NO. 06-20138

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Dr. Joe Morrison, *et al.*,

Plaintiffs,

Dr. Joe Morrison, Dawn Morrison, Randy Councill, Janet Councill, Dan Higgins, Helen Higgins, Ron Green, Karen Green, Victor Brook, Cathy Brook, Richmond Eagle Corp., Dave Roberts, Rose Roberts, Tony Cutaia, Mary Cutaia, Warren Bird, Donna Bird, Kye Yeaman, Wade McKay, Debbie McKay, Robert Price,

Plaintiffs – Appellants,

Herbert Hamilton, Marilyn Hamilton, Donald May, Celeste May, Michael Cutaia, Karen Cutaia, Randall Laine, Diana Laine, Frank Mazzola, Karen Mazzola, Larry Rogers, Suzanne Rogers, Robert Schmanski, Dana Schmanski,

Appellants,

v.

Amway Corporation, *et al.*

Defendants

Amway Corporation, Dexter Yager, Individually, doing business as Yager Enterprises and Internet Services Corp., Donald R. Wilson, Individually, doing business as WOW International, Inc., Randy Haugen, Individually, doing business as Freedom Associates, Inc., Freedom Tools, Inc., John Sims, Individually, doing business as Sims Enterprises, Internet Services Corp., Yager Enterprises,

Defendants – Appellees,

v.

Pamela Gale Johnson, Joe & Dawn Morrison Bankruptcy Estate, William G. West, Tony & MaryAnn Cutaia Bankruptcy Estate, Robert Newhouse, Herbert & Marilyn Hamilton Bankruptcy Estate, Helen G. Schwartz, Wade & Debbie McKay Bankruptcy Estate, Christopher Moser, Warren & Donna Bird Bankruptcy Estate, William G. West, Randy & Janet Council Bankruptcy Estate, Ben Floyd, Michael & Karen Cutaia Bankruptcy Estate, W. Steve Smith, Ron & Karen Green Bankruptcy Estate, Ben Floyd, Frank & Karen Mazzola Bankruptcy Estate, Janet Casciato-Northrup, Dave & Rose Roberts Bankruptcy Estate, Ben Floyd, Dana & Robert Schmanski Bankruptcy Estate,

Trustees – Appellants.

On Appeal From The United States District Court for the Southern District of Texas, Houston Division Trial Court Cause No. 4:98-CV-1695 and 4:98-CV-352

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CERTIFICATE OF INTERESTED PERSONS

Pursuant to Federal Rule of Appellate Procedure 26.1 and Local Rule 28.2.1, Appellants represent:

1. The style of the cases are:

   No. 4:98-CV-1695; ***Amway Corporation, et al. v. Musgrove, et al.*;** and

   No. 4:98-CV-352; ***Dr. Joe and Dawn Morrison, et al. v. Amway Corporation, et al.***

2. The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal:

   Plaintiffs – Appellants:

   Dr. Joe Morrison, Dawn Morrison, Randy Councill, Janet Councill, Dan Higgins, Helen Higgins, Ron Green, Karen Green, Victor Brook, Cathy Brook, Richmond Eagle Corp., Dave Roberts, Rose Roberts, Tony Cutaia, Mary Cutaia, Warren Bird, Donna Bird, Kye Yeaman, Wade McKay, Debbie McKay, Robert Price

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By:_____
BROCK C. AKERS

Attorney of Record for Appellants

STATEMENT REGARDING ORAL ARGUMENT

This case primarily concerns the evident-partiality standard in arbitration cases. Oral argument is necessary because this is a fact-intensive case and, as a panel of this Court recently stated, "the caselaw in this area is confusing and complicated" and this Court has not definitively addressed the scope of this standard. *Positive Software Solns., Inc. v. New Century Mortgage Corp.*, 436 F.3d 495, 499 (5th Cir. 2006), *reh'g en banc granted* 2006 U.S. App. LEXIS 11773 (May 5, 2006). Like *Positive Software*, this case presents a matter of first impression in the Fifth Circuit and this case should be heard as a companion case to *Positive Software*.

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Issue Three

Is there an enforceable, written agreement to arbitrate pre-existing disputes when, on the eve of suit being filed, a corporation unilaterally adds an arbitration clause to its "rules of conduct" without consideration or a meeting of the minds, and while reserving the right to unilaterally modify or abolish the arbitration program?

Issue Four

Does the scope of the alleged arbitration agreement extend to all of the Distributors' claims when prior to suit being filed, Amway consistently maintained its arbitration clause does not apply to disputes about Business Support Materials and even introduced a separate arbitration program for those disputes?

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TABLE OF AUTHORITIES

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RECORD CITATIONS[1]

All references to public portions of the record are to the consecutive page numbers in the court's original record, using the following abbreviations:

"Tr." = pages that appear in the Clerk's Record

"R." = pages that appear in the Reporter's Record

Pursuant to Federal Rule of Appellate Procedure 28(e) and the Court's instructions, all references to sealed portions of the record[2] are to the page number of the original document as follows:

> SD #____, p. _____" for Sealed Document, its docket number, and the page number of the original document.

All citations to pages of SD # 132 containing DVD-excerpt citations are intended to include citation to the DVD portion.

Appellants' Record Excerpts include a copy of Distributors' May 16, 2006 Motion to Check Out Sealed Portions of the Record, which in turn contains an index to the sealed portions of the record.

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[1] Because the district court unexpectedly issued its final judgment before a final evidentiary hearing and the filing of two briefs not yet due, the record does not contain arbitration-hearing transcripts or other information that might have otherwise been included.

[2] The first sealed document in the record is "Plaintiffs' Motion to Vacate Arbitration Award and Reinstate Case on the Court's Active Docket" filed January 1, 2005.

JURISDICTIONAL STATEMENT

The district court's subject-matter jurisdiction was based on federal-question jurisdiction and supplemental jurisdiction over state-law claims. *See* 28 U.S.C. §§ 1367, 1441(b). The federal questions presented included RICO and antitrust claims.

This Court has jurisdiction because this is a timely appeal from a final judgment that disposed of all parties' claims. *See* 28 U.S.C. § 1332. The district court entered final judgment on September 15, 2005. On September 21, 2005, Distributors filed a motion for new trial and rehearing which was denied in an order entered October 5, 2005. Distributors perfected appeal on November 3, 2005.

Several individual Distributors filed for bankruptcy after the district court issued its final judgment on September 15, 2005. Thus, their respective bankruptcy trustees have standing and have joined this appeal to protect any interests of the bankruptcy estates. *See Transit Mgmt. of S.E. Louisiana*, *Inc. v. Group Ins. Admin., Inc.*, 226 F.3d 376, 384 n.10 (5th Cir. 2000). The individual Distributors who have filed bankruptcy remain proper parties to the appeal to protect their interests, including their Seventh Amendment right to a jury trial on pre-bankruptcy claims. *See In re Jensen*, 946 F.2d 369, 373-75 (5th Cir. 1991).

I.

ISSUES PRESENTED

ISSUE ONE

Did the district court erroneously confirm the arbitration award without a promised evidentiary hearing on the Distributors[3]' Motion to Vacate based on evident partiality and bias, when the Distributors learned *after arbitration, for the first time,* Arbitrator Gifford failed to disclose, *inter alia*, after this lawsuit was filed, but before the arbitration hearing:

(1) Defendants, Jody Victor and Amway, "trained her" on substantive issues in the case;

(2) Amway's attorney interviewed her *ex parte*;

(3) She viewed videotaped statements from named defendants; and

(4) Amway attorneys created the roster of arbitrators JAMS circulated and from which the parties selected Arbitrator Gifford?

ISSUE TWO

Is the alleged arbitration agreement unconscionable because Amway forced it on Distributors, Distributors lacked a viable alternative to renewal of their distributorship agreements, and because the arbitration agreement was so one-sided that it allowed Amway to handpick the entire pool of arbitrators, change or abolish the arbitration program at any time, and train and interview the arbitrators *ex parte*?

[3] Appellants are Amway distributors and are collectively referred to as "Distributors." Appellees are Amway Corporation, distributors in Appellants' upline, and sellers of Business Support Materials. In this brief, Appellees are collectively referred to as "Amway."

ISSUE THREE

Is there an enforceable, written agreement to arbitrate pre-existing disputes when, on the eve of suit being filed, a corporation unilaterally adds an arbitration clause to its "rules of conduct" without consideration or a meeting of the minds, and while reserving the right to unilaterally modify or abolish the arbitration program?

ISSUE FOUR

Does the scope of the alleged arbitration agreement extend to all of the Distributors' claims when prior to suit being filed, Amway consistently maintained its arbitration clause does not apply to disputes about Business Support Materials and even introduced a separate arbitration program for those disputes?

ISSUE FIVE

Did the district court lack subject matter jurisdiction to confirm the arbitration award because Amway failed to show a written agreement in which Distributors consented to entry of judgment?

II.

STATEMENT OF THE CASE

This case is about Distributors who participated in arbitration, in good faith, only to find out after the close of arbitration that the arbitrator had prior contacts with Amway which were not revealed and clearly indicate evident partiality. Among other things, a named defendant and witness in the lawsuit and Amway Corporation, trained the arbitrator on substantive issues in the case, defense counsel John Peirce and Defendant Jody Victor privately interviewed the arbitrator for two hours as the last word on the arbitrator's suitability, the arbitrator viewed

ex parte statements from at least five defendants in the case, and the roster of "neutrals" JAMS/Endispute circulated from which to select the arbitrator, contained arbitrators the defense had handpicked for inclusion on the roster.

This case is also about the district court's prior decision to compel arbitration against parties who refused to sign an alleged arbitration agreement and three who did sign, despite the agreement being otherwise unenforceable for lack of consideration, a meeting of the minds, and unconscionability.

A. Procedural History

On January 8, 1998, Distributors filed suit in Texas state court, following months of attempting to resolve disputes that peaked in June 1997. (Tr. 8-33; SD #132, p.19). Distributors' asserted fourteen state and federal causes of action. Amway removed the cases to federal court. (Tr. 88-92).

In federal court, Amway moved to compel arbitration using the new JAMS/Amway arbitration program. (Tr. 362-367). JAMS is an alternative-dispute-resolution provider. Though all but three Distributors refused to sign the alleged arbitration agreement, and it was not an enforceable contract even as to them, on October 15, 1998, the district court issued a memorandum opinion and order, granting the motion to compel in its entirety. (Tr. 1190-1200). Distributors filed a request for rehearing of the order compelling arbitration and an alternative

request for interlocutory appeal, and both requests were denied. (Tr. 1201-1245, 1342).

