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Supreme Court of Texas.
In Re: Morgan Stanley and Co. Incorporated, Successor to Morgan Stanley DW,
Inc.
No. 07-0665.

October 15, 2008.

Appearances:
Thomas R. Phillips, Baker Botts, LLP, Austin, TX, for petitioner.
Charles T. Frazier, Jr., Alexander Dubose Jones & Townsend, LLP, Dallas, TX, for respondent.

Before:

Wallace B. Jefferson, Chief Justice; Don R. Willett, Paul W. Green, Nathan L. Hecht, Dale Wainright, Phil Johnson, and Scott A. Brister, Justices

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ORAL ARGUMENT OF THOMAS R. PHILLIPS ON BEHALF OF THE PETITIONER

MR. PHILLIPS: [inaudible] Court. Sole question for the courts' determination today is whether under the federal arbitration act, a court or an arbitrator should decide a defense that the resisting party lack the mental capacity to enter into a contract when one of the, of the provisions of that contract provides for arbitration of disputes.

In this case, Mr. Griffin claims that his ward Helen Freeman Taylor lacked the mental capacity to sign any of the new client account agreements with Morgan Stanley that she executed. This defense obviously goes to the entire agreement. Not just the arbitration clause that was one of the clauses in that agreement. Under the Supreme Court's case in *Prima Paint v. Flood & Conklin* (388 U.S. 395) in 1967, the arbitration provision is deemed to have been separately agreed upon from the rest of the contract so that if a party raises a defense to the contract as a whole, the parties are deemed to have made a separate agreement that provides for the arbitrator to resolve the underlying challenge to the whole contract.

The language of *Prima Paint* (388 U.S. 395) was very broad but the holding was limited to the particular defense raised in that case, which was fraud in the inducement. And thus in the ensuing four decades, courts struggled with whether or not any and every defense to

a contract should be decided by the arbitrator or whether there were some exceptions under the FAA where the court should make an initial determination. Some courts held that the Prima Paint doctrine applied only to defenses based on the behavior of the parties, not defenses based on their status. Others opined and held that defenses that render the contract as a whole void as opposed to merely voidable should be decided by the court and not the arbitrator.

The Supreme Court of Florida relied on that letter distinction "void" and "voidable" to hold that an arbitration clause in a usurious contract was not enforceable, and it could be he-- so held by court because under Florida law, a usurious contract was held to be void *ab initio* and not merely voidable.

The Supreme Court-- the United States took that appeal in *Buckeye Check Cashing, Inc. v. Cardegna* (546 U.S.440). The court expressly adopted *Prima Paint* (388 U.S. 395) very broadly and extended it and held that Florida's distinction between "voided" and "voidable" contracts was not valid under Section II of the federal arbitration act.

"Since that statute referred to revocation of a contract," said the court, "There can be no doubt that a contract must include contracts that later proved to be void." But still, *Buckeye* (546 U.S. 440) did not hold that a defense raised to every con-- every type of contract had to go to an arbitrator. In footnote one, which is provided for you in big type in tab two of our joint bench book, the court said, "The issue of the contracts validity is different from the issue whether any agreement between the alleged obligor and obligee was ever concluded." Our opinion today addresses only the former and does not speak to cases which hold that it is for courts to decide whether the alleged obligor every signed the contract, whether the signor lacked authority to commit the alleged principle, and whether the signor lacks the mental capacity to assent. That final one is really the basis of why we're here today. Because there has been no state Supreme Court and no Court of Appeals opinion on what that language means since *Buckeye* (546 U.S. 440), and there have been two federal district court opinions, and one state trial court opinion that I will later explain are distinguishable.

JUSTICE HECHT: State trial court or Court of Appeals?

MR. PHILLIPS: It was a state trial court in Tennessee I believe, court of chancery. Well, maybe it was court of-- went to Court of Appeals, yes. Not a, not a state Supreme Court.

Thus says, one case has recognized at Florida Appellate court, *Buckeye* (546 U.S. 440) acknowledged that a third potential type of challenge exist, but the court declined to state who, the court or the arbitrator, should decide this issue.

