No. 07-_____

In The
Supreme Court of the United States

DONNA ROSSI and ALBERT MARCO,

Petitioners,

v.

JOSEPH CHRIS PERSONNEL SERVICES, INC.,
Doing Business As Joseph Chris Partners,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Under what circumstances does a party, by participation in litigation about a claim, lose its right to demand arbitration of that claim?

PARTIES

The parties to this case are set out in the caption.

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PETITION FOR WRIT OF CERTIORARI

Petitioners Donna Rossi and Albert Marco respectfully pray that this Court grant a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on October 10, 2007.

OPINIONS BELOW

The November 15, 2005, opinion of the District Court, which is not officially reported, is set forth at pp.13a-25a of the Appendix. The October 10, 2007, opinion of the Court of Appeals, which is unofficially reported at 2007 WL 2948578, is set forth at pp.1a-12a of the Appendix.

STATEMENT OF JURISDICTION

The decision of the court of appeals was entered on October 10, 2007. The Court has jurisdiction pursuant to 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Section 3 of the Federal Arbitration Act, 9 U.S.C. §3, provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such

> suit or proceeding is referable to arbitration under such agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

STATEMENT OF THE CASE

The issue in this case is whether the plaintiff, Joseph Chris Personnel Services, Inc. ("JCPS"), waived its right to demand arbitration of the claims at issue because it initially sought to litigate those same claims in court. The District Court concluded that JCPS had indeed waived its right to arbitration. The Court of Appeals Circuit reversed, holding that JCPS could abandon its lawsuit and have its claims referred instead to arbitration. The Fifth Circuit frankly acknowledged that the legal standard which it applied in resolving the waiver issue conflicts with the standard in the Seventh Circuit.

JCPS is a nationwide executive search firm that specializes in real estate related placements. JCPS is headquartered in Houston, Texas, and has offices throughout the United States. Petitioners Donna Rossi and Albert Marco are Wisconsin residents who were hired by JCPS in 2001 and 1998, respectively, and who worked out of the firm's Middleton, Wisconsin office. After Rossi and Marco separately resigned from JCPS, they started their own placement company, the Trovato Group, also in Middleton.

On June 4, 2003, JCPS filed suit against Rossi and Marco in Texas state court. The petition[1] raised a variety of claims, particularly a contention that Rossi and Marco's new business violated non-competition agreements contained in their earlier employment contracts with JCPS. JCPS in its state court pleading sought an award of "damages, attorneys' fees, costs, pre-judgment interest, post-judgment interest and a declaratory judgment," and "all other available legal, equitable, statutory, general, specific, whole or partial relief."[2] If the non-compete agreement were held unreasonably broad, the petition asked the court "to reform" the contract. JCPS also requested a temporary and permanent injunction.[3] The petition twice asked the state court to conduct "a full trial on the merits."[4]

Two sentences in the 20-page petition mentioned the existence of an arbitration agreement. After briefly describing that agreement, the petition stated, "Should this Court determine that arbitration is required in this case, then Joseph Chris seeks an

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[1] Under Texas procedure the initial filing is denoted a petition, rather than a complaint. The initial state court pleading in this case encompassed several different matters, and was entitled Application for Temporary Injunction, Original Petition and Motion for Leave to conduct Expedited Discovery. For convenience we refer to that document simply as the Petition.

[2] Petition, p.19.

[3] Petition, pp.18-19.

[4] Petition, p.19.

order in this case forcing the Defendants to appear at arbitration."[5] Under the terms of the agreement the duty to submit to arbitration was created only by the making of a "written request of one party served on the other."[6] At the point in time when the petition was filed, neither party had made such a written request triggering any duty to arbitrate. The prayer in the petition did not ask the state court either to hold that arbitration was required or to compel the parties to engage in arbitration.

The state court petition included two ex parte requests, both of which were granted by the state judge two days after the petition was filed. The first ex parte order directed Rossi and Marco, both of whom lived and worked in Wisconsin, to appear for a deposition at the Houston, Texas office of the plaintiff's attorneys. The order also directed Rossi and Marco to bring with them to the Houston deposition most of the written records of their new company.[7]

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[5] Petition, p.15.

[6] Employment Agreement, par. 10.0.

[7] Order Granting Motion for leave to Conduct Expedited Discovery (June 6, 2003). The order directed Rossi and Marco to produce (1) "[a]ll documents that relate to the identity of all persons that have sought employment using the services of either Donna Rossi, Albert Marco and/or [their new firm] since February 1, 2003," (2) "[a]ll documents that relate to the identity of all businesses and persons that have sought to use the services of Donna Rossi, Albert Marco and/or [their new firm] since February 1, 2003," and (3) "[a]ll documents that show who Donna Rossi, Albert Marco and/or [their new firm] have contacted for the

(Continued on following page)

The second ex parte order directed Rossi and Marco to appear in July in state court in Houston "to show cause, if any there be, why a temporary injunction should not be issued."[8]

On July 7, 2003, Rossi and Marco removed this proceeding to federal court. JCPS immediately filed a jury demand, which it was entitled to only because the Petition sought damages. (R.105).

On July 11, 2003, shortly after removing the case, Rossi and Marco moved to quash the ex parte discovery order that had been issued by the state court.[9] Noting that discovery in a removed case must conform to federal standards, petitioners argued that the application for that order did not meet federal standards and that the issuance of such ex parte orders was not permitted by the federal rules. Rossi and Marco objected that under federal law such depositions should be held in Wisconsin, where the defendants resided, not in Texas. The District Court on July 15, 2003, quashed the disputed discovery. (R.258).

On July 11, 2003, Rossi and Marco filed a potentially outcome determinative motion regarding which state's law applied to JCPS's claim regarding the noncompete agreements. Petitioners asked the District

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purpose of soliciting personnel service business since February 1, 2003."

[8] Order to Show Cause and to be Deposed.

[9] Defendants' Motion for Protection and to Quash Depositions. (R.108 and 118).

Court to hold that the validity of those agreements – which the plaintiff sought to enforce to bar business activities by Rossi and Marco in Wisconsin – were governed by Wisconsin law rather than Texas law. The motion noted that the non-compete agreements in question were clearly unenforceable under Wisconsin law.[10] The District Court did not act on this motion for some time. When the District Court ultimately held that Wisconsin law applied, summary judgment in favor of the defendants regarding the non-compete agreements followed as a matter of course.[11]

During the two months following removal the district judge held a series of pre-trial conferences with the parties. To expedite discovery, "[t]he court ordered the parties to refrain from exchanging unnecessary, boilerplate discovery requests. Instead, it asked each party what it needed to know, and then it ordered the other side to furnish that information." (Pet.App.17a). The first such discovery order was issued on July 11, 2003, and the required information

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[10] Defendants' Memorandum of Law Regarding Application of Wisconsin Law. (R.156, 160-63).

[11] The district court ruled on August 30, 2004, that Wisconsin law applied to the agreements. Defendants moved for summary judgment on this and all other issues on January 21, 2005. That motion reiterated defendants' argument that the agreements were unlawful under Wisconsin law. Donna Rossi and Al Marco's Motion for Summary Judgment, pp.8-12. In granting summary judgment on this issue, the District Court relied on the same Wisconsin statute quoted in petitioners' original July 11, 2003 motion. (Pet.App.19a-20a).

was produced as directed by July 16. Following a conference on July 21, 2003, a second detailed discovery order was issued requiring both sides to produce documents or information. A third pre-trial conference was held on August 19, 2003, and the discovery order of that date required both sides to produce a third round of discovery information by August 27, 2003. A fourth pre-trial conference was scheduled for September 2, 2003.

At no time in the federal proceedings did JCPS make a motion for a preliminary injunction. Although the plaintiff's original state court petition contained a prayer for a temporary injunction, the petition itself did not, of course, satisfy the requirements established by the local federal rules for any motion filed in federal District Court.[12]

On August 29, 2003, without any prior indication to the federal court that it might do so, JCPS filed an arbitration demand with the Judicial Arbitration and Mediation Service. The substantive claims in that demand, and almost all of the relief which it sought, were essentially the same as those in JCPS' original state court petition, then pending in the federal

[12] The local rules require the moving party to submit a separate motion, a statement of authorities, a proposed order, and a statement that counsel for the parties have conferred and been unable to resolve the matter between them. Southern District of Texas Local Rules, Rule 7. The state court pleading understandably did not contain any of those elements.

district court.[13] Because JCPS had indicated to counsel for petitioners a few days earlier that it was about to submit such an arbitration request,[14] on August 29, 2003, Rossi and Marco filed a motion in federal

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[13] Some portions of the arbitration request were evidently lifted verbatim from the state court petition. For example, paragraph 5.11 of the arbitration demand reads:

> In this regard, without limitation and in the unlikely event the *Court* should determine that the written or actual scope or text of any contractual relief or limitation is unreasonable or unnecessary, then Joseph Chris asks the *Court*, to the fullest extent possible, to reform the written or actual scope or text of any contractual relief or limitation to a reasonable and necessary geographic, temporal, spatial or other relevant dimensions or parameters.

(Emphasis added). Original Statement of Claims, p.10. This is identical to paragraph 50 of the state court petition.

[14] At 1:12 p.m. on August 19, 2003, an attorney who represented another individual who had been sued by JCPS advised the attorney for Rossi and Marco that JCPS' attorney had stated in a phone call that "he is not going to quote mess with your clients, uh, with Judge Hughes anymore that they're just going to proceed forward in the arbitration against your folks." (R.344). At 2:47 p.m. that same day a JCPS lawyer sent to Rossi's and Marco's counsel an e-mail stating that "I prepared the arbitration demand to be filed today *as necessary*, but we have not filed it." (R.346)(Emphasis added). At the pre-trial conference later that afternoon, counsel for JCPS said nothing about arbitration to either the court or to opposing counsel. (Pet.App.16a).

In July 2003 JCPS had indicated to opposing counsel, but not to the court, that it was considering arbitration. On July 21, 2003, defendants' counsel responded he did not want to refer the matter to arbitration. Plaintiff's attorney did not raise this matter again until a month later.

district court seeking to enjoin "a duplicative arbitration proceeding."[15] At the September 2, 2003 pre-trial conference, the district judge ordered a stay of the arbitration.[16] JCPS subsequently asserted that even when it originally initiated the state court litigation in June 2003 it had actually "intended to seek injunctive relief in the suit and then pursue the damage claims in arbitration.... There was never any question that [Joseph Chris] would arbitrate."[17]

Rossi and Marco subsequently asserted a counterclaim for unpaid commissions, and then moved for summary judgment on those claims as well as regarding the plaintiff's claims. On November 15, 2005, the District Court awarded defendants summary judgment on the counterclaims and on most of the plaintiff's claims.