On or around May 2001, Distributors filed a demand for JAMS/Amway arbitration, but at all times protested there was no arbitration agreement and the arbitration system was one-sided and unconscionable. (SD #99, p. 2). Once the case was in arbitration, Distributors filed a motion to dismiss the case because there was not an enforceable arbitration agreement and the arbitrator "training" and one-sidedness were unfair. (SD #114, p. 3, Ex. A at pp 1, 5, 13). After denial of this motion, Distributors continued to object on these grounds in arbitration pleadings including an motion-for-summary-judgment response and their written closing argument (SD #114, Exhibit C, Exhibit D at pp. 29-20, Exhibits E and H). Between January 5, 2004 and January 24, 2004, an evidentiary arbitration hearing was held in Houston with Anne Gifford of JAMS arbitration presiding as arbitrator. (SD #98, p. 311). Arbitrator Gifford and Amway represented Arbitrator Gifford was a neutral arbitrator and that JAMS had independently created the roster of eight neutrals from which the parties selected Arbitrator Gifford. (Tr. 451-461; SD #97, Tabs 6, 9, 10).

On January 13, 2005, Distributors received a final Arbitration Award which denied all of their claims and all of Amway' counterclaims. (SD #89, Exhibit A). Even though Distributors as counter-defendants prevailed on counterclaims, the

final Arbitration Award found Distributors jointly and severally liable for Amway's attorney fees and costs in an amount that totals $6,452,914.32, after an offset of $1,039,998 for Distributors' attorney fees and costs in defending certain counterclaims. (SD #89, Exhibit A).

After the arbitration proceeding closed, Distributors learned the arbitrator and arbitration scheme were not impartial at all, and did not adhere to ordinary notions of ethics, or the minimal disclosure standards necessary for parties to make informed decisions. On January 26, 2005, Distributors filed a motion to vacate in the district court, requesting discovery on the arbitrator's evident partiality, an evidentiary hearing after discovery, jury trial on any fact issues, and that the judge vacate the award. (SD #89). Distributors' motion to vacate included a transcript of an oral hearing held in *Nitro Distributing, Inc. v. Alticor, Inc.*, No. 03-3290-CV-S-RED, in the U.S. District Court for the Western District of Missouri. (SD #89, Exhibit B). The hearing addressed the enforceability and unconscionability of the same arbitration scheme. (SD #89, Exhibit B). Through the transcript, Distributors learned bits and pieces of surprising information about their own arbitration, including the training issue. (SD #114, pp. 8-9, summarizing contents of *Nitro* transcript).

The *Nitro* transcript showed Defendant Jody Victor had trained Arbitrator Gifford and that JAMS had allowed Amway to select the arbitrator pool and

otherwise dominate JAMS/Amway arbitrations. (SD #144, Exhibit A). The post-arbitration discovery revealed after Distributors' suit was filed, Victor and Amway's company representative at the arbitration hearing, Sharon Grider, not only trained Arbitrator Gifford, but indoctrinated her on substantive issues in the case, Amway's attorney Peirce and Victor interviewed her *ex parte* as part of the "last cut" culling process (which Gifford obviously passed with flying colors), she viewed videotaped statements from five named defendants, and defense attorneys Peirce and Bill Abraham[4] created the roster of arbitrators from which the parties selected Arbitrator Gifford though the arbitration rules provided JAMS would establish the roster independently. (SD# 132, **Exhibits** C-J).

In response, rather than denying the Distributors' allegations, Amway argued Distributors should have known Defendant Victor trained Arbitrator Gifford because Amway disclosed the arbitrator would participate in "cultural training" the Amway Distributors Association (hereinafter "ADA") co-conducted, and Victor was an ADA member. (SD #98). Amway did not really respond to the other facts that formed the basis of Distributors' Motion to Vacate, other than to say administration of the arbitration program necessarily entailed incidental contact between JAMS and Amway. (SD #98, pp. 4-8, 10-15).

[4] Rick Abraham assumed representation of parties whom Bill Abraham previously represented.

In response to Amway's Motion to Confirm the Award, Distributors raised the issue that Amway failed to prove Distributors consented to entry of judgment on any arbitration award, as is necessary for subject matter jurisdiction to confirm. (SD #115; SD #123). Distributors had been told there would be no court proceedings following arbitration. (Tr. 787–788).

On April 14, 2005, the district court ordered Distributors to file a reply explaining Amway's contention Distributors were aware of the "training" pre-arbitration and how they had not waived their evident-partiality objection. (SD #100). On May 20, 2005, the district court also held an evidentiary hearing on the waiver issue and the believed non-disclosures. (SD #100; R. Vol. 11). Distributors presented arguments and evidence at the hearing, including Distributor Joseph Morrison, M.D.'s testimony that he was surprised to learn Victor trained the arbitrator because Victor had specifically represented he would not be involved in the arbitrator-training program. (R. Vol. 11, p. 21, line 12 to p. 22, line 9; p.22, line 18 to p. 27, line 5).

On May 20, 2005, the district court entered an order that Distributors did not waive their objections to the arbitrator's partiality and allowed Distributors to conduct discovery on the issue. (SD #113). The court also ordered the parties to file a joint status report at the conclusion of discovery, summarizing what the discovery revealed and indicating any need for a hearing. (SD #113). Distributors

timely filed their status report on August 19, 2005, presenting a treasure trove of previously undisclosed information about the relationship between the arbitrator, defendants, defense counsel, JAMS and Amway. (SD #132). Instead of filing any contribution to the joint status report, Amway filed an unopposed motion to establish a new briefing schedule. (Tr. 1487-1491). The district court then ordered Amway to file a response to Appellant's status report before September 19, 2005, and both parties to file a joint status report by September 23, 2005. (Tr. 1492).

Without explanation, before Amway' status was filed or was even due to be filed, on September 15, 2005, the district court entered an order confirming the arbitration award and entering judgment against Distributors, making them jointly and severally liable for over $6,000,000.00 in attorney fees. (Tr. 1494-1510). The district court's memorandum opinion and order contained assertions about the absence of evidence from the record that were simply inaccurate, *if the evidence in Distributors' Status Report was considered.* (Tr. 1494-1510; SD #132). For example, in fact finding twenty-one, the district court treated the transcript of the *Nitro* hearing as the only evidence Distributors submitted in support of their motion to vacate and inaccurately stated the record contains no other evidence of *ex parte* contact with the arbitrator. (Tr. 1502). The court also found Distributors waived any objection to the arbitrator's evident partiality because, the court

reasoned, Distributors' failed to inquire about the arbitrator's partiality. (Tr. 1496-1499).

Less than twenty-four hours after the district court issued its opinion, having received the exact same evidence, the federal district court in *Nitro*, held the exact same arbitration scheme was unconscionable and unenforceable. (SD #144, Exhibit A).

A motion for reconsideration was filed, suggesting and questioning politely whether the district court had read Appellant's briefing, given that the order failed to refer to any of the clear, uncontroverted evidence submitted. (SD #144). The District Court denied this motion, suggesting the motion for rehearing did not provide new information or arguments. (Tr. 1609).

III.

STATEMENT OF THE FACTS

A. Background on Amway and Distributors' Relationship with Amway

Distributors are a group of independent Amway distributors. (Tr. 1198). They are not Amway corporation agents or employees in any way. (Tr. 470). Amway distributes household products through its network of independent distributors. (Tr. 1198). To become Amway distributors, each Distributor executed a Distributorship Agreement Application, purchased the Amway sales kit, purchased an annual subscription to the "Amagram" magazine and promised to

abide by Amway regulations and Rules of Conduct for Distributors as amended from time to time and published in official Amway literature. (Tr. 417-418).

Once a distributor is authorized to sell Amway products, each product sale benefits Amway, the distributor making the sale, and each distributor in the "upline" network, which includes the distributor's sponsor, that distributor's sponsor and so on. (Tr. 1198). Those persons who occupy positions above a given distributor are the distributor's "upline." Those persons who occupy positions below a given distributor are the distributor's "downline." A distributor's success is dependent on building a large downline and achieving a certain sales volume.

There are ranks of direct distributors. (Tr. Vol. 11, p.20, lines 1-11). Distributors were in Appellee Dexter Yager's downline. (Tr. 76). Distributors were some of the most successful direct distributors in the Amway network, achieving the Emerald and in one case the Diamond level. (Tr. Vol. 11, p.20, lines 1-11). Diamond is among the highest-level direct distributors may achieve. (Tr. 77). For most Distributors, when the claims at issue in this case arose, they worked as full-time distributors and Amway was their sole income source. (Tr. 76-77).

A parallel industry of Business Support Materials (hereinafter "BSM") compliments the Amway network. (Tr. 75-81, 462-468). BSM consists of rallies, tapes, books, and functions designed to motivate distributors. (Tr. 75-81, 462-

468). Due to legal concerns, Amway has long held distributors may not sell BSM through their distributorships but must set up separate businesses to market BSM. (Tr. 75-81, 462-468). For example, Dexter Yager's BSM business is Appellee Internet Services Corporation. (Tr. 75-81, 462-468).

B. The Amway Arbitration Program

In June 1997, disputes between Distributors and Amway over a request for a change in upline leadership, BSM commissions, Amway Distributors Association (hereinafter "ADA") actions and other matters, came to a head. (SD #132, p.19). Anticipating a lawsuit, in Fall 1997, Amway introduced an arbitration program. The arbitration firm selected to administer the program, JAMS, even commented the time frame for implementing it was unusually "aggressive" and maybe even "impossible." (SD #132, Exhibit V). In September 1997, Amway published announcements in its Amagram and other media sent to distributors informing them it was starting the arbitration program. (Tr. 462-468). Though Amway had always maintained its separateness from the BSM industry, the announcements curiously introduced a separate, optional BSM arbitration agreement. (Tr. 462-468).

Each distributor was generally required to renew the agreement each year, either by signing up for automatic renewal or manually signing and returning an "Intent to Continue" form. (Tr. 462-468). As to the distributorship arbitration

agreement, the announcements stated distributors who were on auto-renewal would be receiving an "acknowledgement form" which they needed to sign and return to Amway before October 3, 1997. (Tr. 462-468). Distributors not on auto-renewal needed to sign an "Intent to Continue Form" containing the arbitration clause in order to renew their distributorships for 1998. (Tr. 473-476). The Intent to Continue Form containing the arbitration clause was due back to Amway before October 3, 1997. Both forms contained an arbitration clause that provided the Distributor agreed to submit any claim relating to an Amway distributorship to binding arbitration. (Tr. 379, 473-476).

Although these announcements solicited Distributors' agreement, they also stated the arbitration clause automatically became part of their distributorship agreements but did not explain how that could be the case. (Tr. 462-468, 473-476). The announcements stated distributorship disputes that could not be resolved through Amway's internal conciliation procedures would be subject to arbitration. (Tr. 462-468). The announcements did not mention that judgment could be entered on an arbitration award, say who would serve as arbitrator, or contain any arbitration rules. (Tr. 462-468).

