2012 WL 933475 (Ala.Civ.App.) (Appellate Brief)
Court of Civil Appeals of Alabama.

PORTER CAPITAL CORPORATION, et al., Plaintiffs/Appellants,
v.
Dennis R. THOMAS, M.D., Defendant/Appellee.

No. 2101203.
January 10, 2012.

On Appeal from the Circuit Court of Jefferson County, Alabama CV-2009-2224

Reply Brief of Appellants Porter Capital Corporation and Porter Bridge Loan Company, Inc.

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***1 SUMMARY OF ARGUMENT**

The Circuit Court's order denying Plaintiffs' Motion to Compel Arbitration is erroneous for several reasons and must be reversed. First, the Circuit Court failed to consider the Second Arbitration Agreement - signed by the Defendant in his personal capacity -- in which he agreed to arbitrate the claims that are the subject of this proceeding. The Plaintiffs based their Motion to Compel on both the First and Second Arbitration Agreements, and the Circuit Court improperly limited its decision to only the First

Arbitration Agreement. Had the Circuit Court given the Second Arbitration Agreement proper consideration, it would have found that the Defendant did in fact agree to arbitrate the pending claims.

Second, the Circuit Court erred when it found that the Defendant was not a third party beneficiary of the First Arbitration Agreement. Although the First Arbitration Agreement was executed separately from the Commercial **Financing** Agreement, Security Agreement, Performance Covenant and Waiver, and Guaranty, each of those documents are part of the same ongoing transaction and should be read together. The Circuit Court should have considered the ***2** Defendant's representation in the Performance Covenant and Waiver that he was a direct beneficiary of the **financing** along with the First Arbitration Agreement and, in doing so, determined that the Defendant was a third party beneficiary of the entire transaction. As such, the Defendant must accept the burdens of the arbitration provision along with the benefits of the **financing**.

Finally, the Plaintiffs did not waive their right to compel arbitration of the Defendant's Amended Counterclaims. Although the Plaintiffs did initiate the breach of contract action against the Defendant, and they answered the Defendant's breach of fiduciary duty counterclaim, the scope of the case was significantly altered when the Defendant belatedly added claims based on "fraud, suppression, negligence/wantonness in publishing private **financial** information, privacy law violations, failure to act in a commercially reasonable manner and Athlon being a mere instrumentality of plaintiffs." *Appellee's Brief* at 31. Under Alabama law, the Plaintiffs' right to compel arbitration was revived because the Defendant injected issues that were materially different from those that were already pending. The Defendant also ***3** failed to demonstrate he would be prejudiced if the Motion to Compel was granted and, accordingly, the Circuit Court's order should be reversed.

*4 ARGUMENT

I. THE DEFENDANT AGREED TO ARBITRATE CLAIMS INVOLVING HIMSELF AND THE PLAINTIFFS.

Defendant argues that the Circuit Court was correct in finding that the Defendant was not a signatory to an arbitration agreement. However, as explained by the Plaintiffs in greater detail in their Initial Brief, the Circuit Court improperly failed to consider the Second Arbitration Agreement executed by the Defendant in connection with the Restated and Amended Commercial **Financing** Agreement. This agreement was signed by the Defendant in his personal capacity, and he specifically agreed to arbitrate any claims "arising out of, in connection with, or relating to" any "**past,** present, or future" transactions between Porter Capital and Athlon. See Second Arbitration Agreement at p. 1 (C. 327). The claims asserted in this proceeding are all based upon and arise from Defendant's responsibility for payment of Athlon's obligations under the Loan Agreement. Accordingly, these issues plainly fall within those matters the Defendant agreed to arbitrate.

The Defendant also argues that the Arbitration Agreements are party specific, and relate only to claims ***5** involving the Plaintiffs and Athlon. However, a review of the Second Arbitration Agreement makes clear that the Defendant is a party entitled to compel, and be required to participate in, arbitration proceedings:
Confidentiality. Borrower, ***you*** and Lender agree that the arbitration proceedings are confidential.

Claims Excluded from Arbitration. Notwithstanding the foregoing, neither Borrower, ***you*** nor Lender can require the other to arbitrate (i) foreclosure proceedings, etc.

Costs and Expenses. At your request, the Lender will advance the first $100.00 of any filing and hearing fees for any arbitration demand ***you*** may file relating to a Claim.

Interstate Commerce. ***You*** acknowledge that this, previous and future Transactions constitute interstate commerce....

(C. 328) (emphasis added).

Again, if the Circuit Court gave proper consideration to the Second Arbitration Agreement -signed by the Defendant in his individual capacity - it would have found that the Defendant did in fact agree to arbitrate the issues in this case. Indeed, to fail to acknowledge the Defendant's agreement to arbitrate would render portions of the Second Arbitration Agreement referenced above ***6** meaningless. In other words, there would be no need for the Defendant, as guarantor, to have signed the Second Arbitration Agreement unless there could be independent claims in arbitration arising between the Defendant and the Plaintiffs.

