The Arbitration Newsletter

(Published by Whitaker Chalk Swindle & Schwartz PLLC)
(John Allen Chalk, Sr., Editor)

April, 2016

****

The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

****

BE CAREFUL OF AMENDMENTS TO ARBITRATION AGREEMENT

Nelson v. Watch House Int'l, L.L.C., No. 15-10531, 2016 U.S. App. LEXIS 3959 (5th Cir. Mar. 2, 2016).

Michael Nelson ("Nelson") is a former employee of Watch House International, L.L.C. ("Watch House"). On March 18, 2010, Nelson was offered a job as a Recurrent Training Instructor for the Federal Air Marshal Program at Dallas, Texas.[2] Also, on March 18, 2010, Nelson was sent an electronic copy of the employee handbook that contained Watch House's Arbitration Plan ("Plan").[3] In pertinent part, the Plan read as follows:

> As a condition for reviewing your application for employment and if employed, continued employment . . . [Company] and the Applicant/Employee designated below mutually agree to arbitrate claims relating to his/her being considered for employment and subsequent employment, if any, as specified below.
>
> The Company and Applicant/Employee each voluntarily promise and agree to submit any claim covered by this agreement to binding arbitration. We further agree that arbitration pursuant to this agreement shall be the sole and exclusive remedy for resolving any such claims or disputes. . . .
>
> It is mutually agreed that this document shall govern and apply to the resolution of all claims and/or disputes between and among Applicant/Employee and the Company . . . concerning: (1) Any federal, state, or local laws, regulations, or statutes prohibiting employment discrimination (such as, without limitation, race,

---

[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel. My thanks to Macdonald A. Norman, a third-year law student at Texas A&M University School of Law, for his research and drafting assistance.

[2] *Nelson v. Watch House Int'l, L.L.C.*, No. 15-10531, 2016 U.S. App. LEXIS 3959, at *1 (5th Cir. 2016).

[3] *Id.* at *1–2.

> color, sex, national origin, age, disability, religion) and harassment . . . [and] (4) Any claim for failure to hire or wrongful discharge of any kind. . . .
>
> This agreement is issued with the authority of the Company and is binding on the Company. This Agreement may not be altered except by consent of the Company and shall be immediately effective upon notice to Applicant/Employee of its terms, regardless of whether it is signed by either Agreeing Party. Any change to this Agreement will only be effective upon notice to Applicant/Employee and shall only apply prospectively.[4]

Nelson worked for Watch House for almost four years from March 31, 2010 until March 12, 2014.[5] According to Nelson, he was harassed by his coworkers at Watch House based on religion and race.[6] Specifically, Nelson's coworkers made racial comments related to his interracial relationship.[7] Nelson reported these comments to his supervisor; Nelson was terminated roughly fifteen days after reporting the comments.[8]

Nelson filed suit in federal district court alleging, among other causes of action, "he was discharged in violation of Title VII the Civil Rights Act of 1964 and Chapter 21 of the Texas Labor Code."[9] Watch House moved to compel arbitration.[10] In opposition, Nelson first argued that he was not an "employee" under the Plan because the Plan defined "employee" as "the individual whose signature is affixed hereto."[11] Nelson never signed the Arbitration Plan.[12] Second, Nelson argued that the Plan was illusory.[13] The district court granted Watch House's motion to compel and dismissed Nelson's lawsuit without prejudice.[14]

On appeal, the Fifth Circuit held that the Plan was illusory because it did not contain a Halliburton-type savings clause and declined to reach Nelson's other issues.[15] The court first considered whether Watch house and Nelson agreed to arbitrate this particular type of dispute.[16] To answer this question, a court must determine: "'(1) whether there is a valid agreement to arbitrate between the parties; and (2) whether the dispute in question falls within the scope of that arbitration agreement.'"[17] Nelson only challenged the validity of the agreement to arbitrate.[18]

---

[4] *Id.* at *2–3 (alterations in original).
[5] *Id.* at *3.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.* at *4.
[12] *Id.*
[13] *Id.* Nelson argued that the Plan was illusory under *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002) and *Lizalde v. Vista Quality Markets*, 746 F.3d 222 (5th Cir. 2014).
[14] *Id.*
[15] *Id.* at 1 and 7.
[16] *Id.*
[17] *Id.* at 6 (quoting *Carey v. 24 Hour Fitness, USA, Inc.*, 669 F.3d 202, 205 (5th Cir. 2012)).
[18] *Id.*