If the court interprets the federal arbitration act to say that an arbitrator should decide all such disputes, then obviously the probate judge in this case abused his discretion and mandamus should be granted. But if the court decides that the type of defenses referenced in *Buckeye* (546 U.S. 440) footnote one should be decided by the court, the probate still-- or the probate court still abused his discretion under the facts of this case and the law of the state. The only guidance that this Court has in interpreting the federal arbitration act is the language of footnote one where Justice Scalia, speaking for eight members of the court said the issue is, "Whether any agreement between the alleged obligor and obligee has ever been concluded."

Under Texas law, we know that these new client account agreements between Morgan Stanley and Mrs. Taylor were concluded. It is clear

under the FAA, that each state's law governs on the issue of whether a contract has ever been formed.

And under Texas law, a defense of lack of mental capacity does not prevent a party from making a contract. That contract, this Court has held in a writ refused case, is voidable but not void. That means that Mrs. Taylor or her successors at their options could enforce a contract that they made with Morgan Stanley. And it also means that Morgan Stanley could seek to enforce that contract and could enforce it unless Mrs. Taylor or her successors raise lack of mental capacity as a defense.

JUSTICE WILLET: So I'm looking at what I think at Section IV of the FAA, which as I read it says the federal district court may order arbitration "Upon being satisfied at the making of the agreement for arbitration or the failure to comply there with is not an issue." Okay. "The making of the agreement." But you would say that mental capacity doesn't go to the making of the agreement.

MR. PHILLIPS: That's right the-- this is a sort-- essentially sort of circular. First, it's not clear to me, and I spent about 30 minutes this morning trying to figure it out, whether or not Section IV applies to state courts or not. It's purely procedural and it talks about federal district court. And the best place to look is page 445 of the *Buckeye* (546 U.S. 440) opinion, which seems to impart some of the Section IV language into Section II but it doesn't actually say that.

At any rate, all that I-- all that actually clearly applies to a state court, I think, is Section II. But let's assume this does apply or has there been imported or should be borrowed. If the making of the arbitration agreement refers both to a separate arbitration agreement, and a number of the cases that Mr. Griffin cites are cases where there's a separate stand alone arbitration agreement, and there are all these defenses of course that can and have to be decided by the court before a case is referred to arbitration.

Secondly, to the extent that it is talking about the making of an agreement and the defense to that goes to the contract as a whole, you're right into *Prima Paint* (388 U.S. 395). In fact, *Prima Paint* (388 U.S. 395) was a section IV case.

So we've got the concept of severability that is read into, super imposed on, part of this language in Section IV if it applies to a case that starts out in state court.

JUSTICE HECHT: So what issues do you think are judicial issues?

MR. PHILLIPS: Well, I-- it seems to me, in footnote one, which says, we're not going to decide this, is if, if it's later decided that, that means there is a category. It seems to me that the sup-- that the proper line the Supreme Court used when they talked about concluding a contract is between the existence of a contract and the content of that contract.

JUSTICE HECHT: Is that the same as the "void", "voidable" distinction do you think?

MR. PHILLIPS: Well, in some instances is and in some it isn't. I'm glad you-I'll finish this thought then I'll take you to a language that I think explains this. It's not quite the same, because in the Florida case of *Cardegna* (546 U.S. 440), the parties had no doubt made this usurious contract. It, it existed, you couldn't take it away, it just wasn't enforceable. Since it was usurious, apparently neither side can enforce it under Florida law and that may vary from state to state. So, I think a forgery case, if a de-- if a defense is we-- we've never signed, that-- that's not our signature.

Under Texas law, *Board of Trustees, Tarrant County Jr. College v.*

National Indem. Co. (484 S.W.2d 399), that's a void contract. Neither side can enforce it. I can't say, well, that's my not signature but I sure would like that loan at three percent, so give it to me and the bank can't obviously hold you to a-- to pay off a loan you never signed.

So I would think that's an easy one. Forgery is pretty easy. Usury falls on the other side. I think Agency is tougher, but if the law of the state is, is that you have to prove agency and if you didn't have-- if the agent didn't have authority, actual or apparent, to make this to, to make an agreement then you're not bound by, then that would fall on the side of a contract that was never [inaudible].

CHIEF JUSTICE JEFFERSON: What about a contract to the-- a minor a, a, a five year old, you know, I mean obviously he or she shouldn't or can't be bound by that. Is that a void, voidable thing or is it more forgery?

