The Arbitration Newsletter

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(John Allen Chalk, Sr., Editor)

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

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ATTACK THE ARBITRATION CLAUSE NOT THE CONTRACT AS A WHOLE IF YOU DON'T WANT TO GO TO ARBITRATION

The U.S. Supreme Court in a decision announced on February 21, 2006 made it clear, again, that the possible invalidity under state law of a contract that contained an arbitration clause did not mean that a court (instead of an arbitrator) should decide the contract invalidity question.[2] The U.S. Supreme Court directed the Florida Supreme Court to send the case back to the trial court to compel arbitration even where the Plaintiffs in state court claimed a "Deferred Deposit and Disclosure Agreement" they signed was usurious under Florida state law.[3] The state court Plaintiffs didn't specifically attack the validity of the arbitration clause in the "Deferred Deposit and Disclosure Agreement," therefore, the contract validity question was for the arbitrator not the court.[4] The Federal Arbitration Act requires the trial court, state or federal, in this situation to compel arbitration leaving the contract validity question for the arbitrator not the

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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 legal counsel.

[2]*See Buckeye Check Cashing, Inc. v. Cardegna*, 126 S.Ct. 1204, 163 L.Ed.2d 1038, 2006 U.S.LEXIS 1814 (February 21, 2006).

[3]126 S.Ct. at 1207.

[4]"...[Plaintiffs in state court alleged] that Buckeye charged usurious interest rates and that the [Deferred Deposit and Disclosure] Agreement violated various Florida lending and consumer-protection laws, rendering it criminal on its face." 126 S.Ct. at 1207.

judge.[5] Justice Scalia, for the majority (Roberts, Stevens, Kennedy, Souter, Ginsburg, and Breyer), summarized three principles taught by the earlier cases of *Prima Paint Corp. v. Flood & Conklin Mfg.Co.*, 388 U.S. 395, 87 S.,Ct. 1801, 18 L.Ed.2d 1270 (1967) and *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed. 2d 1 (1984): (1) "...as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract"; (2) "...unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance"; and (3) "...this arbitration law applies in state as well as federal courts."[6] What had not been clear prior to this decision, at least as the Plaintiffs saw it, was whether this "substantive federal arbitration law" regarding severability of the arbitration clause from the remainder of the contract in which it is found applied to state courts as well as federal courts. The U.S. Supreme Court held that the doctrine of severability of the arbitration clause from the contract as a whole did apply whether the challenge was brought in a state or a federal court.[7]

SOME PRACTICAL LESSONS FROM *BUCKEYE CHECK CASHING*

1. If you want your contract disputes arbitrated then make sure that the arbitration clause in your contracts expressly adopts the Federal Arbitration Act as the law of the arbitration.[8] *See* 9 U.S.C. §1 *et seq*.

2. If you don't want to arbitrate a dispute subject to an arbitration clause in a contract, then don't waste your time and money attacking the validity of the contract generally (even when you have a strong basis for your invalidity claim); attack specifically the validity of the arbitration clause, not the contract as a whole, "upon such grounds as exist at law or in equity for the revocation of any contract."[9]

3. What the court decides and what the arbitrator decides (known as "arbitrability") has been answered again but with greater emphasis by the U.S. Supreme Court in *Buckeye* - unless the issue is the existence of a valid arbitration agreement (for the court to decide),

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[5] *Id*. at 1210.

[6] *Id*. at 1209.

[7] *Id*. at 1210.

[8] Assuming you can qualify the contract in question as one "evidencing a transaction involving [interstate] commerce." 9 U.S.C. §2.

