IN THE SUPREME COURT OF TEXAS

NO. 01-0774

J. M. DAVIDSON, INC.

v.

CHELSEY J. WEBSTER

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE THIRTEENTH DISTRICT OF TEXAS

Argued on December 11, 2002

Justice Schneider, joined by Justice O'Neill, dissenting.

I respectfully dissent. The controversy in this case involves a company's arbitration policy that an employee agreed to sign after beginning his employment. When the company sought to enforce the arbitration policy, the trial court denied the motion to compel arbitration. A divided court of appeals affirmed the trial court's order. The Court says that the wording in the arbitration policy is ambiguous and that the case should be sent back to the trial court to hear evidence concerning the parties' intent. But I would not be as hasty as the Court to send this matter back to the trial court because I cannot imagine what such a hearing would look like. I would, in the first instance, hold that the policy provisions are not ambiguous. Then, in the second instance, I would hold the employee is entitled to complete relief in this Court. The arbitration promise made by the company is illusory, and because it is, I would affirm the court of appeals' judgment denying the motion to compel arbitration.

FACTS

Chelsey Webster ("Webster") went to work for J.M. Davidson, Inc. ("Davidson"). A few days after beginning employment, Webster signed the agreement that is at the heart of the controversy in this matter. The document, prepared by Davidson, is titled "Alternative Dispute Resolution Policy" ("ADR Policy").[1] It is undisputed that Webster was employed by Davidson at the time he signed the agreement.

Approximately eleven months after commencing his employment, Webster was injured on the job. Webster filed for workers' compensation benefits. Then, about one month later, Davidson terminated Webster. Webster filed suit, alleging Davidson fired him in retaliation for filing a workers' compensation claim. Davidson sought to enforce the arbitration clause contained in the ADR Policy that Webster had signed.

A hearing on Davidson's Motion to Compel Arbitration was held before the trial court. During the hearing, Davidson introduced a copy of the arbitration policy signed by Webster. Davidson never signed the agreement. But, Webster has never complained about the absence of Davidson's signature.

Davidson had the initial burden of proof to establish the arbitration agreement's existence and to show that the claims asserted against it fell within the arbitration agreement's scope. *See Williams Indus. Inc. v. Earth Dev. Sys. Corp.*, 110 S.W.3d 131, 134 (Tex. App.–Houston [1st

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[1] The ADR Policy Webster signed contained only two paragraphs. The first paragraph had two sentences covering thirteen lines, and the second paragraph had thirteen sentences and nineteen lines, for a total of fifteen sentences spanning twenty-seven lines of text. Arbitration is only discussed in two of the fifteen sentences. The body of the document occupied approximately half of a letter size page. The ADR Policy has the company name, J.M. Davidson, Inc., at the top of the page in an all capitals, bold face font similar to a company letterhead. The title of the agreement, also in all capital, bold letters, is "**ALTERNATIVE DISPUTE RESOLUTION POLICY.**" The sub-title of the document is "EMPLOYMENT APPLICATION LANGUAGE," styled in all capitals under the title.

Dist.] 2003, no pet.). If Davidson had met its burden of proof, then the burden would have shifted to Webster to show why the arbitration agreement did not apply. *Id.* At the Motion to Compel Arbitration hearing, the trial court properly considered the pleadings of the parties, the motion to compel arbitration, and responses. *See Jack B. Anglin Co. Inc. v. Tipps*, 842 S.W.2d 266, 269 (Tex. 1992) ("the trial court may summarily decide whether to compel arbitration on the basis of affidavits, pleadings, discovery, and stipulations."). But, the trial court heard no live testimony about the ADR Policy. *Cf. id.* (noting that "if the material facts necessary to determine the issue are controverted, "the trial court must conduct an evidentiary hearing to determine the disputed material facts").