MR. PHILLIPS: Minors at-- Minors are pretty close to mental incapacity in the law. But I don't think there-- you can read texture which collects all the cases and end up not being sure what you've read. Mo-- and it depends on the type of contract it is, but most of the time, a minor can subsequently ratify contract and can enforce that contract. It's at the minor's option to get out of that contract. But the nuances of it seem to be a little bit different than mental capacity. Returning to Justice Hechts' question -

JUSTICE HECHT: Illegality or -

MR. PHILLIPS: - on void and voidable.

JUSTICE HECHT: - What about illegality?

MR. PHILLIPS: Illegality, it seems to me is a-- has been foreclosed by *Buckeye* (546 U.S. 440). If you made the deal, the arbitrator has to decide ...

JUSTICE BRISTER: So a gambling contract goes to the arbitrator?

MR. PHILLIPS: A gambling contract goes to the arbitrator. You, you made that deal. Maybe neither side can enforce it. Only the IRS can enforce it.

JUSTICE BRISTOL: You need to tell the gamblers about that. Normally they're unenforceable, but who knows what an arbitrator will do, right?

MR. PHILLIPS: Well, there is an underlying prejudice I think, that permeates a lot of literature against arbitration and which is why I included Tab nine to our, our joint exhibit book.

The arbitrations that, that arise from a dispute over a brokerage contract are not decided in some fly by night matter, some, some secret arbitration. They're decided pursuant to the Rules of FINRA, which is a successor to, to the NASD, and every arbitration award is posted on line virtually, instantly after it's handed down. The front page there is the FINRA home page. Arbitration and mediation is the bottom thing, you punch that, the next screen has most viewed and the first one is arbitration awards on-line. You punch that and you fill in the name of the case or the document number or the dates it was decided. So I did, 919 thru 922 and pulled up the number of cases. I picked the third one, which is the Nielson award and that's a complaint by the Nielsons against Schwab and they asked for 355 thou-- $365,000 and got $304,000. The claimants win 40 to 50 percent of their claims in these arbitrations. It's a transparent process and there's three different lists ...

CHIEF JUSTICE JEFFERSON: Are you suggesting we might decide the case differently if there were not this kind of formality?

MR. PHILLIPS: No, I just think it's good background to know that

there are arbitrations that have come under a lot of attack and those who the-- have generally not been included within the scope of various of-- for instance, the legislature is looking at restricting. I want to ask you to turn your attention to tab five, which is a case called, Barrolow versus Time Warner Cable. This was written by Judge Kimba Wood in the southern district of New York and turn to footnote 14, which is on page eight of this printout and on star six of the opinion, and Judge Wood is talking about some of the cases which set up some of these distinctions principally, cases involving the power of an agent and what affect they were affected by the void, voidable language in *Buckeye* (546 U.S. 440), and she says, the last sentence of that footnote 14 in the right hand column, "These cases appear to use a different definition of void, than the *Buckeye Check Cashing* (546 U.S. 440) court, which found that a claim that a contract containing an arbitration is, "void for illegality" because it violated state laws must be resolved by an arbitrator not a court." Because spear drake and its progeny actually used the term "void" in the sense of none existent, those cases appear to be consistent with *Buckeye Cashing* (546 U.S. 440), despite the conclu-- potential confusion caused by the differing use of the same terms. So, I think if the court focuses on word "concluded," it's easy to see that void and voidable still has a place in terms of if there's been a concluded contract that one party has the authority to get out of versus the type of void contract that simply doesn't ever exist.

CHIEF JUSTICE JEFFERSON: Are there any further questions? Thank you counsel. The court is ready to hear argument from the real party in interest.

COURT ATTENDANT: May it please the Court. Mr. Frazier will present argument for the real party in interest.

ORAL ARGUMENT OF CHARLES T. FRAZIER, JR. ON BEHALF OF THE RESPONDENT

MR. FRAZIER: Good morning, and may it please the Court. Because Griffin's mental capacity challenge goes to the formation of the contract under Section IV, it cannot logically be addressed solely to the arbitration clause in the contract. The court did not clearly abuse its discretion in holding that a capacity challenge is for the court and not for the arbitrator.