Confused by these vague and contradictory announcements, Distributors Joe Morrison and Ron Green questioned Amway about arbitration on behalf of themselves and their downlines. (SD #98, Exhibit B; Tr. 746-748, 750-790, 798-

802). The district court even relied on and cited Morrison's letter in her September 15, 2005 opinion confirming the arbitration award. (Tr. 1507, para. 3). In September 1997, Morrison wrote Amway asking whether agreeing to arbitration was mandatory, who would serve as arbitrator, who would train the arbitrators, and requested the arbitration rules. (Tr. 1507, para. 3). Morrison was told no rules existed yet. (Tr. 744). That same month, Green called Amway and asked the same questions. (Tr. 750-790, 798-802). Amway's Director of Distributor Relations, Rob Davidson, told Green distributors could continue their distributorships without agreeing to arbitration. (Tr. 750-790, 798-802). Morrison and Green both made it clear to Amway they would not sign any form containing the arbitration agreement. (SD #98, Exhibit B; Tr. 746-748; Tr. 750-790, 798-802).

Following, the lead of Morrison and Green, most Distributors refused to sign any document containing the arbitration clause. Thinking it was mandatory to continue their distributorships and maintain their livelihood, Distributors Kye Yeaman and Dan and Helen Higgins signed and returned the forms. (Tr. 473-476). The McKays, because they wanted to continue their distributorships, but did not want to agree to arbitration, returned their form unsigned. (Tr. 381). Amway did not give Distributors any additional benefit for agreeing to arbitrate. (Tr. 468-476).

Several months after these conversations, and after the October 3, 1997, deadline to renew distributorships for 1998, in November 1997, JAMS/Amway

circulated internally draft arbitration rules. (Tr. 440-460, 744). These draft rules provided the arbitrator would be "neutral" but would also participate in "cultural training" conducted by Amway and the ADA to introduce arbitrators to the Amway system and culture. (Tr. 440-460, 744). The draft rules also stated the arbitrator could make distributors liable for an opponent's attorney fees, and that Michigan law would apply to disputes. (Tr. 440-460, 744).

C. Distributors' Lawsuit

In January 1998, Distributors sued Amway in state court asserting fourteen causes of action, nine of which pertained to BSM disputes and many of which concerned alleged ADA misconduct. (Tr. 65, 88-92). Following removal to federal court, Amway moved to compel arbitration and argued the arbitration clause was a rule of conduct that automatically became part of each Distributors' Amway contract by virtue of their distributorships having been automatically renewed and their prior agreement—when they first became Amway distributors—to abide by Amway Rules of Conduct as they are amended from time to time. (Tr. 363-367). In support of this position, Amway submitted the Bamborough Declaration to the district court. (Tr. 378-476). But, the Declaration shows Amway lacked evidence of auto-renewal agreements for nineteen Distributors and the record shows the Morrisons were not on auto-renewal and had refused to sign the Intent to Continue Form. (Tr. 378-476).

Despite the Distributors' objections, there was not an enforceable arbitration agreement, the arbitration scheme was unconscionable, and fundamentally unfair and Amway dominated even in the training of arbitrators, the district court compelled arbitration. (Tr. 1190-1200). After the close of the arbitration, the Distributors learned facts that showed the arbitrator violated her ethical and legal disclosure obligations. (SD #132).

IV.

SUMMARY OF THE ARGUMENT

The district court reversibly erred when it confirmed the arbitration award despite overwhelming, uncontroverted evidence Arbitrator Gifford failed to disclose facts that demonstrated "evident partiality" and corruption, or to quote this Court, facts that "create a reasonable impression of the arbitrator's partiality." *See* 9 U.S.C. §10(a)(2); *Positive Software Solns., Inc. v. New Century Mortgage*, 337 F.Supp.2d 862, 880 (N.D. Tex. 2004), *aff'd.* 436 F.3d 495, 502 (5th Cir. 2006) *reh'g en banc granted* 2006 U.S. App. LEXIS 11773 (May 5, 2006). Distributors did not waive their objections to the nondisclosure because they did not know about the *ex parte* contacts, training by Defendant Victor and others on substantive issues, and that Amway unilaterally selected the entire arbitration panel, until after the close of the arbitration. *See Positive Software*, 436 F.3d at 504-5. Distributors objected in the district court and to Arbitrator Gifford the arbitration agreement

was unenforceable because, among other things, Amway and the ADA would train the arbitrators.

The judgment should also be reversed and this case remanded because there was not an enforceable arbitration agreement. All but three Distributors refused to sign the arbitration agreement. It cannot automatically become part of their renewed distributor contracts under Texas law. First, contractual authority to change incidental rules from time to time cannot be used to fundamentally alter a contract particularly as to deprive Distributors of their vested jury-trial right. Second, as to auto-renewal Distributors and those who signed, the alleged arbitration agreement is unenforceable for lack of consideration and a meeting of the minds.

Continued operation of the distributorship after introduction of arbitration does not amount to consideration that supports the arbitration clause because: 1) Distributors were told they could reject the clause and continue; and 2) this is not an at-will employment relationship in which continued performance is the consideration that supports the distributor's side of the bargain.

Finally, the district court lacked subject matter jurisdiction to enter judgment on the arbitration award because Amway cannot show a written agreement containing consent to enter judgment on any arbitration award. Distributors were told there would be no court proceedings following any arbitration award. The

Bamborough Declaration Amway filed cannot show consent to entry of judgment because it contains no paperwork for nineteen Distributors, two Distributors (the Morrisons) were no longer on auto-renewal and did not sign any arbitration agreement, and for those Distributors on auto-renewal, the deadline to select or reject auto-renewal was October 3, 1997, well before publication of the arbitration rules which state parties are "deemed" to have consented to entry of judgment. Additionally, as to Distributors Larry and Suzanne Rogers, the district court lacked jurisdiction to enter judgment because they were not named in or subject to the Arbitrator Gifford's Final Award.

V.

STANDARD OF REVIEW

This Court reviews a district court's decisions compelling arbitration and confirming an arbitration award under the same standard as any other district court decision. *See Hughes Training, Inc. v. Cook*, 254 F.3d 588, 592 (5th Cir. 2001). Accordingly, the district court's fact findings in confirming the arbitration award are reviewed for clear error. *See id.* Questions of law and the application of law to fact are reviewed *de novo*. *See Walker Int'l Holdings, Ltd. v. Republic of Congo*, 395 F.3d 229, 233 (5th Cir. 2004), *cert. denied*, 125 S.Ct. 1841 (2005).

VI.

ARGUMENT AND AUTHORITIES

ISSUE ONE

A. The overwhelming evidence of nondisclosure of facts relating to partiality, *ex parte* contacts, and an unfairly unilateral arbitrator-selection process required vacatur of the award

The high deference paid to arbitration rulings demands a high standard of impartiality. *See Positive Software Solns.*, 436 F.3d at 502. Inability to rely on arbitrator impartiality jeopardizes the federal policy favoring arbitration because litigants will not submit their controversies to arbitration if biased and partial awards are enforced. *See id.* Thus, arbitrators are held to a standard of strict morality and fairness to disclose to the parties any dealings that might create an impression of possible bias. *See Commonwealth Coatings Corp. v. Continental Casualty Co.* 393 U.S. 145, 149 (1968); *Middlesex Mutual Ins. Co. v. Levine*, 675 F.2d 1197, 1200 (11th Cir. 1982).

1. Arbitrator Gifford flagrantly violated her legal and ethical disclosure responsibilities by not disclosing or causing to be disclosed key facts learned in post-arbitration discovery

In *Commonwealth*, a purportedly neutral arbitrator was discovered to have an undisclosed business relationship with the successful party to the arbitration. *See Commonwealth*, 393 U.S. at 146. The prevailing party had paid the arbitrator approximately $12,000.00 in consulting fees in the years preceding the arbitration,

and the relationship "went so far as to include the rendering of services on the very projects" involved in the arbitration. *See id.*

The Court found the significant undisclosed relationship between the arbitrator and the prevailing party was analogous to a litigant learning, after the fact, that a jury foreperson or judge had such a relationship with a party. *See id.* at 148. The Court also reasoned courts must be scrupulous in safeguarding the impartiality of arbitrators because arbitrators have "completely free reign to decide the law as well as the facts and are not subject to appellate review." *Id.* at 149. Thus, the Court held failure to disclose the relationship constituted evident partiality justifying vacatur even though there was not evidence of actual bias. *See id.* at 147; *see also Schmitz v. Zilveti, III*, 20 F.3d 1043 (9th Cir. 1994); *Burlington N. R.R. Co. v. Tuco, Inc.*, 960 S.W.2d 629 (Tex. 1997)(summarizing state and federal evident-partiality decisions).

In *Totem Marine v. North American Towing, Inc.*, 607 F.2d 649 (5th Cir. 1979), this Court vacated an arbitration award Totem learned after the close of arbitration, the arbitration panel received *ex parte* evidence on damages and Totem was not notified of this. *See id.* at 650. The *ex parte* contact violated the arbitration rules that prohibited *ex parte* communication between the arbitrators and any party. *See id.*

The significance of nondisclosure is greater when the applicable arbitration rules provided the arbitrator would disclose any information that might create an appearance of bias. *See Commonwealth*, 393 U.S. at 149; *Totem*, 607 F.2d at 650. Promulgation of such rules is "highly significant" because it heightens the parties' expectations the arbitrator will follow the law and disclose information necessary to allow them to select an arbitrator intelligently. *See Commonwealth*, 393 U.S. at 149; *Totem*, 607 F.2d at 650.

In this case, the district court erroneously confirmed the arbitrator's award despite jaw-dropping evidence of partiality that violated the *Commonwealth* standard and JAMS' own ethics rules requiring disclosure of any relationship or "other information" that might lead a party to question the arbitrator's impartiality. JAMS ARBITRATORS ETHICS GUIDELINES, V. Gifford's conduct also violated JAMS/Amway arbitration rule 14, and others, which prohibited *ex parte* contact between an arbitrator and a party whether before, during, or after the arbitration hearing. (Tr. 451-461).

The district court issued its memorandum opinion and order confirming the award before two final briefs were even due and before a promised evidentiary hearing. (Tr. 1492, 1494-1510). The opinion only addressed the arbitrator's nondisclosure of training from Defendant Jody Victor and her financial stake in the Amway arbitration scheme. The memorandum opinion does not reference or

address any pleading or evidence submitted after the district court's May 20, 2005 order allowing discovery on the arbitrator's evident partiality. (Tr. 1494-1510). Thus, the district court's opinion does not even mention hugely significant issues and uncontroverted evidence raised in Distributors' August 19, 2005 status report. (SD #132).

In March 1998, after Distributors' suit was filed and Amway was attempting to compel arbitration, Amway's arbitration scheme was still in draft form. The public plan was to have JAMS provide a list of arbitrators for the program, which arbitrators would in turn be given training relating to the Amway business, given its allegedly unique business model that would otherwise be unfamiliar to most arbitrators.

