

# RECENT DEVELOPMENTS

creditors is determined on the basis of the order in which judgments are docketed or executed. While the “Decision After Inquest” determined the rights to the marital assets as between husband and wife, the decision did not purport to determine the rights to the assets as between Tanya and all other judgments lien creditors. Based upon these considerations, and the undisputed fact that the matrimonial judgment was docketed after the filing of the Chapter 7 petition, the court held that the marital assets were part of the bankruptcy estate and subject to distribution in due course by the bankruptcy court.

## NO HOMESTEAD EXEMPTION FOR BOAT

Norris v. Thomas, 215 S.W.3d 851 (Tex. 2007).

**FACTS:** Norris filed for bankruptcy and claimed his yacht as exempt property under the homestead exemption. Norris stated that he took up permanent residence on the boat after selling a previous home. Norris lived on the boat while it was drydocked, and the boat received water, phone service, and electricity through connections to a dock. Norris testified that after purchasing the boat he cruised the Gulf Coast extensively.

After the bankruptcy petition was filed, the boat was moved from Port Aransas to a marina in Corpus Christi. Although the boat was described in the record as “drydocked,” there was no indication that Norris ever permanently affixed the boat to real estate or intended to do so. Rather, the boat retained its mobile character, being capable of self-propulsion at all times.

The bankruptcy court held that the Texas homestead exemption, even broadly construed, does not include boats. The federal district court agreed, concluding that the boat was a movable chattel “by virtue of its self-powered mobility”. Norris appealed to the Fifth Circuit Court of Appeals, which certified the question: “[d]oes a motorized waterborne vessel, used as a

primary residence and otherwise fulfilling all of the requirements of a homestead except attachment to land, qualify for the homestead exemption under Article 16, §§ 50 and 51 of the Texas Constitution?”

**HOLDING:** A waterborne vessel not permanently attached to land cannot qualify for the homestead exemption under current law.

**REASONING:** The Texas Supreme Court held that boats do not meet the constitutional requirements for homestead protection. The Texas Constitution restricts the maximum size of a protected homestead, limiting rural and urban homesteads by acres of land and including any land-based improvements. TEX. CONST. art. XVI, § 51. The court emphasized the use of “thereon” and “on the land” in the provisions of the Constitution. While the court reviewed several mobile home cases involving homestead claims, the court distinguished a boat from a mobile home given the Constitution’s unequivocal requirement that protected improvements be on the land. Norris’s boat, unlike a dwelling permanently affixed to land, retains its independent, mobile character even when attached to dock-based amenities because it has self-contained utility and plumbing systems as well as its own propulsion. Though Norris took steps to tether the boat to realty, these steps did not alter the boat’s mobile character. The court held that Norris’s boat remained a movable chattel. It did not rest “thereon” or “on the land” as Texas homestead law clearly requires; it had not become a permanent part of the real estate; and was not sufficiently attached to real property to merit homestead protection. In the court’s view, the homestead exemption contemplates a requisite degree of physical permanency and attachment to fixed realty - “thereon” and “on the land” constituted the operative language.

**The court held that Norris’s boat remained a movable chattel.**

## ARBITRATION

### DECEASED’S CHILDREN AND PARENTS ARE BOUND BY ARBITRATION AGREEMENT UNDER THE THEORY OF DIRECT BENEFIT ESTOPPEL

In re Ford Motor Co., \_\_\_ S.W.3d. \_\_\_ (Tex. App.—San Antonio 2006).

**FACTS:** In 2003, Rudy Leija and his wife Maricella DeLeon bought a used 2000 Ford Expedition from Gillespie Motor Company. They signed a contract containing an arbitration provision that required any claims “be settled solely by the means of final and binding arbitration.” In 2005, Rudy was killed when the Expedition was involved in a rollover accident. His wife sued Ford and Gillespie individually, as a representative of her husband’s estate, and on behalf of their three minor children. Leija’s parents also joined the lawsuit. They alleged that through the sale of the Ford Expedition to the plaintiffs, the defendants expressly and impliedly warranted that the vehicle was fit for the purposes for which it was intended.

