

# ARBITRATION CLAUSES: ARE ARBITRATION CLAUSES IN ENGAGEMENT LETTERS BINDING WHEN THE CLIENT DOESN'T SIGN AND THE PARTY SUING IS DOING SO DERIVATIVELY?

By Ashley Tegeler\*

**Cedillo v. Immobiliere Jeuness Etablissement**, 476 S.W.3d 557 (Tex. App.—Houston [14th Dist.] 2015, pet. denied).

On August 27, 2015, the 14th District Court of Appeals in Houston (“Court”) determined that arbitration may be compelled based on the arbitration clause contained in a law firm’s representation agreement with their client.<sup>1</sup> The “Lichtenstein entity”<sup>2</sup> that brought suit in this case was bound to the arbitration clause because it was suing derivatively on behalf of the client; the claims at issue fell within the scope of the clause; and the client bound itself to the representation agreement even though the client did not sign the agreement.<sup>3</sup>

The case at hand was a legal malpractice case against Davis, Cedillo, & Mendoza, Inc. (“DCM”) and three of its attorneys, brought by IJE, the Liechtenstein entity, on behalf of two partnerships (“Original Partnerships”) in which IJE was a partner.<sup>4</sup> Beginning in March 2009 and continuing until June 2011, DCM represented the Original Partnerships in litigation involving transactions relating to the development of an affordable housing complex, initiated by IJE.<sup>5</sup> The representation agreement between DCM and the Original Partnerships consisted of the following arbitration clause:

**Arbitration:** Any disputes arising out of the relationship between Firm [DCM] and Client [the Original Partnerships] shall be submitted to binding arbitration, and both Firm and Client agree to be bound by the results of arbitration. The arbitration shall be governed by the Commercial Arbitration Rules of the American Arbitration Association. San Antonio, Bexar County, Texas shall be the exclusive venue, and any disputes submitted to arbitration shall be governed by the laws of the State of Texas.<sup>6</sup>

In June 2011, DCM determined that a conflict had arisen in their representation of the Original Partnerships and the trial court thereafter granted their motion to withdraw.<sup>7</sup> The case concerning the affordable housing units was ended around May 2013.<sup>8</sup> The legal malpractice case against DCM was brought in August 2012 by IJE on behalf of the Original Partnerships alleging malpractice on the part of DCM through its legal work and representation of the

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<sup>1</sup> *Cedillo v. Immobiliere Jeuness Etablissement*, 476 S.W.3d 557, 572 (Tex. App.—Houston [14th Dist.] 2015, pet. denied).

<sup>2</sup> *Id.* at 561, probably should read “Liechtenstein”.

<sup>3</sup> *Id.* at 564–70.

<sup>4</sup> *Id.* at 561.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 562.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

Original Partnerships.<sup>9</sup> After a seventeen (17) month abatement and the beginning of discovery, DCM's attorneys discovered the Arbitration Clause and subsequently filed a Motion to Compel Arbitration.<sup>10</sup> The trial court denied DCM's motion on the basis that IJE was not a party to the representation agreement and this interlocutory appeal followed.<sup>11</sup>

In beginning its analysis of whether DCM had the right to compel arbitration, the Court first discussed the validity of the arbitration clause in light of the fact that the Original Partnerships never signed the representation agreement.<sup>12</sup> Since the Original Partnerships never signed the agreement, the court had to determine if a non-signatory is bound by the arbitration clause.<sup>13</sup> The lack of signature does not by itself defeat the arbitration clause because neither Federal nor Texas arbitration rules require that arbitration clauses be signed, they must only be written and agreed to by the parties.<sup>14</sup> The court found that because DCM performed under the representation agreement by representing the Original Partnerships in the housing issue and the Original Partnerships accepted DCM as their counsel until DCM withdrew, the Original Partnerships accepted the representation agreement and the arbitration clause contained within it.<sup>15</sup> Therefore, the arbitration clause contained in the representation agreement was valid.<sup>16</sup>

IJE argued and the trial court found that even if the arbitration clause was valid, IJE was not bound by the clause because it was not a party to the representation agreement.<sup>17</sup> IJE is suing DCM in a derivative suit on behalf of the Original Partnerships.<sup>18</sup> The Court noted that a plaintiff who brings a derivative suit "steps into the shoes" of the party on whose behalf plaintiff brings the suit.<sup>19</sup> This means that a derivative plaintiff is also bound by any agreements entered into by that party.<sup>20</sup> The Court found that the trial court erred in determining that the motion to compel arbitration should be denied solely because IJE was not the original party to the arbitration agreement.<sup>21</sup> The Court found no compelling reason to depart from the principle discussed above, that a derivative plaintiff suing on behalf of another party is bound to any agreements made by that party.<sup>22</sup> The Court declined to follow IJE's argument that they were not bound by the representation agreement since the malpractice action was brought derivatively.

