The Arbitration Newsletter

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ARBITRATION CLAUSES ARE ALIVE AND WELL IN TEXAS: EQUITABLE ESTOPPEL ROPES NON-SIGNATORIES INTO ARBITRATION

***Hays v. HCA Holdings, Inc.*, No. 15-51002, 2016 U.S. App. LEXIS 17667 (5th Cir. Sept. 29, 2016).**

Claimant, John T. Hays, M.D. ("Hays"), is a cardiologist in Texas with over thirty years in medical practice. He began suffering from epilepsy and taking medication in 1998. Dr. Hays's seizures were well-controlled but "exacerbated by stress."[2] In 2006, Hays's practice was purchased by Austin Heart, P.L.L.C. ("Austin Heart"), and Hays informed Austin Heart's managing director of his condition and requested a less demanding schedule. In 2009, Austin Heart and Capital Area Cardiology ("CAC") entered into a Physician Employment Agreement ("Agreement") with Dr. Hays containing an arbitration clause. In December 2013, Hays experienced seizures for two days. He was then put on administrative leave by Defendants HCA Holdings, Inc. and HCA Physician Services, Inc., and his employment was terminated in January 2014.

Dr. Hays alleged wrongful termination against his former employer based on his stress-related seizures. Hays's employment agreement, to which Hays, Austin Heart, and CAC were signatories, contained an arbitration clause "providing that any 'controversy or claim arising out of or related to' the Agreement will be submitted to mandatory, binding arbitration before the American Health Lawyers Association (AHLA)."[3] Hays initially brought claims against CAC, Austin Heart, and HCA Holdings. As signatories to the Agreement with Hays, the state court granted CAC and Austin Heart's motion to dismiss and compel arbitration.

Hays then amended his state court complaint against HCA Holdings, Inc. and added HCA Physician Services, Inc. (collectively "HCA") as a defendant. HCA removed the case to federal court. Among Hays's added claims against HCA was tortious interference with at-will

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[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 Tave Parker Doty, a third-year law student at Texas A&M University School of Law, for her research and drafting assistance.

[2] Plaintiff John T. Hays's Original Petition and Requests for Disclosure ¶ 9.

[3] Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at*2 (W.D. Tex. Sept. 30, 2015).

employment.[4] The Western District of Texas applied direct benefits estoppel and required the parties to arbitrate "[b]ecause HCA's liability under the tortious interference claim could not 'be determined without reference to the Physician Employment Agreement.'"[5] Hays appealed to the Fifth Circuit Court of Appeals ("Fifth Circuit"), which reviews "an order compelling arbitration de novo," and claimed that the district court abused its discretion when it compelled arbitration under equitable estoppel.[6] The Fifth Circuit found that "HCA's liability depends on the Agreement" and that "the district court did not abuse its discretion in applying direct benefits estoppel to Hays's tortious interference claim."[7]

When a party seeks to compel arbitration, it must establish the existence of a valid arbitration agreement and that the dispute falls within the scope of the arbitration agreement.[8] This is the two-step analysis courts employ to compel arbitration under the Federal Arbitration Act.[9] A presumption of arbitrability arises when an arbitration clause is present in a contract.[10] This presumption "requires [the] [c]ourt to resolve any ambiguities as to the scope of the arbitration agreement in favor of arbitration."[11]

Generally, a party must sign an arbitration agreement to be bound to it.[12] However, state law determines whether a non-signatory may be bound to or may be permitted to enforce, an arbitration agreement in certain circumstances.[13] Texas policy favors arbitration, "but it alone cannot authorize a non-party to invoke arbitration."[14] When non-signatories attempt to assert a claim in arbitration the gateway issue becomes did the signatories agree that non-signatories could make such a claim because the "parties to an arbitration agreement may grant non-signatories the right to compel arbitration."[15]

Courts have allowed non-signatories to enforce arbitration agreements against signatories by equitable estoppel.[16] Direct benefits estoppel is a special type of equitable estoppel and arises when the contract creates a claim, which would be "unable to 'stand independently' without the contract."[17] The claim's substance, "not artful pleading," determines "[w]hether a claim seeks a direct benefit from a contract containing an arbitration clause."[18] However, when the claim's substance arises under state law, rather than contract, "'direct benefits' estoppel does not apply,