Ford and Gillespie moved to stay the trial court proceedings

and order all plaintiffs to arbitrate the claims. The court ordered only DeLeon, individually and as the representative of her husband’s estate to arbitration, rejecting that the children and the parents should be compelled to arbitrate. The trial court rejected the defendants’ argument that Leija’s children and parents should be required to arbitrate under the theory of direct benefit estoppel. The defendants then petitioned the court for a writ of mandamus to compel the trial court to order arbitration for Leija’s children and parents.

**HOLDING:** Writ of mandamus conditionally granted.

**REASONING:** First, the appeals court found the contract was governed by the Federal Arbitration Act (“FAA”) because it covered a transaction involving interstate commerce. Under the FAA, courts must decide gateway matters such as whether an arbitration agreement is binding on a nonparty absent evidence to the contrary. Texas law places the burden of proving both the existence of a valid arbitration agreement and that claims fall within the scope of that agreement on the party seeking to compel arbitration. Ford and Gillespie were unable to provide unmistakable evidence that the parties intended the arbitrator to

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make the decision whether nonparties were to be bound by the contract. The court held it was a gateway decision for the trial court.

Second, the court agreed with Ford and Gillespie that Leija's children and parents were bound by the arbitration agreement under the theory of direct benefit estoppel. The court noted that a nonparty's claim is based on a contract if the substance of the claim seeks to derive a direct benefit from the contract containing the arbitration provision. The claims of Leija's children and parents were seeking to enforce express warranties as if they were parties to sales contract so they were subject to the terms of contract and the arbitration addendum. The court held that Leija's children and parents were subject to the arbitration agreement because they chose to file claims based on the contract. The appeals court directed the trial court to comply with its decision within ten days of the opinion, or the writ of mandamus would be issued.

## ALL CLAIMS, INCLUDING THOSE FOR PERSONAL INJURY, ARE SUBJECT TO ARBITRATION PROVISION

In re Jim Walter Homes, 207 S.W.3d 888 (Tex. App.—Houston [14th Dist.] 2006).

**FACTS:** Sarah Cryer, individually and on behalf of Mildred Wooten contracted with Jim Walter Homes ("JWH") to build a home. The contract between plaintiffs and JWH contained a broad arbitration clause. Plaintiffs filed suit against JWH, alleging the home was defective. Plaintiffs asserted claims for breach of contract, violation of the Deceptive Trade Practices Act, fraud, negligence, negligent misrepresentation, and negligent hiring

and supervision. Among other things plaintiff sought damages for personal injury as a result of alleged negligent repairs made to the home. JWH moved to compel arbitration of all of plaintiffs' claims under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 ("FAA"). The district court ordered arbitration for all contract-related claims, but ruled that the claims for personal injury were not arbitrable. JWH sought a writ of mandamus ordering

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the trial court to vacate the portion of its order that denied arbitration. Plaintiffs also sought a writ of mandamus, requesting that the trial court be ordered to vacate the portion of its order that compelled arbitration.

**HOLDING:** JWH's petition for writ of mandamus granted.

**REASONING:** The Texas Court of Appeals had jurisdiction to review the trial court's denial of arbitration, though not the order compelling arbitration. The court held that a party seeking to compel arbitration by a writ of mandamus must (1) establish the existence of a valid agreement to arbitrate under the FAA, and (2) show that the claims in dispute are within the scope of this agreement. *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 737 (Tex. 2005).

