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Supreme Court of Texas.
(09-0432) In re: Olshan Foundation Repair Company, LLC and, Olshan Foundation Repair Company of Dallas, Ltd., Relators. Kenneth and Vickie Kilpatrick, Real Parties in Interest;
(09-0433) In re: Olshan Foundation Repair Company, LLC and Olshan Foundation Repair Company of Dallas, Ltd., Relators. Charley and Gladys Tisdale, Real Parties in Interest. Hon. John Fostel, Respondent;
(09-0474) In re: Olshan Foundation Repair Company, LLC and Olshan Foundation Repair Company of Dallas, Ltd. Real Parties in Interest: Craig and Joy Waggoner;
(09-0703) In re: Olshan Foundation Repair Company, LLC and Olshan Foundation Repair Company of Dallas, Ltd. Real Parties in Interest: Robert and Marta Tingdale.
Nos. 09-0432; 09-0433; 09-0474; 09-0703.

March 23, 2010

Appearances:

Stephan B. Rogers, Rogers & Moore, Boerne, TX, for relators, for petitioner.
Edwin Todd Lipscomb, Loree, Hernandez & Lipscomb, San Antonio, TX, for real parties in interest, for respondent.

Before:

Chief Justice Wallace B. Jefferson, Justice Nathan L. Hecht, Justice Harriet O'Neill, Justice Dale Wainwright, Justice David M. Medina, Justice Paul W. Green, Justice Phil Johnson, Justice Don R. Willett, Justice Eva Guzman.

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CHIEF JUSTICE WALLACE B. JEFFERSON: The Court is ready to hear argument in the four consolidated cases, In re Olshan Foundation Repair Company and Olshan Foundation Repair Company of Dallas, Limited.

MARSHALL: May it please the Court, Mr. Rogers will present argument for the Relators. The Relators

have reserved five minutes for rebuttal.

ORAL ARGUMENT OF STEPHAN B. ROGERS ON BEHALF OF THE PETITIONER

ATTORNEY STEPHAN B. ROGERS: Thank you, Chief Justice Jefferson. Good morning, and may it please the Court. The Plaintiffs in all four of these cases agreed to submit all disputes to arbitration according to the rules of the American Arbitration Association. All four of these transactions affected interstate commerce, and thus triggered the Federal Arbitration Act. The courts below all refused to require the plaintiffs to honor their agreements to arbitrate, contrary to State and Federal law. The first issue I would like to address the morning is whether a mere reference to the arbitration laws of a state in a contract is enough to exclude the Federal Arbitration Act. In 1999 this Court said that you have to have a specific exclusion in the contract in order to exclude the Federal Arbitration Act. But bear in mind, that the reason this is an issue here is because the Plaintiffs want to avoid arbitration by invoking a section of the Texas General Arbitration Act that says that for small transactions involving $50,000 or less, you have to have an attorney's signature.

JUSTICE DAVID M. MEDINA: That seems pretty significant. I mean you make it -- you just kind of brush it off like it's no big deal. I mean these are homeowners, consumers, investing perhaps a lot of money to them, certainly a lot of money to me, and you seem to not think that that is significant.

ATTORNEY STEPHAN B. ROGERS: No, not at all, Your Honor. I think it is very significant. The question is whether they're going to pursue their rights -- and certainly I respect their rights -- pursue their rights in a judicial forum or in an arbitral forum. That's the issue here. There is a section of the Texas General Arbitration Act that would exclude a whole category of consumer transactions and other transactions involving the purchase of goods or services from the scope of arbitration. That section is preempted by the Federal Arbitration Act. This Court held that In re Nexion Health Services. So that's my point, not that I was denigrating the claim.

JUSTICE DAVID M. MEDINA: Okay.

JUSTICE EVA GUZMAN: When you're looking to an arbitration agreement and specifically the language, that you're going in that direction, "pursuant to the arbitration laws of your state," and then we look at Kempwood, and I think the language there was "pursuant to the law of this state," is there a material difference though between the language in those cases? Because "in your state," is more specific, I would think. I mean it's --

ATTORNEY STEPHAN B. ROGERS: Right. What the cases that I've cited to the Court say that if you have a reference to State law in a choice of law provision or in the Arbitration Clause itself, the effect of that is to choose the Texas law over the law of some other state. That it does not mean that Federal law does not apply. In addition to that, as this Court recognized in the Kempwood (9 S.W.3d 125) decision, Federal law is the law in the State of Texas, and so when you say "the law of the state," that does certainly not indicate any preference for State law to the exclusion of Federal law.

JUSTICE EVA GUZMAN: Doesn't indicate any preference for the TAA?

ATTORNEY STEPHAN B. ROGERS: Well, one of the four cases has language that references the Texas General Arbitration Act. I don't think that makes a difference because, again, what the cases say is that that states a preference for Texas law as opposed to the Arbitration law of some other state. Again, there's no indication there. I would say not even an implied indication, certainly not a specific exclusion.

CHIEF JUSTICE WALLACE B. JEFFERSON: Well, could you choose? Could you say, "Only under the" -- and I forget the section number, but -- "the General Arbitration Act of the State of Texas, Section blank in the Civil Practice and Remedies Code" or wherever it's located, and then would the Texas Act be the only one that applies? How specific do you have to be? This seems pretty -- the Waggoner case seemed pretty specific to the TAA.