After considering the evidence, the trial court denied the motion to compel arbitration without stating a reason for the denial. The record must be construed in a light favorable to supporting the judgment. *See Keller v. Nevel,* 699 S.W.2d 211, 212 (Tex. 1985). Davidson appealed, and the court of appeals affirmed the trial court.

ANALYSIS

In deciding the motion to compel arbitration, the trial court should have considered two issues: 1) was there a valid arbitration agreement; and 2) if so, did the agreement encompass the claim? *See In re Oakwood Mobile Homes, Inc.*, 987 S.W.2d 571, 573 (Tex. 1999); *Dallas Cardiology Assocs., P.A. v. Mallick*, 978 S.W.2d 209, 212 (Tex. App.–Texarkana 1998, pet. denied); *Dalton Contractors, Inc. v. Bryan Autumn Woods, Ltd.*, 60 S.W.3d 351, 353 (Tex. App.–Houston [1st Dist.] 2001, no pet.). The first of these issues is the subject of this appeal;

thus, we must decide if the trial court was correct in concluding there was no valid arbitration agreement.

A. Standard of Review

We review a trial court's decision to deny a motion to compel arbitration under a legal sufficiency or "no evidence" standard of review when factual findings are in dispute. *See Certain Underwriters v. Celebrity Inc.*, 950 S.W.2d 375, 377 (Tex. App.–Tyler 1996, writ dism'd w.o.j.). However, in this case, the only issue before us is the trial court's legal interpretation of the arbitration clause; no findings of fact were made. Thus, *de novo* review is appropriate. *Id.*; *see also Nationwide of Bryan, Inc. v. Dyer*, 969 S.W.2d 518, 520 (Tex. App.–Austin 1998, no pet.); *Dalton Contractors, Inc.*, 60 S.W.3d at 353.

B. Construction of the ADR Policy

Under the guise of a *de novo* review of the trial court's legal interpretation of the agreement, the Court may not create an agreement for the parties that is different from the one they entered. But, the Court attempts to do just that. The ADR Policy expressly reserves Davidson's right to "unilaterally abolish or modify any personnel policy without prior notice." The Court raises ambiguity as an issue *sua sponte* and concludes that this unilateral termination provision in the ADR Policy is ambiguous because "it is not possible to determine from the document itself whether the unilateral termination right applies to the parties' agreement to arbitrate, or only to 'personnel policies' concerning the at-will employment relationship." But neither Webster, Davidson, the trial court, nor the Court of Appeals have suggested the language quoted above is ambiguous. I would hold that this language regarding the unilateral termination

right unambiguously applies to the entire agreement, including the agreement to arbitrate. Although ultimately the contract fails for lack of consideration (see discussion below), it cannot be said that the ADR Policy is ambiguous.

1. The ADR Policy is not ambiguous.

There are several reasons why the document can be unambiguously read so that the universal termination right language applies to the entire document. First, the document is entitled "Alternative Dispute Resolution Policy," which suggests that the unilateral termination right contained within it would apply to arbitration, as the title would be applicable to the entire document. *See e.g. Neece v. A.A.A. Realty Co.*, 322 S.W.2d 597, 606 (Tex. 1959) (Calvert, J., dissenting) (recognizing that the title of an agreement can have the legal effect of importing words into the contract).

Secondly, the unilateral termination right applies to "any personnel policy," and it is reasonable to conclude that an arbitration policy would fall under the category of a personnel policy. Arbitration agreements are often a part of employee manuals or personnel policies. *See e.g., In re Tenet Healthcare Ltd.*, 84 S.W.3d 760, 763 (Tex. App.–Houston [1st Dist.] 2002, orig. proceeding) (analyzing a legally binding arbitration agreement appearing in an employee handbook containing personnel policies). Moreover, the ADR Policy was provided by an employer to be signed by an employee, suggesting it is a personnel policy. It is not only reasonable to believe the arbitration provision is a personnel policy of the company, it is unreasonable to reach any other conclusion. The Court seems to suggest that the "personnel

policy" must be one or the other–either a policy, or an agreement. Surely a reasonable interpretation is that it could be both.