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<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 562–63.

<sup>11</sup> *Id.* at 563.; see TEX. CIV. P. REM. CODE §51.016 (authorizing interlocutory appeal of denial of motion to compel arbitration under the Federal Arbitration Act); and TEX. CIV. P. REM. CODE §171.098(a)(1) (permitting interlocutory appeal of denial of motion to compel arbitration under the Texas General Arbitration Act).

<sup>12</sup> *Cedillo*, 476 S.W.3d at 564.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 564–65.

<sup>15</sup> *Id.* at 566.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 563.

<sup>18</sup> *Id.* at 566.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* (citing *In re Labatt Food Serv., L.P.*, 279 S.W.3d at 644–46).

<sup>21</sup> *Cedillo*, 476 S.W.3d at 567.

<sup>22</sup> *Id.*

Finally, the Court determined the scope of the arbitration clause by analyzing the specific language within the arbitration clause.<sup>23</sup> The Court notes that doubts concerning the scope of an arbitration clause are resolved in favor of arbitration, in line with the strong presumption favoring arbitration agreements.<sup>24</sup> Here, the burden was on IJE to show the issues in their legal malpractice case fell outside of the scope of the arbitration clause.<sup>25</sup> The Court focused on the factual aspects of the issues in the legal malpractice case to determine if the claim fell within the scope of the clause.<sup>26</sup> The Court looked to the following specific language within the arbitration clause to determine what the scope of the clause was: “any dispute arising out of the relationship.”<sup>27</sup> “Relationship” was never defined in the agreement, however, it was noted that the term “representation” was defined as including only the legal representation of the Original Partnerships.<sup>28</sup> The Court found that “relationship” was a broader term than “representation” and made the arbitration clause broader in scope.<sup>29</sup> Based on the factual allegations alleged by IJE and the broad scope of the arbitration clause, it is plausible that at least some of IJE’s allegations would fall within the scope of the arbitration clause.<sup>30</sup> Since, IJE was unable to overcome its burden to establish that the issues of the legal malpractice claim fell outside of the arbitration clause, the Court concluded that the claims brought by IJE fell within the clause.<sup>31</sup>

IJE also alleged two defenses to the arbitration clause to overcome the motion to compel, unconscionability of the arbitration clause and waiver of arbitration.<sup>32</sup> The Court found that neither defense overcame DCM’s motion to compel arbitration nor lent credence to the trial court’s decision to deny the motion to compel arbitration.<sup>33</sup> The party opposing arbitration bears the burden of proving the clause was unconscionable.<sup>34</sup> IJE, within its response to the motion to compel, tried to move the burden of proof to DCM and failed to present any evidence concerning unconscionability, thereby providing no basis to their defense against the motion to compel arbitration.<sup>35</sup> IJE also asserted waiver of the arbitration.<sup>36</sup> For a party to waive their right to arbitration, they must substantially invoke, to the opposing party’s detriment, the judicial process.<sup>37</sup> A strong presumption against waiver of arbitration exists, making the burden of proof difficult to meet.<sup>38</sup> The Court’s determination of the existence of waiver of arbitration depended on the totality of the circumstances, including any reason for

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<sup>23</sup> *Id.* at 567–70.

<sup>24</sup> *Id.* at 567.

<sup>25</sup> *Id.* (citing *Prudential sec. Inc. v. Marshall*, 909 S.W.2d 896, 899-900 (Tex. 1995); *Osonia v. AmeriMex Motor & Controls, Inc.*, 367 S.W.3d 707, 712 (Tex. App.—Houston [14th Dist.] 2012, no pet.)).

<sup>26</sup> *Cedillo*, 476 S.W.3d at 567.

<sup>27</sup> *Id.* at 568.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 569.

<sup>31</sup> *Id.* at 570.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 570–72.

<sup>34</sup> *Id.* at 570.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

delay in enforcing an arbitration clause, the amount of discovery conducted before enforcement, and if the movant sought disposition on the case based upon the merits.<sup>39</sup> Since, DCM only took five (5) months from the end of the abatement to enforce the clause, minimal discovery occurred after the abatement, and no motions for a ruling on the merits of the case been filed by DCM, the Court concluded that waiver of the arbitration clause did not occur.<sup>40</sup>

After the Court established that a valid arbitration agreement existed, and determined that IJE was bound by this clause through its derivative suit and the claims fell within the scope of the clause, the Court reversed the trial court's denial of DCM's motion to compel arbitration and remanded for proceedings consistent with their opinion.<sup>41</sup>

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<sup>39</sup> *Id.* at 571.

<sup>40</sup> *Id.* at 571–72.

<sup>41</sup> *Id.* at 572.