In truth and fact, Amway and its counsel worked to find prospective arbitrators around the country, which list Amway reviewed and culled. Finally, from an initial list of several hundred arbitrators, Amway invited fifteen prospective arbitrators for the final cut and training. Arbitrator Gifford was among this group, and outlasted the other several hundred to win the Amway eligibility prize. The training session for the final fifteen was recorded and videoed, unbeknownst to Distributors until after the arbitration ruling. This video provides a first-hand rendition of what the purportedly even-handed explanation of the Amway business was all about—an indoctrination session of its arbitrator fleet

which they claim was nothing more than "training." The status report to the court explained this, including some of the following:

(1) Arbitrator Gifford viewed *ex parte* videotaped presentations from five named Defendants. (SD #132, pp. 8, 14-15).

(2) Defendant Jody Victor and lead defense counsel John Peirce met with Arbitrator Gifford and privately interviewed her for two hours, off camera, as the final interview session to see which of the arbitrators would remain on Amway's acceptable list for Amway. (SD #132, p.20, Exhibit C at 10226, 001234, 001236; Exhibit E; Exhibit H-J).

(3) Though Distributors were told JAMS independently created the "roster of neutrals", Amway not only had a heavy hand in creating the initial list of prospective neutrals, it also had the exclusive opportunity to cull the arbitrators it found unacceptable. (SD #132, pp. 21-22).

(4) Arbitrator Gifford received training from Victor and other Amway representatives on application of substantive law to the facts of Amway cases in areas including antitrust, enforceability of the arbitration agreement, pyramid laws, and a choice-of-law clause hidden in the arbitration rules. (SD #132, pp. 16-18). Videotape also shows Victor explained to Arbitrator Gifford there is not much income to be gained in BSM sales and BSM and Amway are separate. (SD #32, p.18). The Distributors' claims involved misrepresentations about the amount of income BSM generated. (Tr. 79).

(6) Though Distributors were specifically told Victor would not be involved in the arbitration process, Victor trained Arbitrator Gifford for hours in March 1998, calling JAMS Amway's "white horse" and "preventative medicine" during his presentations. (*Cf.* R. Vol. 11, p. 22, lines 18 to p. 27, line 5 *with* SD #132, p. 22).

(7) At least one "example" discussed at the training session mirrored the facts of Distributors' dispute, despite prior

admonitions from JAMS training must not touch on actual cases or it will not be neutral. (*Cf* SD #132, p. 17; Exhibit L).

(8) The pro-Amway presentations lead one prospective arbitrator to question whether there was anything negative about Amway and another person to question whether these "examples" crossed ethical boundaries. (SD #132, pp. 24-25).

(9) During the training session, Arbitrator Gifford role played she was an Amway distributor eagerly receiving a large bonus check. (SD #132, p. 18).

(10) Amway's in-house counsel and corporate representative at the hearing, Sharon Grider, and Defendant, Rich De Voss, explained Amway only finds itself at odds with uneducable distributors who have done something "bad." (SD #132, pp. 24-25).

11) In e-mail, the JAMS case administrator for this case described JAMS/Amway arbitration as a "significant source of business" for JAMS and through 2003, JAMS revenue from Amway arbitration was over $466,000.00. (SD #132, p. 26; Exhibit 16 to Exhibit B; Exhibit B at p.232, lines 1-16).

(12) In other JAMS/Amway arbitrations, JAMS provided affidavits in support of Amway motions to compel arbitration, in violation of JAMS' own ethics rules that bar JAMS agents from serving as witnesses in pending cases. (SD #132, p. 26; Exhibit M).

(13) In another JAMS/Amway arbitration, JAMS reversed its decision it lacked jurisdiction after Amway's in-house counsel, Grider, e-mailed JAMS, ***ex-parte***, to chastise and clarify the proper interpretation of the Amway arbitration rules. Shortly after, JAMS changed its initial ruling on jurisdiction and appointed an arbitrator. (SD #132, p. 22; Exhibits N-P; Exhibit B, pp. 172. lines 19-24, p. 189, line 22 to p. 190 line 5, p. 190, line 18 to p. 193 line 13, p. 194, line 20 to p. 195, line 5).

(14) JAMS regarded independence between Amway and the ADA as essential to fairness of the arbitration system, and later came to believe Jody Victor was too closely aligned with Amway to represent the ADA. (SD #132, pp. 8-13; Exhibit L; Exhibit 68 to Exhibit B). Evidence obtained in discovery also showed ADA was not independent from Amway. (SD #132, pp. 9-12).

(15) Months before this arbitration hearing, the prospective arbitrators' terms were about to expire, and Defendant Victor had the exclusive call as to which of the original arbitrators would keep their positions. In so doing, Victor had the unilateral ability to permit Arbitrator Gifford to keep her job. (SD #132, p.20; Exhibit R).

That Gifford failed to disclose these facts is evident from even a cursory comparison of this list against the summary of Gifford's disclosures contained in the Peirce Declaration. (SD #97, Tabs 6-10). Under *Commonwealth*, *Totem*, and this Court's *Positive Software* decision, the nondisclosure of these facts is fundamentally unfair and creates at least an appearance of bias, requiring vacatur. These facts also show actual bias, as evidenced by JAMS' complicity in the one-sided arbitration system and the uncontroverted fact that no litigant has prevailed on its claims against Amway in this or any other JAMS arbitration. (SD #144, Exhibit A, p. 24).

2. Arbitrator Gifford failed to disclose Amway and defense counsel, not JAMS, created the roster of neutrals even though the arbitration rules required JAMS to act as an independent third party and establish the roster

The post-arbitration discovery also revealed Amway and defense counsel John Peirce and Bill Abraham culled a pool of 103 arbitrators to eight arbitrators

which appeared on a "roster of neutrals" which JAMS distributed to all parties as though JAMS had created the list, as provided for in the arbitration rules. Under the FAA, parties must have equal rights to select and control the arbitration panel. When one party unilaterally directs the arbitrator-selection process, the arbitration scheme is one-sided and unenforceable. *See Hooters v. Phillips*, 173 F.3d 933, 939 (4th Cir. 1999)(holding arbitration agreement unenforceable because Hooters had right to select entire pool from which arbitrators would be selected).

By analogy, if one party to a dispute were able to select, employ, and direct an Article III judge, it would certainly be grounds for recusal if not disciplinary action. The parties' power to select an arbitrator has been called the "essence of arbitration." *See* Alan Scott Rau, *Integrity in Private Judging,* 38 S. Tex. L. Rev. 485, 506 & n. 82 (1997). Where arbitrators are not appointed by a neutral party, such as the AAA, both parties must have an equal right to participate in the appointment process. *See Mandatory Arbitration of Statutory Employment Disputes*, 109 Harv. L. Rev. 1670, 1686 (1996).

As the Peirce Declaration shows, JAMS circulated a roster of eight arbitrators from which Distributors could select as though JAMS created the roster of neutrals independently. (SD #132, Tabs 6-10). The Amway Arbitration Rules recite the JAMS case administrator will establish the roster of neutrals, and there is no mention Amway and defense counsel in pending suits will unilaterally

participate in the selection process. (Tr. 451-461)(**e.g., Amway Arbitration Rule No. 14, "***The Administrator shall establish and maintain a Roster of Amway/ADA Neutrals…"*). The following bullet points summarize arbitrator-selection information obtained in post-arbitration discovery, but not even addressed in the district court's opinion affirming the arbitration award. All citations are to sections of the Status Report (SD #132):

1. **An interview schedule** shows Amway's outside counsel Peirce, in-house counsel Grider, and Defendant Victor, interviewed Arbitrator Gifford on March 12, 1998 at 8:30 a.m. The notes from these interviews were never produced, but the record contains a copy of the schedule and suggested interview questions, including questions that probe the arbitrator's knowledge and personal beliefs. (**Exhibit C** *at* ALN0010226, ALN001234-36).

2. **December 6, 1997 letter from JAMS to Amway Senior Attorney, Dave Carroll**, explaining JAMS narrowed down a list of arbitrators that reflect "individuals who have a profile very close to the one we (JAMS and Amway) discussed several weeks ago in Grand Rapids." (*See* **Exhibit D).**

3. **December 19, 1997 letter from Amway to JAMS explaining Amway has narrowed JAMS' list of arbitrators down to 47 candidates.** Amway says it intends to further narrow the list to 15 arbitrators whom Amway will train and interview. Defense counsel Bill Abraham and Peirce participate in the process. (**Exhibits E & F**).

5. **January 7, 1998 fax from defense counsel Bill Abraham to Amway Senior Counsel,** rating potential arbitrators. (**Exhibit G**).

6. **January 27, 1998 fax from JAMS to Senior Amway Attorney**, Dave Carroll, asking him to check off arbitrators "to

be trained and interviewed" with check marks made by Amway. (**Exhibit I**).

7. **January 16, 1998 Redacted Confidential ADA Board Report** stating "approximately 30 "neutrals" are being reviewed and the list reduced to 15-20 based on draft criteria. This list will be submitted to an unidentified "special group" of ADA Board members for selection of "neutrals" to interview. Training is set for early March 1998. (**Exhibit H** *dated January 16, 1998, eight days after the filing of this lawsuit, which was followed by media coverage, and an Amway system-wide "Amvox" call to all distributors*).

8. **June 3, 1998 fax from JAMS to Amway Attorney**, Dave Carroll, asking him to "take a quick look at these summaries of neutrals' biographies and let me know if this is what you had in mind." Attached to the fax is a list of eleven arbitrators, including Arbitrator Gifford, whom Defendants Amway, Jody Victor, and Amway Counsel John Peirce trained and interviewed. (**Exhibit J**).

Because these facts and the nondisclosure of them, respectively, give rise to a reasonable impression of bias, this Court should vacate the arbitration award.

3. JAMS financial stake in Amway arbitration, coupled with the fact that no litigant has prevailed against Amway in JAMS arbitration, and the lack of dichotomy between the ADA and Amway also create an impermissible appearance of bias

Amway and the district court took the position Defendant, Jody Victor, trained Arbitrator Gifford in his capacity as a member of the ADA (which in later years was renamed the "IBOIA") and this undisclosed training and JAMS' financial stake in the litigation were harmless. This position is inconsistent with

Commonwealth and the uncontroverted evidence in the record. As one intermediate appellate court recently observed:

> It merits mention that J•A•M•S/Endispute, Inc., is an entity owned by the very arbitrators who adjudicate disputes between the borrower and the very lender who assigns the disputes to J•A•M•S. Thus the arbitrators, in their role as owners, must seek to promote the goodwill of the lenders so as to develop and maintain a volume of business, namely, cases for adjudication. CitiFinancial is a supplier of cases, even, perhaps, a major source of business for J•A•M•S. It matters little whether it was Aesop or Confucius who counseled that *one should not bite the hand that feeds,* since the message is an apt reminder of the quite valid perception of a conflict of interest in the arbitration process.

Lytle v. CitiFinancial Services, Inc. 810 A.2d 643, 651 n. 5 (Pa. Super. 2002).