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[15] The Wisconsin Defendants' Emergency Motion Under the All Writs Act to Enjoin Plaintiff From Filing a Duplicative Arbitration Proceeding. (R.325).

[16] This order was not memorialized in the docket entries for that date. It is referred to by both parties in subsequent papers. E.g., [Plaintiff's] Motion to Reconsider Court's Arbitration Order (filed Sept. 4, 2003), p.1; Wisconsin Defendants' Motion for Reconsideration (filed Oct. 22, 2004), p.2.

[17] Motion to Reconsider the Court's Arbitration Order, pp.4, 9. This assertion is in some tension with the fact that the petition itself did ask for damages, while the arbitration demand asked that the arbitrator issue "a permanent injunction" and "all other available ... equitable ... relief." Original Statement of Claims, p.10.

The district judge explained that he had earlier enjoined the proposed arbitration because he concluded that JCPS had waived its right to arbitrate. First, the court noted that in its original state court petition, JCPS, after mentioning the existence of the arbitration agreements, nonetheless asked for a judicial trial on the merits.

> Specifically, it stated, "should this court determine that arbitration is required in the case, then Joseph Chris seeks an order in this case forcing defendants to appear at arbitration." ... It then requested a "full trial on the merits," not an arbitration.... Joseph Chris acknowledged and then waived its right to arbitrate.

(Pet.App.15a). Second, the District Judge objected to the fact that the attorney for JCPS, in repeated pretrial conferences with the judge, had failed to disclose that it was contemplating demanding arbitration.

> [T]he court held three pre-trial conferences. The parties discussed the facts, jurisdiction, and choice of law questions. Meanwhile – in between conferences – Joseph Chris was apparently contacting defendants to discuss arbitration. Then, two hours before the hearing of August 1[9], Joseph Chris called defense counsel and said that it intended to pursue arbitration. Again, it did not mention its "plan" to the court.

(Pet.App.16a). Finally, the court noted that JCPS had actively engaged in litigation for several months before deciding instead to seek arbitration.

> Joseph Chris has waived whatever right it had to arbitrate by its acknowledgement of the [arbitration] clause and then by its repeated use of the courts and their ordinary techniques of litigation to attack the defendants.

(Pet.App.16a).

On appeal the Fifth Circuit reversed, holding that JCPS had not waived its right to arbitrate by initiating and then participating in the state and federal litigation. Under established Fifth Circuit precedent, the panel explained, a party may demand arbitration despite having litigated the same claim in court so long as the litigation did not cause "the kind of prejudice ... that is the essence of waiver." (Pet.App.6a-7a, *quoting Miller Brewing Co v. Fort Worth Distrib. Co.*, 781 F.2d 494, 497 (5th Cir.1986)). The controlling issue, it held, was whether or not the plaintiff's actions in filing suit and litigating its claims for several months before turning to arbitration had caused "the type of prejudice relevant to the waiver determination." (Pet.App.7a).

Prior Fifth Circuit decisions, the panel held, required greater prejudice than had been imposed in this case on the party opposing arbitration.

> [T]he fees and delay associated with Joseph Chris's decision to file suit were insignificant. Joseph Chris formally requested arbitration only three months after filing suit. The discovery that had been conducted up until that point was fairly insubstantial.... The other litigation activities that Rossi and Marco point to, such as the three pre-trial conferences, involved relatively minor expense....
>
> On facts similar to these, we have held that a party did not waive its right to arbitrate. For example, in *Tenneco Resins, Inc. v. Davy International, AG*, [770 F.2d 416, 421 (5th Cir.1985)], we held that a party had not waived its right to arbitration after it was demanded eight months into the litigation and after a "minimal amount of discovery had been conducted. There we cited numerous cases where other courts allowed "considerably more activity without finding that a party had waived a contractual right to arbitrate." ... [W]e concluded that taking part in a little bit of discovery ... would not result in waiver. Such is the case here.

(Pet.App.9a-10a)(footnote omitted). The court of appeals noted that the Seventh Circuit, applying a very different legal standard, did not require proof of any prejudice to establish waiver. "The Seventh Circuit, however, has charted a different path from the Fifth Circuit in determining whether waiver has occurred." (Pet.App.11a).

REASONS FOR GRANTING THE WRIT

I. THERE IS A CONFLICT AMONG THE COURTS OF APPEALS REGARDING WHEN A PARTY BY PARTICIPATING IN LITIGATION OF A CLAIM WAIVES ITS RIGHT TO DEMAND ARBITRATION OF THAT CLAIM

This case presents an important issue implicating the Federal Arbitration Act and the efficient administration of justice. In a substantial number of cases involving a claim that is subject to an arbitration agreement, the parties initially begin to litigate that claim in federal or state court.[18] At some point in

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[18] J. Davis, *When Does A Party Waive Its Right to Enforce Arbitration?*, 63 Ala.Law. 42, 43 (2002):

> [O]ne would think that in every case where an arbitration clause is present, at least one of the parties would immediately locate and seek to enforce the agreement. However, there are a surprising number of reported cases in which a party is accused of waiving its right to arbitration because of delay in asserting that right.... For whatever reason, some parties wait weeks, months or even years after the complaint is filed to move to compel arbitration. In the interim, the parties may engage in discovery and motion practice....

A. DeToro, *Waiver of the Right to Compel Arbitration of Investor-Broker Disputes*, 21 Cumb.L.Rev. 615, 615 (1990/1991):

> [P]arties entering commercial transactions are increasingly agreeing to resolve their prospective disputes by arbitration rather than litigation. Nevertheless, many parties continue to initiate arbitrable actions in court. When such a lawsuit is commenced, the issue of waiver of the right to compel arbitration arises. This may occur either through plaintiff's conduct in filing

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the litigation process one of those parties decides it would instead prefer that the claim be resolved in arbitration, and demands (or seeks to compel) arbitration. The courts of appeals are sharply and openly divided regarding what standard should be applied to determine whether a party can in this manner terminate the litigation and move the dispute to an arbitrator.[19]

Several circuits, including the Fifth Circuit, believe their particular standard is compelled by the Federal Arbitration Act ("FAA"), and by this Court's interpretation of the FAA in *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). (Pet.App.6a). If that were correct, application of the federal standard would be mandatory in state court litigation as well. The state courts themselves are divided about that issue. Some state courts agree with the Fifth Circuit that the FAA and *Moses Cone* dictate the answer; most state courts, however, hold that this is a matter of state law. A difference between

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> a lawsuit dispute the arbitration agreement or defendant's conduct in participating in the litigation before seeking to compel arbitration.

(Footnotes omitted).

[19] Most courts characterize the issue as whether the party seeking arbitration has waived its right to do so. Other decisions describe the question as involving default under section 3 of the FAA, repudiation of the contract containing the arbitration agreement, or a new contractual agreement not to arbitrate. For simplicity we refer to all of these issues simply as a question of waiver.

federal and state standards on this question poses significant questions under *Erie RR. Co v. Tompkins*, 304 U.S. 64 (1938), and its progeny.

A. The Fifth Circuit Standard: Substantial Prejudice to the Party Opposing Arbitration Required

The decision below applied the well-established Fifth Circuit rule that litigation of a claim does not waive the right to later demand arbitration except where there would be substantial prejudice to the party opposing arbitration. "[P]rejudice ... is the essence of waiver." (Pet.App.6a)(*quoting Miller Brewing Co. v. Fort Worth Distrib. Co.*, 781 F.3d 494, 497 (5th Cir.1986)). "The proper test is whether participation in litigation prejudiced the other party." *Cargill Ferrous Int'l v. Sea Phoenix MV*, 325 F.3d 695, 700 (5th Cir.2003). "Waiver will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party." *Walker v. J.C. Bradford & Co.*, 938 F.2d 575, 577 (5th Cir.1991).

Prejudice is the outcome determinative issue for resolving waiver claims in the Fifth Circuit. The Fifth Circuit has repeatedly rejected a claim of waiver because the court found that the litigation activities of the party that later sought arbitration had not

sufficiently prejudiced the party opposing waiver.[20] Conversely, the limited number of Fifth Circuit decisions holding that a waiver occurred have expressly been based on a finding of such prejudice.[21]

The Fifth Circuit's prejudice standard is a demanding one. In the Fifth Circuit there is a strong "presumption" against waiver[22] and a party asserting

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[20] *Tristar Financial Ins. Agency, Inc. v. Equicredit Corp. of America*, 97 Fed.Appx. 462, 464 (5th Cir.2004) (no waiver because parties opposing waiver "do not persuade us that they have suffered unfair prejudice."); *Cargill Ferrous Int'l v. Sea Phoenix MV*, 325 F.3d at 700 (no waiver because "Cargill was not prejudiced by Serene's participation in the litigation."); *Walker v. J.C. Bradford & Co.*, 938 F.2d at 578 (no waiver because "plaintiffs simply have not presented enough evidence that Bradford's delay materially prejudiced them."); *Lawrence v. Comprehensive Business Services Co.*, 833 F.2d 1159, 1165 (5th Cir.1987)(no waiver because party opposing arbitration did not "show that the earlier suit prejudiced their present claim."); *Valero Refining, Inc. v. M/T Lauberhorn*, 813 F.2d 60, 66 (5th Cir.1987) ("no waiver because Trade did not substantially invoke the litigation process to such a degree as to prejudice Valero."); *Tenneco Resins, Inc. v. Davy International, AG*, 770 F.2d 416, 421 (5th Cir.1985)(no waiver because eight months of litigation insufficient to demonstrate "prejudice to the party opposing the motion to stay litigation.").

[21] *E.g.*, *Stevenson v. Rochdale Investment Mgt., Inc.*, 1999 WL 152885 at *1 (5th Cir.1999)(waiver found because "[t]he district court's finding of prejudice ... was not clearly erroneous."); *Miller Brewing Co. v. Fort Worth Distrib. Co.*, 781 F.2d at 497 (waiver found because litigation activities of party seeking arbitration were "to the substantial detriment and prejudice" of party opposing arbitration.).