Arbitration, in essence, the scope, the whole premise of arbitration, is agreement. Therefore, an assent based challenge to the underlying contract is an exception to the bright line test of *Prima Paint* (388 U.S. 395). So there are two grounds the court can rule in favor or, or hold that the trial court or the probate court did not abuse its discretion.

First, is what has been argued all ready, and that is whether or not the challenge goes to the formation or the making, as Justice Wallace pointed out in Section IV of the contract. Now, the-- I'll go right to the point of the "void" versus "voidable" issue. Both the Supreme Court in *Buckeye* (546 U.S. 440) and even the fifth circuit in other decisions, have made it clear that the "void" and "voidable" distinction is immaterial. Courts that have applied the *Prima Paint* (388 U.S. 395) template, if you will, have applied it on contracts that the state law holds or held, was void as well as voidable. The courts that apply the *Spahr v. Secco* (330 F.3d 1266), the tenth circuit case

that we relied upon, paradigm also apply that analysis on both void and voidable contracts, so that is truly immaterial. What is material is whether the defense, as Justice Scalia pointed out in footnote one in *Buckeye* (546 U.S. 440), goes-- challenges the signatory power. If you look at tab II, and you'll see the list of cases, the three types, those that have been grouped into signatory power challenges. Was there a mental assent or did a signatory have authority? Did the signatory have capacity? That's what we have to look at. If there was no assent, no meeting of the minds, no mutual ascent, then that focuses in-- that by definition addresses the making of a contract and under Section IV, it goes to the trial court not to the arbitrator. That's the first premise that this Court can uphold or denied mandamus on the trial-- the probate court's decision.

Secondly, if the court wants to apply or look at the *Prima Paint* (388 U.S. 395) and says, and, and believes that there is a contract for purposes of this argument, then the *Spahr v. Secco* (330 F.3d 1266) analysis, is the second ground. In that case, and that is at tab four of the hand out, the, the, the, tenth circuit grappled with a defense that cannot be parsed between the contract in its entirety and an arbitration provision contained there in. Now, conduct based defenses such as illegality, fraud in the inducement, duress, unconscionability that this Court has actually addressed, can be parsed between the two. You can have fraud in inducing arbitration as opposed to allowing a party to have their, their grievances addressed in the courts. But if you are incapacitated, mentally incapable of understanding what you're doing, you cannot have capacity as to one provision yet have capacity as to the entire contract.

JUSTICE HECHT: Could Taylor insist on arbitration?

MR. FRAZIER: Could Taylor insist on arbitration? I don't think-- I don't think there's a meeting of the minds so that goes to whether or not she could even enforce the agreement.

JUSTICE BRISTER: But they did trading for years, right?

MR. FRAZIER: The, the agreements were, were entered into from 1999 and some in 2003. So there, there was some trading.

JUSTCICE BRISTER: The lie-- hundreds of thousands of dollars.

MR. FRAZIER: Yes. In fact, the premise of our claim is, is that they stole 3.5 million dollars in Exxon stock and put it into speculative agreements or speculative investments. So there was activity under that. But ...

JUSTICE BRISTER: So how can you, how can you, after you've made use of the brokerage for years, to move lots and lots of money around then come back and say, well, but I had no capacity? So none of its been valid, haven't, aren't, aren't you too far down the road to do that?

MR. FRAZIER: I don't think so, your Honor. I don't think so. Because again, the court is looking at contracts, whether they are voidable later to be determined a void or void *ab initio* have applied the pre-- or applied the *Spahr v. Secco* (330 F.3d 1266) and the defense over capacity and said that, you-- you, you cannot go to arbitration.

JUSTICE BRISTER: But if-- I mean if ...

MR. FRAZIER: So it doesn't it-- whether or not that there was trading or not or whether or not that there was a, a voidable contract, the courts can go through your initial formation.

JUSTICE BRISTER: What if, what if you, you know, borrowed a million dollars and then after you got the money, you said, well, sorry, I was-- had no mental capacity so I don't have to pay it back. We, would-- we wouldn't give that person the time of day. If you take,

if you take the benefit of the contract, you're estopped to claim, well, I don't have to live up to the obligations.

