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ARBITRATION

SUPREME COURT RULES NONPARTIES CAN ENFORCE ARBITRATION AGREEMENT

Arthur Andersen LLP v. Carlisle, 129 S. Ct. 1896 (2009).

FACTS: Respondents Wayne Carlisle, James Bushman, and Gary Strassel set out to minimize their taxes from the 1999 sale of their construction-equipment company. Arthur Anderson LLP, a firm that had served as their company's accountant, auditor, and tax adviser, introduced them to Bricolage Capital, LLC, which in turn referred them for legal advice to Curtis, Mallet-Prevost, Colt & Mosle, LLP. According to respondents these advisers recommended a "leveraged option strategy" tax shelter later found illegal by the IRS. As part of the scheme, respondents invested in various stock warrants through newly created limited liability corporations ("LLCs"), which were also respondents in the case. The respondent LLCs entered into investment-management agreements with Bricolage providing that any controversy arising out of the agreement be settled by arbitration under the Commercial Arbitration Rules of the American Arbitration Association. Respondents filed a diversity suit in the Eastern District of Kentucky alleging fraud, civil conspiracy, malpractice, breach of fiduciary duty, and negligence. Petitioners moved to stay the action, invoking § 3 of the FAA and arguing that the principles of equitable estoppel demanded that respondents arbitrate their claims under their investment agreements with Bricolage. The district court denied the motions. Petitioners filed an interlocutory appeal, which the Court of Appeals for the Sixth Circuit dismissed for want of jurisdiction.

HOLDING: Reversed.

REASONING: The Supreme Court first addressed whether the Sixth Circuit had jurisdiction to review the district court's denial. The Court noted that under the FAA "an appeal may be taken

from...an order...refusing a stay of any action under section 3 of this title." 9 U.S.C. § 16(a)(1)(A). The Court found that by that provision's clear and unambiguous terms, any litigant who asks for a stay under § 3 is entitled to an immediate appeal from denial of that motion—regardless of whether the litigant is in fact eligible for a stay. Because each

petitioner in this case explicitly asked for a stay pursuant to § 3, the Sixth Circuit had jurisdiction to review the district court's denial.

The Court then considered the Sixth Circuit's determination that those who are not parties to a written arbitration agreement are categorically ineligible for relief. The Court found that § 2 of the FAA makes written arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of a contract." The Court reasoned that § 3 allowed litigants already in

federal court to invoke agreements made enforceable by § 2. The Court found that § 3 requires the court, "on application of one of the parties," to stay the action if it involves an "issue referable to arbitration under an agreement in writing." The Court noted that respondents do not contest that the term "parties" in § 3 refers to parties to the litigation rather than parties to the contract.

The Court held that state law is applicable to determine which contracts are binding under § 2 and enforceable under § 3, "if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 493 (1987). The Court reasoned that neither provision purports to alter background principles of state contract law regarding the scope of agreements. The Court found that because traditional principles of state law allow a contract to be enforced by or against nonparties to the contract through estoppel and other principles, the Sixth Circuit's holding that nonparties to a contract are categorically barred from § 3 relief was error.

ARBITRATION CLAUSE WAIVING CLASS ACTIONS DEEMED UNCONSCIONABLE UNDER OREGON LAW

Chalk v. T-Mobile USA Inc., 560 F.3d 1087 (9th Cir. 2009).

FACTS: Plaintiffs-Appellants Paul Stewart and Ellen Chalk bought a wireless PC card from T-Mobile that enables a computer to connect wirelessly to the internet, and signed a one-year service agreement with T-Mobile. Section three of the service agreement contained a mandatory arbitration clause, which provided that parties agree to arbitrate all claims. The section also contained a class action waiver and severability clause. Plaintiffs were able to use the card for approximately three weeks after purchasing it from T-Mobile. After not using it for a few months, the card would no longer insert properly into plaintiffs' computer. Despite multiple replacements, plaintiffs were not able to successfully insert the wireless card into their computer again. After a representative from the T-Mobile store promised to contact plaintiffs to solve the problem, and never did so, and after numerous unanswered email inquiries made by plaintiffs, plaintiffs filed a class action lawsuit in federal district court against T-Mobile, alleging multiple violations of state and federal law. The court concluded that Plaintiffs were required to arbitrate their claims under the service agreement plaintiffs signed with T-Mobile.