[9] 9 U.S.C. §2; "We reaffirm today that, regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator." *Buckeye*, 126 S.Ct. at 1210.

contract validity as well as all other issues and disputes go to the arbitrator.[10]

4. There should be less cases, after *Buckey Check Cashing*, in which parties are forced to ask courts to compel arbitration and there should be less reluctance by judges to compel arbitration when there is no legitimate claim of invalidity of the *severable* arbitration clause in the parties' contracts.[11]

TEXAS SUPREME COURT ORDERS ARBITRATION IN A DIRECT ATTACK ON THE ARBITRATION CLAUSE

The Texas Supreme Court directed a Texas trial court to compel arbitration in an employment dispute after a discharged employee had sued the employer and a supervisor rather than making her claim in arbitration.[12] The state court denied Dillard's motion to compel arbitration and the El Paso Court of Appeals denied Dillard's Petition for Writ of Mandamus.[13] But the Texas Supreme Court said that all Dillard had to show was (1) a valid arbitration agreement and (2) the employee's claims fall within the arbitration agreement's scope.[14]

Contract law "determines the validity of arbitration agreements," as a matter of law.[15] If the arbitration agreement is unambiguous the objective intent of the parties as expressed therein

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[10]"We decide whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality." *Buckeye*, 126 S.Ct. at 1207.

[11]"We rejected [in *Prima Paint*] the view that the question of 'severability' was one of state law, so that if state law held the arbitration provision not to be severable a challenge to the contract as a whole would be decided by the court." *Id*. at 1208; *citing Prima Paint*, 388 U.S. at 400, 402-403.

[12]*See In re Dillard Department Stores, Inc. and Reeder*, 186 S.W.3d 514 (January 27, 2006).

[13]"It is undisputed that the Federal Arbitration Act (FAA) applies to the arbitration agreement." 186 S.W.3d at 515.

[14]*Id*.; *citing In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 737 (Tex.2005). *See also In re Weekley Homes, L.P.*, 180 S.W.3d 127 (Tex.2005) ("Generally under the FAA, state law governs whether a litigant agreed to arbitrate, and federal law governs the scope of an arbitration clause.").

[15]*Id*.; *citing In re Kellogg Brown & Root, Inc.*, 166 S.W.3d at 737, and *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 227 (Tex.2003).

"controls the construction" of the arbitration agreement.[16] Dillard and its employee had signed an arbitration agreement prior to the employee's discharge that included in its scope "personal injuries."[17] The employee claimed that her defamation cause of action against Dillard was outside the scope of the arbitration agreement both of them had signed. But the Texas Supreme Court could not say "with positive assurance" that the arbitration clause in question was "not susceptible of an interpretation which would cover the dispute at issue,"[18] especially since Texas recognizes "injuries to reputation," which includes defamation, as a personal injury.[19]

SOME PRACTICAL LESSONS FROM *Dillard Department Stores*

1. If you are an employer make sure your arbitration agreement with your employees covers all possible claims arising out of or related to their employment.[20]

2. If you are an employer make sure that you and your employees are both bound by the arbitration agreement.[21]

3. The issues raised in *Dillard Department Stores* did **not** get raised by the Plaintiffs in *Buckeye*: (1) Is the arbitration agreement (versus the contract as a whole) valid?; and (2) Are the claims being made within the scope of the arbitration agreement?

4. In a case controlled by the Federal Arbitration Act (as both *Buckeye* and *Dillard Department Stores*), the only issues for the court and not sent to the arbitrator are (1)

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[16]*Id*.

[17]*Id*. at 516.

[18]*Id*. at 516; *citing Prudential Securities, Inc. v. Marshall*, 909 S.W.2d 896, 899 (Tex.1995).

[19]*Id*.

[20]The employee's claim in this case was for defamation which had not been expressly mentioned in the arbitration agreement.