MR. FRAZIER: I think under some circumstances, but the, the courts in Texas have been less than clear about whether contracts with incompetence are void *ab initio* or that they're voidable. The, the key is, is that, is this challenge going to the making, the formation, or if there is a contract-- let's say there is a contract then it doesn't fit the, the *Prima Paint* (388 U.S. 395) template. Excuse me

JUSTICE HECHT: But it's one thing to let the potentially incompetent promisor out of the contract on that basis but it's another thing to force the party out because the other party doesn't want to performs this. Now, you end up-- that seems rather perverse. I don't have to sell you the land because you're crazy when, when you offered to buy it.

MR. FRAZIER: Well, I know there are some circumstances, your Honor where it-- there, there maybe some inconsistency. But under the facts of this case, there's evidence that she lacked the mental capacity, which is the whole reason and why there, there's a lawsuit because 5 billion dollars of her estate, have been whittled away.

JUSTICE HECHT: But in my example, the seller the, the the, the seller can't defend for the breach of contract case on the basis that the buyer was incompetent at the time of the contract, can he?

MR. FRAZIER: No, I don't think so.

JUSTICE HECHT: Okay. Well, it does seems it's sort of a perverse result that one side can enforce this arbitration agreement but not the other side. Mrs. Taylor could if she wanted to.

MR. FRAZIER: I think ...

JUSTICE HECHT: But the others-- but Morgan Stanley can't.

MR. FRAZIER: I think we're looking at balancing the, the equities, at balancing the public policy behind for protecting someone incompetent like Mrs. Taylor, who has had her estate whittled away, and the rights of the parties to continue on and enforce the agreement. And we believe that this challenge goes to protecting someone like Mrs. Taylor who has been harmed and going into the formation, that's what it attacks and the, the case law that has come down since *Spahr v. Secco* (330 F.3d 1266) and since *Buckeye* (546 U.S. 440) have all held that capacity challenges are to be solved by the court.

CHIEF JUSTICE JEFFERSON: So you look at it in terms of protection and I see that argument going to the merit of the cases that said arbitration isn't a detriment necessarily, it's just a forum; it's a different way to resolve the litigation. So, I'm not sure I understand that argument. I am curious about the "void" versus "voidable" your-- the opposition says, no, we're pretty clear in Texas that this is a voidable type issue, not void and where, where do you [inaudible] about ...

MR. FRAZIER: There are two, two cases in the footnote three of our brief that have held that contracts the court of in Nobine cases that contracts within covenance are void *ab initio* and so we have some disparity. But, I want to go back and re-emphasize that the United States Supreme Court has held, in terms of the FAA, the void versus voidable issue is immaterial and every court that has addressed mental capacity since *Spahr v. Secco* (330 F.3d 1266) and since *Buckeye* (546 U.S. 440) has held that that challenge goes to the court. Now, I know *Primerica* (304 F.3d 469) is out there and hasn't been addressed, but that's the fifth circuit case that Judge Jones wrote. That was the first case that we have found that has a, that addressed the mental capacity the assent based challenge to an FAA arbitration agreement.

They had nothing to work with. And so they, they took the *Prima Paint* (388 U.S. 395) template, placed it on the defense at hand, mental capacity, and saw that it was made to the entire contract, not just the arbitration clause, and therefore held that *Prima Paint* (388 U.S. 395) applies. It, it wasn't to the clause by it self, therefore, it goes to arbitration. But six years have passed since *Primerica* (304 F.3d 469)...

JUSTICE HECHT: They were-- it seems, it seems to me the panel was aware of the issue cause Judge Dennis wrote in his concurrence that there are all these other issues but we're not getting into that. He seemed to be worried that maybe the majority was. So at least they did seem to have had in, in mind this problem.

MR. FRAZIER: They, they may have. They were the first to apply that, and since *Primerica* (304 F.3d 469), which was in August 2002, ten months later we have *Spahr v. Secco* (330 F.3d 1266), which the court is well aware and the briefs were laid out, contains facts virtually identical to this case, and that's where the court said, "We cannot logically apply *Prima Paint* (388 U.S. 395) to a status based defense such as incapacity." So we have-- we had the *Spahr v. Secco* (330 F.3d 1266) ...