The training and relationship between JAMS and Amway cannot be harmless. JAMS recognized early on the need for a true diversity of interests between Amway and the ADA to preserve some semblance of fairness. However, post-judgment discovery reveals JAMS discovered this diversity was illusory, and continued to service the Amway arbitration scheme regardless.

JAMS agreed to serve as the arbitrators for this program based on its belief the arbitration system was co-administered and co-created by Amway on the one hand and distributors on the other. That this was JAMS' understanding is shown in a March 1998 memo from JAMS to Amway, stating the "mutual involvement [of the ADA and Amway] in the development and operation of the arbitration program

is an essential element of its neutrality and fairness." (SD #132, **Exhibit L, p. 2, § II.**).

The idea was that the arbitration program JAMS and Amway were developing was formulated with the input and interests of the two parties that would be involved in such disputes—a distributor, as represented by the ADA, and the corporation, Amway. Literally during the arbitration proceeding, JAMS realized the folly of the diversity issue. In an internal JAMS memorandum dated January 2004, Catherine Zinn, the JAMS case manager, wrote "Jody Victor is too close to the corporation [Amway] to be neutral." (SD #132 at Exhibit 68 to **Exhibit B)**. Because Distributors in this case alleged the ADA breached certain duties, it is difficult to understand how the ADA could represent their interests.

At his *Nitro* deposition, Mr. Victor testified as the corporate representative of the ADA which is a Michigan non-profit trade association. (SD #132, Exhibit A, p. 6, lines 11-21; p. 16, lines 7-21; p. 22, line 25 to p. 23 line 3). Victor admitted that JAMS participated in the Amway arbitration program with the understanding it was jointly developed by distributors acting through the ADA board members. However, the ADA board members, now called the IBOIA board members, must be in the elite Amway class of diamonds, whose interests are more closely aligned with Amway Corporation than an average distributor. (SD #132, Exhibit A, p. 197, line 25 to p. 198, line 11; p. 33, lines 11-20). Victor also

testified he is in the Amway "downline" of Rich DeVos and Jay Van Andel, Amway's founders who were Defendants in this lawsuit in 1998. (SD #132, Exhibit A, p. 38, lines :3-13, p. 52, lines 5-8). He further testified the ADA does not maintain any roster or listing of its members and does not know how many distributors are also ADA members. (SD #132, Exhibit A, p. 26, line 6 to p. 27, line 7). The ADA has not held regular meetings of its members since the late 1980's and Amway Corporation screens its public statements. (SD. #132, Exhibit A, p. 41, lines 12-16; p. 27, line 8 to p. 28, line 4). The ADA does not even know which of its members are eligible to vote. (SD #132, **Exhibit A**, p. 29, lines 6-9).

Only Amway distributors who reach the elite "Diamond" or higher levels can serve on the ADA board. (SD #132, p. 31, lines 12-13; p. 33, lines 11-13). Amway's corporate representative testified in the *Alticor* litigation only .018% of all distributors ever reach this level of eligibility. (SD #132, **Exhibit Q**, p. 488, lines 23-25). Only "Platinum" distributors can actually vote on the ADA and the voting right is the right to elect Diamonds to serve on the ADA board. (SD #132, **Exhibit A**, p. 24, lines 16-19). According to Amway, only .52% of all distributors reach the Platinum level. (SD #132, **Exhibit Q**, p. 488, lines 18-22). Only twelve of the ADA's board members are elected by the Platinum ADA members eligible to vote–from a pool of candidates existing directors nominate. (SD #132, **Exhibit A**, p. 32, line 19 to p. 35, line 7). The other twelve ADA board members are

elected by existing Board members–***from a pool Amway Corporation nominates.*** (SD #132, **Exhibit** A, p. 32, line 19 to p. 35, line 7). According to Amway's Gary Vander Ven, it is possible all of the ADA directors are within Defendant Dexter Yager's downline. (SD #132, **Exhibit Q**, p. 264, lines 14-19). Interestingly, four of the named Defendants in this litigation are or were among the elite ADA board members—Yager, Wilson, Haugen and of course, Victor.

JAMS turned a blind eye to the alignment of Amway and the ADA. The result? Huge arbitration fees JAMS has been able to continue to charge, while not one time finding in favor of a distributor and against Amway. This clearly creates an unacceptable appearance of bias.

4. Before the District Court compelled arbitration and during arbitration, Distributors objected strenuously to Amway and the ADA training Arbitrator Gifford and the one-sidedness of Amway arbitration; Distributors' evident-partiality complaints are premised on facts learned post-arbitration and to place a burden of inquiry on Distributors incentivizes concealment of facts the arbitrator is duty-bound to disclose

After ruling on May 20, 2005 that the Distributors did not waive their objections to the arbitrator's partiality especially as to contacts with Jody Victor, the district court inconsistently held on September 15, 2005 that Distributors waived their objections to the arbitrator's receipt of training from Jody Victor. (*Cf.* SD #113 and Tr. 1494-1508). The district court erred in only addressing Arbitrator Gifford's nondisclosure of training from Defendant Victor and Gifford's pecuniary

interest in arbitration when many other facts formed the basis of Distributors' complaint. (*Cf.* SD #132 and Tr. 1494-1508). In reaching this conclusion, the district court also erroneously applied an adequacy of disclosure standard, and entered clearly erroneous fact findings that Distributors never objected or attempted to disqualify Arbitrator Gifford before arbitration on account of her receiving training from the ADA. Distributors objected strenuously to the Amway/ADA training and the one-sidedness of the alleged agreement in the district court *before* arbitration and in the arbitration proceedings. (Arbitration Objections: SD #114 at p. 3; Exhibit A, pp. 1, 5; Exhibit C; Exhibit D, pp. 29-20; Exhibits E and H)(Pre-arbitration objections in the district court: Tr. 698, 748, 792-793, 798-803, 1290-1292, 1297, 1233–1334, 1236, 1241). The district court further downplayed the significance of the *ex parte* Jody Victor training and concluded because ADA training was disclosed, the burden shifted to Distributors to inquire which individuals trained Gifford. (Tr. 1495-1495).

As this Court recently held in *Positive Software*, an arbitration participant cannot waive its objection to the arbitrator's nondisclosure where the facts that form the basis of an evident-partiality complaint are not actually learned until after the arbitration. *See Positive Software*, 436 F.3d at 504-05. The cases the district court relied on to apply an "adequacy of disclosure standard" are inapplicable because they hold a party cannot wait until after the close of arbitration to first

object to facts known at the outset of arbitration. *See e.g.*, *Bernstein, Seawell & Kove v. W.E. Bosarge*, 813 F.2d 726, 732 (5th Cir. 1987); *Delta Mine Holding Co. v. AFC Coal Props., Inc.*, 280 F.3d 815, 818-19 (8th Cir. 2002); *JCI Communications, Inc. v. Int'l Brotherhood of Elec. Workers*, 324 F.3d 42, 51-52 (1st Cir. 2003); *Lummus Global Amazonas, S.A. v. Aguatia Energy Del Peru*, 256 F.Supp.2d 594, 620-26 (S.D. Tex. 2002). The parties in those cases did not object prior to entry of an adverse award and the cases do not involve new information learned after the close of the arbitration hearing. The cases are also distinguishable because they involved arbitration panels and partisan arbitrators.

For example, in *Lummus* one member of a three-arbitrator panel, Mr. Jaffe, disclosed during the arbitrator-selection process that a former partner in his law firm may have done work for a party, Aguatyia Energy Del Peru, while serving its business partner, El Paso, who was still a major client of the arbitrator's firm though the arbitrator did not work on El Paso cases and the cases currently did not involve Aguatyia. *See Lummus*, 256 F.Supp.2d at 620. Mr. Jaffe was a party-selected arbitrator under an agreement that allowed each party to select an arbitrator, with a third arbitrator appointed by the International Chamber of Commerce. *See id.* at 619. No party objected to this *disclosed* contact during the arbitration. *See id.* at 625. After the arbitration, Lummus learned that El Paso's president was a former partner with Mr. Jaffe's firm and the prior El Paso cases

had involved representing El Paso in financing and insurance matters pertaining to Aguatyia. *See id.* at 623.

The *Lummus* court distinguished *Commonwealth*, because in *Commonwealth*, as in the case at bar, the arbitrator had contact with the parties on matters at issue in the litigation. Because Jaffe's disclosure included the post-learned information, though in slightly less detail, the *Lummus* court declined to vacate the arbitration award for evident partiality particularly because the three arbitrators had reached a unanimous decision. *See id.* at 620-26. However, the court vacated portions of the award for other reasons. *See id.* at 600.

Lummus is not on point because Distributors objected to the Amway and ADA training before and during arbitration. Also, the single arbitrator in this case never disclosed to Plaintiffs her training with Jody Victor and other Amway representatives on substantive issues at issue in the litigation and as demonstrated above, the scope of Distributors' evident-partiality complaint far exceeds the Jody Victor issue. The district court's holding that Distributors' were on inquiry notice of the facts that form the basis of their evident partiality complaint only addresses nondisclosure of the Jody Victor issue and impermissibly shifts the arbitrator's disclosure burden to the parties.

In *Middlesex Mutual Ins. Co. v. Levine*, 675 F.2d 1197 (11th Cir. 1982), the appellate court held an arbitrator cannot shift the burden of determining and

disclosing potential sources of bias to a party by claiming the party has a duty to inquire. *See id.* at 1202–04. For arbitration to work in a relatively cost-effective and fair manner, the onus of disclosure must remain on the arbitrator at the outset of a case. *See id.* at 1204. To hold otherwise, places a premium on concealment. *See id.*

In *Levine*, the only neutral arbitrator on a three-arbitrator panel failed to disclose his past adversarial experiences with two parties to the arbitration, Middlesex, and Patriot insurance companies. *See id.* at 1199. After the arbitrator in question, Hartnett, and one of the other arbitrators entered an award for $1,200,000.00 in favor of the claimant for underinsured motorist benefits, Middlesex learned that Hartnett and his family's insurance company, Hartnett, Inc., had recently been embroiled in a dispute over the forwarding of insurance premiums owed to Middlesex and Patriot, and that arbitrator Hartnett was subject to the Florida Bar's ongoing investigation of his use of client trust funds to pay some of the premiums. *See id.* Prior to the arbitration, Middlesex had actually sued Hartnett, Inc. for unpaid premiums and Mr. Hartnett had personally written two letters to Middlesex disputing the amounts owed. *See id.* Arbitrator Hartnett did not disclose these facts despite his legal duty to do so and the applicable AAA rule requiring disclosure of any information that might create a presumption of bias. *See id.* at 1202.