HOLDING: Reversed and remanded.

REASONING: The court considered both procedural and substantive unconscionability. Oregon law requires substantive unconscionability to render a contract invalid, not both substantive and procedural unconscionability.

The court noted that procedural unconscionability focuses on two factors in contract formation: oppression and surprise. Oppression is determinable by real opportunity to negotiate and the presence of meaningful choice, and surprise is determinable by hidden terms which serve as an escape clause for a party seeking to avoid enforcement of the agreement. Oregon law deems a contract of adhesion insufficient to render it unconscionable. The court reasoned that where a party has opportunity to review an open and obvious arbitration clause, there

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is a presumption of that party's assent, regardless of bargaining power. Plaintiffs had to break the seal, which drew their attention to the arbitration clause, to access the purchased card. The court determined that there was no oppression, surprise, or procedural unconscionability, even though the contract was a contract of adhesion.

Substantive unconscionability is based on disparity in bargaining power and terms which are unreasonably favorable to the party with the greater power. The court reasoned that a consumer contract class action waiver is considered unreasonably favorable because it is inherently one-sided in a consumer contract because no commercial entity would ever find itself engaging a class action suit against a consumer. Also, the court noted that the class action waiver is unreasonably favorable because it essentially denies the consumer any possible vindication of his rights. Litigation being prohibitively expensive, consumers seeking minimal damages are unlikely to pursue justice against a merchant if they must bear the burden of litigation alone. The court held that a class action waiver where individual damages are likely to be small is substantively unconscionable as a matter of Oregon state contract law. The court noted that Plaintiffs' actual damages were less than \$1,000, including the cost of the card and the monthly service fee for the duration of the contract.

The court specified that it was not holding all class action waivers unconscionable, merely those in consumer contracts involving small claims. The arbitration clause included a provision preventing severance of the class action waiver. In accordance with that provision, the arbitration agreement as a whole was held unenforceable. The court reversed and remanded the district court's dismissal pending arbitration.

MANIFEST DISREGARD OF THE LAW IS NOT A VALID NONSTATUTORY BASIS FOR VACATING AN ARBITRATION AWARD SUBJECT TO THE FEDERAL ARBITRATION ACT

Citigroup Global Mkts., Inc. v. Bacon, 562 F.3d 349 (5th Cir. 2009).

FACTS: In 2002, Debra Bacon ("Bacon") notified Citigroup that her husband had made five withdrawals from her Citigroup IRA without her permission. In 2004, Bacon submitted a claim in arbitration against Citigroup seeking reimbursement for the unauthorized withdrawals. The arbitration panel found in favor of Bacon and awarded her \$256,000. Citing §10 of the Federal Arbitration Act ("FAA"), Citigroup made an application to the district court requesting vacatur of the award. The district court granted the motion to vacate, holding that the award was in manifest disregard of the law. Bacon appealed.

HOLDING: Vacated and remanded.

REASONING: The court began by analyzing the Supreme Court's recent opinion in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S.Ct. 1396 (2008). The court determined that the Supreme Court rejected manifest disregard of the law as an independent ground for vacatur, and noted that §§10 & 11 of the FAA provide the exclusive basis for vacating, modifying or correcting an arbitration award. The court then evaluated the findings of other circuit courts. The Sixth, Second and Ninth Circuits have found that manifest disregard of the law is folded into §10(a)(4) of the FAA.

However, the Fifth Circuit found the Supreme Court was clear in its holding and held the statutory provisions in §10 are the exclusive grounds for vacatur. The court stated that manifest disregard of the law as an independent, nonstatutory ground for setting aside an award must be abandoned and rejected. The court vacated the district court's judgment and remanded for reconsideration in accord with the exclusivity of the statutory grounds.