ATTORNEY STEPHAN B. ROGERS: That's right. I would say that what "specific exclusion" means is that you've basically got to say, "We're excluding Federal law." For example, you would say, "You must conduct this arbitration in accordance with the Texas General Arbitration Act and not the Federal Arbitration Act." Some words that explicitly express the preference that Federal law not apply. The parties are certainly entitled to do that, but there is a strong presumption in favor of the Federal Act when the transaction affects interstate commerce. And so what we're doing is we're accommodating this strong federal presumption in favor of arbitration under the Federal Act.

JUSTICE EVA GUZMAN: You have unsophisticated consumers, you present them with an arbitration agreement that says, "The laws in your state," and somehow the consumer is supposed to know that the Federal Arbitration Act will govern their dispute, not the Texas Arbitration Act?

ATTORNEY STEPHAN B. ROGERS: Well, I think the accurate answer to that is that in many of these arbitrations both the Federal Arbitration Act and Texas Arbitration law are going to apply. They're not mutually exclusive. It's not a choice between one or the other. The State law supplies much of the procedures and other things that go along in the course of arbitration --

JUSTICE EVA GUZMAN: Well, and the protections of 171.002 in the context of consumer transactions?

ATTORNEY STEPHAN B. ROGERS: Yes, because of the supremacy clause, obviously if there is a conflict between the federal act and the state act, there's going to be preemption there. And that's one of the areas where there is preemption. But there's going to be areas where there's not preemption. For example, the Volt Information Services (489 U.S. 468) case, the United States Supreme Court case that's discussed in the brief.

JUSTICE DAVID M. MEDINA: At what point do you decide or do we decide whether or not an arbitration fee is unconscionable?

ATTORNEY STEPHAN B. ROGERS: Well, the primary burden would be on the party resisting arbitration, the party who has agreed to arbitrate their dispute, and then decides that they don't want to do that. If they think it's going to be too expensive, then they need to put on evidence of what it's going to cost, and that that's going to be a financial hardship. And if there are opportunities to do the arbitration on a cost-savings basis, as are provided in the American Arbitration Association Rules, some discussion of why those don't apply. For example, you know, we asked the triple A if we could do this arbitration on a low-cost basis, and they refused. So you can -- when you apply to the -- you submit your claim for arbitration to the triple A, you fill out a form.

JUSTICE DAVID M. MEDINA: We're familiar with the procedure.

ATTORNEY STEPHAN B. ROGERS: Okay.

JUSTICE DAVID M. MEDINA: The -- so at what point does a consumer, do they have to incur the expense, do they have to make a phone call, at what point do we determine whether or not that's unconscionable? If you're trying to pursue a remedy on a $10,000 contract and it costs you $5,000, do they have to incur that $5,000? Do they need to get a phone call to say, "It's going to cost you X amount of dollars"? At some point the consumer is going to have to make a decision, do they throw good money after a case like this?

ATTORNEY STEPHAN B. ROGERS: Justice Medina, that's an excellent question. And I would say that what is required is for the consumer to go to the triple A and get an estimate of what the costs are going to be, and if they consider if they are in a hardship kind of situation, ask the triple A to provide them some accommodation. And what you do, as was done, at least in part, in the Ayala case in 2005, is you provide something from the triple A that says, "This is going to be your cost. We estimate this to be your cost." Okay, one of the things you have to do in that process is select how much money you're seeking, and that hasn't been done in this case. But to make sure I'm clear on answering your question, what you need is a

paper from the triple A that says, "This is the estimated cost of the arbitration for you."

JUSTICE DAVID M. MEDINA: And who makes that decision, a trial judge or triple A, as whether or not the consumer can go forward or the contract is void?

ATTORNEY STEPHAN B. ROGERS: That would be an issue for the trial court to decide. I think the cases, I think it's pretty clear in the cases now that the trial court would decide if the contract was substantively unconscionable, if the Plaintiff were to meet their burden, so that with the necessary information. Then that would be a decision for the trial court.

JUSTICE NATHAN L. HECHT: There's an issue about whether the Texas Home Solicitation Act was violated.

ATTORNEY STEPHAN B. ROGERS: Yes, Your Honor.

JUSTICE NATHAN L. HECHT: And Respondent seems to concede that that should ordinarily be decided by the arbitrator.

ATTORNEY STEPHAN B. ROGERS: Correct.

JUSTICE NATHAN L. HECHT: But asserts that there's really no defense to the claim of violation. You say that there in your Reply Brief that there is, but you're not required to show it at this point, because you can present it to the arbitrator. But I'm wondering if it was just totally without defense, whether that would be true. I mean it would just end up being a waste of time. What's your response to that?

ATTORNEY STEPHAN B. ROGERS: Justice Hecht, thank you for asking that. The Texas Home Solicitation Act challenge, the purpose of that is to knock out the contract, so that they don't have to arbitrate.

JUSTICE NATHAN L. HECHT: And you agree that if it knocked it out, quote-unquote, they wouldn't have to arbitrate?

ATTORNEY STEPHAN B. ROGERS: That's correct, that's correct. I mean there are some cases out there that say if there's fraud in the factum --

JUSTICE NATHAN L. HECHT: Right.

ATTORNEY STEPHAN B. ROGERS: -- that the contract never existed under State law. The United States Supreme Court and this Court in the Abbott Labs case have said no to that, but there are some cases that say that.

JUSTICE NATHAN L. HECHT: Right.

ATTORNEY STEPHAN B. ROGERS: But to get to your point, in this case, you know, there was a contract signed, there were services and goods provided, compensation was paid, and at some later point the Plaintiff wants to say, "Well, the contract was void." But of course, they're seeking to recover damages based on the DTPA, not just on breach of contract. And in the arbitral forum, the question is going to be how much damages are the plaintiffs entitled to. The issue of whether the contract is void or not is not really going to be that important an issue.