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[4] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *1 (Tex. Sept. 29, 2016).
[5] *Id.* (quoting Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at *2 (W.D. Tex. Sept. 30, 2015).
[6] Craford Prof'l Drugs, Inc. v. CVS Caremark Corp., 748 F.3d 249, 256 (5th Cir. 2014).
[7] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *5 (Tex. Sept. 29, 2016).
[8] G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502, 524 (Tex. 2015).
[9] Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at *2 (W.D. Tex. Sept. 30, 2015).
[10] *Id.* at *3.
[11] *Id.*
[12] In re Kellogg Brown & Root, Inc., 166 S.W.3d 732, 739 (Tex. 2005).
[13] *Id.*
[14] Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 532 (5th Cir. 2000).
[15] G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502, 524 (Tex. 2015) (quoting In re Rubiola, 334 S.W.3d 220, 222 (Tex. 2011)).
[16] G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502, 524 (Tex. 2015).
[17] *Id.* at 528 (Tex. 2015) (quoting In re Kellogg Brown & Root, Inc., 166 S.W.3d 732, 739–40 (Tex. 2005)).
[18] In re Weekley Homes, L.P., 180 S.W.3d 127, 131–32 (Tex. 2005).

even if the claim refers to or relates to the contract."[19] Direct benefits estoppel functions to prevent parties from "having it both ways."[20] A claimant cannot on "one hand, seek to hold the non-signatory liable pursuant to duties imposed by the agreement, which contains an arbitration provision, but, on the other hand, deny arbitration's applicability because the defendant is a non-signatory."[21]

The federal district court found, and the Fifth Circuit affirmed, that applying direct benefits estoppel to Hays's tortious interference with an at-will employment claim against HCA was proper because the claim could not stand without the Agreement. As this claim was pled in the alternative if Hays was not found to be an employee of HCA, the nature of Hays's employment with Austin Heart and CAC had to also be determined. The existence of an employment contract is not dispositive under Texas law when considering whether a person's employment is at-will; "[a] contract of employment for a term may still be at-will if the agreement allows termination for any reason."[22] The district court found, and the Fifth Circuit upheld, that both the nature of Hays's employment and Hays's claim against HCA relied on the Agreement, which required any "controversy or claim arising out of or related to" the Agreement be submitted to mandatory, binding arbitration.[23]

After amending his complaints against HCA, Hays also alleged wrongful termination in violation of the Texas Commission on Human Rights Act ("TCHRA"), negligence, and breach of contract.[24] The federal district court applied intertwined claims estoppel to these claims and compelled the parties to arbitration. The Fifth Circuit noted that the "Texas Supreme Court has not expressly adopted intertwined claims estoppel as a valid theory of estoppel."[25] However, the Texas Supreme Court recognized that "other federal circuits have estopped signatory plaintiffs from avoiding arbitration with nonsignatories using an 'intertwined-claims' test."[26]

The Fifth Circuit noted that the Texas courts of appeal are split on whether or not the Texas Supreme Court recognizes intertwined claims estoppel. To review Hays's appeal, the Fifth Circuit made "an *Erie* guess [to] determine as best [it could] what the Supreme Court of Texas would decide."[27] In its *Erie* guess, the Fifth Circuit found that the Texas Supreme Court would likely recognize intertwined claims estoppel and that Hays's remaining claims were subject to arbitration.[28]

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[19] G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502, 528 (Tex. 2015) (quoting In re Morgan Stanley & Co., 293 S.W.3d 182, 184 n.2 (Tex. 2009)).
[20] G.T. Leach Builders, LLC v. Sapphire V.P., L.P., 458 S.W.3d 502, 527 (Tex. 2015).
[21] *Id.* (quoting Meyer v. WMCO-GP-LLC, 211 S.W.3d 302, 306 (Tex. 2006)).
[22] Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at *6 (W.D. Tex. Sept. 30, 2015) (citing C.S.C.S., Inc. v. Carter, 129 S.W.3d 584, 591 (Tex. App.—Dallas 2003, no pet.)).
[23] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *5 (Sept. 29, 2016); Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at *2 (W.D. Tex. Sept. 30, 2015).
[24] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *1 (Sept. 29, 2016).
[25] *Id.* at *5.
[26] *Id.* (quoting In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 193 (Tex. 2007)).
[27] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *5 (Tex. Sept. 29, 2016) (quoting Harris Cnty. v. MERSCORP, Inc., 791 F.3d 545, 551 (5th Cir. 2015).
[28] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *15 (Tex. Sept. 29, 2016).