The district court vacated the arbitration award, holding Hartnett's failure to disclose this information when the parties were considering whether to select him as an arbitrator, amounted to evident partiality. *See id.* at 1199. This information was relevant to allow counsel to make an informed decision in the arbitrator-selection process. *See id.* at 1203–04. Levine argued Middlesex and Patriot constructively knew or should have known about the alleged partiality prior to the arbitration and waived any objection by failure to diligently investigate Hartnett's background, since they were under a duty to investigate or know whether their files showed a conflict of interest. *See id.* at 1202. Both the trial court and the appellate court rejected this argument, holding that a party should be able to rely on the truthfulness and completeness of an arbitrator's disclosure and there was no legal authority for placing a duty of inquiry on the parties. *See id.* at 1202–04. The law does not require a party to conduct a vast check to determine whether an arbitrator has violated his duty to disclose. *See id.* at 1203. In reaching its decision, the appellate court found that in light of the arbitrator's strict duty of disclosure under *Commonwealth*, finding waiver would be inappropriate unless the party had full knowledge during the arbitration of the facts that are the basis of the evident-partiality claim, and failed to object during the arbitration. *See id.* at 1204.

Because Distributors objected to the facts known before arbitration was compelled and during arbitration and the facts that form the basis of their evident-

partiality complaint were unknown until after the arbitration, Distributors have not waived their complaint. *Positive Software*, 436 F.3d at 504-05.

VII.

ISSUE TWO

A. The Arbitration agreement is unconscionable because it was literally forced on Distributors and Amway handpicked, trained, and interviewed the entire pool of arbitrators while retaining the right to abolish or modify the arbitration program at any time

Less than twenty-four hours after the district court issued its opinion confirming the arbitration award, the U.S. District Court for the Western District of Missouri issued an opinion in *Nitro* that held the exact same arbitration agreement was procedurally and substantively unconscionable under Michigan law. Because the reasoning of the *Nitro* opinion applies with equal force to the unconscionability determination in this case, a copy of is included in the record. (SD #144, **Exhibit A**).

Unconscionability must be determined on a case-by-case basis, considering the entire atmosphere in which the agreement was made. *See Pony Express Courier Corp. v. Morris*, 921 S.W.2d 817, 821 (Tex. App.—San Antonio 1996, no writ); *Tri-Continental Leasing Corp. v. Law Office of Burns*, 710 S.W.2d 604, 607 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.). Although no single formula exists, proof of unconscionability begins with two broad questions: 1)

How did the parties arrive at the terms in controversy (procedural unconscionability), and 2) are there legitimate commercial reasons justifying the inclusion of the terms (substantive unconscionability)? *See Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 498-99 (Tex. 1991) (Gonzalez, J., concurring).

An agreement is procedurally unconscionable if it was procured in an unconscionable manner. *See In re H.E. Butt*, 17 S.W.3d 360, 371 (Tex. App.—Houston [14th Dist.] 2000, no pet.). Procedural unconscionability may be demonstrated by the presence of overreaching or sharp business practices, the absence of a viable alternative, the inability to bargain, or the parties' relative acumen. *See Tri-Continental Leasing*, 710 S.W.2d at 607; *In re H.E. Butt*, 17 S.W.3d at 371; *In re Turner Bros. Trucking Co.*, 8 S.W.3d 370, 377 (Tex. App.—Texarkana 1999, no pet.). In this case, the district court erroneously found Distributors' relative sophistication barred a finding of unconscionability and concluded unconscionability could not be used to disturb the allocation of risks because of superior bargaining power. (Tr. 1193). The district court's holding is wrong because a court may find procedural unconscionability even if a party possesses some sophistication, and the alleged arbitration agreement, if anything, involved coercion rather than the parties' allocation of risks by agreement. *See In re H.E. Butt*, 17 S.W.3d at 371.

Amway forced this arbitration clause on Distributors after events culminating in June 1997 made it clear Distributors would file suit. (SD #132, p. 19). Initially, Amway took the position Distributors would need to sign an arbitration agreement for it to become effective, but after Distributors refused to sign, Amway unjustly changed its position and maintained the arbitration agreement automatically became part of Distributors' contracts by virtue of prior consent to rule amendments from time to time. (Tr. 461-476). Distributors did not know or agree unilateral rule amendments could be used to fundamentally alter their distributorship agreements without assent or consideration. (Tr. 1201-1226). Further, by refusing to sign arbitration agreements and filing suit in state court, all Distributors continued to specifically reject the application of the arbitration clause to existing disputes. As demonstrated below, under issue three, unilateral assertion of an arbitration clause in this manner is an illegal misuse of authority to alter incidental rules from time to time.

Distributors lacked any bargaining ability as to the alleged arbitration agreement. Because the ADA was not independent from Amway, and its actions formed the basis of some of the Distributors' complaints, the ADA could not represent Distributors' interests in any alleged bargaining process. When the Morrisons asked Amway questions about the nature of arbitration and that changes be made to the Intent to Continue Form, their questions went unanswered. (Tr.

746-748; SD #132, Exhibit B). For most Distributors, including the Morrisons and the Greens, when this suit was filed, they had established highly successful distributorships that were their sole income source. (R. Vol. 11, p. 20, lines 1-11). Distributors had no viable alternative to renewing their distributorships and subsequently having the alleged arbitration clause forced on them. (R. Vol. 11, p. 20, lines 1-11).

Substantive unconscionability is concerned with the fairness of the resulting agreement. *See DeLanney*, 809 S.W.2d at 499 (Gonzalez, J., concurring); *Pony Express*, 921 S.W.2d at 821. An agreement is unconscionable if it is so one-sided that it is unreasonable and unfair. *See Wade v. Austin*, 524 S.W.2d 79, 86-87 (Tex. App.—Texarkana 1975, no writ). First, the arbitration agreement is not commercially necessary because Distributors and Amway successfully maintained their respective businesses for many years before arbitration was introduced. Second, the alleged arbitration agreement is too one-sided to be fair and enforceable (*See* Issues One and Three).

Amway unilaterally forced the arbitration agreement on Distributors, handpicked the arbitrators, interviewed and trained them on substantive issues in the dispute, and retained the power to change the scope of the arbitration agreement, and to remove the arbitrator and even the entire arbitration program. No wonder that NO litigant has ever prevailed on its claims against Amway in

JAMS/Amway arbitration. (SD #144, Exhibit A, p. 24). As the *Nitro* court held, these facts render the arbitration agreement substantively unconscionable. (SD #144, Exhibit A, p.25).

VIII.

ISSUE THREE

A. Arbitration agreements are not enforceable when an arbitration clause is unilaterally introduced into an existing contract without consideration or a meeting of the minds, and when the party introducing the arbitration clause reserves for itself the "right" to unilaterally abolish or modify the arbitration program

Section two of the Federal Arbitration Act ("FAA") provides a written agreement to arbitrate contained in a contract involving interstate commerce shall be enforceable except to the extent it is an invalid contract at law or in equity. *See* 9 U.S.C. § 2. "Arbitration under the FAA is a matter of consent, not coercion" and parties are not required to arbitrate when they have not entered a valid arbitration agreement. *See EEOC v. Waffle House, Inc.*, 534 U.S. 279, 293-94 (2002); *Will-Drill Res., Inc. v. Samson Res. Co.*, 352 F.3d 211, 217 (5th Cir. 2003).

The strong federal policy favoring arbitration does not apply to the determination of whether there is a valid arbitration agreement and in this case Texas contract law applies to the determination of whether there is a valid arbitration agreement. *See Will-Drill*, 352 F.3d at 214. The district court apparently applied the presumption in favor of arbitration to the determination of

the existence of a valid arbitration agreement and then misapplied Texas contract law. (Tr. 1197). There is no valid arbitration agreement for at least four independent reasons.

1. Under Texas contract law, a party's agreement to abide by incidental rules and policies as they are amended "from time to time" cannot be invoked to fundamentally alter a party's existing legal rights and create a fundamentally different agreement

In this case, Amway argued and the District Court found, that because Amway retained the right to modify its "Rules of Conduct" "from time to time" under the initial distributorship agreements with Distributors, Amway could unilaterally modify the "Rules of Conduct for Amway Distributors" so as to include an arbitration clause. (Tr. 378-476). This reading of the alleged contract contradicts Texas contract law under which authority to modify incidental rules and policies from "time to time" cannot be used the fundamentally alter a person's rights to enforce a contract.

In *Central Education Agency v. George West Independent School District*, 783 S.W.2d 200 (Tex. 1989), the Texas Supreme Court rejected a school district's attempt to use its right to change policies, rules, and regulations "from time to time" to deprive a teacher of due-process rights that the teacher retained under her contract with the school district. *Id.*

Applying *George West*, Amway cannot invoke its authority to alter incidental rules and policies from "time to time" to deprive Distributors of their

Seventh Amendment right to a jury trial. *See Edmonson v. Leesville Concrete Co., Inc.*, 500 U.S. 614 (1991)(discussing constitutional right to a jury trial); *see also Louisiana Power & Light Co. v. Fed. Energy Regulatory Comm'n.*, 587 F.2d 671, 675 (5th Cir. 1979); *Ashford Dev., Inc. v. USLife Real Estate Svcs. Corp.*, 661 S.W.2d 933, 934-35 (Tex. 1983)(rejecting absurd, strained readings of contract language giving limited right to change incidental contract provisions). When Distributors entered their respective distributorship agreements, their Seventh Amendment rights became part of their distributorship agreements as though expressly set forth in the contracts. *George West*, 783 S.W.2d at 201. Accordingly, contrary to Amway's assertion, the arbitration clause could not automatically become part of the distributorship agreements by virtue of Amway's reservation of authority to change incidental rules of Amway distributor conduct because this would change the agreement fundamentally and deprive Distributors of protections inherent in their contracts to bring suit on claims that arose before introduction of the arbitration program.

2. Under Texas law, there is no valid agreement when one party reserves the unilateral "right" to abolish or modify the arbitration program

The alleged arbitration agreement is also invalid under Texas contract law because it is one-sided, allowing Amway to unilaterally change or even revoke the arbitration clause and rules. Texas courts have repeatedly held arbitration

agreements in which one party reserves the right to unilaterally abolish or modify the arbitration clause are not valid agreements under Texas law.

In *J.M. Davidson v. Webster*, 128 S.W.3d 223 (Tex. 2003), the Texas Supreme Court refused to find an enforceable arbitration agreement when the record was unclear as to whether the party seeking to compel arbitration reserved the right to unilaterally modify or abolish the alleged arbitration agreement. *See id.* at 229-31; *In re C&H News Company*, 133 S.W.3d 642 (Tex. App.—Corpus Christi 2003, no pet.)(holding arbitration agreement unenforceable because company retained right to modify all policies, including arbitration). The alleged agreement gave the employer the right to "unilaterally abolish or modify any personnel policy without prior notice" and if that right applied to the arbitration agreement, the arbitration agreement was unenforceable. *See Webster*, 128 S.W.3d at 226, 232.