JUSTICE NATHAN L. HECHT: Why not? Because it picks the forum. If they prove that the contract was void, they don't have to be in arbitration, they can be in court.

ATTORNEY STEPHAN B. ROGERS: Right. And that's certainly their argument, but the --

JUSTICE NATHAN L. HECHT: Do you agree with that?

ATTORNEY STEPHAN B. ROGERS: No, I don't agree with that, and the United States Supreme Court doesn't agree with it, and this Court --

JUSTICE NATHAN L. HECHT: Well, I thought you agreed that if the arbitrator finds that the agreement is void under Section whatever it is of the -- 601.201, that they don't have to arbitrate?

ATTORNEY STEPHAN B. ROGERS: I was -- well, first of all, that's not the issue having to do with, with the unconscionability. What we're talking about is the Home Transaction Act.

JUSTICE NATHAN L. HECHT: Yes, that's right.

ATTORNEY STEPHAN B. ROGERS: And we do not agree that that would be a basis for avoiding arbitration in this case.

JUSTICE NATHAN L. HECHT: If the arbitrator concludes that the sale or contract entered into in this case is void under Section 601.201 they have to arbitrate anyway?

ATTORNEY STEPHAN B. ROGERS: That would be our position.

JUSTICE NATHAN L. HECHT: Why?

ATTORNEY STEPHAN B. ROGERS: They -- the way this works is generally, and as the Court knows, if there's a challenge to the Arbitration Clause itself, that's an issue for the trial court generally under the Prima Paint (388 U.S. 395).

JUSTICE NATHAN L. HECHT: Right. And if it's about the contract, it's an issue for the arbitrator. And now the arbitrator decides --

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE NATHAN L. HECHT: -- yes, indeed it is void.

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE NATHAN L. HECHT: Now what?

ATTORNEY STEPHAN B. ROGERS: Then our argument would be that the Arbitration Clause in that case is severable, and that that agreement to arbitrate disputes can be enforced independently of the contract under Federal Law.

JUSTICE NATHAN L. HECHT: And is there any other argument? You say in the Reply Brief you have defenses, but is there anything other than severability that you would claim in that situation?

ATTORNEY STEPHAN B. ROGERS: I think there might be an estoppel defense in terms of -- you know, you've gone through this transaction and you didn't complain about any of these matters and you didn't ask to rescind the contract, and under these circumstances you should be held to be estopped.

JUSTICE NATHAN L. HECHT: Those are not in the statute any more?

ATTORNEY STEPHAN B. ROGERS: Not in the statute, no, Your Honor.

JUSTICE DAVID M. MEDINA: There's no reason to complain until they figure out there's a problem, right?

ATTORNEY STEPHAN B. ROGERS: Well, that would, that would be something to argue about in

arbitration, about whether there was a basis for estoppel.

JUSTICE DALE WAINWRIGHT: Counsel, you mentioned the Kempwood decision in 1999. We said that arbitration language, it only refers to, quote, "the law of the state," doesn't preclude application of the FAA. Three of the four contracts have that language. Let's put that issue to the side, it's been asked about the Waggoner contract that says, "Arbitration," quote, "pursuant to the Texas General Arbitration Act," close quote, a little more specific language. What's bouncing around in my head is that the Waggoner Agreement was entered in 1998, the year before Kempwood, the other three agreements were entered after Kempwood. So Olshan changed the language of its agreements at some point, and three of the agreements, other than the Waggoner Agreement, contain "under state law," or the "law of the state" language that we specifically talked about in Kempwood.

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE DALE WAINWRIGHT: Did Olshan make a decision to change the language because of Kempwood?

ATTORNEY STEPHAN B. ROGERS: I'm pretty sure not, but I don't know for sure. I have -- I know of no reason to think that that change was made because of that case. I suspect that the folks of Olshan weren't even aware of that case. But I'm speculating, I do not know, Justice Wainwright.

JUSTICE DALE WAINWRIGHT: Do you think it's significant that the Waggoner language prior to Kempwood, versus the language in the other three agreements after Kempwood changed, and the three agreements after Kempwood used the language of Kempwood?

ATTORNEY STEPHAN B. ROGERS: I see what you're arguing, and --

JUSTICE DALE WAINWRIGHT: I'm actually not making an argument; I'm asking you a question.

ATTORNEY STEPHAN B. ROGERS: Right, right. I do not know the answer to that question. That had not occurred to me.

JUSTICE DALE WAINWRIGHT: Okay.

ATTORNEY STEPHAN B. ROGERS: I don't know the answer to that. I don't think so. I think that the language, if there was an intent to exclude the Federal Arbitration Act, it certainly easy to say that. Okay, if the parties want to exclude Federal law, it's very easy to say. It's just like in this Court's cases dealing with waiver of sovereign immunity, in your case from last year, Southwestern Bell vs. Harris City Toll Road Authority.

JUSTICE DAVID M. MEDINA: You know, your comment is well-taken. It's very easy to say what the parties want. If you're dealing with a homeowner that essentially is getting a service. You take it or leave it. If you want this done, sign this contract, we'll do it. There's really no remedy for the homeowner or room to negotiate. If the consumer says, "Strike this, strike this, strike this," they're going to say, "Go get somebody else." So they're not on equal bargaining power, right?

ATTORNEY STEPHAN B. ROGERS: Chief Justice, may I respond?

CHIEF JUSTICE WALLACE B. JEFFERSON: You may.