With respect to the First Arbitration Agreement, although the Circuit Court made the fining that it was party specific, the court also recognized that arbitration of Defendant's claims could still be binding under the doctrine of third party beneficiary. In its Order, the Circuit Court stated:

> Defendant not being a signatory, nor a party contemplated by the signatories as a party bound by the said agreement, the only other basis upon which a binding agreement to arbitrate may be found by the Court arises under the equitable estoppel, or intertwining of claims, or under the doctrine of third party beneficiary. Plaintiff argues the latter.

(c. 630).

So, the fact that the First Arbitration Agreement refers to claims between the *Lender and Borrower* is not fatal to the Plaintiffs' position. According to the Circuit Court, as long as the Defendant is an intended ***7** third party beneficiary of the Loan Documents, which he is, the First Arbitration Agreement is enforceable against him.

II. The Defendant is a Third Party Beneficiary of the Loan Documents

As recited in their Initial Brief, Athlon and Porter Capital entered into certain agreements in October of 2007 including the Commercial **Financing** Agreement, a Security Agreement, and the First Arbitration Agreement. At the same time, the Defendant executed two documents pursuant to which he agreed to guaranty Athlon's obligations to Porter Capital: the Performance Covenant & Waiver and a Guaranty. It was in this Performance Covenant that the Defendant represented and warranted to Porter Capital that he was receiving a direct benefit from Porter Capital's agreement to provide Athlon with the agreed **financing**. (the Commercial **Financing** Agreement, Security Agreement, First Arbitration Agreement, Performance Covenant & Waive and Guaranty shall be collectively referred to as the "Loan Documents").

In his brief, the Defendant attempts to avoid the clear implications of his representations and warranties made in the Performance Covenant and Waiver by claiming that the First Arbitration Agreement is a stand-alone agreement ***8** which should be read independently from the other documents. However, it is well-recognized by Alabama courts that contracts executed as part of a continuing transaction should be read together and construed as if in one form. *Dan Wachtel Ford, Lincoln, Mercury, Inc. v. Modas,* 891 So. 2d 287, 290 (Ala. 2004); *ANCO TV Cable Co. v. Vista Communications Ltd. P'ship,* 631 So. 2d 860 (Ala. 1993); *Pacific Enters. Oil Co. (USA) v. Howell Petroleum Corp.,* 614 So. 2d 409 (Ala. 1993). This rule contains no exceptions for stand-alone arbitration agreements. *See Dan Wachtel Ford,* 891 So. 2d at 291 (ruling that a retail buyer's order, retail installment contract, delivery receipt, and stand-alone arbitration agreement executed in connection with the purchase of a vehicle constituted one agreement between the parties).

Fountain v. Ingram, 926 So. 2d 333 (Ala. 2005), relied upon by the Defendant and cited by the Circuit Court, is distinguishable on its facts. In *Fountain,* Defendant Ingram purchased a mobile home from Plaintiff Fountain, d/b/a Pioneer Sales ("Pioneer"). The parties executed an installment contract requiring Ingram to make certain payments for the purchase of the mobile home. *Id.* at 334. ***9** Ingram also signed a separate document giving Pioneer the right to repossess the mobile home if the account was more than 2 months and 3 weeks past due. *Id.* Neither of the documents contained an arbitration agreement.

At the same time, Ingram entered into a loan agreement with the Bank of Brewton (the "Bank") which included a stand-alone arbitration agreement pursuant to which Ingram and the Bank agreed to arbitrate disputes arising out of or relating to the "Loan Agreements". *Id.* at 334-35.

Pioneer later assigned the installment contract to the Bank. *Id.* at 335.

On May 5, 2004, Ingram sued Pioneer alleging that it illegally repossessed her home. *Id.* Pioneer then moved to compel arbitration based on the stand-alone agreement between Ingram and the Bank. *Id.* In denying Pioneer's motion, the court determined that Ingram and the Bank had limited the scope of the arbitration agreement to disputes only among themselves. Ingram's agreement with Pioneer did not contain an arbitration agreement, and none of the documents indicated that Pioneer was a third-party beneficiary of the loan agreement between Ingram and the Bank. *Id.* at 337-38.