In reaching its decision, the Court distinguished the facts of *Webster* from the facts of *In re Halliburton Company*, in which the Court found an enforceable arbitration agreement. *See id.* at 228. In *In re Halliburton*, 80 S.W.3d 566 (Tex. 2002), Halliburton's promise to arbitrate disputes in exchange for the signatory's promise to arbitrate constituted valid consideration because any changes to the arbitration policy applied only *prospectively* to claims that were unknown to Halliburton when modifying the policy, and termination of any arbitration policy

required notice to both parties and applied equally to both. *See id.* at 569-70. The Halliburton arbitration agreement would have been unenforceable if Halliburton had reserved the "right" to introduce, modify, or discontinue the program and make such changes applicable to disputes of which Halliburton "had actual notice on the date of amendment." *See id.* at 570.

By contrast, Amway retained the "right" to introduce, modify, or continue the arbitration program even as to disputes of which it had actual knowledge on the date of amendment and it exercised that right. Therefore, this Court should reverse the trial court's decision to compel arbitration because there is no valid arbitration agreement under the *Webster*, *C&H News*, and *Halliburton* line of cases.

The right to modify the "Rules of Conduct" which Amway argued and the trial court found gave Amway the right to unilaterally introduce the arbitration policy when it knew of pending disputes, also gave Amway the "right" to unilaterally modify or abolish it altogether. (Tr. 376-441). This is evident from: i) the plain language of the line in the respective distributorship agreements which gives Amway the right to amend its "Rules of Conduct" from "time to time;" ii) Amway's introduction of its arbitration policy after it knew of Distributors' dispute and imminent lawsuit; iii) Amway's unilateral modification of its arbitration program between the time of introducing its arbitration policy and the litigation in the district court, and iv) and the "Arbitration Rules" which Amway finished

drafting months after introducing the arbitration policy. (Tr. 376-441, 744, 747-749).

The district court held Amway had the authority to unilaterally introduce the arbitration policy because each Distributor signed an agreement to "comply with the Amway Sales and Marketing Plan and to observe and abide by the Code of Ethics and the Rules of Conduct of Amway Distributors, and all other rules, requirements, and regulations as they are set forth from time to time in official Amway literature." (Tr. 1194-1196). On its face, if this language was used to justify introduction of the arbitration policy and procedures, it is also broad enough to permit Amway to unilaterally abolish or modify the arbitration clause or procedures.

After announcing its arbitration policy, Amway did unilaterally modify the arbitration policy in terms of its implementation and purported scope. When Amway first announced the arbitration policy, it maintained a separate arbitration agreement governed disputes between distributors over BSM (business support materials). *Initially, Amway's position was the source of the arbitration agreement was the distributor's consent on an Intent to Continue or Acknowledgement Form, and there was no mention the arbitration agreement was a unilaterally amended Rule of Conduct, or that arbitration was automatic.* However, after the vast majority of Distributors refused to sign consent forms and filed suit, Amway

changed the requirement and took the position automatic renewal was sufficient to bind the Distributors to the alleged arbitration agreement.

The official Amway literature from 1997 is contained in the Bamborough Declaration and provides automatic renewal will not suffice to renew distributorships for 1998 because of the new arbitration clause, and distributors must sign new agreements. (Tr. 461-468). Later, Distributors were told they could renew their distributorship agreements for 1998 without accepting the arbitration clause. (Tr. 750-790, 798-802). However, in the body of the Bamborough Declaration and its motion to compel arbitration, Amway took the position auto-renewal was sufficient to bind Distributors to arbitration—even as to BSM disputes—because they had previously agreed to abide by Amway's Rules of Conduct as amended from time to time. (Tr. 363-367, 473-476).

The Amway arbitration rules further demonstrate Amway's arbitration program allowed it to selectively avoid or engage in arbitration by allowing Amway to abolish or modify the arbitration program. (Tr. 440-460). Rule One expressly states that nothing in the arbitration rules limits Amway Corporation's right to modify any rule or contract "relating to the Amway business opportunity." (Tr. 456-460). As the Texas Supreme Court noted in *Webster*, this type of arbitration language is unenforceable because it allows the favored party to "have its cake and eat it too" by selectively avoiding or engaging in arbitration. *See*

Webster, 128 S.W.3d at 231 n.2; *Halliburton*, 80 S.W.3d at 70. Because Amway retained the right to unilaterally abolish or modify the arbitration program, the arbitration agreement is unenforceable under Texas law.

3. The alleged arbitration agreement is unenforceable because there is no fresh consideration or a meeting of the minds supporting it

Even if Amway's misuse of its right to change the Rules of Conduct from time to time and its reservation of the right to unilaterally modify the arbitration program did not render the agreement unenforceable, it is unenforceable for lack of consideration and a meeting of the minds, respectively. Consideration and a meeting of the minds are fundamental elements of any valid contract. To be valid, a modification to a contract must itself be supported by fresh consideration and a meeting of the minds. *See Hathaway v. Gen. Mills*, *Inc.*, 711 S.W.2d 227, 228 (Tex. 1986); *Fubar, Inc. v. Turner*, 944 S.W.2d 64, 67 (Tex. App.—El Paso 1997, no writ).

When a contract is renewed, there must be a meeting of the minds for any of the original contract terms to be changed. *See Safeway Man. Gen. Agency v. Cooper*, 952 S.W.2d 861, 867 (Tex. App.—Amarillo 1997, no writ). Even when an agreement provides one party may alter certain terms from time to time, new consideration and a meeting of the minds must support a contract modification made pursuant to the "time to time" clause. *See Walden v. Affiliated Computer Servs., Inc.*, 97 S.W.3d 303, 314 (Tex. App.—Houston [14th Dist.] 2003, pet.

denied); *see also Culbertson v. Brodsky*, 788 S.W.2d 156, 157 (Tex. App.—Fort Worth 1990, writ denied).

In the at-will employment context, Texas courts have found that in the absence of language or facts showing one party reserved the right to unilaterally modify or abolish the disputed arbitration policy, an arbitration agreement may be formed by virtue of an at-will employee's continued performance of work after receiving notice of a prospective arbitration clause on a "take it or leave it" basis. These cases do not support the conclusion there is an enforceable arbitration agreement in this case because Distributors were told they could continue their distributorships without accepting the arbitration clause and continued performance is not the consideration that supports Distributors' bargain. Further, the relationship between Amway and Distributors is not an employment relationship, which Amway takes great pains to ensure. The relationship between Amway and Distributors is by way of contract, making the at-will cases meaningless to this Court's analysis.

In re Dillard Department Stores, Inc., No. 04-1132, 2006 WL 508629 (Tex. Mar. 3, 2006)(per curiam), is the most recent Texas Supreme Court decision addressing formation of an enforceable arbitration agreement in the at-will context. In *Dillard*, the court addressed whether there was a valid arbitration contract under Texas law which provides, an at-will employer can add an enforceable term to the

employment agreement by proving: 1) unequivocal notice of the change in employment terms; and 2) the employee's acceptance of the term by working after receiving unequivocal notice of the modified employment terms. *See id.* at *1. In reaching its *Dillard* decision, the court expressly followed its *Hathaway* and *Halliburton* decisions. *See id.* Under *Hathaway*, whether the contract is modified depends on the parties' intentions. *See Hathaway*, 11 S.W.2d at 229. Thus, equivocal notice of the change or continued work under protest are insufficient to render an attempted modification enforceable. *See id.* The court held under such circumstances, there is no consideration and no meeting of the minds. *See id.*

First, the notice-and-acceptance rule does not apply to this case because this is not at-will employment. If, as here, distributors refused to agree to a proposed arbitration policy, but Amway continued to treat them as distributors, the maintenance of their respective distributorships would not constitute acceptance of the arbitration provision because the language of the distributorship agreement shows, maintenance of the distributorship is not the consideration that supports the Amway distributorship agreement. (e.g. Tr. 422-423). For example the backside of the distributorship-agreement form states, violation of Rules of Conduct may or may not result in revocation of distributorship authorization and in this case it did not through the time of arbitration. (Tr. 423).

Unlike *Dillard*, in this case, there was no warning that continuing one's Amway distributorship would constitute acceptance of the arbitration clause. Instead, Amway alternated between stating the arbitration clause "automatically" became part of the distributorship agreement and representing Distributors were required to sign an "Intent to Continue Form" for continued authorization to operate their distributorships. (Tr. 461-476). Those Distributors who did not sign Intent to Continue Forms, reasonably manifested their lack of agreement by not signing the form. However, once Distributors sued, Amway switched its position and argued the arbitration clause was a Rule of Conduct to which Distributors were automatically bound by auto-renewal even if they had not signed the Intent to Continue Form and Amway could not show auto-renewal forms for them. (Tr. 473-476). Either way, unlike the arbitration clause in *Dillard*, the Amway arbitration clause was not offered on a clear take it or leave it basis.

Even if notice-and-acceptance rule were applied, the arbitration agreement would remain unenforceable because the notice was equivocal, Distributors clearly protested against arbitration, and Amway reserved the right to unilaterally modify the arbitration—an issue the *Dillard* court specifically addressed as a bar to enforceability. *In re Dillard*, 2006 WL 508629 at *3.

As in *Hathaway*, Distributors protested the proposed arbitration clause rather than accepting it. In a letter the District Court relied on it reaching its decision to

confirm the arbitration award, appellant Dr. Joseph Morrison wrote to Amway on September 29, 1997, and specifically rejected the arbitration clause. (SD #98, Exhibit B; Tr. 746-748).

In his letter, Dr. Morrison made it clear he spoke in a representative capacity for himself and other loyal long-term distributors who could not assent to the arbitration clause and therefore refused to sign. (Tr. 1507, para. 3). Even those Distributors who signed the Intent to Continue Form filed affidavits in the District Court explaining they never intended or agreed to arbitrate existing disputes. (Tr. 1201-1226). Distributors continued to protest the arbitration clause by filing suit in Texas state court, in countless pleadings filed in the District Court (after Defendants removed to federal court) and with the arbitrator. (Tr. 85-92). Because notice of the arbitration provision was equivocal and Distributors protested rather than accepting the clause, the arbitration agreement is unenforceable even under a notice and acceptance analysis like the one applied in *Dillard*.

IX.

ISSUE FOUR

A. The alleged arbitration agreement could not include all of Distributors' claims when Amway maintained the arbitration clause does not apply to disputes about Business Support Materials and even introduced a separate arbitration program for such disputes and the plain language of the alleged arbitration agreement applies to distributorship-agreement disputes and not Business Support Materials

BSM are literature, rallies, tapes, and functions designed to motivate Amway distributors. (Tr. 75-81, 462-468). Though Amway distributors are generally free to buy and sell BSM, Amway has long held that for legal reasons, any business venture selling BSM must be entirely separate from Amway distributorships. (Tr. 75-81, 462-468). In the alternative that this Court finds an enforceable arbitration agreement, the district court's order compelling arbitration as to claims concerning BSM should be reversed because the alleged agreement does not cover those claims.