[22] *Keytrade USA, Inc. v. Ain Temouchent M/V*, 404 F.3d 891, 897 (5th Cir.2005)(noting presumption; waiver "not a favored

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a waiver thus bears a "heavy burden" of proof.[23] (Pet.App.6a)(*quoting Subway Equipment Leasing Corp. v. Forte*, 169 F.3d 324, 326 (5th Cir.1999)); *see Cargill Ferrous Int'l v. Sea Phoenix MV*, 325 F.3d at 700 (Fifth Circuit standard is "fairly strict"). That circuit's requirement of "prejudice" is thus difficult to meet. The panel decision noted that the Fifth Circuit has found a lack of prejudice in cases where the litigation had proceeded for six and eight months, and noted that there were "numerous cases" in which a claim of waiver had been rejected despite "considerably more activity." (Pet.App.10a)(*quoting Tenneco v. Resins, Inc. v. Davy International, AG*, 770 F.2d 416, 420-21 (5th Cir.1985)). *Tenneco* itself cited with approval decisions which held that no waiver had occurred despite thirteen months and two years of litigation in the courts. 770 F.2d at 421.

"A party may participate in the discovery process [without waiving arbitration] so long as it does

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finding"); *Cargill Ferrous Int'l v. Sea Phoenix MV*, 325 F.3d at 700 (noting presumption); *Steel Warehouse Co., Inc. v. Abalone Shipping Ltd. of Nicosai*, 141 F.3d 234, 238 (5th Cir.1998)(noting presumption); *Walker v. J.C. Bradford & Co.*, 938 F.2d at 577 (noting presumption); *Lawrence v. Comprehensive Business Services Co.*, 833 F.2d 1159, 1164 (5th Cir.1987)(noting presumption).

[23] *Tristar Financial Ins. Agency, Inc. v. Equicredit Corp. of America*, 97 Fed.Appx. at 464 ("Appellees did not carry their heavy burden of showing a waiver."); *Walker v. J.C. Bradford & Co.*, 938 F.2d at 577 ("heavy burden"); *Tenneco Resins, Inc. v. Davy International, AG*, 770 F.2d at 420 ("The burden on one seeking to prove a waiver of arbitration is a heavy one.").

not 'shower[ ] [the opposing party] with interrogatories and discovery requests.'" *Keytrade USA, Inc. v. Ain Temouchent M/V*, 404 F.3d 891, 897 (5th Cir.2005)(*quoting Steel Warehouse Co., Inc. v. Abalone Shipping Ltd. of Nicosai*, 141 F.2d 234, 236 (5th Cir.1998)(party which served interrogatories and document requests did not waive arbitration because it did not "shower[ ]" opposing party with discovery requests.)). "Delay by itself falls far short of establishing waiver." *Tristar Financial Ins. Agency, Inc. v. Equicredit Corp. of America*, 97 Fed.Appx. 462, 464 (5th Cir.2004).

The stringent nature of the Fifth Circuit prejudice requirement is illustrated by that court's statement in the instant case that "the fees ... associated with Joseph Chris's decision to file suit were insignificant." As a result of that suit, defendants' attorney filed a request for removal, a substantial motion to quash, and a detailed motion to declare the non-compete agreements controlled by Wisconsin law, responded to three rounds of court-directed discovery, and took part in three pre-trial conferences. Counsel fees for that volume of litigation were understandably substantial. A standard which dismisses such fees as "insignificant" is exceptionally demanding.

B. The Seventh Circuit Standard: Prejudice Ordinarily Irrelevant

The Seventh Circuit has repeatedly rejected the Fifth Circuit rule that prejudice is necessary for,

indeed the very essence of, a waiver. In 1992 the Seventh Circuit noted that other courts of appeals had held that "a defaulting party's actions cannot amount to waiver absent prejudice to the non-defaulting party," but rejected that rule. "Where it is clear that a party has foregone its right to arbitrate, a court may find waiver even if that decision did not prejudice the non-defaulting party." *St. Mary's Medical Center of Evansville, Inc. v. Disco Aluminum Products Co., Inc.*, 969 F.2d 585, 590 (7th Cir.1992).

The Seventh Circuit reiterated that rule in *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388 (7th Cir.1995)(Posner, J.).

> To establish a waiver of the contractual right to arbitrate, a party need not show that it would be prejudiced if the stay were granted and arbitration ensued.... [W]e have deemed an election to proceed in court a waiver of a contractual right to arbitrate, without insisting on evidence of prejudice beyond what is inherent in an effort to change forums in the middle (and it needn't be the exact middle) of a litigation."

50 F.3d at 390. The Seventh Circuit held that the actions of the party seeking arbitration in *Cabinetree* constituted a waiver of arbitration even though "there would have been no demonstrable prejudice to [the opposing party] by ordering arbitration." 50 F.3d at 391. *See Grumhaus v. Comerica Securities, Inc.*, 223 F.3d 648, 651 (7th Cir.2000)("The central question is

... not whether either party would be prejudiced by the forum change.").

The Seventh Circuit has expressly rejected the basic premise of the Fifth Circuit rule, that the courts should apply a strong presumption against waiver.

> In determining whether a waiver has occurred, the court is not to place its thumb on the scales; the federal policy favoring arbitration is ... merely a policy of treating such clauses no less hospitably than other contractual provisions.

Cabinetree, 50 F.3d at 390; *see St. Mary's Medical Center*, 969 F.2d at 590. The Seventh Circuit holds that prejudice need not be shown to establish waiver of a right to arbitrate because "in ordinary contract law, a waiver normally is effective without proof of consideration or detrimental reliance." *Cabinetree*, 50 F.3d at 390; *see St. Mary's Medical Center*, 969 F.2d at 590-91. "Once a party selects a forum, *the courts* have an interest in enforcing that choice and not allowing parties to change course midstream." *Grumhaus*, 223 F.3d at 651 (emphasis added).

Cabinetree announced a straightforward standard; a party which becomes involved in any litigation will be deemed to waive the right to arbitrate unless it seeks to exercise that right at the earliest possible moment.

> Selection of a forum in which to resolve a legal dispute should be made at the earlier possible opportunity in order to economize on the resources, both public and private, consumed in

> dispute resolution.... Parties know how important it is to settle on a forum at the earliest possible opportunity and the failure of either of them to move promptly for arbitration is powerful evidence that they had made their election – against arbitration. Except in extraordinary circumstances ... they should be bound by their election.

50 F.3d at 391. That is the standard applied in the Seventh Circuit today. *Ernst & Young LLP v. Baker O'Neal Holdings, Inc.*, 304 F.3d 753, 757-58 (7th Cir.2002)(finding waiver because party seeking arbitration failed "to make the earliest possible determination of whether to proceed judicially or by arbitration.").

C. The District of Columbia Circuit Standard: Prejudice *May* Be Considered But Is Not Necessary

The District of Columbia Circuit has expressly rejected the argument that waiver of the right to arbitration requires proof of prejudice to the party opposing arbitration. *National Foundation for Cancer Research v. A.G. Edwards & Sons, Inc.*, 821 F.2d 772 (D.C.Cir.1987).

> Edwards argues that prejudice to the objecting party is a prerequisite of a finding of waiver.... This circuit has never included prejudice as a separate and independent element of the showing necessary to demonstrate waiver of the right to arbitration.... We

> decline to adopt such a rule today.... [W]aiver may be found absent a showing of prejudice.

821 F.2d at 777. On the other hand, in the District of Columbia Circuit, unlike the Seventh Circuit, prejudice is relevant. "[A] court may consider prejudice to the objecting party as a relevant factor." *Id.*

D. The Tenth Circuit Standard: Prejudice *Should* Be Considered But Is Not Necessary

The Tenth Circuit has consistently rejected requiring proof of prejudice. In *Reid Burton Construction, Inc. v. Carpenters District Council of So. Colo.*, 614 F.2d 698 (10th Cir.1980), the parties alleged to have waived its right to arbitration unsuccessfully argued that prejudice was the essential element of a waiver:

> Mere delay, they say, does not constitute waiver, absent a showing of prejudice.... Defendants ... contend that [i]t is not the inconsistency or apparent inconsistency of the[ ] pleadings, but rather any prejudice flowing therefrom which determines the waiver issue.

614 F.2d at 701. The Tenth Circuit refused to adopt that specific and narrow definition, holding instead that "[t]here is no set rule as to what constitutes a waiver." 614 F.2d at 702. The court of appeals in *Reid Burton* then set out a list of six "relevant factors" that "courts have typically looked at," no one of which was

essential. *Id*. The last of the listed six factors was "whether the other party was affected, misled, *or* prejudiced by the delay." *Id*. (Emphasis added).

Since *Reid Burton* the Tenth Circuit has repeatedly set out that same list of six factors, consistently refusing to describe any of them as mandatory. *Dexter v. Prudential Ins. Co. of America*, 2000 WL 728821 at *2 (10th Cir.2000)("factors to consider"); *McWilliams v. Logicon, Inc.*, 143 F.3d 573, 576 (10th Cir.1998)("relevant" factors); *Altresco Philippines, Inc. v. CMS Generation Co.*, 1997 WL 186257 at *6 (10th Cir.1997)(factors a court "must examine"); *Metz v. Merrill Lynch, Pierce, Fenner & Smith*, 39 F.3d 1482, 1489 (10th Cir.1994)(factors "we examine"); *Midamerica Federal Savings and Loan Ass'n v. Shearson/American Express, Inc.*, 886 F.2d 1249, 1260 (10th Cir.1989)(factors courts "must examine"); *Peterson v. Shearson/American Express, Inc.*, 849 F.2d 164, 167 (10th Cir.1988)("this court examines" the six factors). The decision in *Metz* is now regarded as the leading case in the Tenth Circuit.

Proof of prejudice clearly is not required under the Tenth Circuit standard. No one of the six Tenth Circuit factors is necessary to support a finding of waiver; each is simply relevant. The sixth factor is whether the opposing party was "affected, misled or prejudiced"; any one of these alternative considerations would demonstrate the presence of that factor. In *Peterson* the Tenth Circuit, in holding that there had been a waiver, concluded that the opposing party had been "affected and probably misled." 849 F.2d at 468. The court made no mention of the presence or

absence of prejudice. In *Metz* the Tenth Circuit's finding of waiver did not discuss whether that sixth factor was present. 39 F.3d at 1490.