JUSTICE BRISTER: But that's-- but that's not what *Buckeye* (546 U.S. 440) says.

MR. FRAZIER: *Buckeye* (546 U.S. 440), then we have *Buckeye* (546 U.S. 440).

JUCTICE BRISTER: It just, it says, we're not telling it.

MR. FRAZIER: Well, *Buckeye* (546 U.S. 440) they set out that in a footnote that there is a distinction-- that there is a distinction ...

JUSTICE BRISTER: But they didn't say whether that distinction made any difference.

MR. FRAZIER: Well, the-- footnote two Justice Brister says, "That it is for the courts to decide whether or not a signor has the mental capacity to assent citing *Spahr v. Secco* (330 F.3d 1266).

JUSTICE: No. All they're, all they're saying is it does not speak to the issue decided by those cases.

MR. FRAZIER: Yeah.

JUSTICE BRISTER: The case, the cases hold that.

MR. FRAZIER: Yes.

JUSTICE BRISTER: But we're all waiting with bated breath to see what the Supreme Court thinks.

MR. FRAZIER: Yes. But I believe that this footnote sets out a distinction between signatory based challenges that we're making and challenges that go to the validity of an agreement. And since *Buckeye* (546 U.S. 440), we have had several other courts across the country that have addressed that, interesting in the *Spahr v. Secco* (330 F.3d 1266) case, Judge Tom really was sitting by assignment, and so now, that six years have passed, we have *Spahr v. Secco* (330 F.3d 1266), we have *Buckeye* (546 U.S. 440), we have three other courts after *Buckeye* (546 U.S. 440) holding in our favor, asserting our position. We have many commentators, I've not seen any commentators that have agreed with the *Primerica* (304 F.3d 469) challenge or the *Primerica* (304 F.3d 469) holding, but have challenged that holding and support *Spahr v. Secco* (330 F.3d 1266). And then we have CitiGroup versus Brown, which is tab six in, in the hand out. I put that in there and I'll just be up front, that court did not flatly address or decide this issue about mental incapacity, but the court did say, "Without deciding we assume that the trial court had authority to address the mental capacity defense," and goes through the evidence that the trial court considered and the Court

of Appeals addresses that. That was the 14th Court of Appeals and again it's in tab six, this, this past August. So now that we're removed six years from *Primerica* (304 F.3d 469), we may have a different decision if an *en banc* court of the fifth circuit re-convenes or convenes on this issue. But, there are two grounds ...

JUSTICE BRISTER: Following through on that, the issue of whether a client was-- had mental capacity at the time she signed would be a jury issue in court.

MR. FRAZIER: Yes.

JUSTICE BRISTER: So how's this going to work? Trial judge makes-- we have the motion compel, the trial judge says, well I think there is a fact issue so then we do a jury trial and I suppose we'll do discovery and have experts and all the things as folks and courts do, and then if the jury decides she had-- she did have capacity, then it doesn't matter that we've done all this, it all just goes to arbitration. That's not going to work very well, is it?

MR. FRAZIER: Well, but-- I think the cases contemplate, your Honor, a, a procedure where the court makes a determination about the capacity defects. But ...

JUSTICE BRISTER: But in Texas, that, that, that determination is a jury determination.

MR. FRAZIER: It, it can be, yes. But we, we have uncontroverted evidence here at, at this hearing and if the court decides that, that this Court-- that the probate court should decide the issue and sends it to the probate court to determine from the-- finally if the court determines they haven't made that finding, which I think the evidence can do-- can support that -

JUSTICE BRISTER: But, but my, my ...

MR. FRAZIER: - and the court makes that finding and then it goes to arbitration or they can decide.

JUSTICE BRISTER: My, my point is its-- it is exactly the same as the issue in the case. The merit issue in the case, that's gotta be a jury determination. It only gets to the jury if the judge decides she didn't have capacity, and if the jury decides otherwise, then all of that was a mistake and what do we do then?

MR. FRAZIER: Well, it, it-- you, you stay in a trial court because same thing can happen in the arbitration realm.

JUSTICE BRISTER: [inaudible]

MR. FRAZIER: They, they can find that there is ...

JUSTICE BRISTER: Didn't we just violate the supremacy clause if we did that? I mean this is a federal statute.