In order to determine whether an arbitration agreement is valid, "courts apply ordinary state-law principles that govern the formation of contracts."[19] Texas law governed here, and, under Texas law, an arbitration agreement must be supported by consideration.[20] Typically, a mutual agreement to arbitrate claims will satisfy the consideration requirement, but the agreement is illusory if "one party has the unrestrained unilateral authority to terminate its obligation to arbitrate."[21]

Yet, a party can retain some ability to terminate the agreement. In *In re Halliburton*, the Texas Supreme Court held that an arbitration agreement was not illusory based on two provisions in the agreement: 1) "no amendment shall apply to a Dispute of which . . . [employer] had actual notice on the date of amendment"; and 2) that "termination shall not be effective until 10 days after reasonable notice of termination is given to Employees or as to Disputes which arose prior to the date of termination."[22] Due to these two provisions, the Texas Supreme Court held that Halliburton could not wholly avoid arbitration by amending or terminating the agreement.[23]

In *Lizalde v. Vista Quality Markets*, the Fifth Circuit has stated a three-part test for determining whether a *Halliburton*-type savings clause sufficiently restrains an employer's unilateral right to terminate arbitration.[24] An arbitration agreement is not illusory if an employer retains termination power as long as that power: "(1) extends only to prospective claims, (2) applies equally to both the employer's and employee's claims, and (3) so long as advance notice to the employee is required before termination is effective."[25]

Citing case law that pre-dated *Lizalde*, Watch House attempted to argue that an arbitration agreement is not illusory as long as the agreement meets the first prong of the *Lizalde* test.[26] The Fifth Circuit did not agree and stated that: "we have never published a decision holding that an arbitration agreement satisfied Halliburton where the agreement applied only to prospective claims but did not also require advance notice."[27] While the Texas Supreme Court has not addressed the validity of the *Lizalde* test, various Texas Court of Appeals' opinions have rejected arguments similar to those of Watch House.[28]

Satisfied that the *Lizalde* test is still valid Texas law, the Fifth Circuit applied *Lizalde* to Watch House's Arbitration Plan.[29] After comparing the approved provision in *Lizalde* against the Watch House Plan, the court held "Watch House's retention of this unilateral power to terminate the Plan without advance notice renders the Plan illusory . . ."[30]

---

[19] *Id.* (quoting *Carey*, 669 F.3d at 205) (internal quotation marks omitted).
[20] *Id.* (citing *Lizalde v. Vista Quality Markets*, 746 F.3d 222, 225 (5th Cir. 2014)).
[21] *Id.* at *6–7 (quoting *Lizalde*, 746 F.3d at 225).
[22] *Id.* at 7 (quoting *In re Halliburton Co.*, 80 S.W.3d 566, 569–70 (Tex. 2002) (alterations in original).
[23] *Id.* at 7–8 (quoting *In re Halliburton Co.*, 80 S.W.3d at 70)).
[24] *Id.* at 8 (citing *Lizalde v. Vista Quality Markets*, 746 F.3d 222, 226 (5th Cir. 2014)).
[25] *Id.* (quoting *Lizalde v. Vista Quality Markets*, 746 F.3d at 226).
[26] *Id.* at 9.
[27] *Id.*
[28] *Id.* at 9–13 (*citing Temp. Alts., Inc. v. Jamrowski*, 2014 Tex. App. LEXIS 5437, at *4-5 (Tex. App. – El Paso, May 21, 2014.
[29] *Id.* at 13–15.
[30] *Id.* at 15.

OBSERVATIONS

1. New employee had notice of the arbitration agreement in the Employee Handbook, even if he did not sign the arbitration agreement.

2. The employee's knowledge was enough to establish the validity of the arbitration agreement.

3. Draft the arbitration agreement to be enforceable under the applicable state law of contracts.

4. The Fifth Circuit's test for validity of changes to an arbitration agreement contains three items versus two items in the current test applied by the Texas Supreme Court.[31]

5. Make sure when drafting a right to amend an existing arbitration clause that the right to amend meets all three Fifth Circuit tests in *Lizalde*.

[31] *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002).