E. The Varying Standards in the Remaining Circuits

The First Circuit requires evidence of prejudice, but not much. "Even as justice delayed may amount to justice denied, so it is with arbitration.... [W]e require simply that [the party opposing arbitration] demonstrate *a modicum* of prejudice." *In re Tyco International Ltd. Securities Litigation*, 422 F.2d 41, 46 (1st Cir.2005)(emphasis added).

The Second Circuit, rather than setting a specific level or type of prejudice that must be shown, recognizes that the degree of prejudice will vary, and holds that the amount of prejudice (not whether or not some requisite level of prejudice is present) is a factor to be weighed with others.

> Generally, waiver is more likely to be found the longer the litigation goes on, the more a party avails itself of the opportunity to litigate, and the more that party's litigation results in prejudice to the opposing party.

Thyssen, Inc. Calypso Shipping Corp., S.A., 310 F.3d 102, 105 (2d Cir.2002).

The Third Circuit, while requiring a finding of prejudice, has formulated its unique six-part standard for determining the existence of prejudice. *Ehleiter v.*

Grapetree Shores, Inc., 482 F.3d 207, 223 (3d Cir.2007); *Hoxworth v. Blinder, Robinson & Co., Inc.*, 980 F.2d 912, 926-27 (3d Cir.1992).

The Fourth Circuit standard appears to be similar to that in the Fifth Circuit. The party opposing arbitration bears a "heavy burden of demonstrating prejudice." *Patten Grading & Paving, Inc. v. Skanska USA Building, Inc.*, 380 F.3d 200, 206 (4th Cir.2004). The Fourth Circuit, like the Fifth, expressly permits a litigant to engage in some discovery without losing its right to arbitration. *Id.* at 207.

The Sixth, Eighth, Ninth and Eleventh Circuits all require some evidence of prejudice; the caselaw in these circuits leaves unclear whether they follow the approach of First Circuit, the Second Circuit, the Third Circuit, or the Fifth Circuit.

F. The Conflict With and Among the State Courts

The Fifth Circuit has repeatedly insisted that its stringent waiver standard is mandated by the Federal Arbitration Act and by this Court's decision in *Moses H. Code Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). (Pet.App.6a); *see, e.g., Miller Brewing Co. v. Fort Worth Distrib. Co., Inc.*, 781 F.2d 494, 496-97 (5th Cir.1986). If that is correct, the state courts would be obligated to utilize the same standard, since the FAA applies to state court litigation. *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984). Six states have accepted that view, and apply what they believe

to be mandatory federal standards in determining whether a state court litigant waived the right to arbitration; these states generally require some showing of prejudice.[24] Most states, however, have concluded that state law, not federal, controls, and state court decisions in those states use a wide variety of standards in determining whether a litigant waived its right to arbitration.[25]

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[24] *Zedot Constr., Inc. v. Red Sullivan's Conditioned Air Services, Inc.*, 947 So.2d 396, 399 (Ala.2006); *Century 21 Maselle and Assoc., Inc. v. Smith*, 965 So.2d 1031, 1036-37 (Miss.2007)(under *Moses H. Cone* "parties claiming waiver must offer sufficient evidence ... to overcome the presumption in favor of arbitration"; "Procedurally, it shall be no different in state court."); *Saga Communications of New England, Inc. v. Voornas*, 756 A.2d 954, 958-59 (Me.2000)("The Federal Arbitration Act ... governs the current case."; *citing Moses H. Cone Hospital*); *Sentry Engineering and Constr., Inc. v. Mariner's Cay Development Corp.*, 287 S.C. 346, 351, 338 S.E.2d 631, 634 (1985)(prejudice must be shown because "[f]ederal decisions require a showing of prejudice when waiver is asserted."); *Prudential Securities Inc. v. Marshall*, 90 S.W.2d 896, 898 (Tex.1995)(applying presumption against waiver in light of *Moses H. Cone* and policy of "federal and state law); *David v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 440 N.W.2d 269, 274 (N.D.1989)(applying wavier standards required by "the Federal policy favoring arbitration.").

[25] *E.g., Blood v. Kenneth Murray Ins., Inc.*, 68 P.3d 1251, 1255 (Alaska 2003)(requiring, in addition to prejudice, "direct, unequivocal conduct indicating a purpose to abandon the right [to arbitrate.]"); *Bolo Corp. v. Homes & Son Constr. Co.*, 105 Ariz. 343, 347, 464 P.2d 788, 793 (1970)(filing suit always constitutes waiver regardless of prejudice); *City and County of Denver v. District Court*, 939 P.2d 1353, 1369 (Colo.1997)(six relevant

(Continued on following page)

II. THE CONFLICT REGARDING THIS ISSUE IS WIDELY RECOGNIZED

The conflict presented by this case is well entrenched and widely recognized.

Circuit Court Decisions

The Fifth Circuit in the instant case candidly recognized that the prejudice standard in that circuit differs from the Seventh Circuit standard under *Cabinetree*, which held that a party waives its right to arbitrate – regardless of the absence of prejudice – if (like the plaintiff in the instant case) it files suit regarding the arbitrable claim.

> Rossi and Marco ... primarily rely on a Seventh Circuit case, *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.*, where the court held that a party presumptively waives its right to arbitrate when it files suit.... The Seventh Circuit, however, has charted a different path from the Fifth Circuit in determining whether a waiver has occurred. Whereas this court places a heavy burden on the party opposing waiver [sic] and requires a showing of prejudice, the Seventh Circuit has concluded that courts are "not to place [their] thumb[s] on the scales" against finding waiver and that the party opposing waiver [sic] does *not* have to show prejudice.

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factors); *Raymond James Financial Services, Inc. v. Saldukas*, 896 So.2d 707, 711 (Fla.2005)(rejecting prejudice requirement).

(Pet.App.11a-12a)[26](Footnotes omitted; emphasis in original); *see id*. at n.20 (noting that the Seventh Circuit decision in *Cabinetree* acknowledged that its standard "had departed from the waiver-test applied by the Second, Fifth, and Eleventh Circuits.").

The Seventh Circuit recognized the inter-circuit conflict when it first held that waiver of the right to arbitrate does not require proof of prejudice.

> Several circuits have held that a defaulting party's actions cannot amount to waiver absent prejudice to the non-defaulting party.... However, not all the circuits hold that prejudice is indispensable to waiver. In [*National Found. for Cancer Research*] the D.C. Circuit held that ... waiver may be found absent a showing of prejudice.

St. Mary's Medical Center of Evansville, Inc. v. Disco Aluminum Products Co., Inc., 969 F.2d 585, 590 (7th Cir.1992). Judge Posner frankly acknowledged that conflict in his opinion for the Seventh Circuit in *Cabinetree*. "Ours may be the minority position but it is supported by the principal treatise on arbitration." *Cabinetree*, 50 F.3d at 390.

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[26] In this passage the court of appeals evidently meant to refer to the party opposing arbitration, not the party opposing waiver.

District Court Decisions

In *Uwaydah v. Van Wert County Hospital*, 246 F.Supp.2d 808 (N.D.Ohio 2002), the party seeking arbitration urged the court to hold that prejudice was a necessary element of any waiver, relying on decisions in the Second, Third and Ninth Circuits. The district court noted that

> not all courts agree with plaintiff's contention that a party opposing an untimely arbitration demand must show prejudice for the demand to be overruled. In other circuits, prejudice is a factor, but is not dispositive. *See Cabinetree ... Metz ... National Found. for Cancer Research* ... The Sixth Circuit['s] ... decisions, on balance can most fairly be read as recognizing prejudice as a factor, but not solely dispositive.

246 F.Supp. at 811-12.

In *U.S. for Use and Benefit of DMI, Inc. v. Darwin Const. Co.*, 750 F.Supp. 536, 538 (D.D.C.1990), the district court acknowledged that "[v]arious jurisdictions have adopted conflicting standards for determining what amounts to waiver of an arbitration right," contrasting the D.C. Circuit decision in *National Found. for Cancer Research* ("inconsistency, not prejudice, determines waiver of right to arbitration") with the Ninth Circuit decision in *Van Ness Townhouses v. Mar. Indus. Corp.*, 862 F.2d 754 (9th Cir.1989)("party seeking to prove waiver ... must demonstrate ... prejudice to the party opposing arbitration."). 750 F.Supp. at 538 n.2.

Several other district courts have noted this conflict. *Southern Systems Inc. v. Torrid Oven Limited*, 105 F.Supp.2d 848, 852-53 (W.D.Tenn. 2000)("[v]arious jurisdictions have adopted different tests to determine waiver of arbitration rights.... A number of circuits regard prejudice as the pivotal factor.... Not all of the circuits hold prejudice to be an indispensable requirement."); *Reidy v. Cyberonics, Inc.*, 2007 WL 496679 *5 (S.D.Ohio 2007)("Courts disagree as to the importance of the prejudice factor."); *Hasco Inc. v. Schuyler, Roches & Zwirner*, 981 F.Supp. 445, 450 (S.D.W.Va. 1997)(The Fourth Circuit, "like many sister circuits, ... requires a showing of prejudice to demonstrate waiver. *But see Cabinetree* ... (finding prejudice unnecessary....)").

State Court Decisions

Houston Lighting & Power Co. v. City of San Antonio, 896 S.W.2d 366, 370 (Tex.App.–Houston [1st Dist.] 1995, writ dism'd w.o.j.), noted this conflict among the federal courts of appeals.

> Some cases hold that a party must demonstrate prejudice to show waiver of the right to arbitration; other cases hold that proof of prejudice is not required. *Compare E.C.Ernst, Inc. v. Manhattan Constr. Co.*, 559 F.2d 268, 269 (5th Cir.1977)("[P]rejudice ... is the essence of waiver."), *with National Found. for Cancer Research v. A.G. Edwards & Sons, Inc.*, 821 F.2d 772, 777 (D.C.Cir.1987)("[W]aiver may be found absent a showing of prejudice.").

Raymond James Financial Services, Inc. v. Saldukas, 896 So.2d 707, 710 (Fla.2005), recognized the same problem.