WRONGFUL DEATH COMPLAINTS SUBJECT TO ARBITRATION CLAUSE

Graves v. BP American Inc., 568 F.3d 221 (5th Cir. 2009).

FACTS: Ronnie Graves, an employee of defendant J.V. Piping, died in a work-related accident at defendants' BP Texas facility. His survivors brought a diversity action, suing under the Texas wrongful death statute and the Texas survival statute. The defendants brought motions to compel arbitration pursuant to the arbitration clause in Ronnie Graves' employment agreement. The district court granted the motions with respect to the survival claims, as it found those claims to be wholly derivative of the decedent's rights, but denied the motions with respect to the wrongful death claims, as it found those claims to be personal to the plaintiffs. Defendants appealed.

HOLDING: Reversed.

REASONING: The court noted that there is uncertainty as to whether state or federal law applies to whether a nonsignatory should be compelled to arbitrate. The court did not decide the choice-of-law issue because federal and Texas law provide the same outcome. Under Texas law, although damages for a wrongful death action are for the exclusive benefit of the beneficiaries and are meant to compensate them for their own personal loss, the cause of action is still entirely derivative of the decedent's rights. Because the nonsignatory plaintiffs stood in the decedent's legal shoes, they were bound by the arbitration agreement. Under federal common law, the "direct benefits" version of estoppel prevents a nonsignatory from knowingly exploiting an agreement containing the arbitration clause. The court found that the plaintiffs could not sue under an agreement while at the same time avoiding its arbitration clause.

The court reasoned that because wrongful death was a state cause of action, the nature of the suit is defined by Texas law. Under Texas law, a wrongful death action is entirely derivative of the decedent's rights. The court found that because the plaintiff's cause of action was premised on the decedent's employment agreement, the plaintiffs were bound by the employment agreement's arbitration clause.

WEBSITE ARBITRATION AGREEMENT IS ILLUSORY AND UNENFORCEABLE

Harris v. Blockbuster, Inc., 622 F. Supp. 2d 396 (N.D. Tex. 2009).

FACTS: Harris, a Blockbuster Online customer, rented movies through their website. Blockbuster had an agreement with Facebook, a social networking site, which allowed transmission of online rental information to Facebook, who then broadcast the

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information to the customer's Facebook friends. Harris claimed that this violated the Video Privacy Protection Act, which requires the video service provider to obtain informed written consent at the time the disclosure is sought before disclosing personally identifiable information about a customer. Blockbuster attempted to invoke an arbitration provision in its "Terms and Conditions." Harris argued that the provision was unenforceable for two main reasons: (1) it was illusory; and (2) it was unconscionable. The U.S. District Court for the Northern District of Texas reviewed the company's motion to compel individual arbitration.

HOLDING: Motion denied.

REASONING: The court reached its conclusion under Texas contract law, which requires consideration for a contract to be enforceable. The court relied on a prior Fifth Circuit ruling, *Morrison v. Amway Corp.*, which held an arbitration clause to be illusory when it contained no express limit on to the company's unilateral modification ability nor a clause excluding arbitration from disputes arising, or arising from events occurring, before the publication of the changes. *Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir. 2008). After it established that the case was properly

before the court as a challenge to the arbitration provision, the court evaluated this provision against the *Morrison* standard.

From the text of the contract, the court concluded that Blockbuster reserved the right to modify the Terms and Conditions, including the section that contained the arbitration provision, "at its sole discretion"

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and "at any time." The court found the only express limitation on Blockbuster's unilateral right was that the modification was not effective until published notice was provided on the website, but found this publication requirement to be an inadequate limit on modification.

Blockbuster had no limit on the application to prior disputes and argued that because they attempted no retroactive modification in this case, the provision was not illusory. The court rejected the argument that *Morrison* only applied when a retroactive modification was involved and decided the issue on the basis that the ability to change the contract terms at any time made the contract illusory. The court found the provision to be illusory and did not need to reach the unconscionability issue.

FEDERAL ARBITRATION ACT APPLIES TO AGREEMENTS THAT AFFECT OR INVOLVE INTERSTATE COMMERCE

In re MP Ventures of S. Texas, Ltd., 276 S.W.3d 524 (Tex. App.—San Antonio 2008).