ATTORNEY STEPHAN B. ROGERS: Justice Medina, the policy at both the Federal and the State level is that arbitration is an effective, just, less expensive, more expedient way of resolving disputes, and that's been the policy for several years, and I think that's still the policy. Going to arbitration doesn't mean that you don't get to defend your rights. You do get to defend your rights. The theory is, the hope is that you will be able to get to a just result faster and cheaper than you would in a judicial forum.

CHIEF JUSTICE WALLACE B. JEFFERSON: Further questions? Thank you, Mr. Rogers. The Court is ready to hear argument from the Real Parties in Interest.

ATTORNEY STEPHAN B. ROGERS: Thank you, Your Honor.

MARSHALL: May it please the Court, Mr. Lipscomb will present argument for the Real Parties in Interest.

ORAL ARGUMENT OF EDWIN TODD LIPSCOMB ON BEHALF OF THE RESPONDENT

ATTORNEY EDWIN TODD LIPSCOMB: May it please the Court, the first thing I'd like to do or begin, is I'm going to ask you to make an assumption, and it's the same assumption we ask you to make in this brief. We want you to assume that what he's saying about the Separability Doctrine is correct, and that when you're analyzing this contract, we're not talking about the contract as a whole, I want you to look solely at the Arbitration Clause. When you do that and you apply the Home Solicitation Act, even giving them their arguments, they cannot prevail. And that's why four district courts and that's why three courts of appeal have all agreed with us in this case. And the reason I say that is you need to go to the Buckeye Check Cashing case (546 U.S. 440), and when you look at that case, and this case then did some interpretation of that in In re Morgan Stanley. And it looked at the issues and it says, there are contract formation issues and there are defenses to the contract. In Buckeye Check Cashing, they said, "Under the Usury Laws of the State of Florida, this contract is void, and therefore that is an issue to be submitted to the arbitrator." That makes sense. The arbitration contract itself, the Arbitration Clause does not have any provision quoting an interest rate. So if you look at it independently, that clause doesn't run afoul of the Usury Statute. That's not the case with the Home Solicitation Act. If you severe out the Arbitration Clause in this case, the Home Solicitation Act is a unique law to the State of Texas, where the Legislature decided that in contract formation, when it's done in someone's home, the homeowner has the unequivocal right to cancel the contract for three days. That's a rule of contract formation. And when --

JUSTICE NATHAN L. HECHT: But I don't see the difference between that and the usury.

ATTORNEY EDWIN TODD LIPSCOMB: I'll try to explain that, sir.

JUSTICE NATHAN L. HECHT: [Inaudible] broad, or all these other --

ATTORNEY EDWIN TODD LIPSCOMB: And the difference, the difference here is that this law in terms of contract formation, i.e., you have a right of three days of cancellation, applies not only to a contract for construction services like we have here, but to an arbitration agreement. So if Olshan had come over to their house and said, "Here is our arbitration agreement. We're going to arbitrate pursuant to the arbitration laws in your state," and that's all the agreement was, that agreement --

JUSTICE NATHAN L. HECHT: What are they going to arbitrate?

ATTORNEY EDWIN TODD LIPSCOMB: It's just agreement, and that agreement --

JUSTICE NATHAN L. HECHT: You've got to arbitrate something. I mean you just --

ATTORNEY EDWIN TODD LIPSCOMB: Well, any disputes that would ever arise. Maybe they did separate consideration, but if you're looking just at that, it would still be required because it's done in their home with the Home Solicitation Act. They still must put on that language that says, "You have an automatic right in contract formation in a consumer transaction in your home for three days to cancel it." And if the merchant fails to give you that required notice, as required by law, this contract is void. And that applies specifically to the arbitration agreement, and that's why it's an issue for the Court to decide.

JUSTICE NATHAN L. HECHT: If it's not, do you have any other argument?

ATTORNEY EDWIN TODD LIPSCOMB: Yes, Your Honor.

JUSTICE NATHAN L. HECHT: Which is?

ATTORNEY EDWIN TODD LIPSCOMB: One of the exhibits we provided today is a chart labeled, "Unconscionability."

JUSTICE NATHAN L. HECHT: No, no. I mean before you get to that --

ATTORNEY EDWIN TODD LIPSCOMB: Yes, Your Honor.

JUSTICE NATHAN L. HECHT: If under Buckeye, and we've indicated we're going to follow, try to follow Buckeye if we can figure out what it means, but if under that this is an issue for the arbitrator to decide, I thought you were arguing that if there's just really nothing to decide, there's just no issue there, you shouldn't have to go pay for an arbitrator to tell you that.

ATTORNEY EDWIN TODD LIPSCOMB: And that is correct, sir, and then that's why it comes into the unconscionability. According to our chart, we have three different things that we presented to the trial court. One, we believe it is an adhesion contract, as Justice Medina brought up earlier. Although there's good case law that says that alone is not sufficient to render it unconscionable, it is an element that courts are allowed to consider and weigh. You combine that with the cost affidavits we provided. Again, something that's added, and there's no response to it. Third, you then have the useless act. And we vehemently dispute their contention as to what will happen in arbitration. Just because there's a Separability Doctrine and it could be severed out, as the Arbitration Clause, when the arbitrator decides that it's void, we absolutely believe it comes back to the state court, because you don't have an agreement to arbitrate at that point. Separability may give the arbitrator the authority to decide that decision, but it doesn't resurrect a void clause. And so when you combine the useless of the act, when you combine the cost, and when you combine the adhesion of the contract, the trial court had no choice. That was the only evidence that it was presented, it was the only evidence that was presented to the court of appeals, and they all agreed that this evidence is sufficient enough to show unconscionability. Olshan could have gotten an affidavit, they could have gone out and said, "If this is going to be so cost-effective, here's what we've paid in prior arbitrations." Nothing. I'll tell you why I think why. They know it's expensive. It isn't about --

JUSTICE HARRIET O'NEILL: But doesn't the arbitrator have the authority to allocate those expenses? Does this contract say anything about -- there's no splitting of costs here?