> [T]here is a conflict among the federal appellate courts on this issue.... *National Foundation for Cancer Research* ... [held that] waiver may be found absent a showing of prejudice.... Whereas ... *S & H Contractors, Inc. v. A.J. Taft Coal Co.*, 906 F.2d 1507 (11th Cir.1990) [held that a] showing of prejudice is required....

Saga Communications of New England, Inc. v. Voornas, 756 A.2d 954, 961 and n.11 (Me.2000), commented:

> [A] majority of the federal courts have required a demonstration of prejudice as the *sine qua non* of waiver.... [In] [o]ther courts prejudice is considered but waiver can be found even in its absence.

(Footnote omitted).

LAS, Inc. v. Mini-Tankers, USA, Inc., 342 Ill.App.3d 997, 1002-03, 796 N.E.2d 633, 637-38, 277 Ill.Dec. 547, 551-52 (Ill.App. 5th Dist.2003), also recognized this division:

> The majority of federal cases ... hold[ ] [that t]he party asserting waiver bears a heavy burden of proof to show ... that the party asserting waiver suffered prejudice as a result of the alleged waiver.... *Cabinetree of Wisconsin, Inc.*, ... is a minority view.... [T]here is a

> split of authority among the federal circuit courts of appeal....

Rich v. Walsh, 357 S.C. 64, 68, 590 S.E.2d 506, 508-09 (2004) noted:

> [T]he various federal circuit courts of appeal have adopted different standards.... A number of circuits require the party opposing arbitration to demonstrate it has suffered "actual prejudice".... Not all of the circuits hold prejudice to be an indispensable requirement.

See Aviation Data, Inc. v. American Express Travel Related Services, Inc., 152 Cal.App.4th 1522, 1538, 62 Cal.Rptr. 396, 408 (1st Div.2007)("the federal circuits differ on the nature and degree of prejudice necessary to find waiver ... and at least one circuit has expressly rejected the notion that prejudice is [necessary]."); *Alaia v. Tramontana Group-1, Inc.*, 2007 WL 2446847 at *4 n.1 (Cal.App.2d Dist.)(noting that *Cabinetree* is the "minority" position.); *Saint Agnes Medical Center v. Pacificare of California*, 31 Cal.4th 1187, 1203 n.6, 82 P.3d 727, 738 n.6, 8 Cal.Rptr. 517, 630 n.6 (2003)(*Cabinetree* is "the minority position."); *J.L. Steele v. Lundgren*, 85 Wash.App. 845, 852, 935 P.2d 671, 675 (Div.1 1997)(there is "a multitude of federal circuit court decisions 'which, even on a good day, are sometimes hard to reconcile.'")(*quoting* 2 I. MacNeil, R. Speidel & T. Stipanowich, *Federal Arbitration Law* §21.3.2.1 (1994)).

Commentators

Commentators have long recognized this inter-circuit conflict.

> Most of the conflict over the standards to be applied in determining what amounts to waiver of an arbitration right centers on the question of prejudice. For most courts a finding of prejudice is a necessary prerequisite to finding waiver.... At the other end of the spectrum are cases that find prejudice may be a factor in the analysis but is not essential.... The ... Seventh Circuit has taken the lead in ruling that prejudice is unnecessary to establish waiver.

6 Bruner and O'Connor on Construction Law, §20.98 (2007)(footnotes omitted).

> In determining whether a party has waived arbitration, the federal Circuits are divided as to whether the party who resists arbitration must demonstrate having been prejudice by the delay.

T. Oehmke, Commercial Arbitration, §50.46 (2007)(emphasis in original; footnotes omitted).

> The Seventh Circuit's focus [in *Cabinetree*] on choice, election, and manifest intent not to arbitrate without requiring contemporaneous finding of prejudice constitutes a significant departure from other circuits' precedent and is in vivid contrast to those analyses....

M. Forsythe, *The Treatment [of] Arbitration Waivers under Federal Law*, 55 Dispute Resolution Journal, May 2000, 8, text at nn.43-44.

III. THE QUESTION PRESENTED IS OF SUBSTANTIAL IMPORTANCE

The current state of the law creates significant problems for the efficient administration of justice. The standard in the Fifth Circuit expressly accords to parties an opportunity to litigate their disputes for a period of time in federal court, and then to change forums – for whatever reason – and move the dispute instead to arbitration. The Fifth Circuit specifically permits a party to engage in discovery before deciding whether to opt for arbitration. The standard in many other circuits creates a similar, albeit narrower and ill-defined, safe harbor for pre-arbitration litigation.

Whatever the burdens or advantages of this system for litigants, it undeniably results in a squandering of scarce judicial resources. In reluctantly applying the Fifth Circuit standard, one panel in that circuit conceded that "[s]uch actions waste the time of both the courts and the opposing party. The decision whether to arbitrate is one best made at the onset of the case." *Walker v. J.C. Bradford & Co.*, 938 F.2d 575, 577 (5th Cir.1991). The district judge in the instant case, commendably seeking to move the proceedings forward with dispatch, issued three discovery orders, conducted an equal number of pre-trial conferences, and resolved the motion to quash depositions – only

to see the plaintiff, three months into the litigation, attempt to move the dispute to arbitration. "The advantages of arbitration evaporate when arbitration is used not as a substitute for litigation, but as a supplement to litigation." *Zirger v. General Accident Ins. Co.*, 144 N.J. 327, 343, 676 A.2d 1065, 1074 (1996).

The leading authority on federal arbitration law has strongly criticized the prejudice requirement.

> The requirement of prejudice, particularly in courts loathe to find prejudice, protects the federal contract right to arbitrate at considerable cost to efficiency. The current approach tends to encourage litigation of whether a waiver in fact occurred. It sometimes permits a party who has chosen to engage in the litigation to stop, demand arbitration, and move to another forum. And it often permits a defending party to waste much time and sometimes considerable effort by the other or even gain litigational advantage before demanding arbitration.... All this appears to be the exact opposite of what parties desire when they agree to arbitration – delay instead of speed, formality instead of informality, and complexity instead of simplicity.

2 I. MacNeil, R. Speidel, T. Stipanowich, *Federal Arbitration Law: Agreements, Awards and Remedies under the Federal Arbitration Act*, §21.3.3 (1999).

The adverse impact on district judges of the Fifth Circuit rule permitting parties to first pursue judicial relief and then repudiate litigation for arbitration is reflected in the pattern of decisions in that circuit. Many of those Fifth Circuit decisions are opinions overturning the determination of a district judge that a litigant had waived the right to arbitrate a claim by first litigating the claim before that judge. In these cases the district court litigation had continued for substantially longer than in the instant case before one of the parties filed a motion seeking arbitration.[27]

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[27] *Keytrade USA, Inc. v. Ain Temouchent M/V*, 404 F.3d 891, 897 (5th Cir.2005)(reversing district court finding of waiver); *Tristar Financial Ins. Agency, Inc. v. Equicredit Corp. of America*, 97 Fed.Appx. 462, 464 (5th Cir.2004)(reversing district court finding of waiver where party did not seek arbitration until 8 months after suit commenced); *Cargill Ferrous Int'l v. Sea Phoenix MV*, 325 F.3d 695, 700-01 (5th Cir.2003)(reversing district court finding of waiver); *Texaco Exploration and Production Co. v. AmClyde Engineered Products Co., Inc.*, 243 F.3d 906, 911-12 (5th Cir.2001)(reversing district court finding of waiver); *Subway Equipment Leasing Corp. v. Forte*, 169 F.3d 324, 326 (5th Cir.1999)(reversing district court finding of waiver where party did not file demand for waiver until 6 years after suit commenced); *Steel Warehouse Co., Inc. v. Abalone Shipping Ltd. of Nicosai*, 141 F.3d 234, 236 (5th Cir.1998)(reversing district court finding of waiver where party did not move to stay litigation until 10 months after suit commenced); *Williams v. Cigna Financial Advisors, Inc.*, 56 F.3d 656, 661-62 (5th Cir.1995)(reversing district court finding of waiver); *Walker v. J.C. Bradford & Co.*, 938 F.2d 575, 576 (5th Cir.1991)(reversing district court finding of waiver where party did not seek arbitration until 13 months after suit was commenced); *Tenneco Resins, Inc. v. Davy International, AG*, 770 F.2d 416, 420 (5th Cir.1985)(reversing district court finding of waiver where party did not move to stay litigation until 8

(Continued on following page)

The lower courts have widely condemned litigants who "test the waters" in federal or state litigation, and then resort to arbitration if the results are unfavorable. But those courts have understandably found it impracticable to hold hearings to decide the motives of the attorneys who, after a period of litigation, demand arbitration instead. In the Fifth Circuit a litigant – whatever its motive – has a right to insist on arbitration so long as its conduct has not yet created the prohibited (and demanding) level of prejudice.[28] In the proceedings below the district court was sharply critical of the tactics of JCPS' attorneys.[29] But neither court below attempted to decide why JCPS had asked for arbitration three months after suing Rossi and Marco and demanding a "full trial on the merits."

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months after suit commenced); *General Guaranty Ins. Co. v. New Orleans General Agency, Inc.*, 427 F.2d 924, 927-28 (1970)(reversing district court finding of waiver).

[28] *Walker v. J.C. Bradford & Co.*, 938 F.2d 575, 578 (5th Cir.1991):

> We recognized that Bradford simply may be requesting arbitration so that it might further delay these proceedings.... The only relevant issue is whether Bradford's delay waived its contractual rights. This issue is evaluated objectively, independent of motivation. The question simply is whether Bradford still retains a right to invoke its arbitration agreement. If so, it can for whatever reason....

[29] It characterized the behavior of those attorneys as "uncooperative, unprepared, and belligerent." (Pet.App.17a-18a).

The conflict among the lower courts reflects to some degree the competing considerations articulated in this Court's arbitration decisions. Some lower courts rely on decisions which describe arbitration as highly favored, *e.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), while others invoke instead decisions explaining that the FAA seeks only to put arbitration agreements on the same footing as other contracts. *E.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967). Several lower court decisions permitting arbitration after significant litigation reason that the purpose of the FAA is to favor arbitration, regardless of the impact on efficiency; other decisions rely instead on this Court's insistence that the purpose of the arbitration, and thus the FAA, is to promote the efficient resolution of claims, a purpose ill served by changing forums in the midst of a dispute. *E.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 649 n.14 (1985).