FACTS: Walter Oggoian sued MP Ventures for breach of contract, negligent misrepresentation, and deceptive trade practices, pursuant to a contract for the purchase and installation of a greenhouse, which allegedly failed to maintain a consistent temperature in contradiction to MP Ventures' sales brochures. MP Ventures moved to compel arbitration under the Texas Arbitration Act and in accordance with the arbitration clause of the

sales agreement. MP Ventures then amended its motion, seeking to compel arbitration under common law contract principles and the Federal Arbitration Act. The district court denied MP Ventures' motions on all grounds. MP Ventures sought a writ of mandamus to compel arbitration under the FAA.

HOLDING: Granted.

REASONING: The court noted that a party seeking a writ of mandamus to compel arbitration under the FAA must: 1) establish the existence of a valid arbitration agreement; and 2) show that the claims asserted are within the scope of the agreement. *In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 607 (Tex. 2005). The court held that the arbitration agreement was valid, because Oggoian acknowledged that the sales agreement would be governed by the Texas General Arbitration Act. The court held that the terms were within the scope of the agreement, because the language of the arbitration provision was comprehensive ("all unresolved disputes...relating to this agreement"), and Oggoian did not deny that the claims fell within the scope of the agreement.

The court noted that when there is no express agreement to arbitrate under the FAA, a party may establish the applicability of the FAA by showing that the transaction affects or involves interstate commerce. The court stated that commerce under the FAA is broadly construed and that commerce considered in the contract need not be substantial. The court reasoned that a party who alleges interstate commerce is affected may show it in several ways: 1) location of headquarters in another state, 2) transportation of materials across state lines, 3) manufacture of parts in a different state, 4) billings prepared out of state, and 5) interstate mail and phone calls in support of a contract. MP Ventures had shown evidence that materials used in the greenhouse were transported to Texas from South Carolina and that MP Ventures transmitted a letter concerning the project from Texas to South Carolina. The court found that the record contained no indication that Oggoian either disputed the evidence of interstate commerce or offered evidence to the contrary. The court ruled that it was bound to accept the undisputed evidence of interstate commerce as true, and consequently, that MP Ventures had met its burden to show that the arbitration agreement is governed by the FAA.

ARBITRATION WAIVED BY INVOKING JUDICIAL PROCESS

Woods v. Gentry, ___ S.W.3d ___ (Tex. App.—Dallas 2009).

FACTS: Laurie Gentry retained Holmes, Woods & Diggs ("Firm") and the parties executed a fee agreement. The fee agreement contained an arbitration clause in which the parties agreed disputes arising out of the Firm's representation of Gentry would be resolved through arbitration. A dispute over fees arose, and the Firm filed suit to recover unpaid fees. Gentry contacted the Firm and requested mediation or arbitration in accordance with the fee agreement; the Firm agreed. Gentry never filed an answer to the suit filed by the Firm, and the Firm filed a motion for default judgment, which was granted.

Gentry filed a bill of review, and both parties conducted extensive discovery on issues to be tried in the bill of review. The Firm filed a motion for summary judgment and argued the default judgment should be enforced and the bill of review denied. The

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trial court initially granted the motion, but after Gentry filed a motion for rehearing, signed an order setting aside the initial summary judgment order.

The trial court ordered the parties to mediate, but the dispute was not resolved. The trial court then granted the bill of review and set aside the default judgment. As a result, the Firm's original suit was set on the court's trial docket.

Gentry filed an answer and counterclaim. The Firm answered the counterclaim and filed a motion to enforce the arbitration clause in the fee agreement. Gentry responded and asserted the Firm had waived its right to arbitrate. The trial court denied the Firm's motion and the Firm appealed.

HOLDING: Affirmed.

REASONING: The court explained that while neither the trial court, the parties, nor the agreement indicated whether this action is governed by the Texas General Arbitration Act or the Federal Arbitration Act, the standard for determining waiver of the right to arbitration is the same.