The court stated that whether a valid arbitration agreement exists is a legal question subject to de novo review. *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 781 (Tex. 2006). The court continued that to determine whether an existing arbitration agreement covers a party's claims, a court must "focus on the complaint's factual allegations rather than the legal causes of action asserted." The court determined that all of plaintiffs' claims related to their "defective home" were factual allegations, and accordingly fell within the scope of the broad arbitration clause that plaintiffs signed. The arbitration clause covered all claims "arising out of or relating to" "the House that is the subject of this Agreement," whether those claims are "asserted in tort, contract or warranty." The court found that this language obviously applied to plaintiffs' claims, even those involving personal injury. On that basis, the court of appeals held that the trial court should have ordered arbitration of all claims, because "[o]nce the trial court concludes that the arbitration agreement encompasses the claims...[it] has no discretion but to compel arbitration and stay its own proceedings." *FirstMerit N.A.*, 52 S.W.3d 749, 753-54 (Tex. 2001).

## ARBITRATION AGREEMENT THAT WOULD REQUIRE PAYMENT OF \$28,000 IN FEES BY PERSON LIVING ON SOCIAL SECURITY NOT UNCONSCIONABLE

Overstreet v. Contigroup Cos., Inc., 462 F.3d 409 (5th Cir. 2006).

**FACTS:** Gertrude Overstreet raised chickens for Contigroup Companies under a series of agreements detailing the role and responsibilities of each party. The most recent agreement was entered into in Mississippi in 2001 and provided that: (1) Contigroup would supply Overstreet with chickens, feed, and medication, (2) Overstreet would raise and care for chickens, and (3) Contigroup would pay Appellee monthly for her services. The contract included an arbitration clause stating that any and all disagreements between the parties would be settled under specific arbitration guidelines. Under these guidelines, the parties were each responsible for an equal share of the cost of arbitration, each party agreed to have any dispute heard by a panel of three arbitrators, and each party expressly waived exemplary, punitive and consequential damages. Approximately two months after entering into this agreement, Overstreet sold her chicken farm and informed Contigroup that she would no longer raise chickens for them. Three years later, Overstreet sued Contigroup in Mississippi state court and alleged that (1) Contigroup fraudulently induced her to raising chickens for them, (2) that the requirements imposed by Contigroup for growing the chickens forced Overstreet to use harmful chemicals that damaged her former farm, and (3) Contigroup wrongfully terminated the contract. Looking to the arbitration clause within the most recent contract between the two parties, Contigroup filed a motion for stay and to compel arbitration. Overstreet then argued that both the arbitration clause and the contract were unconscionable. The district court only addressed the issue of whether the arbitration clause was unconscionable. After examining Overstreet's financial situation and the expected costs of arbitration, the court determined the clause was unconscionable and denied Contigroup's motion for stay and to compel arbitration.

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**HOLDING:** Reversed and remanded.

**REASONING:** Because the choice of law provision within the contract dictated that all aspects of the contract were to be governed by Georgia law, the court applied Georgia law to determine if the arbitration clause was in fact unconscionable. The court noted that Georgia law generally does not recognize claims of unconscionability when the claim was based on the costs of arbitration and economic disadvantage. The court re-examined Overstreet's financial status and determined that, although she now owned no real property and had no cash savings, the record reflected no facts as to her financial situation at the time she entered into the contract with Contigroup. The court cited its previous decision that the party resisting arbitration shoulders the burden of proving that the dispute is not arbitrable. *Am. Heritage Life Ins. Co. v. Lang*, 321 F.3d 533, 539 (5th Cir. 2003). Overstreet had not carried her burden of showing that the dispute was not arbitrable, because she failed completely to address the circumstances existing at the time the contract was made. Based on the facts presented, the court determined Overstreet failed to meet her burden of proof and held that the district court erred in finding the arbitration clause unconscionable.

## ARBITRATION AWARDS SHOULD NOT BE OVERTURNED BASED ON A "MERE APPEARANCE" STANDARD

*Positive Software Solutions, Inc. v. New Century Mortgage Co.*, 476 F.3d 278 (5th Cir. 2007).