ATTORNEY EDWIN TODD LIPSCOMB: There is no prohibition in it other than the normal triple A rules. The unfortunate part is it's purely discretionary, and so what it does is it puts the homeowner to a horrible choice. Do you steal from your child's college fund to take a shot at arbitration? Do you cash in your 401Ks to get to arbitration?

JUSTICE HARRIET O'NEILL: Do the triple A rules require prepayment in full?

ATTORNEY EDWIN TODD LIPSCOMB: You have to pay the administrative fee, which is part of it, which can be waivered. The problem is going to be the fees associated with the arbitrator's time, and that's where the real costs add up.

JUSTICE HARRIET O'NEILL: But I guess what I'm saying is, the consumer could go to arbitration and the arbitrator could listen to the evidence and then award fees based on the evidence that's heard. So there's a scenario where the homeowner would not pay anything.

ATTORNEY EDWIN TODD LIPSCOMB: I believe there are provisions where that money would not have to be allocated up front. I believe you're correct on that, Your Honor. The problem with that is that the homeowner is still betting in gambling terms on the come. And that is do we risk the $10 or $15,000 that we have saved up on the chance the arbitrator is going to rule on our side, and what are the consequences of that if I don't? My kid doesn't go to school, I don't have retirement funds because I wanted to take a shot at this and see if I can get my house fixed.

JUSTICE DALE WAINWRIGHT: How is that different from your client's position from the client pursuing the same claim in a court of law?

ATTORNEY EDWIN TODD LIPSCOMB: In a court of law --

JUSTICE DALE WAINWRIGHT: Don't you have to have a comparison of the respective costs in order to say one is unconscionable and the other isn't?

ATTORNEY EDWIN TODD LIPSCOMB: And I think --

JUSTICE DALE WAINWRIGHT: What if both cost the same, or litigation costs more?

ATTORNEY EDWIN TODD LIPSCOMB: In this case in particular and in consumer transactions, I don't believe arbitration does save money. I think the studies on that are based upon large-scale litigation, and here's why.

JUSTICE DAVID M. MEDINA: Wouldn't you have an opportunity for plaintiff's lawyer to take it on a contingency fee basis and then sue for his costs because of breach of contract?

ATTORNEY EDWIN TODD LIPSCOMB: Our contingency fee, as well as all the other construction plaintiff's lawyers I know of in this state specifically exclude arbitration costs because they're so high. And the reason why in a consumer transaction, in particular, is there's only like five depositions taken in a case like this. The homeowner, the corporate representative and each side's expert. That's it. You don't save anything whether you're in a court, or whether you're in the arbitration forum in that discovery. In contrast, you do add one unique aspect. Things you would get free from a judge, discovery rulings, final decisions, the time he spends during the trial itself, you all have to pay for.
JUSTICE PAUL W. GREEN: So in all of these smaller types of transactions, the agreements to arbitrate, you would contend that those are all unconscionable because of the added costs?

ATTORNEY EDWIN TODD LIPSCOMB: I would contend in the vast majority of these consumer-type of transactions, in the Legislature's mind, those under $50,000, that would most likely be the case.

JUSTICE HARRIET O'NEILL: How do you square your --

JUSTICE DALE WAINWRIGHT: In a court of law you have --

JUSTICE HARRIET O'NEILL: How do you square your argument with Kempwood?

ATTORNEY EDWIN TODD LIPSCOMB: Kempwood, I think is a properly decided case. I can tell you exactly where Kempwood comes from. It says when you have a General Choice of Law Clause, the law of the State of Texas will apply. And it goes along with a number of other courts across the country. And in Kempwood, what they cite to, is the Mastrobuono case (514 U.S. 52)-- and I'm butchering that name, I apologize -- as well as about five other cases, such as Porter vs. Hayden (136 F.3d 380), UHC (148 F.3d 992), all of which say when you have a conflict, you have an Arbitration Clause and then a General Choice of Law Clause, when you look at that General Choice of Law Clause, we have a presumption, and that presumption is you are not making a decision as to the arbitration regime you're going under. You are simply choosing the substantive law that will be applied in the case. That's what happened in Kempwood. It says, "This contract will be interpreted under the laws of Texas." So whether you're under the FAA, the TAA or in court, that contract is applying Texas law. There is no case, not one that I could find, a single one, where you have a specific regime selected. And that's why I have this exhibit, and I think this language is very important. If you look at the blue language, it says, "Pursuant to the Texas General Arbitration Act," and likewise in the other case, it says, "Pursuant to the arbitration laws in your state."

CHIEF JUSTICE WALLACE B. JEFFERSON: The arbitration laws in Texas are the Texas Arbitration Act

and the Federal Arbitration Act. They're both combined within that phrase.