The existence of this inter-circuit conflict creates an undesirable incentive for forum shopping. If the instant lawsuit had been brought in federal court in Wisconsin, where the defendants lived, Seventh Circuit precedent would have precluded JCPS from later demanding arbitration. The outcome would also be different in a case such as this if the federal district court in Texas had transferred venue to the district court in Wisconsin, the district in which most of asserted contract violations were alleged to have occurred.

In addition to these differences between the standards applied by the various courts of appeals, it often is difficult to predict how any given standard would be applied in a particular case. Under the Fifth Circuit standard, for example, litigants cannot know how much discovery and motion practice over how great a period of time will cross the line from "a little bit" of discovery to a "shower" of discovery. That uncertainty itself, as this case well illustrates, gives rise to extensive litigation that is inconsistent with the efficient administration of justice and the purpose of the FAA.[30] The Seventh Circuit standard avoids that problem by putting all parties on notice that they must demand arbitration at the very outset of any litigation.

This issue is ripe for resolution. Every federal geographic circuit has now addressed this issue. The differing standards are well established and have been repeatedly applied. The Fifth Circuit prejudice standard dates from its 1985 decision in *Tenneco*; the Seventh Circuit rejected any such prejudice requirement in its 1992 decision in *St. Mary's Medical Center*. Each

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[30] The variety of tests courts currently apply actually encourage litigation, thereby increasing delay and the expense of arbitration, contrary to all established policy objectives. The resulting uncertainty has also made strategic litigation decisions difficult for the party forced to respond to litigation covered by an arbitration agreement.

A. DeToro, *Waiver of the Right to Compel Arbitration of Investor-Broker Disputes*, 21 Cumb.L.Rev. 615, 616 (1990/1991).

circuit recognizes that conflict and has refused to alter course. Only action by this Court can resolve this disagreement.

CONCLUSION

For the above reasons, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 06-20235

JOSEPH CHRIS PERSONNEL SERVICES INC
d/b/a Joseph Chris Partners

Plaintiff-Counter Defendant-Appellant

v.

DONNA ROSSI; ALBERT MARCO

Defendants-Counter Claimants-Appellees

Appeal from the United States District Court
for the Southern District of Texas
USDC No. 4:03-CV-2554

(Filed October 10, 2007)

Before JONES, Chief Judge, and REAVLEY and SMITH, Circuit Judges.

PER CURIAM:*

Joseph Chris Partners sued Donna Rossi and Albert Marco, two of its former employees, for breach

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* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

of a non-compete agreement and breach of fiduciary duties. Rossi and Marco counterclaimed for unpaid wages. After the district court held that Joseph Chris had waived its right to arbitrate the case, Rossi and Marco successfully moved for summary judgment on their wages claim and were granted summary judgment on all of Joseph Chris's claims. Joseph Chris appeals, contending that the district court improperly granted summary judgment and erroneously concluded that it had waived its right to arbitrate. Because Joseph Chris did not waive its right to arbitrate, we reverse and remand.

I. Background

Joseph Chris is a personnel recruitment firm that helps clients find employment in the national real estate market. In 1998, Marco signed an employment contract with Joseph Chris to work as a recruiter; in 2001, Rossi did the same. Both contracts contained a provision that granted the right to arbitration to all parties in disputes regarding the contract. The contracts also contained a safe-harbor provision that allowed a party the right to sue in court "for the purpose of obtaining injunctive relief without waiver of the right to arbitrate." A similar provision is found in the Texas Arbitration Act, which "allow[s] trial court[s] to grant injunctions before arbitration proceedings begin." *See Menna v. Romero.*[1]

[1] 48 S.W.3d 247, 251 (Tex.App. – San Antonio 2001, pet. dism'd w.o.j.) (citing Tex. Civ. Prac. & Rem. Code § 171.086).

In early 2003, Rossi and Marco left their jobs at Joseph Chris and started their own recruiting firm. In response, on June 4, 2003, Joseph Chris filed suit in Texas state court. The complaint alleged, among other things, that Rossi and Marco were violating a non-compete provision in their employment contracts and were breaching their fiduciary duties by using and/or disclosing Joseph Chris's confidential and proprietary information. Joseph Chris requested a temporary injunction prohibiting Rossi and Marco from taking advantage of that information and also requested damages. The complaint also requested an ex parte order requiring Rossi and Marco to each show up for a two-hour deposition "[t]o facilitate the hearing on the temporary injunction." The court promptly granted Joseph Chris's ex parte request and set July 15 for both depositions.

On July 3, Rossi and Marco answered and four days later removed the case to federal court. Once in federal court, Rossi and Marco filed a motion for a protective order, asking the district court to quash their depositions. Shortly thereafter at a pre-trial conference, the district court wiped the discovery slate clean, quashing all formal discovery, and ordered the parties to exchange some pertinent information. Rossi, for example, was required to give Joseph Chris her customer lists.

On July 17 – only ten days after the case had been removed to federal court – Joseph Chris's attorney sent a letter to Rossi and Marco's attorney first raising the issue of arbitration: "The contract

between our clients provides for arbitration using JAMS. Since it was drafted I have come to prefer AAA, [sic] what is your thought about making that change?" No response was given. A day later, the litigation continued to plod along and another pretrial conference was held.

On July 21, Joseph Chris's counsel again raised the issue of arbitration in an e-mail: "Turning next to failures to respond to prior correspondence, I asked you if you would like to use AAA rather than JAMS for the arbitration. If I do not get a decision from you by this afternoon I will start the procedure with JAMS." On the same day, Rossi and Marco's counsel responded that they "object[ed]" to moving the case to arbitration.

On August 19, the district court held another pretrial conference, where, like during the previous two conferences, Joseph Chris did not bring up the subject of arbitration. Later that day, Joseph Chris's counsel sent the following e-mail to opposing counsel: "You may receive a copy of an arbitration demand in the mail. Although we still intend to file an arbitration demand, we have not filed the arbitration demand with JAMS as reflected in the package you received. I prepared the arbitration demand to be filed today, as necessary, but we have not filed it." Joseph Chris explains to this court that the "as necessary" language referenced its attempts to obtain a preliminary injunction hearing – if it believed it could not quickly obtain such a hearing, it would forgo the attempt at a preliminary injunction and move right to arbitration.

On August 29, Joseph Chris went ahead and filed its arbitration request with JAMS (the Judicial Arbitration and Mediation Services). That same day, Rossi and Marco filed an emergency motion in district court asking that Joseph Chris be enjoined from pursuing the arbitration. The district court eventually granted the motion, concluding that Joseph Chris had waived its right to arbitrate given its participation in the litigation.

Rossi and Marco subsequently filed a counterclaim, alleging that Joseph Chris owed them unpaid commissions. They eventually filed motions for summary judgment on all of Joseph Chris's causes of action and on their back wages claims. The district court granted each motion and entered judgment against Joseph Chris. This appeal ensued.

II. Discussion

Joseph Chris contends that Rossi and Marco never should have had the opportunity to file for summary judgment because the case should have been submitted to arbitration. Joseph Chris contends that it did not waive its right to arbitrate and that the district court erred when it concluded to the contrary. Since the district court made no factual findings regarding whether Joseph Chris waived its right to arbitrate, we review its determination of

waiver de novo. *See Price v. Drexel Burnham Lambert, Inc.*[2]

Congress has decreed a strong federal policy in favor of arbitrating disputes. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*[3] As a result, the U.S. Supreme Court has warned that when determining whether a party has waived its right to arbitrate, "any doubts . . . should be resolved in favor of arbitration."[4] Thus, this circuit employs a strong presumption against a finding of waiver, and a party alleging waiver must carry a heavy burden. *Subway Equipment Leasing Corp. v. Forte.*[5]

Nonetheless, "[w]aiver will be found when the party seeking arbitration substantially invokes the judicial process to the detriment or prejudice of the other party."[6] Once a party "[s]ubstantially invok[es] the litigation machinery," that "qualifies as the kind of prejudice . . . that is the essence of waiver." *Miller*

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[2] 791 F.2d 1156, 1159 (5th Cir. 1986) (concluding that waiver of the right to arbitrate is reviewed de novo, but any factual findings underpinning that determination are reviewed for clear error).

[3] 460 U.S. 1, 24, 103 S. Ct. 927, 941 (1983) (citing 9 U.S.C. § 2).

[4] *Id.* at 24-25.

[5] 169 F.3d 324, 326 (5th Cir. 1999).

[6] *Id.* (quoting *Miller Brewing Co. v. Fort Worth Distrib. Co.,* 781 F.2d 494, 497 (5th Cir. 1986).

Brewing Co. v. Fort Worth Distrib. Co.[7] Prejudice, in this context, "refers to the inherent unfairness – in terms of delay, expense, or damage to a party's legal position – that occurs when the party's opponent forces it to litigate an issue and later seeks to arbitrate that same issue."[8]

At the outset, to clear away some of the brush, we first address Rossi and Marco's argument that Joseph Chris's request for a jury trial, initiated once the case was removed to federal court to avoid waiving the right to a jury, resulted in the waiver of arbitration. Rossi and Marco argue that when Joseph Chris made the request, it automatically conferred on them a right to a jury trial and had they been forced to go to arbitration, they would been prejudiced by losing that right. Rossi and Marco's argument misconstrues the type of prejudice relevant to the waiver determination. The question is what prejudice the party opposing arbitration has suffered *because of the unnecessary litigation* – not what prejudice the party would suffer by going to arbitration.[9] To hold to the contrary would mean that anytime a plaintiff filed

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[7] 781 F.2d at 497 (quoting *E.C. Ernst, Inc. v. Manhattan Const. Co.,* 559 F.2d 268, 269 (5th Cir. 1977)).

[8] *Subway,* 169 F.3d at 327 (quoting *Doctor's Assocs. v. Distajo,* 107 F.3d 126, 134 (2d Cir. 1997)).

[9] *See Subway,* 169 F.3d at 327 (describing the relevant prejudice as the prejudice incurred by the party opposing arbitration when it is forced "to litigate an issue and later seeks to arbitrate the same issue" (quoting *Doctor's Assocs.,* 107 F.3d at 134)).

suit and asked for a jury trial, the defendant would be precluded from requesting arbitration because allowing arbitration would "prejudice" the plaintiff by waiving its right to a jury. That is clearly not the law.