**FACTS:** New Century Mortgage Corporation licensed an automated software support program from Positive Software Solutions, Inc. Two years later, during negotiations for a renewal of that license, Positive Software alleged that New Century copied the program in violation of the parties' agreement and applicable copyright law. Positive Software filed suit against New Century in the northern district of Texas. The district court granted Positive Software's motion to preliminarily enjoin New Century from using the program and, pursuant to the parties' contract, submitted the matter to arbitration. The parties selected Peter Shurn to arbitrate the case from a list of candidates provided by the American Arbitration Association ("AAA"). The AAA contacted Shurn about serving as an arbitrator, and he agreed, after stating that he had nothing to disclose regarding past relationships with either party or their counsel. At the conclusion of the arbitration, Shurn held that New Century had not violated the parties' agreement or applicable copyright law. Thereafter, Positive Software launched a detailed investigation of Shurn's background, which revealed that Shurn and his former law firm had previously represented New Century.

Positive Software filed a motion to vacate the arbitration award. The district court granted Positive Software's motion and vacated the award. New Century appealed and the court of appeals affirmed. The court of appeals granted New Century's petition for rehearing en banc.

**HOLDING:** Reversed and remanded.

**REASONING:** In *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968), the majority imposed "the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias." Thus, arbitrators

"not only must be unbiased but also must avoid even the appearance of bias." The *Commonwealth* court's concurring opinion held that while it was true that disclosure of prior significant contacts and business dealings between a prospective arbitrator and the parties furthers informed selection, it was not true that "the best informed and most capable arbitrators" should be automatically disqualified (and their awards nullified) by failure to inform the parties of a trivial relationship. The court, in the present case, relied heavily on the *Commonwealth* court's concurring opinion in finding that because Shurn's prior relationship was trivial, the arbitration award at hand should not be overturned.

**Arbitrators "not only must be unbiased but also must avoid even the appearance of bias."**

## FLORIDA COURT STRIKES DOWN ARBITRATION CLASS ACTION BAN

*Reuter v. Davis*, 2006 WL 3743016 (Fla. Cir. Ct. 2006).

**FACTS:** While on maternity leave, Donna Reuter's rate of pay dropped substantially, and she started having trouble making ends meet. To help deal with her financial difficulties, Ms. Reuter took out "pay day" loans from a variety of establishments, including Check 'N Go of Florida, Inc. This type of loan required Ms. Reuter to write a check to the lender for the sum borrowed plus a fee. In turn, the lender agreed to wait two weeks to call for payment. If the customer wished to suspend payment for longer than the two week period, Check 'N Go would charge additional interest for the extended period, which over a year's time would equal an interest rate of about 338.93% to 615.94%. In each transaction, Ms. Reuter signed an agreement, the terms of which provided that in the event of a dispute, any party to the transaction could choose to have it settled via binding arbitration. The agreement also provided that Ms. Reuter relinquish her right to participate in or bring a class action suit to settle the claim. Ms. Reuter's attorney, Mr. Yates, advised her to stop making payments to the pay day lenders, as he believed these types of loans fell under Florida's usury laws.

In 2001, Ms. Reuter brought suit against Check 'N Go, which subsequently removed the case to federal court, though it was later remanded back to state court. Check 'N Go (and other defendants) moved to dismiss her complaint or to compel arbitration, with the terms of the agreements unchanged, and lift the stay that was put into place pending the resolution of a recent United States Supreme Court case. Ms. Reuter maintained that the terms of the agreements she signed were illegal and, as such, the contracts were void, rendering their arbitration clauses and class action waiver provisions unenforceable. She sought to bring class action causes of action based on violations of Florida's statutory usury laws, its Consumer Finance Act, its Deceptive and Unfair Trade Practices Act, and under its Civil Remedies for Criminal Practices Act.

**HOLDING:** Arbitration compelled; stayed pending completion of arbitration.

**REASONING:** The court agreed with Ms. Reuter that the class action waiver contained within each agreement's arbitration clause was unconscionable and, as such, unenforceable. Under the

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Federal Arbitration Act, the class action waiver was presumed to be enforceable unless voided by one of three factors: (1) it defeated the respective statutes' remedial purposes; (2) it was precluded by statute; or (3) it was unconscionable.