***10** The Supreme Court distinguished the facts in Fountain from those in another case involving the sale of a mobile home, In re Stamey, 776 So. 2d 85 (Ala. 2000). In Stamey, the loan documents specifically referred to the mobile home sellers as the recipient of the borrowed funds, thereby making him an intended third-party beneficiary of the contract. Comparing Fountain and Stamey, this case is actually more analogous to Stamey because the Defendant is named as an intended third-party beneficiary of the Loan Documents. This fact is a critical distinction from Fountain that renders Fountain unpersuasive. Instead, when the Loan Documents are properly considered as a single form, Stamey and the other cases cited by the Plaintiffs in their Initial Brief all support a findings that the Defendant is subject to the First Arbitration Agreement under the third party beneficiary doctrine

III. The Plaintiffs' Right to Demand Arbitration was Revived When Defendant Amended His Counterclaim to Include Claims Which Were Materially Different from the Pending Litigation

According to the Alabama Supreme Court, a litigant's waiver of the right to compel arbitration can be revoked when the course of the litigation necessitates such a finding. In re Hood, 712 So. 2d 341, 344 (Ala. 1998); ***11** *Companion Life Ins. Co. v. Whitesell Mfg., Inc.*, 670 So. 2d 897 (Ala. 1995).

In his brief, the Defendant argues that Hood and other cases cited by the Plaintiff should not apply because the Plaintiff did not assert its right to compel arbitration until approximately 20 months after the lawsuit was initiated. The Defendant also asserts that the Plaintiffs actively participated in the litigation process by filing motions objecting to Defendant's jury demands and participating in discovery. The Defendant ignores the fact that he did not file his Amended Counterclaims, which injected an additional six counts' worth of new issues into the litigation, until the matter had been pending for nearly 18 months. After being served with the Amended Counterclaims, the Plaintiffs did not file an answer, continue to engage in the litigation process or proceed with discovery. Rather, the Plaintiffs' initial response to the additional claims was to file their Motion to Compel Arbitration.

The Defendant would like this Court to believe that the Plaintiffs should have anticipated the filing of the Amended Counterclaims and, therefore, the Plaintiffs were ***12** required to assert their right to compel arbitration sooner. However, courts have recognized that the earliest point in time in which a right to compel arbitration can be waived is ordinarily the filing of an answer. In re Hood, 712 So. 2d at 346; *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 494 So. 2d 1, 3 (Ala. 1986). So, until the Defendant actually filed his Amended Counterclaims which required the filing of an answer, the Plaintiffs were not in a position to know what claims, if any, would be filed. Once those counterclaims were in fact filed, and the Plaintiffs could assess the impact they had on the pending litigation, the Plaintiffs timely responded by asserting their right to compel arbitration.

Recently, in *Krinsk v. Suntrust Banks, Inc.*, 654 F.3d 1194 (11th Cir. 2011), the Eleventh Circuit Court of Appeals was faced with a similar issue. In that case, Plaintiff Krinsk initiated a class action lawsuit against SunTrust Bank ("SunTrust") and others for improperly suspending home-equity lines of credit. The original complaint contained seven counts ranging from breach of contract to ***13** **financial** **elder** **abuse** [1], and defined the proposed class of plaintiffs as follows:

all Florida permanent or part-time residents that entered into an agreement with SunTrust... and who, after attaining the age of sixty-five (65), received a letter from SunTrust between July 1, 2008 and October 16, 2008, requesting updated **financial** information . and who were subsequently informed their collateralized credit line had been suspended or reduced during the draw period for purportedly failing to provide the information requested by SunTrust.

Id. at 1198.

In a later motion for class certification, Krinsk estimated that this defined class would consist of hundreds of members throughout Florida. *Id.*

SunTrust filed a motion to dismiss Krinsk's complaint, and it made no mention of the arbitration clause found in Krinsk's loan agreement. The motion to dismiss remained pending for over six months during which time the litigation proceeded. Specifically, the parties filed a Case Management Report in which SunTrust expressly stated that it opposed arbitrating the claims contained in the ***14** Original Complaint. Id. SunTrust further set forth its discovery plan covering interrogatories, requests for admissions, production requests, expert witness disclosures, depositions, and the handling of confidential information. *Id.* at 1198, fn. 6. The parties agreed on deadlines for discovery and the filing of dispositive motions, and they agreed on dates for the pretrial conference and trial.

Moreover, SunTrust "levied a vigorous defense against and opposition to class certification and class discovery." Id. at 1198. The Eleventh Circuit noted that, "[t]hroughout this time, SunTrust did not assert its right to compel arbitration under the Loan Agreement or otherwise indicate its intent to do so." Id.