ATTORNEY EDWIN TODD LIPSCOMB: I tend to disagree with that statement, Your Honor, and here's why. The origin of that is from Blackman case, a case that was decided by the Texas Supreme Court. It was done shortly after, I believe, the Southland opinion. In the Southland opinion, the U.S. Supreme Court resolved an ongoing dispute that was going throughout the nation. And that dispute focused on, is the FAA a creature of federal procedural law, or is it a substantive body of law that can be applied in state court? Justice O'Connor led the dissent, and it's one that Justice Thomas and Justice Scalia continue to this day. And their position is the FAA can't be extended through the Interstate Commerce Clause to its full extent, and therefore only is a creature of federal procedure and not applicable. That argument didn't carry the day. The majority came back and said as a policy reason, the vast majority of contracts are enforced in state court, and therefore the FAA is the substantive law. Blackman looked at that case. The Texas Supreme Court and they said, "Guess what? It's substantive law, and in that context it can therefore be enforced in the state courts of Texas." That's all it did. It simply created the extension that you have that same type of enforceability that was expressed in Southland. That then gets us to Kempwood, and in Kempwood, you again just have that general selection clause. And we think that's good Federal law that says when you have that general clause, there is nothing in that clause that states a preference for which arbitration regime you're going under. In our case, it says, "Pursuant to the arbitration laws in your state." So is a specific selection of arbitration laws in contrast to any other form of substantive law. So it is not a General Choice of Law Clause, but a very specific one to the arbitration laws. Then you look at the next language. "Pursuant to," that is a specific choice as to which governing regime you want to use. So if we're doing it pursuant to the Texas General Arbitration Act. You can tell where my kind of state of mind is, my wife might laugh at me, but the analogy I'm come to in my own mind to clear this up, is imagine your wife is having a baby, and you're going to the hospital and you go up to a painter and say, "I want my room painted blue." I come back, we have all the baby stuff there, it's a little boy, and the whole room is pink. And I sit there and I go, "What happened?" He goes, "Well, I know the contract said I was going to paint it blue, but you didn't exclude pink." That's what they're arguing here. Under the Kilpatrick, Tisdale and Tingdale language, it's a slight derivation of that. Instead of going to running off to the hospital to get that baby delivered, I say, "Paint the room a color for a boy." I come back and the room is painted pink. Now, 99.9 percent of the people out there would probably perceive that was supposed to be blue, but there's that real tiny percentage that might say, "No, you didn't exclude pink, and maybe we like the pink for the boy as well." In that case, the ambiguity there should be construed against the drafter. If I'm the one that made that choice and didn't say blue, but instead "a boy's color," it would be construed against me. That's not this case. In this case, Olshan drafted the whole contract, Olshan made the choice.

JUSTICE HARRIET O'NEILL: But in that, in your example, there's no overriding policy consideration, and I think the problem we've got here is there has there been a policy consideration set by, under the FAA, that arbitration is preferred, in any State law or contract that impinges upon that right in interstate commerce is no good. And so we start from that premise, not all hospital rooms should be painted yellow. There is no policy infusion in your example, and --

ATTORNEY EDWIN TODD LIPSCOMB: The policy cases that I've interpreted from the U.S. Supreme Court say that once you have a, first of all, a valid agreement, which we don't believe exists. But assuming that there is a valid agreement, the only time that it's construed in favor of arbitration is where you're construing the scope of the agreement. And again, there's a logical reason for that. The reason they wanted the scope expanded, was because like this case. We have DTPA claims, we have fraud claims, we have contract claims. One of the ways people tried to avoid that application was to say, a misrepresentation has nothing to do with the contract itself, so my DTPA claims don't have to be arbitrated. My fraud claims aren't dealing with the contract, they're separate and apart, they don't have to be arbitrated. The Supreme Court came back and said no. When you're looking at the scope of the agreement, we're interpreting that scope as broadly as possible. So you just can't plead around and try to use some device to get around it. That doesn't apply when you're applying State Contract law principles to ascertaining the parties' intent. And the Supreme Court whether it be in Mastrobuono or whether it be in Volt or any of its other cases, have always said that arbitration is not a matter of coercion, but merely reflecting the parties' intent.

JUSTICE HARRIET O'NEILL: I think one of the things that bothers me about these clauses is to the

average layperson, "pursuant to the arbitration laws in your state" means your state's arbitration laws. And if they had just put the period after Tripe A, then it might be pretty clear that Federal and State law would apply, but when they say, "pursuant to your state law," a reasonable consumer I would think would think my State law.

ATTORNEY EDWIN TODD LIPSCOMB: I think that's absolutely true, Your Honor. There are multiple ways they could have invoked the FAA. The easiest and most obvious is if they were simply silent. You simply eliminate the words in blue, and there's no dispute, that absent the unconscionability claim, absent the Home Solicitation Act claim, we'd be in arbitration instead of here today.

JUSTICE HARRIET O'NEILL: In fact, is there any other purpose for putting in "pursuant to the arbitration laws in your state"?

ATTORNEY EDWIN TODD LIPSCOMB: I do not believe so. I think it's the only purpose. And under the rules of construction, giving each phrase a meaning, it would be meaningless if you adopted the interpretation they have, because that phrase as well as any choice of law would have no meaning, because anytime you said, "Texas General Arbitration Act," under "them" it would include both, and therefore that entire provision, that entire intent would be wiped off the face of it. The other way they could have done it is they could have simply said, "We want to arbitrate under the FAA," and that --

JUSTICE DALE WAINWRIGHT: That almost sounds like an argument -- excuse me, counsel -- to overrule Kempwood.

ATTORNEY EDWIN TODD LIPSCOMB: I don't think Kempwood is wrongly decided. I think there's some language in Kempwood that people have taken a little bit too far. To the extent that Kempwood is dealing with a General Choice of Law Clause, in reconciling that with an arbitration provision, I think that's consistent with the majority of rule from both the United States Supreme Court as well as the majority of circuits which hold, "When you have a General Choice of Law Clause, that is a choice of substantive law and not the arbitration regime. And therefore in those specific circumstances, we are not going to hold that sufficient enough to exclude application of the FAA." In contrast, when you're saying, "pursuant to the arbitration laws in Texas," you have obviously chosen a specific regime and therefore that is the specific intent to exclude the FAA.