Claims that are not within the scope of an arbitration agreement may not be compelled to arbitration. *See Complaint of Hornbeck Offshore (1984) Corp.*, 981 F.2d 752, 754 (5th Cir. 1993). In ruling on this same issue, the Missouri Supreme Court held the Amway Rules of Conduct could not render BSM disputes subject to arbitration because Amway has long maintained the separateness of BSM and even created the separate BSM arbitration agreement. *See Nitro Distrib. v. Jimmy V. Dunn*, Cause No. SC86854, 2006 Mo. LEXIS 55, *6–11 (May 2, 2006). In this

case, though the language of the alleged agreement covered "any claim or dispute arising out of or relating to my Amway distributorship," it did not mention or reach disputes concerning BSM. (Tr. 1191-1192). To that end, as shown in the exhibits to the Bamborough Declaration, a separate, optional BSM arbitration agreement was introduced around the same time the alleged arbitration agreement was introduced. (Tr. 463). Because Distributors refused to sign the BSM arbitration agreement, they are not bound to arbitrate BSM disputes. Because the BSM arbitration and rules announcing it are more specific, they trump any overbroad reading of the general Amway-distributorship arbitration clause that would otherwise render it applicable to BSM disputes. *See id.; Hilco Elec. Coop. v. Midlothian Butane Gas Co.,* 111 S.W.3d 75, 81 (Tex. 2003).

X.

ISSUE FIVE

A. The District Court lacked subject matter jurisdiction to enter judgment on the award because the Distributors never consented to entry of judgment on the arbitration award, Amway represented arbitration as an alternative to going to court, and two Distributors were not even parties to the arbitration award

The District Court lacked subject matter jurisdiction to enter judgment on the arbitration award because Amway failed to show a written agreement containing consent to enter judgment on any arbitration award. A federal court may exercise jurisdiction over cases only as expressly provided by the Constitution

and laws of the United States. *See* U.S. CONST. Art. III §§ 1-2; *Kokkonen v. Guardian Life Ins. Co. of Am.,* 511 U.S. 375, 377 (1994). A party seeking relief in a federal district court bears the burden of establishing the subject matter jurisdiction of that court. *See Langley v. Jackson State Univ.,* 14 F.3d 1070, 1073 (5th Cir.).

Section nine of the FAA governs motions to confirm. In relevant part, section nine provides "if the parties *in their agreement* have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court," then on proper petition the district court shall enter judgment on the award unless it is vacated. 9 U.S.C. § 9 (emphasis added).

Section nine creates subject matter jurisdiction to confirm an arbitration award under the FAA only when the parties in their agreement have agreed that a court judgment shall be entered on the award. *See Oklahoma City Assocs. v. Wal-Mart Stores, Inc.*, 923 F.2d 791, 793–94 (10th Cir. 1991)(holding no jurisdiction to enter judgment on award because lessor could not show consent-to-entry-of-judgment language in the arbitration agreement).

The leading case from this Court is *T&R Enterprises, Inc. v. Continental Grain Company,* 613 F.2d 1272 (5th Cir. 1980), but is not on point. In *T&R*, the district and appellate courts found implied consent to enter judgment because in addition to the agreement providing for "final and binding" language, the party arguing

against confirmation invoked the federal court's jurisdiction by filing its pre-arbitration complaint in the federal district court. *See id.* at 1278-79. The rule of *T&R Enterprises* does not apply in this case because Distributors did not file suit in the district court. Accordingly, Amway retained the burden of proving consent to enter judgment and they did not meet this burden.

1. The Bamborough Declaration cannot prove consent to entry of judgment by virtue of auto-renewals because at least two Distributors were not on auto-renewal in 1997, the declaration contains no evidence whatsoever as to 19 Distributors and the Rogers are not even named in the arbitration award

When Distributors raised this issue in the district court, Amway argued the Bamborough Declaration showed consent to entry of judgment. (SD #115, #118, #119). Amway reasoned the auto-renewals relied on to argue a binding arbitration agreement also showed consent to entry of judgment, but Amway are mistaken.

First, Appellants were expressly told in a tape-recorded conversation, that no one would "go to court" after arbitration." (Tr. 787–788) Second, as Morrisons' letter shows, the Morrisons were no longer on auto-renewal in 1997. (SD #98, Exhibit B; Tr. 746-748). Because the Morrisons were not on auto-renewal in Fall 1997, Amway sent them an "Intent to Continue" form which they refused to sign. (SD # 98, Exhibit B, Tr. 746-748). Because these Distributors were not on auto-renewal, they cannot conceivably be argued to have automatically renewed their Amway distributorship agreements and thereby agreed to entry of judgment.

Second, the Bamborough Declaration does not contain any application, auto-renewal, or other form of evidence as to the following Distributors named in the arbitration award:

- Michael and Karen Cutaia
- Herbert and Marilyn Hamilton
- Randall and Diane Laine
- Donald and Celeste May
- Frank and Karen Mazzola
- Robert and Barbara Price
- Richmond Eagle Corp.
- Larry and Suzanne Rogers
- Dana and Robert Schmanski
- Clay and Lisa Young

Accordingly, for these Distributors, the Bamborough Declaration cannot contain the showing of consent to entry of judgment necessary for subject matter jurisdiction. *See* 9 U.S.C. § 9. In addition, as to Distributors Larry and Suzanne Rogers the district court lacked jurisdiction to enter judgment because they were not listed in or subject to the Arbitrators Final Award. *See id.; see also Orion Shipping & Trading*, *Co. v. E. States Pet. Corp of Panama*, 312 F.2d 299 (2d Cir. 1963)(providing confirmation is improper against a party not named in the award).

2. As to the Distributors on auto-renewal who did not sign arbitration agreements, the Bamborough Declaration cannot prove consent to enter judgment because the arbitration rules did not exist when Distributors allegedly consented, the announcements introducing the program do not create consent to enter judgment, and Amway maintained distributorships would not be automatically renewed with the arbitration clause unless these Distributors signed an arbitration agreement

As to Distributors on auto-renewal who refused to sign the arbitration agreement, auto-renewal in Fall 1997 cannot show Distributors consented to entry of judgment when Distributors did not agree to any language containing consent to the entry of judgment prior to the time the auto-renewal was considered effective, October 3, 1997. Prior to the deadline to revoke auto-renewal for 1998, Distributors were not sent any announcements that informed them Amway would take the position auto-renewal would subject them to arbitration and the prospect of entry of judgment in federal district court. The September 1997 Amagram, September 1997 Newsgram, and ANA Business Preview (undated but predating September 1997 according to language in the document) which Bamborough cites as providing notice of the duty to arbitrate present arbitration as an alternative to lawsuits and do not reference the prospect of a court judgment:

> ITC [Intent to Continue Form] and Application Change: Arbitration Agreement:
>
> This change incorporates an agreement to arbitrate all distributor disputes relating to the Amway business, including issues involving the Sales and Marketing Plan and the Rules of Conduct. Arbitration is a process of dispute resolution by which an independent third party,

> known as an arbitrator, listens to both sides of a dispute and then renders a final and binding decision. Arbitration can be a very effective way to quickly resolve any disputes which cannot be solved by Amway's Conciliation process. In addition, arbitration is usually much faster and less costly than a lawsuit.

(Tr. 461-468) For these Distributors, Defendants have not shown and cannot show, the Plaintiffs were informed of entry of judgment on any arbitration award.

Third, Amway is attempting to have its cake and eat it too, by arguing auto-renewal suffices for consent to entry of judgment. The official Amway literature from 1997 and contained in the Bamborough Declaration states that automatic renewal will not suffice to renew distributorships for 1998 because of the 1998 addition of arbitration:

> AUTOMATIC RENEWAL PROGRAM
>
> Because of the recent changes to the Intent to Continue (renewal form) and the introduction of the new Business Support Materials Arbitration Agreement described in the previous sections, this year Automatic Renewal Program participants *must review the changes and sign an acknowledgement.* The same letter which accomplishes those *requirements* will give distributors the opportunity to sign a BSMAA. The letter will be mailed in mid-September.

(Tr. 461-468)(emphasis added) Even a casual reading of the "acknowledgement form," shows that it is an arbitration agreement form by which Amway solicited consent to arbitrate. (e.g., Tr. 379). Accordingly, any consent-to-entry of judgment clause contained in the 1998 Intent to Continue Form and Amway Distributor Application cannot even be arguably binding on auto-renewal Plaintiffs

absent a showing these Distributors reviewed and signed any such acknowledgement that included consent to enter judgment.

Fourth, because the Arbitration Rules did not exist until November 14, 1997, and were not even final at that time, the arbitration rules cannot provide the necessary agreement to enter judgment. (Tr. 460, 744). The arbitration rules were nonexistent in September 1997—at the time of the alleged effective date of auto-renewal. (Tr. 460, 744). *Cf. McKee v. Home Buyers Warranty Ass'n*, 45 F.3d 981, 983–84 (5th Cir. 1995); *Varley v. Tarrytown*, 477 F.2d 208, 209 (2nd Cir. 1973).

XI.

CONCLUSION

Because Arbitrator Gifford failed to disclose facts tending to show a conflict of interest which any litigant would have wanted to know at the outset of arbitration and because there was not a binding arbitration agreement, Distributors respectfully ask this Court to reverse the district court's judgment, to vacate the arbitration award, to reverse the order compelling arbitration and to remand this case for the jury trial to which Distributors are entitled.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Brock C. Akers, certify that today, June 6, 2006, a copy of the brief for Appellants, a copy of the record excerpts and computer disk were served upon 1) Rick Abraham, by overnight delivery, Fed Ex Airbill 8575 6048 1965, to him at Abraham Law Offices, 24 North High Street, Columbus, Ohio 43215, Telephone (614) 221-5474, Facsimile (614) 221-7363, 2) Thomas W. Taylor, by hand delivery, to him at Andrews & Kurth, 600 Travis, Suite 4200, Houston, Texas 77002, Telephone (713) 220-4200, Facsimile (713) 220-4285, 3) John C. Peirce, by overnight delivery, Fed Ex Airbill 8575 6048 1976, to him at Bryan Cave, L.L.P., 700 Thirteenth St, N W, Suite 700, Washington, D. C. 20005-3960, Telephone (202) 508-6000, Facsimile (202) 508-6200, and 4) Michael Y. McCormick, by hand delivery, to him at McCormick, Hancock & Newton, 1900 West Loop South, Suite 700, Houston, Texas 77027, Telephone (713) 297-0700, Facsimile (713) 227-6222.

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CERTIFICATE OF COMPLIANCE

Pursuant to 5th Cir. R. 32.2 and .3, the undersigned certifies this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7).

1. Exclusive of the exempted portions in 5th Cir. R. 32.2, the Brief contains **13,923 words** printed in a proportionally spaced typeface.

2. The Brief has been prepared in proportionately spaced typeface using **Times New Roman 14 point** in text and **Times New Roman 12 point** in footnotes produced by **Microsoft Word 2002** software.

3. The undersigned understands a material misrepresentation in completing this certificate, or circumvention of the type-volume limits in Fed. R. App. R. 32(a)(7), may result in the Court's striking the Brief and imposing sanctions against the person signing the Brief.

BROCK C. AKERS