On January 8, 2010, the district court finally ruled on SunTrust's motion to dismiss, granting it in part. All claims were dismissed as to SunTrust's corporate parent, SunTrust Banks, Inc., and Chief Executive Officer James M. Wells III, and Krinsk was given twenty days to amend the Original Complaint. Thereafter, Krinsk filed an amended complaint (the "Amended Complaint") which asserted "revised, but mostly similar, claims" only as against ***15** SunTrust. *Id.* at 1199. Krinsk also amended the definition of the proposed class to include "Florida residents of any age whose HELOCs SunTrust had suspended for any reason during a three-year class period." *Id.* at 1199. This new definition significantly enlarged the size of the potential plaintiff class. Whereas the Original Complaint was estimated to include hundreds of plaintiffs in the potential class, the plaintiff class for the Amended Complaint was estimated to be in the thousands. *Id.*

SunTrust answered the Amended Complaint, and included a demand for arbitration in its affirmative defenses. SunTrust also filed a motion to compel arbitration and to stay the proceeding pending arbitration. *Id.* Krinsk objected on the basis that SunTrust had waived its right to compel arbitration by previously participating in the litigation process with respect to the Original Complaint.

The district court denied SunTrust's motion to compel arbitration on the basis that SunTrust had invoked the judicial process for a period of nine months without any indication that it was considering arbitration. In particular, the district court focused on SunTrust's express opposition to arbitration in the Case Management ***16** Report and SunTrust's "significant motions practice in opposition to Krinsk's request for class certification and class discovery." *Id.* at 1201. The district court also decided that Krinsk would have been prejudiced if arbitration was compelled and, in so doing, stated that the filing of the Amended Complaint was immaterial to its assessment because the claims raised in both complaints were based on the same operative facts. *Id.*

On appeal, SunTrust argued that the Amended Complaint revived its right to compel arbitration because the new class definition greatly broadened the scope of the litigation. As a result, the amendments to the Original Complaint were not "immaterial". *Id.* at 1203.

Agreeing with SunTrust, the Eleventh Circuit found that the "vast augmentation of the putative class so altered the shape of the litigation that, despite its prior invocations of the judicial process, SunTrust should have been allowed to rescind its waiver of its right to arbitration." Id. at 1204. The court further explained that "SunTrust proceeded in court on the expectation that, if the class action were certified, it would defend itself against only the relatively small plaintiff class defined in the Original ***17** Complaint. SunTrust could not have foreseen that Krinsk would expend the putative class in such a broad way nine months into the litigation." Id. This was an unforeseen alteration in the shape of the case, and SunTrust should have been allowed to rescind its earlier arbitration waiver. Id.

Likewise, in this case the Plaintiffs proceeded with the litigation on the understanding that they were prosecuting their claim for breach of contract and defending Defendant's counterclaim for breach of fiduciary duty. Then, nearly 18 months into the case, the Defendant altered the shape of the case by filing claims that the Circuit Court determined were "materially different" than what was already pending. [C. 317]. Instead of defending one counterclaim for breach of fiduciary duty, the Plaintiffs found themselves defending claims for "fraud, suppression, negligence/wantonness in publishing private **financial** information, privacy law violations, failure to act in a commercially reasonable manner and Athlon being a mere instrumentality of plaintiffs." Appellee's Brief at 31.

***18** These materially different claims greatly broadened the scope of the litigation and the Plaintiffs' perceived risk of an adverse judgment. At that time, and in plain fairness, the Plaintiffs should have been allowed to rescind their earlier waiver. *See Krinsk,* 654 F.3d at 1204.

Moreover, even if this Court determines that the Plaintiffs sufficiently invoked the litigation process to constitute a waiver, the Court must allow arbitration to proceed if the Defendant will not be substantially prejudiced. *See Jericho Mgt., Inc. v. Fidelity Nat'l Title Ins. Co. of TN,* 811 So. 2d 514 (Ala. 2001) (finding that insurer had not waived its right to compel arbitration by waiting 19 months to file motion). "Alabama caselaw shows that a party alleging prejudice is unlikely to prevail without presenting supporting evidence." *Aurora Healthcare, Inc. v. Ramsey,* 2011 WL 5009781 (Ala. Oct. 21, 2011).

Here, no evidence was presented to the Circuit Court upon which it could determine whether the Defendant would be prejudiced by arbitration. Moreover, the Defendant has only recently filed his Amended Counterclaims, and the ***19** Defendant agreed to arbitration as a forum for the type of claims asserted therein. There is simply no basis on the current record to suggest that the Defendant would be prejudiced by arbitration.

CONCLUSION

Contrary to the finding of the Circuit Court, the Defendant did personally sign the Second Arbitration Agreement pursuant to which he agreed to arbitrate the pending claims, and he was a direct third party beneficiary of the Loan Documents including the First Arbitration Agreement. Plaintiffs therefore respectfully request that the Circuit Court's Order be reversed, and the matter be remanded with instructions to stay further litigation pending arbitration of the parties' claims.

Footnotes

1 The Original Complaint stated claims for: (1) **financial** **elder** **abuse** under Florida's Adult Protective Services Act; (2) breach of contract; (3) deceit; (4) negligent misrepresentation; (5) breach of fiduciary duty; (6) violation of Regulation Z of the Truth in Lending Act; and (7) breach of implied covenant of good faith and fair dealing.

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