With that out of the way, the central issue becomes whether Joseph Chris's decision to file suit, and the related fees and delay caused by that decision, resulted in a waiver of its right to arbitrate.

Under the facts presented here, we hold that Joseph Chris did not waive its right to arbitrate. While typically the decision to file suit will indicate a "disinclination" to arbitrate,[10] Texas state law expressly permitted Joseph Chris to file suit to, among other things, obtain an injunction.[11] More importantly, that protection was extended to this proceeding as these parties contracted for the right to be able to file suit to preserve the status quo with an injunction without waiving the right to arbitrate. Joseph Chris did just that. Indeed, in the complaint filed in state court, Joseph Chris explained that it was seeking to depose both Rossi and Marco for the purpose of facilitating a request for a preliminary injunction. Later, when the case was removed to federal court

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[10] *See Miller,* 781 F.2d at 497 (determining that a party had revealed a "disinclination to resort to arbitration" by, among other things, filing suit in state court without mentioning its desire to arbitrate).

[11] *See Menna v. Romero,* 48 S.W.3d 247, 251 (Tex.App. – San Antonio 2001, pet. dism'd w.o.j.) (citing Tex. Civ. Prac. & Rem. Code § 171.086).

and the district court quashed those depositions, Joseph Chris promptly notified Marco and Rossi of its desire to arbitrate. Any prejudice Rossi and Marco suffered having to deal with Joseph Chris's attempt to obtain a preliminary injunction was prejudice they had contracted to assume. And while Joseph Chris included a paragraph for legal damages in its complaint and it later asked for a jury trial – actions that seem to exceed the scope of their contractual right to pursue a preliminary injunction – Rossi and Marco have made no showing that those requests required them to spend additional time or money or that they were otherwise prejudiced by those requests.

Moreover, the fees and delay associated with Joseph Chris's decision to file suit were insignificant. Joseph Chris formally requested arbitration only three months after filing suit. The discovery that had been conducted up until that point was fairly insubstantial and there was no showing that similar discovery could not have been had in arbitration. The other litigation activities that Rossi and Marco point to, such as the three pre-trial conferences, involved relatively minor expense. Neither Joseph Chris nor Rossi and Marco had filed a potentially dispositive motion. *See, e.g., Republic Ins. Co. v. PAICO Receivables, LLC*[12]; *Price v. Drexel Burnham*

[12] 383 F.3d 341, 344-45 (5th Cir. 2004) (determining that the right to arbitrate had been waived because "extensive litigation activities" had been undertaken, including "full-fledged" discovery and the filing of a motion for summary judgment)

Lambert, Inc.[13] Additionally, at least some of the fees Rossi and Marco complain about were incurred only by their co-defendants (who are no longer a party to this suit), although Rossi and Marco claim they voluntarily paid them. Those fees are irrelevant in determining whether they were prejudiced.

On facts similar to these, we have held that a party did not waive its right to arbitrate. For example, in *Tenneco Resins, Inc. v. Davy International, AG,* we held that a party had not waived its right to arbitration after it was demanded eight months into the litigation and after a "minimal amount of discovery had been conducted."[14] There we cited numerous cases where other courts allowed "considerably more activity without finding that a party had waived a contractual right to arbitrate."[15] Likewise, in *Cargill Ferrous International v. Sea Phoenix, MV,* we held there was no waiver where a party demanded arbitration six months into the litigation and after a small amount of discovery (including a deposition) had been conducted.[16] In both cases we concluded that taking part in a little bit of discovery, coupled with

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[13] 791 F.2d 1156, 1159 (5th Cir. 1986) (determining that the right to arbitrate had been waived after the right was invoked 15 months after the suit was filed and a motion to dismiss and a motion for summary judgment had been filed).

[14] 770 F.2d 416, 421 (5th Cir. 1985).

[15] *Id.* at 420-21.

[16] 325 F.3d 695, 700-01 (5th Cir. 2003).

timely invoking the right to arbitrate, would not result in waiver.[17] Such is the case here.

Rossi and Marco, in support of their argument, primary rely on a Seventh Circuit case, *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.,* where the court held that a party presumptively waives its right to arbitrate when it files suit.[18] There, the court was concerned about a party filing suit to test the waters, only to invoke the right to arbitrate if things did not go as planned in court.[19] Under *Cabinetree,* then, Rossi and Marco contend that Joseph Chris presumptively waived its right to arbitrate and that it cannot overcome that presumption.

The Seventh Circuit, however, has charted a different path from the Fifth Circuit in determining whether waiver has occurred.[20] Whereas this court places a heavy burden on the party opposing waiver and requires a showing of prejudice, the Seventh Circuit has concluded that courts are "not to place [their] thumb[s] on the scales" against finding waiver and that the party opposing waiver does *not* have to

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[17] *See Cargill,* 325 F.3d at 700-01; *Tenneco,* 770 F.2d at 421.

[18] 50 F.3d 388, 390 (7th Cir. 1995) (Posner, C.J.).

[19] *Id.* (noting that the party arguing against waiver could offer no reason why it chose to file suit instead of arbitration except to "weigh its options").

[20] *Id.* (noting that the Seventh Circuit had departed from the waiver-test applied by the Second, Fifth, and Eleventh Circuits).

show prejudice.[21] Moreover, as the *Cabinetree* courts notes, the presumption of waiver is rebuttable in cases where the decision to file suit "does not signify an intention to proceed in court to the exclusion of arbitration."[22] Here, given Joseph Chris's right to file suit for injunctive relief, the decision to proceed in court did not necessarily signify that it intended to forgo arbitration – an intention it quickly expressed to Rossi and Marco.

Finally, Rossi and Marco contend that Joseph Chris was testing the waters by filing suit and, as the *Cabinetree* court put it, playing "heads I win, tails you lose."[23] Rossi and Marco point to the fact that Joseph Chris not only filed suit in lieu of arbitration, but failed to tell the district court of its plan to arbitrate during the pre-trial conferences. But as explained above, Joseph Chris had the right to file suit, it quickly made its intention to arbitrate clear, and it did not wait until the district court had made a number of rulings to test the waters before filing for arbitration.

The judgment is REVERSED and the case is REMANDED.

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[21] *Id.*

[22] *Id.* at 390-91.

[23] *Id.* at 390.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF TEXAS

JOSEPH CHRIS PERSONNEL SERVICES, INC.,	§	
Plaintiff,	§	
versus	§	CIVIL ACTION H-03-2341
DONNA ROSSI, *et al.*,	§	
Defendants.	§	

Opinion on Summary Judgment

1. *Introduction.*

A recruiting company sued three former workers for breach of contract, breach of fiduciary duty, and violations of the Texas Occupations Code. The workers counterclaimed for lost wages and attorneys fees. The workers have moved for summary judgment.

2. *Background.*

Joseph Chris Personnel Services, Inc., recruits employees for national companies in commercial and residential real estate. Its main office is in Kingwood, Texas, but it has offices throughout the country. The Kingwood location has the company's computerized database with client, applicant, and vacancy information.

Albert Marco and Donna Rossi recruited for Joseph Chris in Wisconsin. Marco worked for the company for four and one-half years, and Rossi worked there for two years. Since leaving Joseph Chris, Marco and Rossi started Travato Group, Inc. – a recruiting company with regional offices throughout the county.

Cecilia Floyd started with the Joseph Chris in Texas. After about a year, she moved to open a branch for it in Georgia. She worked there for five years, until that office was closed. After leaving Joseph Chris, Floyd started RESA Group, L.L.P. – a recruiting firm in Georgia.

Joseph Chris says that the defendants generated contacts for their new companies only by exploiting its database and business model. It sues them for breach of their employment contracts, breach of fiduciary duty, and violation of the Texas Occupations Code. Rossi and Marco sued for unpaid wages. Floyd seeks fees and costs.

In its summary judgment response – without leave from the court – Joseph Chris raises additional claims of tortious interference with accounts receivable and destruction of computer information and paper files. Because the company never pleaded these legal theories, it cannot initiate them in a response to motions for summary judgment.

The employment agreements chose Texas law to govern. The defendants moved to apply the law of the states where they worked. On August 30, 2004, this

court granted Marco and Rossi's motion to apply Wisconsin law and Floyd's motion to apply the law of Georgia.

3. *Arbitration.*

Joseph Chris argues that the court should not consider Rossi and Marco's motions for summary judgment because these defendants are bound by an arbitration clause. The court has ruled otherwise. While there is a presumption against waiver of an agreement to arbitrate, the presumption is rebutted where "the party seeking to enforce the agreement substantially invokes the judicial process to the other party's detriment." *EZ Pawn Corp. v. Mancias,* 934 S.W.2d 87, 89 (Tex. 1996) (*citing Miller Brewing Co. v. Fort Worth Distrib. Co.*, 781 F.2d 494, 497 (5th Cir. 1986).

In its original state-court petition, Joseph Chris disclosed that there was a provision in each of the defendant's agreements that required arbitration for "any controversy." Orig. Pet. 15. Specifically, it stated, "should this court determine that arbitration is required in the case, then Joseph Chris seeks an order in this case forcing defendants to appear at arbitration." *Id*. It then requested a "full trial on the merits," not an arbitration. *Id*. 19. Joseph Chris acknowledged and then waived its right to arbitrate.

Marco and Rossi removed the suit. Their case was later consolidated with Floyd's – her contract did not include an arbitration provision. Here, Joseph

Chris demanded a jury. The next month, the court held three pre-trial conferences. The parties discussed the facts, jurisdiction, and choice of law questions. Meanwhile – in between conferences – Joseph Chris was apparently contacting the defendants to discuss arbitration. Then, two hours before the hearing of August 18, Joseph Chris called defense counsel and said that it intended to pursue arbitration. Again, it did not mention its "plan" to the court. Still, the following day, Joseph Chris sent a "draft" of the demand for arbitration to the defendants.

On August 29, 2003, Joseph Chris filed with JAMS – Judicial Arbitration and Mediation Services. That same day, Rossi and Marco filed an emergency motion here to enjoin Joseph Chris from pursuing a duplicative proceeding. The court set a hearing for September 2.

At the hearing, Joseph Chris said that it was not prepared to respond. The court gave Joseph Chris two days to move to compel arbitration. Dkt. No. 26. The company incorrectly responded with a motion to reconsider the arbitration order; however, the motion substantively argued compulsion.

