

COMPELLING ARBITRATION—WHETHER A COURT SHOULD MANDATE ARBITRATION PURSUANT TO AN AGREEMENT WHEN THE MOVANT CHALLENGES THE FORMATION OF THAT AGREEMENT

By Bryan Aldair Ramirez*

S.C. *Maxwell Family P’ship v. Kent*, 472 S.W.3d 341 (Tex. App.—Houston [1st Dist.] 2015, no pet.).

Advice: Do not walk into a trap, especially one of your own making. The Maxwell Family Partnership walked into a trap when it sought to compel arbitration of a dispute involving an asserted partnership agreement with the Kents, while at the same time vigorously arguing that the asserted partnership agreement containing the arbitration clause was never formed because of lack of consideration.¹ Accordingly, the appellate court affirmed the trial court’s decision in denying the attorney’s motion to compel arbitration.²

I. BACKGROUND

The issue in *Maxwell Family Partnership* arose from a dispute between the Maxwell Family Partnership and the Kents. Originally, the Kents had received a letter from the Maxwell Family Partnership, which stated that “the partnership agreement between them was invalid.”³ Thereafter, the Kents filed a declaratory-judgment action, claiming that the partnership agreement was valid.⁴ The Kents alleged that according to the partnership agreement’s terms, they were “50% owners of a self-storage facility in Brenham, Texas.”⁵ During the trial court proceedings, the Maxwell Family Partnership acknowledged that an agent of its general partner had executed the partnership agreement, but asserted a defense of lack of consideration.⁶ It also asserted several defenses, attacking the validity of the partnership agreement including fraud and fraud in the inducement, and failure of consideration.⁷ The Maxwell Family Partnership filed a motion asking the trial court to compel arbitration of the parties’ dispute.⁸ In the motion, the Maxwell Family Partnership stated that since failure of consideration and lack of consideration were present, the partnership agreement was never in existence.⁹ Furthermore, the Maxwell Family Partnership argued that “the validity of the partnership agreement with the Kents were issues for the arbitrator to decide.”¹⁰ The trial court disagreed with the Maxwell Family Partnership and denied its motion to compel arbitration.¹¹

* Bryan Aldair Ramirez, 2017 J.D. Candidate at South Texas College of Law Houston.

¹ S.C. *Maxwell Family P’ship v. Kent*, 472 S.W.3d 341, 342–43 (Tex. App.—Houston [1st Dist.] 2015, no pet.).

² *Id.* at 345.

³ *Id.* at 343.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

An interlocutory appeal followed, in which the Maxwell Family Partnership alleged the trial court had erred in its decision.¹²

II. COURT OF APPEALS FOR THE FIRST DISTRICT OF TEXAS ANALYSIS

On appeal, this Court reviewed the trial court's decision "for an abuse of discretion deferring to the trial court's factual determinations if they [were] supported by the evidence and review[ed] legal determinations de novo."¹³ The court of appeals began its review by stating that in the parties' partnership agreement, the built-in arbitration clause specifically cited to the Texas Arbitration Act ("TAA").¹⁴ Nevertheless, the court of appeals resorted to decisions in its review addressing both the Federal Arbitration Act ("FAA") and the TAA, since neither the Maxwell Family Partnership nor the Kents argued the FAA preempted the TAA.¹⁵

Section 171.021(a) of the Texas Civil Practice and Remedies Code provides that if a movant wants to succeed on a motion to compel arbitration, the movant must establish at the outset "an agreement to arbitrate and the opposing party's refusal to arbitrate."¹⁶ If a movant is not able to prove that an agreement to arbitrate exists, then the movant will be unsuccessful in compelling arbitration, even when "Texas law strongly favors arbitration."¹⁷ While the Maxwell Family Partnership alleged that the issue confronting the arbitration provision within the partnership agreement was to be left for the arbitrator to decide, the *Prima Paint* separability doctrine provides a different proposition.¹⁸ According to the *Prima Paint* separability doctrine, "an arbitration provision is separable from the rest of a contract, such that a challenge to the validity of the entire contract is a question for the arbitrator, while a challenge directed specifically to the arbitration provision may be resolved by a court."¹⁹ The Texas appellate courts have applied this separability doctrine to those agreements governed by the TAA.²⁰

In accordance with this doctrine, when a movant seeking to compel arbitration raises issues on the existence of a contract, the question then becomes, whether those issues impact the contract's 'formation' or the contract's 'validity.'²¹ Under Texas law, the Texas Supreme Court "has held that 'where the very existence of a contract containing the relevant arbitration agreement is called into question, the . . . courts have authority and responsibility to decide the

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See TEX. CIV. PRAC. & REM. CODE ANN. § 171.021(a) (West 2011).

¹⁷ *Maxwell Family Partnership*, 472 S.W.3d at 343–44.

¹⁸ *Id.* at 344.

¹⁹ *Id.* (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967)).

²⁰ See, e.g., *id.*; *Women's Reg'l Healthcare, P.A. v. FemPartners of N. Tex., Inc.*, 175 S.W.3d 365, 368 (Tex. App.—Houston [1st Dist.] 2015, no pet.); *Saxa Inc. v. DFD Architecture Inc.*, 312 S.W.3d 224, 229 n.4 (Tex. App.—Dallas 2010, pet denied).