JUSTICE PHIL JOHNSON: So the specific intent then would preclude -- would exclude the Kempwood and the prior decisions here that we have that say Federal law or that State law includes Federal law?

ATTORNEY EDWIN TODD LIPSCOMB: Correct, Your Honor. I think in this opportunity it would be good to say --

JUSTICE PHIL JOHNSON: So the average consumer can simply disregard the Supreme Court?

ATTORNEY EDWIN TODD LIPSCOMB: It's not an argument of saying they should disregard the Supreme Court, I think it's putting those Supreme Court words in proper context. And I think when the Supreme Court said that it's part of the laws of the State of Texas, it goes back to that reasoning from Southland, that they were simply trying to say that it's enforceable in the State of Texas. I don't think the Supreme Court was really trying to say, with all due respect, that it's become integrated in the Texas General Arbitration Act. There's no provision for it.

JUSTICE HARRIET O'NEILL: Would you answer be different if in Kempwood it had said, and it was a General Choice of Law Provision, it said, "The law of the place where the project is located." If it had said, "Would be governed by the contract law of the place where the project is located," would that be different?

ATTORNEY EDWIN TODD LIPSCOMB: I think under Kempwood that it's still a General Choice of Law Clause and not arbitration specific.

JUSTICE HARRIET O'NEILL: So if it had said, "Governed by the arbitration law of the place where the

project is located"?

ATTORNEY EDWIN TODD LIPSCOMB: Correct, and that's exactly what we have here.

JUSTICE HARRIET O'NEILL: Well, but why would it if you specified contract law, why would that be any different from specifying arbitration law?

ATTORNEY EDWIN TODD LIPSCOMB: I happen to personally disagree with the idea of just saying that General Arbitration Clauses on their own face are not sufficient enough to invoke the arbitration regime, but that ship has long sailed on me. I think the First Circuit, the Fourth Circuit, the Sixth, Eighth and Ninth, as well as the United States Supreme Court, have all said when interpreting the FAA, we have special rules construing a general Contract Clause. I think when you say, "Texas law will be used for the construction of this contract, or interpretation of this contract," they're going to argue that that is still just interpretation of the contract as a whole and is not specific to the arbitration. And so I think in order to avoid that line of reasoning, and state -- you're obviously empowered to overrule Kempwood to the extent it conflicts, but in order to reconcile the two, I think we're left with a situation where you almost have to specifically refer to the regime itself.

CHIEF JUSTICE WALLACE B. JEFFERSON: Mr. Lipscomb, are you essentially saying that all consumer arbitration agreements are unconscionable as sort of a presumptive matter, because the costs to arbitrate are going to exceed the costs to litigate?

ATTORNEY EDWIN TODD LIPSCOMB: I would say no. I would say that Texas Legislature, though, would beg to differ with me, and that when they enacted the Texas General Arbitration Act, they said that you cannot have a consumer transaction arbitration, an amount under $50,000, unless their attorneys sign off on it, so --

CHIEF JUSTICE WALLACE B. JEFFERSON: But how do we determine what it is unconscionable and what is not in a consumer transaction? Is it those that involve $50,000 or less, or is it a percentage, what percent of the fee compares to the matter in controversy? How do you decide?

ATTORNEY EDWIN TODD LIPSCOMB: I don't have a magic bright line test. Unfortunately, I think several courts have struggled with the idea of what constitutes unconscionability. I think in one case the Supreme Court here referenced to [inaudible] and had 20 different things to look at. I think that we have cited, and I think there's a San Antonio court of appeals thing which cites the five elements we've used in our exhibit. That's a target and an element for the trial court to consider. That's a fact question, when weighing all the evidence that's presented to it, that it has to be able to evaluate. And that's why I think those decisions made by the trial court in that respect are due deference, and are entitled to the abuse of discretion standard. That's what happened here, and they chose not to respond to it.

CHIEF JUSTICE WALLACE B. JEFFERSON: Further questions? Thank you, Mr. Lipscomb.

ATTORNEY EDWIN TODD LIPSCOMB: Thank you.

REBUTTAL ARGUMENT OF STEPHAN B. ROGERS ON BEHALF OF PETITIONER

ATTORNEY STEPHAN B. ROGERS: I want to make sure that I was clear in my remarks that I made earlier about the particular Contract Clauses in question here. And, Justice O'Neill, I think you asked the right question, and that is, well, what else could this language mean? The reference to the arbitration laws in your state or the Texas General Arbitration Act. What else could that mean, besides we're excluding Federal law? Well, the point I was trying to make was, it can mean a lot besides --

JUSTICE HARRIET O'NEILL: Well, it's not so much excluding Federal law, as the parties seem to be saying, "We want to operate under the Texas Act, which protects me as a consumer. I'm a consumer, so I want to operate under the Consumer Act."

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE HARRIET O'NEILL: But you would require that I not operate under the Consumer Act and not under Federal law. If I don't say, "and not under Federal law," I'm preempted. And there's just something perverse about that. If the language is this clear, that I want to opt for the arbitrations laws in my state because I know they will protect me.

ATTORNEY STEPHAN B. ROGERS: Right. Well, I don't, I don't think we can assume that the consumers in this case read the language and understood it one way or the other. The law of Texas is that --

JUSTICE HARRIET O'NEILL: Well, I mean contracts have to be understandable.