To determine a waiver's validity in this context, the court looked for both procedural and substantive unconscionability. While the procedural component is marked by the conditions under which the agreement in question was formed, substantive unconscionability has to do with the agreement's terms and their implications. In determining whether the waivers were procedurally unconscionable, the court considered the extent to which the agreements were signed under stress – namely, what percentage of competitors in the market offering pay day loans had contracts with similar provisions – as well as the relative sophistication of the parties to the transaction. Citing general local market conformity in the practice of including class action waiver provisions in such contracts and evidence that the language in the agreements was beyond that which Ms. Reuter could reasonably understand, the court found some evidence of procedural unconscionability.

Turning then to the issue of substantive unconscionability, the court looked to whether the class action waiver effectively served to deny her competent legal representation. Because of the complexity of the legal issues involved, the likelihood that the class of defendants would generally be unable to afford and maintain individual legal representation, and finally the perception that attorneys quite often have trouble collecting on claims in these types of cases, the court found “overwhelming” evidence that the class action waivers in question were substantively unconscionable. Taken together, the waivers were found to be sufficiently procedurally and substantively unconscionable as to be unenforceable. The court granted defendant's motion to stay and compel arbitration, save for the portions of the agreements that served to waive plaintiff's ability to bring or participate in class action proceedings, which were stricken.

## TRIAL COURT ABUSED ITS DISCRETION IN CONCLUDING AN ARBITRATION CLAUSE WAS PROCEDURALLY UNCONSCIONABLE

TMI, Inc. v. Brooks, \_\_\_ S.W. \_\_\_\_ (Tex. App.—Houston [14th Dist.] 2007).

**FACTS:** Trendmaker Homes was in the business of building and selling homes. Appellees in this case were a group of homeowners who purchased new homes in Woodwind Lakes from Trendmaker. Each homeowner signed an agreement that contained an arbitration provision. The arbitration provision of the purchase agreement read, in relevant part, that “all claims, disputes and other matters” related to the “agreement or any alleged

defects relating to the Property” shall be decided by arbitration. After the purchase of their homes, homeowners discovered the property comprising Woodwind Lakes had been the former site of oil and gas operations that caused contamination to homeowners' properties. Homeowners brought suit against the various parties involved in the contamination and development of the land.

Six of the homeowners brought suit specifically against Trendmaker alleging negligence, fraud, violations of the Deceptive Trade Practices Act, negligent misrepresentation, nuisance, and civil conspiracy. Trendmaker asserted that homeowners were barred from bringing suit pursuant to the arbitration provision in the purchase agreement and filed a motion to compel arbitration. The trial court found that, because the clause is both procedurally and substantively unconscionable, homeowners' motion to reconsider would be granted and Trendmaker's motion to compel arbitration would be denied. Trendmaker appealed.

**HOLDING:** Reversed and remanded.

**REASONING:** The appeals court agreed with Trendmaker that homeowners failed to prove their unconscionability defense and, therefore, the trial court erred in denying Trendmaker's motion to compel arbitration of the homeowners' claims.

In *In re FirstMerit Bank*, 52 S.W.3d 749, 756 (Tex. 2001), the court held that the party opposing arbitration bears the burden to prove unconscionability as a defense to an arbitration agreement. Unconscionability has two elements, procedural and substantive unconscionability. Procedural unconscionability refers to the circumstances surrounding the adoption of the arbitration provision, while substantive unconscionability refers to the fairness of the arbitration provision itself. To support their claims of procedural unconscionability, homeowners submitted their own affidavits to the trial court. Except as to one homeowner, none of the affidavits provided evidence that the parties asked any question or requested any explanations of the arbitration provision in the purchase agreement. Absent fraud, a party to a contract may not successfully claim he believed the provisions of a contract were different from those plainly set out in the contract or he did not understand the language used.

The test for substantive unconscionability is “whether, given the parties' general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract.” Because the court held that homeowners did not meet their burden of proving procedural unconscionability, it did not reach the issue of substantive unconscionability.

**Unconscionability has two elements, procedural and substantive unconscionability.**