²¹ *Maxwell Family Partnership*, 472 S.W.3d at 344.

matter.”²² Therefore, if the movant’s claim solely attacks the contract’s very formation, such as a signor lacking the authority or capacity to execute the contract, then these issues are to be resolved by the court.²³ However, if the movant’s claim deals solely with the contract’s validity, then the arbitrator could resolve those issues without the intervention of the court.²⁴

As previously mentioned, the Maxwell Family Partnership was the movant who sought to compel arbitration in this case.²⁵ To be successful, the Maxwell Family Partnership had to satisfy the burden as stated in section 171.021(a) of the Texas Civil Practice and Remedies Code, namely by proving the existence of “an agreement to arbitrate.”²⁶ However, the Maxwell Family Partnership initially repudiated the contract’s formation by claiming that it lacked consideration.²⁷ Also, the Maxwell Partnership repudiated the contract’s validity by asserting fraud and fraud in the inducement.²⁸ This Court noted that if the Maxwell Family Partnership’s claims had solely been directed to the validity of the contract that was formed, the arbitrator could then have decided such issues on its own.²⁹ That was not case here, however.

In his opinion, Justice Massengale placed emphasis on how persistent the Maxwell Family Partnership was in reiterating the lack of consideration claim.³⁰ Not only did the Maxwell Family Partnership mention this lack of consideration claim in its pleadings, but also “reiterated that it was challenging the agreement on the basis of a lack of consideration” at the hearing on its motion to compel arbitration and on appeal.³¹ The evidence undoubtedly showed that the Maxwell Family Partnership had attacked the formation of a valid contract. This evidence presented the Maxwell Family Partnership with a roadblock, as its goal had been to compel arbitration from the beginning.³²

This Court noted that when the central issue was to determine whether the parties in dispute had agreed to arbitrate, “courts generally . . . should apply ordinary state-law principles that govern the formation of contracts.”³³ Moreover, under Texas contract law, consideration is required for the formation of a valid contract.³⁴ The Maxwell Family Partnership presented this “lack of consideration” argument to the appellate court while hoping that it would enforce the arbitration clause in the partnership agreement that it had made with the Kents.³⁵ However, the

²² *Id.* (citing *In re Morgan Stanley & Co.*, 293 S.W.3d 182, 187 (Tex. 2009) (orig. proceeding)).

²³ *Id.*

²⁴ *Maxwell Family Partnership*, 472 S.W.3d at 344.

²⁵ *Id.*

²⁶ *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 171.021(a) (West 2011)).

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *See id.*

³¹ *Id.* (“On appeal, [the Maxwell Family Partnership] stated again that it ‘reserved the right to attack the partnership agreement on the basis that . . . there was a failure of consideration or lack of consideration for the agreement.’”).

³² *Id.*

³³ *Id.* at 344–45.

³⁴ *Id.* at 345.

³⁵ *Id.*

lack-of-consideration claim “undermine[d] the very existence of that contract, [and therefore] it was a matter for the court to resolve.”³⁶ When the trial court denied the Maxwell Family Partnership’s motion to compel arbitration, it was within its discretion to decide on the matter.³⁷

The Maxwell Family Partnership presented a second argument in its appellate brief, alleging the trial court should have allowed for arbitration because the Kents never denied the existence of the agreement.³⁸ However, section 171.021(b) of the Texas Civil Practice and Remedies Code did not support the Maxwell Family Partnership’s assertion.³⁹ As Judge Massengale highlighted, “the Kents [did] not deny the existence of the agreement, but instead affirmatively [sought] to confirm the agreement’s existence and validity.”⁴⁰ Consequently, the Maxwell Family Partnership was unsuccessful with this second claim.⁴¹

Finally, the Maxwell Family Partnership asserted the Kents had admitted during the trial setting that arbitration was appropriate and therefore, this was enough to enforce the arbitration clause.⁴² The record showed the Kents’ counsel had in fact stated: “if there’s a valid Partnership Agreement, I fully agree.”⁴³ This conditional statement, however, did not suggest conclusively that the Kents had admitted to allowing arbitration to occur.⁴⁴ But even if the Kents’ counsel had provided a statement admitting that arbitration was appropriate, the focus on appellate review was on the issue pertaining to the formation of the contract.⁴⁵ For these reasons, the Court of Appeals overruled the Maxwell Family Partnership’s sole issue.⁴⁶

III. CONCLUSION

In *Maxwell Family Partnership*, the movant argued from the outset that it wanted to compel arbitration.⁴⁷ But to do so, the Maxwell Family Partnership alleged that the contract was non-existent by attacking both its validity and its formation.⁴⁸ Had the Maxwell Family Partnership solely brought forth claims attacking the validity of the contract, such as by alleging fraud and fraud in the inducement, these issues would have then been left for an

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹

If a party opposing an application made under Subsection (a) denies the existence of the agreement, the court shall summarily determine that issue. The court shall order the arbitration if it finds for the party that made the application. If the court does not find for that party, the court shall deny the application.

TEX. CIV. PRAC. & REM. CODE ANN. § 171.021(b) (West 2011).

⁴⁰ *Maxwell Family Partnership*, 472 S.W.3d at 345.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.* at 342.

⁴⁸ *Id.* at 344–45.

arbitrator to decide.⁴⁹ However, the Maxwell Family Partnership also attacked the formation of the contract.⁵⁰ Raising the issue that the contract lacked consideration gave the trial court the “authority and responsibility to decide the matter”.⁵¹ Therefore, the First Court of Appeals affirmed the trial court’s decision to deny the Maxwell Family Partnership’s motion to compel arbitration, as the “trial court correctly could have concluded that it failed to satisfy its initial burden to establish the existence of an enforceable arbitration agreement.”⁵²

⁴⁹ *Id.* at 344.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* at 345.