After ruling on the choice of law, the court erroneously ordered the parties to arbitrate and, in response to a motion to reconsider, vacated that order. Joseph Chris has waived whatever right it had to arbitrate by its acknowledgment of the clause and then by its repeated use of the courts and their ordinary techniques of litigation to attack the defendants.

The court will consider the pending motions for summary judgment.

4. *Due Process.*

Next, Joseph Chris says that it cannot respond to the motions for summary judgment, citing violations of due process. It says that the court prohibited it from conducting discovery. This is false.

The court ordered the parties to refrain from exchanging unnecessary, boilerplate discovery requests. Instead, it asked each party what it needed to know, and then it ordered the other side to furnish that information. Dkt. No. 10,14,19,26. Joseph Chris has lists of the defendants' customers, applicants, and contracts. It has a list of the firms that contacted the defendants. It was ordered to compare this information with a list of its clients and candidates. The court also made the parties compile jointly a chronology.

Joseph Chris may not drag former employees into court and *then* search for evidence of a claim. It had a duty to know – or at least reasonably believe – that they breached a valid contract before it sued them. Here, Joseph Chris need not prove its case; it must only raise a fact issue. Joseph Chris's counsel was asked what information he needed by the court, and then the court compelled the defendants to disclose whatever made sense. The court is familiar with litigation being used to impose costs on the other side to the point that an unwarranted settlement is reached. Joseph Chris has been uncooperative,

unprepared, and belligerent in its behavior thus far. Its plea for more discovery is a dodge. The court will consider the motions for summary judgment.

5. *Contracts.*

The dispute concerns two sections of the contracts. Section 7.0 covers competition. For terminated employees, it is limited to a year but is completely unfettered in territory and activity. It prohibits recruiters from (1) soliciting or accepting business from current and former clients and (2) hiring former or current employees.

Section 6.02 – read with section 5.01 – is the non-disclosure covenant. It prohibits former employees from disclosing "confidential or proprietary information." According to Joseph Chris, confidential information includes everything in the company's database as well as "companies seeking or *likely to seek* the benefit of [Joseph Chris's] business and services" [emphasis added].

6. *Rossi and Marco.*

Joseph Chris furnished the court with (1) a list of firms that Marco and Rossi dealt with for it and (2) a list of the companies that Marco and Rossi worked for at Travato. It says – through the affidavit of its lawyer and several exhibits – that of the fifteen companies that Rossi listed as her "business relationships" at Travato, nine were subjects of Marco's and

Rossi's search assignments at Joseph Chris. It says that each of the six companies that Marco listed were former clients of Joseph Chris. It also points to overlap in candidates.

Not only is this a haphazard presentation of evidence, it is unpersuasive. First, Marco and Rossi say that these firms approached them, and Joseph Chris offers nothing to the contrary. Second, even Joseph Chris's most compelling evidence – Marco's list of firms that he contacted "from his personal rolodex" – does not create a fact issue. According to Joseph Chris, Marco and Rossi conducted hundreds of searches for hundreds of firms. *See* Summ. J. Reply 5. That Marco "searched" a firm for Joseph Chris in 1999 – or even within a year of his termination – does not suggest a proprietary relationship without more. Joseph Chris cannot forbid Rossi from soliciting a firm in Virginia that she searched for it on three occasions in 2002.

Under Wisconsin law,

> A covenant . . . within a specified territory and during a specified time is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal. Any covenant . . . imposing an unreasonable restraint is illegal, void and unenforceable even as to any part of the covenant or performance that would be a reasonable restraint.

Wis. Stat. § 103.465 (2002); *see Gen. Med. Corp. v. Kobs*, 507 N.W.2d 281, 384 (Wis. Ct. App. 1993). This statute covers both non-compete and non-disclosure provisions. *Tatge v. Chambers & Owen, Inc.,* 579 N.W.2d 217, 222 (Wis. 1998).

The non-compete provision is substantively and geographically boundless. For one year, it barred Rossi and Marco from working in any capacity anywhere in the world for a company that recruits. It also prohibited them from hiring anyone who had ever worked for Joseph Chris in any capacity. Finally, they could not solicit former customers, regardless of how long it had been since Joseph Chris had worked for them. According to the contract, Rossi and Marco could not move to a state – where they had never worked – to place candidates at a company that had accepted a single worker from Joseph Chris when it opened in 1977. Additionally, the Travato Group could never hire a recruiter who once had worked as a Joseph Chris janitor.

The contract also prevented Rossi and Marco from *ever* using or disclosing any company that ever purchased – or might some day purchase – Joseph Chris's services. There is no reasonable explanation for this requirement. It serves only as a threat to paralyze Joseph Chris workers.

The contracts are unenforceable. Because Wisconsin law is absolute, forbidding reformation, they are void.

7. *Floyd.*

In Georgia, contracts that restrain trade or lessen competition are contrary to public policy. Ga. Const. art. 3, § VI; Ga. Code Ann. § 13-8-2(a)(2) (2004). Whether a restraint of time, geography, or activity is reasonable is a question of law. *Rollins Protective Servs. Co. v. Palermo*, 287 S.E.2d 546 (Ga. 1982). If a contractual restraint is invalid, then all non-competition provisions are unenforceable. *T.V. Tempo, Inv. v. T.V. Venture, Inc.,* 262 S.E.2d 54 (Ga. 1979).

The contract inhibits Floyd from working in Georgia – where Joseph Chris chose to close its business – or any other state for at least a year. It forbids her from hiring the workers who Joseph Chris terminated when it closed the Georgia office. It prevents her from accepting business from companies that have contacted her in Joseph Chris's absence.

Finally, under this disclosure provision, Joseph Chris could prohibit Floyd from "using" information that exists in the database, even if she finds it elsewhere. She is also required to predict – and then avoid – Joseph Chris's future clients. These are not mere marginal restraints to protect the employer's goodwill that has attached to an individual; they require that ex-employees leave the business for a year and leave Joseph Chris's customers and employees free from open competition forever. The contract is unreasonable and, therefore, void.

8. *Other Theories.*

Joseph Chris also claims that the defendants violated the Texas Occupations Code and breached a fiduciary duty to it. These claims, too, fail.

The code states that an employee of a personnel service may not disclose information about an applicant, an employer, an employment position, or the operation of the personnel service. *See* Tex. Occ. Code §§ 2501.001, 2501.101. Not only does the scope of this provision conflict with the contract laws of Wisconsin and Georgia, but Texas may not regulate recruiters – or restrain trade – in those states.

Next, Joseph Chris says that the defendants breached their fiduciary duties to the company. This common law duty was superceded by the contractual agreement between the parties. Joseph Chris categorically listed its expectations of the recruiters in the employment contracts. The law will not allow an employer the protection of the common law after a failed attempt to misuse contract.

Even if the duty had not been superceded, the claim would fail. Joseph Chris says that Rossi, Marco, and Floyd acted without good faith when they disclosed confidential information and trade secrets – both before and after their terminations. Orig. Pet. 13. Specifically, it says that the recruiters stole candidate resumes and other proprietary information while they worked for Joseph Chris. It, however, furnishes no objective evidence to support this serious claim like a trade secret, which would not include a

telephone-book listing of commercial real-estate brokers and developers.

Following termination, common-law duties would be extinguished except for genuine trade secrets.

9. *Commissions.*

Rossi and Marco are seeking unpaid wages. They claim that Joseph Chris breached its obligation to them when it did not pay them for (1) placements they made and (2) retaining companies. They say that they are entitled to compensation based on revenue collected by Joseph Chris after their terminations.

Specifically, Rossi says that she is due payments from two clients – Parkside Senior Services and Metroplex, Inc. Shortly after her termination, she submitted a wage claim to the Wisconsin Department of Workforce Development. On April 30, 2003, Joseph Chris admitted that it owed the money, but said that it was holding the funds until the expiration of its replacement guarantee obligations with the client. The department decided that Joseph Chris owed the money. When it did not pay, the department forwarded the claim to the district attorney's office. Even still, Rossi is without the wages.

Marco believes that he is due compensation on an invoice issued to Bank Atlantic, two retainer payments from Broe Companies, and one retainer from Realti Corporation.

Once again Joseph Chris treats the court to its combination of stupid and mean. The company – with a straight corporate face – says that it cannot respond to the wage claims because it has not been allowed discovery. It says that it was forced to stipulate to a "theoretical sum." Summ. J. Reply 20.

Joseph Chris need not collect information about its own business transactions from its ex-employees. It has the invoices that it sent to the clients. It has the records of the payments it received. It also knows the commission rates of Rossi and Marco. There is nothing left to discover. Besides, it is under an obligation of federal laws accurately to account for its workers and their pay.

Never conceding that it owes the wages, Joseph Chris argues that the payments should be offset. Wisconsin law allows a deduction from wages for "defective or faulty workmanship, lost or stolen property, or damage to property" if the worker is "held liable in a court." Wis. Stat. § 103.455 (2002). It argues that Marco and Rossi stole data from its computers.

Because Joseph Chris did not refute the allegation, it owes Rossi $23,550 and Marco $37,250. Additionally, Wisconsin assesses penalties against employers that do not comply with the wage payment statute. Because Rossi filed an administrative complaint before filing this claim, the court may award her penalty fees of one-hundred percent of the unpaid

wages. Marco did not file a claim with the department and, therefore, he is entitled to fifty percent of the unpaid wages. Wisc. Stat. §109.11(2)(a) (2002).

9. *Remaining Accusations.*

Joseph Chris says that Rossi did not return over one-half of the resumes that he possessed. It also says that Rossi did not return applicant files or her client records. Finally, Joseph Chris has accused Floyd of stealing 1,200 resumes. It says that she also failed to return client records.

By December 15, 2005, Joseph Chris must submit cogent, well-organized documentary or accounting evidence that supports these allegations to the court.

10. *Conclusion.*

The contracts are void. Sound social and economic reasons support the enforcement of covenants not to compete to the extent that they protect the employer's (a) goodwill that is necessarily invested in individuals, (b) proprietary data, and (c) investment in training.

Signed November 15, 2005, at Houston, Texas.

/s/ Lynn N. Hughes
Lynn N. Hughes, USDJ
United States District Judge