[21]The employee in this case claimed Dillard attempted to *unilaterally* change the arbitration agreement when it made its motion based on a later arbitration agreement that specifically included defamation as a covered dispute. But an earlier arbitration agreement that Dillard urged in an amended its motion to compel did not provide Dillard with the right to unilaterally amend that arbitration agreement. Therefore, the arbitration agreement was not illusory but enforceable. 186 S.W.3d at 515-516.

legal question about validity of arbitration agreement and (2) construction of the arbitration agreement for whether the claims made are within its scope.[22]

JUDICIAL RESISTANCE TO ARBITRATION

In *Buckeye* (discussed earlier in this *Newsletter*), Justice Scalia observed that the Federal Arbitration Act (the "FAA") was enacted by Congress "[t]o overcome judicial resistence to arbitration."[23] Texas state judges continue to demonstrate their resistence to arbitration, even when the arbitration issue is controlled by the FAA. A Texas trial court when presented with a defendant's plea in abatement and a motion to compel arbitration, decided instead to order the parties to mediation upon the request of the plaintiff.[24] The Beaumont Court of Appeals directed the trial court to "rule summarily on the motion to compel arbitration,"[25] finding that the FAA controlled because of the interstate shipment of goods purchased by the plaintiff.[26] But the plaintiff contended that the Texas state law favored mediation which the trial court could order without violating the FAA.[27] The Beaumont Court of Appeals did not agree with the plaintiff's contention but rather found that the FAA requires a trial court both to stay the litigation and to compel arbitration upon finding that (1) a valid arbitration agreement exists and (2) the claims are within the scope of the arbitration agreement.[28] Two other Texas courts of appeal have refused to allow discovery before ordering arbitration for the same policy reasons cited in *Heritage*.[29] But *Heritage* was a case of first impression involving a trial court's decision to

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[22]*See also In re Weekley Homes, L.P.*, 180 S.W.3d 127 (Tex.2005) ("Generally under the FAA, state law governs whether a litigant agreed to arbitrate, and federal law governs the scope of an arbitration clause.").

[23]126 S.Ct. at 1207.

[24]*See In re Heritage Building Systems, Inc.*, 185 S.W.3d 539 (Tex.App. - Beaumont, February 9, 2006, *orig. proceeding*)

[25]*Id*. at 543.

[26]*Id.* at 541 (which the plaintiff did not dispute).

[27]*Id.*

[28]*Id*. at 541-542; *citing* 9 U.S.C.A. §4 (compel arbitration) and 2 (stay the litigation).

[29]*Id*. at 542; *citing In re Champion Technologies, Inc.*, 173 S.W.3d 595, 599 (Tex.App. - Eastland 2005, *orig. proceeding*); and *In re MHI Partnership, Ltd.*, 7 S.W.3d 918, 923 (Tex.App. - Houston [1st] 1999, *orig. proceeding*).

interpose mediation before ordering arbitration as requested.[30]

SOME PRACTICAL LESSONS FROM *Heritage Building Systems, Inc.*

1. If you want to reduce time and expense in getting to arbitration make sure that your arbitration clause invokes the Federal Arbitration Act as the governing arbitration law.

2. Don't allow Texas trial judges to slow down or detour you from arbitration if that is what you want; the quickest, least-expensive route to arbitration is appeal (under the Texas General Arbitration Act) or mandamus (under the FAA) a trial judge's unwillingness to summarily order arbitration.

3. The Plea in Abatement and the Motion to Compel should be a summary hearing; don't let the hearing turn into a hearing on the merits as the opponent to arbitration (or maybe even the trial judge) may attempt to make it.

4. Review the arbitration clause you put in your contracts and agreements with your lawyer to make sure that there is no ambiguity in it. Both the validity and scope questions (raised by the motion to compel) will be questions of law if your arbitration clause is clear, specific, and unambiguous.

ABOUT WHITAKER, CHALK, SWINDLE AND SAWYER, L.L.P.

Whitaker, Chalk, Swindle and Sawyer, L.L.P. attorneys and counselors have been serving clients in domestic and international transactions and civil disputes since 1978. See our website at www.whitakerchalk.com for more information about the firm and its lawyers.

John Allen Chalk, Sr., editor of *The Arbitration Newsletter*, has served as an arbitrator in more than two hundred (200) domestic and international arbitrations involving business, commercial, healthcare, employment, insurance, franchise, real estate, oil and gas, partnership, torts, and other issues. Mr. Chalk also serves as a mediator for disputes in all these areas.

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[30] *Id.*