The test for determining waiver is two-pronged: (1) did the party seeking arbitration substantially invoke the judicial process, and (2) did the opposing party prove it suffered prejudice as a result. The judicial process is substantially invoked when

the party seeking arbitration has taken specific and deliberate actions that are inconsistent with the right to arbitrate. Waiver is a valid defense to arbitration, but because public policy favors arbitration, there is a strong presumption against finding a party has waived his right to arbitration, and the burden to prove waiver is a heavy one.

The court considered the first prong and determined that the Firm initiated litigation and elected to aggressively pursue discovery. The court found the Firm's actions evidenced its intent to relinquish its right to arbitrate.

Turning to the second prong, the court explained that prejudice refers to the inherent unfairness in terms of delay, expense or damage to a party's legal position when the party's opponent forces it to litigate an issue and later seeks to arbitrate that same issue. The court found that Gentry incurred substantial attorney's fees and opined that the Firm attempted to manipulate the process, which was precisely the kind of inherent unfairness that constitutes prejudice under federal and state law.

Because the Firm substantially invoked the litigation process and Gentry suffered prejudice, the court concluded that the trial court did not err in its determination that the Firm waived the right to arbitration, and affirmed the trial court's order.

MISCELLANEOUS

REPOSSESSION DID NOT BREACH THE PEACE

Chapa v. Traciers & Assoc., Inc., 267 S.W.3d 386, (Tex. App.—Houston [14th Dist.] 2008).

FACTS: Ford Motor Credit Corporation ("FMCC") hired Traciers & Associates, Inc. ("Traciers") to repossess a white 2002 Ford Expedition owned by Marissa Chapa, who was in default on the associated promissory note. Traciers directed its field manager, Paul Chambers ("Chambers"), to conduct the repossession and gave Chambers an address for Marissa. However, FMCC, Traciers, and Chambers were unaware that the address was that of Marissa's brother, Carlos Chapa, who owned a similar white 2003 Ford Expedition. Carlos and his wife, Maria Chapa ("Chapa"), were not in default on their loan.

Chambers investigated the address, observed the Chapa's white 2003 Ford Expedition, noted that the license plate numbers did not match, but could not see the Expedition's vehicle identification number. The next morning, Maria Chapa loaded her two minor children into the Expedition. Maria then left the keys in the ignition with the engine running while she re-entered the house momentarily. Chambers then quickly towed the vehicle onto an adjacent street before realizing that the Expedition's engine was running. Chambers stopped the vehicle, noticed the two Chapa children inside, and immediately returned the Expedition to the Chapas. During this span of time, Maria returned outside and discovered her children were missing. She frantically called 911 and her husband to report their disappearance.

The Chapas filed suit against FMCC, Traciers, and Chambers for mental anguish suffered, arising from an alleged breach of the peace caused by Chambers while attempting the repossession. The trial court found that the repossession did not

breach the peace and granted summary judgment against the Chapas. The Chapas appealed.

HOLDING: Affirmed.

REASONING: In order for the Chapas to be able to recover against FMCC and Traciers for mental anguish suffered, they must first establish that a breach of the peace occurred. The court examined the elements of breach of the peace both from a criminal law standpoint, as well as from a Uniform Commercial Code ("UCC") standpoint.

Under Texas criminal law, a breach of the peace includes all violations of the public peace or order.

The court recognized that this is a broad definition, and that whether a specific act constitutes a breach of the peace depends on the surrounding facts and circumstances in the particular case. The court noted that it was undisputed that Chambers did not behave violently or threaten physical injury to anyone. It was also undisputed that Chambers did not know the children were in the vehicle when he towed it. Based on the facts of this case, the court found that Chambers' conduct did not breach the peace under criminal or common law.

The UCC specifically addresses breaches of the peace concerning repossession of property, referring to conduct that leads or is likely to lead to an immediate loss of public order and tranquility. The court found no evidence that Chambers met with any objections while attempting to repossess the vehicle. To the contrary, Chambers desisted repossession as soon as he learned of the presence of the children. The court found further

It was also undisputed that Chambers did not know the children were in the vehicle when he towed it.