- 2-3 month delay between the denial of GT Leach's motion to transfer venue and the filing its motion to compel: 2 – 3 months.
 - This is not a substantial delay when compared to the timeline of this case as a whole.
 - Other cases: 8 month delay and two year delay were not waiver.

G.T. Leach Builders, LLC v. Sapphire V.P., LP

- Sapphire did not suffer prejudice.
 - GT Leach could have moved for arbitration sooner, but Sapphire is the party that chose litigation over arbitration.

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