MR. FRAZIER: Yes.

JUSTICE BRISTER: - And if a jury founds she agreed to go arbitration, we can't say, well, but that's-- our procedures trump that federal law.

MR. FRAZIER: The federal cases say that the trial court, the, the FAA says, that the trial court decides this issue. And so I think to contemplate that it was a challenge to the making of the agreement that, that stays, in a trial court and arbitrators can't decide something that may not have ever existed. And I think that's part of the policy behind the FAA. I think that balances the leaning towards arbitration versus the realities.

JUSTICE BRISTER: Well, the-- I mean I see a distinction between somebody who just-- I never signed that agreement at all. But there's no question your lady signed this agreement.

MR. FRAZIER: She signed some of them, yes.

JUSTICE HECHT: Do you agree with the relator that anyone of the

signed agreements would cover all claims made in the underlying case?

MR. FRAZIER: I don't necessarily agree with that. We only have two of the agreements in, in the record. And in having read those, there are reasons why subsequent agreements were signed. So I, I don't know if some of the transactions were unique to a certain agreement and some unique to an agreement that was purportedly signed by a trustee. So, your Honor, I-- from this record, I don't know the answer to that-- if, if it would do cover everything.

JUSTICE HECHT: Is there any question that the federal statute applies?

MR. FRAZIER: No, your Honor, it in voids-- it involves securities and we believe the FAA does apply.

JUSTICE HECHT: But Taylor's competency has not been decided so far. Is that true?

MR. FRAZIER: Well, that's a good question, your Honor, and we have raised that. In fact, they have attacked that in their briefs. We knew, in response to the motion to compel, we said that she is not incompetent and we presented evidence of her incompetency. And Morgan Stanley said, well, it's irrelevant. If the court wants to consider it, then we would want an evidentiary hearing. Well, the court considered it, it was before the court, it was argued extensively and they never asked for an evidentiary hearing. Now we have argued that that evidence is sufficient to support a finding of incompetency. Now if the court, if this Court decides that, that issue wasn't ...

JUSTICE HECHT: Well was, was one made?

MR. FRAZIER: Well, that's a good-- if, if it was made it was implied. He just simply denied the motion. So there's a good argument that it was not made or it was impliedly made. But the record supports incapacity, we believe, and there was no challenge to that evidence or no contrary evidence presented at the hearing, and under Tips in, in Rijebia, it's the duty of Morgan Stanley, in this circumstance, to request an evidentiary hearing if there's a disputed fact issue as to whether or not there was an arbitration agreement.

JUSTICE WILLET: What do you make of opposing counsel's point that it's really unclear whether Section IV is anything more than procedural and whether it even applies to state courts to begin with?

MR. FRAZIER: I, I don't, I don't think it applies uniquely to the district courts. I believe it goes to if the formation, if the making is an issue, then we can't send it to arbitration, whether it's in federal court or whether it's in the state court, because it-- we don't know if there's an arbitration agreement in the first place and we certainly can't go to arbitration. So I think, your Honor, it applies in both, I don't think it's merely federal procedure, I think it says, if the making is at issue and under *Howsam* (537 U.S. 79), unless there's clear and unmistakable evidence that the parties intended, agreed, assented that there be arbitration, unless that's the case, it doesn't go to arbitration.

CHIEF JUSTICE JEFFERSON: Would you say then that a minor can't sign a contract for arbitration in which an arbitration clause exists?

MR. FRAZIER: I think just like an incompetent, it's-- they may be able to sign it but it's is-- it's not enforceable.

CHIEF JUSTICE JEFFERSON: So you can't compel arbitration in that context.

MR. FRAZIER: I believe, I believe you can't. I think again the cases are mixed about whether or not it's void *ab initio*.

CHIEF JUSTICE JEFFERSON: There's a-- I mean the issue will come up, I'm sure. There are all these, you know, employers in the grocery

companies and fast food restaurants, etc, they have arbitration agreements and a work injury benefit plan, and you would say that all of those are, are void or, or, or, or at least the, the employer can't-- cannot compel arbitration in those contexts for minors?

