

TEXAS LAWYER

Fifth Circuit Cracks Open the Courthouse Doors to Decide 'Arbitrability'

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Historically, whether a claim is subject to arbitration is a decision for the court. But after the U.S. Supreme Court's 2010 decision in *Rent-a-Center v. Jackson*, it appeared that courts would have a very limited role in making so-called "gateway" decisions regarding arbitration disputes. There, the court upheld the use of broadly-worded delegation provisions, which empower an arbitrator—and not a court—to decide "arbitrability," that is, whether the agreement covers the parties' dispute.

The *Rent-A-Center* court recognized that parties may agree to arbitrate whether a particular claim is subject to arbitration so long as they "clearly and unmistakably" express their intention to do so by including a delegation provision in their arbitration agreement. Further, the U.S. Supreme Court strongly signaled that courts should not address the merits of arbitrability disputes arising from delegation provisions, even if the underlying claim appears to be frivolous.

In short, if the parties expressed their intent to arbitrate the issue of arbitrability, and did not contest the legal validity of the delegation provision (an issue properly addressed to the court), then courts appeared to be bound to defer to the arbitrator on the issue of the scope of claims subject to arbitration.

Are the federal courts then to have no role as gate-keepers where arbitration is sought on the basis of a delegation provision? A recent Fifth Circuit decision suggests that under certain factual scenarios the courthouse's door may not be closed.

In *Douglas v. Regions Bank* in the Fifth Circuit last year, the plaintiff opened a bank account with a predecessor of Regions Bank and, pursuant to the signature card she executed, agreed to arbitrate disputes, including the issue of a dispute's arbitrability. She closed the account less than a year later.

Some five years down the road, the plaintiff settled an unrelated personal injury lawsuit. An attorney hired by the plaintiff to get the settlement approved in the bankruptcy proceeding she had filed then allegedly absconded with her settlement proceeds. The plaintiff brought suit against Regions alleging that the bank failed to prevent the embezzlement. In response, Regions invoked the arbitration agreement and argued that the issue of arbitrability belonged to the arbitrator.

On appeal, in a divided decision, the Fifth Circuit found that the arbitration agreement and its delegation provision had nothing to do with the claim made by the plaintiff, thus negating the need for a gateway determination by an arbitrator.

To reach that result, the court adopted a two-step inquiry based on a Federal Circuit precedent: 1. did the parties unmistakably intend to delegate the power to decide arbitrability to the arbitrator; and if so, 2. is the assertion of arbitrability "wholly groundless." Consistent with this standard, the court noted that under its own precedent, referral of arbitrability issues to an arbitrator is appropriate only where supported by "plausible" arguments. Notably, both decisions cited by the majority pre-date the Supreme Court's *Rent-a-Center* decision.

Applying the two-step inquiry, the court found that the plaintiff did not intend to bind herself "for life" to gateway arbitration for any and all claims that might ever exist between her and the bank. In the view of the majority, since the events leading to the claim had nothing to do with the plaintiff's checking account opened years earlier for a brief period of time, then the argument that her claim fell within the arbitration agreement was "wholly groundless." Under these circumstances, there was no need to subject the plaintiff to the "rigmaroles" of arbitration.

Without disagreeing with the majority's factual analysis, the dissent asserted that the majority erred by reaching the merits of the arbitrability dispute, which pursuant to the parties' agreement, was delegated to the arbitrator, not the court. The dissent also claimed that the "wholly groundless" standard was contrary to recent Supreme Court decisions addressing arbitrability, including *Rent-A-Center*. The bank's petition for rehearing en banc, supported by an amicus brief from the banking industry, was subsequently denied on an 11-3 vote.

Does the *Douglas* decision foretell a more robust role for federal courts in analyzing delegation provisions, or will the holding of *Douglas* be limited to its somewhat peculiar facts?

The Fifth Circuit's opinion itself is too freshly-minted to have generated many waves in the district courts. And as the dissent observed, no other circuit court has adopted the "wholly groundless" standard. But a smattering of district courts have relied on it, usually on the basis of the Federal Circuit decision cited by the *Douglas* majority.

For example, in a pre-*Douglas* decision, one district court in the Fifth Circuit has suggested that the "wholly groundless" standard is satisfied if the argument in favor of arbitration is not "colorable" or cannot be supported by a "legitimate argument." Applying that standard, the court found that the assertion of arbitrability was not "wholly groundless" where a homebuilder claimed that its former draftsman's copyright claims against it were related to his employment agreement. It is easy to contemplate situations where the parties in fact dispute the applicable agreement that governs their obligations, with each side supported by a "colorable" or "legitimate" argument.

Courts may also be less inclined to compel arbitration of arbitrability, even in the face of a delegation provision, where there is a perception of unequal bargaining positions. This factor may have special resonance in consumer transactions, where arbitration is later sought on a matter that may seem far afield from the original scope of the parties' relationship. This factor may have been at work in *Douglas*, as well as in a recent California case where a court rejected a bank's argument that a mortgage-related claim brought by a homeowner was subject to an arbitration provision found in a deposit agreement with the same institution.

Finally, *Douglas* itself suggests a factual paradigm where courts may be more likely to question the delegation of arbitrability. There, the majority emphasized the unlikely sequence of events connecting the plaintiff's claim to the arbitration provision contained in her checking account signature card, beginning with the opening of her account to the embezzlement of her settlement funds five years later. Although not denominated as such, this lack of foreseeability clearly played a large role in the court's determination that the plaintiff's claim had "nothing to do with" the arbitration agreement.

At a minimum, *Douglas* signals that courts will not always "rubber-stamp" orders compelling the delegation of gateway issues. The exact contours of that oversight role remains unclear, however, which paradoxically may mean more recourse to the courts in arbitration disputes.