Intertwined claims estoppel is a type of equitable estoppel that arises "when a nonsignatory defendant has a 'close relationship' with one of the signatories and the claims are 'intimately founded in and intertwined with the underlying contract obligations.'"[29] The *Merrill Lynch* court observed that "other federal circuits have estopped signatory plaintiffs from avoiding arbitration with nonsignatories using an 'intertwined-claims test.'"[30] *Merrill Lynch* also noted that the "close relationship" requirement generally has been applied in cases when a signatory employs strategic pleading to sue a nonsignatory and avoid an arbitration clause.[31] "[A]llowing litigation to proceed that is in substance against a signatory though in form against a nonsignatory would allow indirectly what cannot be done directly."[32] The "close relationship requirement guards against 'sweep[ing] independent entities and even complete strangers into arbitration agreements,' thereby limiting the exception to instances of strategic pleading."[33] Alone, however, a corporate relationship among parties is not enough to compel arbitration.[34]

"If the facts alleged 'touch matters,' have a 'significant relationship' to, are 'inextricably enmeshed' with, or are 'factually intertwined' with the contract containing the arbitration agreement, the claim is arbitrable."[35] Here, the district court found, and the Fifth Circuit affirmed, that in Hays's TCHRA, negligence, and breach-of-contract claims he treated HCA, Austin Heart, and CAC as a single unit.[36] Hays raised "virtually indistinguishable factual allegations against CAC and Austin Heart in arbitration and against HCA [in his appeal to the Fifth Circuit]"[37] and "treated Austin Heart, CAC, and HCA—affiliates of his former cardiology practice—as if they were interchangeable."[38] The intertwinement of Hays's claims before the Fifth Circuit, and the claims already submitted to arbitration, with the underlying Agreement creates a "tight relatedness of the parties, contracts and controversies."[39] The Fifth Circuit found the federal district court did not abuse its discretion in applying intertwined claims estoppel to compel Hays to arbitrate his remaining claims and noted that "Hays's current efforts to distinguish amongst defendants and claims are the archetype of strategic pleading intended to avoid the arbitral forum, precisely what intertwined claims estoppel is designed to prevent."[40]

Circuit Judge Haynes wrote a separate concurring opinion to join the direct benefits estoppel finding but not the intertwined claims. Judge Haynes agreed with affirming the district court's judgment sending all of Hays's claims to arbitration. Haynes "conclude[d] that all of

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[29] *Id.* at *5(quoting In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 193–94 (Tex. 2007)).
[30] In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 193 (Tex. 2007).
[31] *Id* at 193–94.
[32] *Id.*
[33] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *5 (Sept. 29, 2016) (quoting In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 193–94 (Tex. 2007) (alternations in *Hays*).
[34] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *12 (Sept. 29, 2016) (citing quoting Cotton Commercial USA, Inc. v. Clear Creek Independent School District, 387 S.W.3d 99, 105 (Tex. App.—Houston [14th Dist.] 2012, no pet.)).
[35] FD Frontier Drilling (Cyprus), Ltd. v. Didmon, 438 S.W.3d 688, 695 (Tex. App.—Houston [1st Dist.] 2014, reh'g overruled (July 29, 2014)) (quoting Cotton Commercial USA, Inc. v. Clear Creek Independent School District, 387 S.W.3d 99, 108 (Tex. App.—Houston [14th Dist.] 2012, no pet.)).
[36] Hays v. HCA Holdings, Inc., No. A-15-CA-432-SS, at *8 (W.D. Tex. Sept. 30, 2015).
[37] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *13–14 (Sept. 29, 2016).
[38] *Id.* at *14.
[39] *Id.* at *13–14 (quoting JLM Industries, Inc. v. Stolt-Neilson, SA, 387 F.3d 163, 177 (2d Cir. 2004)).
[40] Hays v. HCA Holdings, Inc., 2016 U.S. App. LEXIS 17677, at *14 (Sept. 29, 2016).

Hays's claims either [met] the test for direct benefits estoppel or constitute[d] the kind of 'artful pleading' designed to avoid direct benefits estoppel that the Texas Supreme Court found ineffectual."[41]

OBSERVATIONS

1. Do not discount the potential arbitrability of claims by or against non-signatories to an arbitration agreement without careful consideration of the interrelatedness of all claims and counterclaims in the dispute.

2. When non-signatories are involved in a dispute in any way related to a contract containing a broad form arbitration clause, look carefully at the relationships of all the parties and potential parties for who should be or can be compelled to arbitrate.

3. As a result of *Hays v. HCA Holdings, Inc.*, strategic pleading to avoid arbitration has become less effective in Texas but careful, thoughtful pleading is still important.

4. A practical cost-saving voluntary agreement to join all parties in the arbitration of this matter after the state court judgment, in hindsight, would have been more economical and efficient.

[41] *Id.* at *15–16 (citing In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185, 188–90 (Tex. 2007)).