MR. FRAZIER: Yes. In *Spahr v. Secco* (330 F.3d 1266) and there's a *Circuit City* (477 F. Supp. 2d 230) case following *Spahr* (330 F.3d 1266), where that was the very issue, your Honor. The *Circuit City* (477 F. Supp. 2d 230) case, it was a minor who was, who was employed by Circuit City and there was an arbitration agreement and the court held that, that could not be enforced. It was a capacity consent based and it went and stayed in the trial court. That case applies here as well as *Spahr v. Secco* (330 F.3d 1266). We ask that the court rule that the tri-- the probate court did not abuse its discretion.

JUSTICE HECHT: And there's no question that the competency issue goes to the entire agreement not just the arbitration clause?

MR. FRAZIER: Yes, your Honor, 'cause I think it can only go to the entire agreement. That type of challenge, which is again the, the basis for the ruling *Spahr v. Secco* (330 F.3d 1266) and in the following cases.

CHIEF JUSTICE JEFFERSON: Any further questions? Thank you, Mr. Frazier.

MR. FRAZIER: Thank you.

REBUTTAL ARGUMENT OF THOMAS R. PHILLIPS ON BEHALF OF PETITIONER

MR. PHILLIPS: First, I think state law is pretty clear. *Neil v. Pure Oil* (101 S.W.2d 402) was a rea-- refused opinion from 1937 that says, "Contracts with mental incompetents in Texas are voidable not void." There are some cases that are cited in foot-- in Griffin's footnote three. Most of them involve minors, as does *Karger v. Sorrentino* (788 S.W.2d 189), that he just mentioned, which is why I said earlier maybe there is some difference between minors. That was a case where the minor bought a car and then tried to give it back and they said, in, in that case where there's been an attempted recession it's void *ab initio*.

Second, I dispute the notion that there's this whole amount of precedent on one side and, and nothing on the other side. *Spahr v. Secco* ()330 F.3d 1266), as you heard, turned on a distinction that when a defense cannot be parsed between the arbitration clause itself and the whole contract, then *Prima Paint* (388 U.S. 395) doesn't apply. The Supreme Court said nothing about that in *Buckeye* (546 U.S. 400). The focus now has got to be on-- has got to be on whether an agreement was concluded because that's the language in *Buckeye* (546 U.S. 400), footnote one. And I'm very glad Justice Hecht brought up Judge Dennis' concurrence in *Primerica v. Brown* (304 F.3d 469), the fifth circuit case. If you don't like Judge Jones' view that all these things should go to arbitration because these distinctions start getting pretty nebulous around the edges, if you don't buy that, then Judge Dennis relied on the fact that in Mississippi law, a contract with a mental incompetent was voidable and not void. And so he says, there has been this wit that's come around the circuits, but we don't need to deal with it here because this is a case where a contract was initially made. Actually, Judge Dennis was quite present, he, he saw what was coming in the future I think.

Now, the three cases that have come since the *Buckeye* (546 U.S. 400) case that, that are more or less on this issue are all quite distinguishable.

One, is *Foss v. Circuit City Stores* (477 F. Supp. 2d 230), which was from the federal district court of Maine. That was an infancy claim not mental incompetent under Maine law, unless there was a written ratification later, the contract never came into existence, so it was a voidable not void.

And secondly, it appears there was a separate dispute resolution agreement. It's not absolutely clear from the opinion but that's the way it reads to me. And of course, there you don't have *Primerica* (304 F.3d 469). If it's merely an arbitration agreement standing alone, the federal court or the state court does have to decide all of this.

Rhymer v. 21st Century Mortgage (2006 WL 3731937), which was the Tennessee Court of Appeals is from a-- has two differences.

One, Tennessee is one of that small minority states where a contract with an incompetent person is void and there's no doubt about it, and the *Rhymer* (2006 WL 3731937) court cited that.

Secondly, definitely there, there was a separate arbitration agreement. So [inaudible] was voidable. And *Washburn* (2006 WL 3404804) was also a separate arbitration agreement, the federal district court in Georgia.

CHIEF JUSTICE JEFFERSON: Are there any further questions? Thank you, counsel. The cause is submitted and that concludes all oral arguments for this morning. The clerk will now adjourn the court.

COURT ATTENDANT: All rise. Oyez, oyez, oyez. The honorable, the Supreme Court of Texas now stands adjourned.

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