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE HARRIET O'NEILL: And again, this seems just clear as day to me, and I'm learned in the law, presumably, and if somebody presented me with this contract, without rereading Kempwood or being specifically aware of it, I would think that I have now opted in to our Act with its consumer protections. And it would come as a great surprise to me that, because I didn't specifically exclude Federal law, I'm no longer protected.

ATTORNEY STEPHAN B. ROGERS: Right, and I certainly understand that. And basically, you know, I think the sentiment is, well, wouldn't it be fair if we overruled In re Nexion (173 S.W.3d 67), which said that this provision, this type of provision is preempted? Wouldn't that be fair? And we would provide more consumer protection for our consumers. Basically if you have a $50,000 or less claim, you don't have to arbitrate under the State Act or the Federal Act. You know, I can picture a world like that, but that's not the world as it exists today. The law is that that provision is preempted by Federal law.

JUSTICE NATHAN L. HECHT: Let me ask you again about the Home Solicitation Act.

ATTORNEY STEPHAN B. ROGERS: Yes, sir.

JUSTICE NATHAN L. HECHT: And let me ask the hardest question I can think of. And so you're not the lawyer for the contractor, but somebody else is, and so there's an issue that comes up in the trial court on the motion to compel arbitration, whether the Act was violated and therefore the contract was void. And the lawyer says, "Well, Your Honor, to be frank with you, yes, we think that the Act was violated, we don't see a defense to that, and we think it is void, but nevertheless, we're entitled to have an arbitrator decide that. That's what the law is under Buckeye, and we should get to go there and have that decision made. If that's the arbitrator's decision, we'll be back." Should the trial court compel arbitration in that circumstance?

ATTORNEY STEPHAN B. ROGERS: I would certainly agree that they should. Again, this is the Prima Paint line of cases. It's an allegation that a contract that was formed as a matter of contract law is void because of some state statute out there that's designed to protect people against usury or overreaching of whatever it is. And they're certainly laudable goals, but you're challenging the entire contract. That goes to the arbitrator. I think that's settled in the cases now. The question, the interesting question you raised that I had struggled a little bit with is does it come back to the trial court if the arbitrator agrees that there was a violation of the Home Solicitation Act. And our position on that is that the Arbitration Clause is severable for all purposes --

JUSTICE HARRIET O'NEILL: Well now, I'm confused, because I thought your argument was because the FAA is not excluded, it preempts? So it doesn't matter because the Home Solicitation Act is a restriction on the FAA's broad-based policy towards arbitration, it doesn't matter whether the Home Solicitation Act has been violated or not because the FAA preempts it?

ATTORNEY STEPHAN B. ROGERS: Well, this is the basic question that was considered in Buckeye and discussed by this Court in Lebatt, and that is, what contracts -- and remember the fraud in the factum issue,

is this void or voidable. There were cases in the past that drew that distinction and said that if it's void under State law, even if it's some statute that comes in after the fact and declares a contract, an existing contract void, even ab initio that --

JUSTICE HARRIET O'NEILL: I thought the purpose of federal preemption was so that states could not put restrictions on, through acts like the Home Solicitation Act?

ATTORNEY STEPHAN B. ROGERS: If it interferes with the letter of Federal law, yes, it's certainly preempted, and that's why In re Nexion held that this provision in question is preempted.

JUSTICE HARRIET O'NEILL: I mean that's what preemption is. So --

ATTORNEY STEPHAN B. ROGERS: Right.

JUSTICE HARRIET O'NEILL: -- if the FAA applies and preempts State law restrictions on arbitration, I don't know why it would matter if the Home Solicitation Act was violated or not?

ATTORNEY STEPHAN B. ROGERS: Well, I certainly agree with that based on the cases as they exist today. This contract was -- it's just like the usury case in Buckeye. It's just like that. And it is preempted, it is preempted, because it interferes with the federal policies of the parties' agreement to arbitrate be enforced.

JUSTICE NATHAN L. HECHT: So I'm sorry, I didn't understand you to ever argue that the Federal Arbitration Act preempts the Texas Home Solicitation Act, but that's your argument?

ATTORNEY STEPHAN B. ROGERS: Well, in response to the questions, I think that's certainly an arguable point. I think that's a good question, because it does interfere with the federal policy of enforcing arbitration agreements. So if pressed to give an answer, I'm going to say, sure, it's preempted.

JUSTICE NATHAN L. HECHT: Well, why doesn't fraud interfere with that, since a contract induced by fraud is void?

ATTORNEY STEPHAN B. ROGERS: Well --

JUSTICE NATHAN L. HECHT: Does the FAA preempt fraud law?

ATTORNEY STEPHAN B. ROGERS: No, no, it would not.

JUSTICE NATHAN L. HECHT: Why does it preempt the Home Solicitation Act?

ATTORNEY STEPHAN B. ROGERS: To the extent that the Home Solicitation Act is being set up as an obstacle specifically to arbitration, it would be preempted in that context.

JUSTICE NATHAN L. HECHT: Is it?

ATTORNEY STEPHAN B. ROGERS: I believe it is in this case. I think that's the only reason it's being raised is to try to defeat arbitration.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions? Thank you, Mr. Rogers. The cause is submitted, and that concludes --

ATTORNEY STEPHAN B. ROGERS: Thank you.

CHIEF JUSTICE WALLACE B. JEFFERSON: -- the arguments for this morning. The Marshall will adjourn the Court.

MARSHALL: All rise.
[End of proceedings.]

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