Webster even promises to abide by all of Davidson's "policies" in the ADR Policy, and it is reasonable to conclude that Davidson wanted to retain the right to unilaterally terminate all parts of the ADR Policy because the policy did not specifically exempt the arbitration agreement from the unilateral termination right.

Finally, neither Davidson nor Webster have ever argued that the unilateral termination right did not apply to the arbitration agreement. The actions of both the parties throughout their litigation reflect the belief that the arbitration policy is a personnel policy. They both came to the Motion to Compel Arbitration hearing arguing about several issues, none of which ever raised the question of whether the arbitration policy was a personnel policy. All of their actions throughout the litigation are consistent with the notion that the right to unilaterally terminate applied to the arbitration policy.

Webster and Davidson do offer different interpretations of the unilateral termination clause. But their differences have nothing to do with factual issues; rather, they differ in the legal significance of the arbitration policy. Nevertheless, the fact that their explanations differ does not render the contract ambiguous. *See Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd.*, 940 S.W.2d 587, 589 (Tex. 1996) (noting that an ambiguity does not arise simply because parties offer conflicting interpretations of the contract). For an ambiguity to exist, both explanations must be *reasonable*. *Id*. Conversely, a contract is ambiguous if its language is subject to two or more reasonable interpretations. *See Monsanto v. Boustany*, 73 S.W.3d 225,

229 (Tex. 2002). Here, there is only one reasonable interpretation of the ADR Policy, and the Court's insistence that it is ambiguous flies in the face of well-established rules of construction.

2. Finding the ADR Policy ambiguous is contrary to well-established rules of construction.

One of the basic tenets of contract interpretation is the assumption that the parties intend every part of an agreement to mean something. When construing a written contract, we are to ascertain the intent of the parties as expressed in the instrument. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. CBI Indus. Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *718 Assocs., Ltd. v. Sunwest N.O.P., Inc.*, 1 S.W.3d 355, 360 (Tex. App.–Waco 1999, pet. denied) (courts will enforce an "unambiguous instrument as written, and ordinarily, the writing alone will be deemed to express the parties intentions"). Contracts are to be read as a whole, and an interpretation that gives effect to every part of the agreement is favored so that no provision is rendered meaningless or as surplusage. *See Westwind Exploration Inc. v. Homestate Savings Ass'n.*, 696 S.W.2d 378, 382 (Tex. 1985).

The Court ignores these well-settled principles of contract interpretation when it concludes the agreement is ambiguous. Davidson's right to unilaterally abolish or modify *any* personnel policy without prior notice must be given its plain and ordinary meaning. Thus, the unilateral termination language must mean that Davidson can cancel or alter any personnel policy without informing Webster. Although I ultimately conclude that the ADR Policy is not binding because it is illusory, the agreement is not ambiguous.

C. The ADR Policy is unenforceable because it is illusory.

In my view, the unilateral termination right in the ADR Policy makes Davidson's performance optional as to the entire policy, and thus, renders the ADR Policy illusory. Thus, I would find that the agreement between Davidson and Webster fails to rise to the level of a contract as it lacks consideration.

1. The ADR Policy does not contain consideration.

Consideration is an essential element for a valid, enforceable contract. *Federal Sign v. Texas S. Univ.*, 951 S.W.2d 401, 408-09 (Tex. 1997). If mutual, reciprocal promises are binding on both parties, they may constitute consideration for a contract. *Texas Gas Util. Co. v. Barrett*, 460 S.W.2d 409, 412 (Tex. 1970); *Johnson v. Breckenridge-Stephens Title Co.*, 257 S.W. 223, 225 (Tex. Com. App. 1924).

But, if the terms of a promise make performance optional, the promise is illusory and cannot constitute valid consideration. *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 645 (Tex. 1994) ("When illusory promises are all that support a purported bilateral contract, there is no contract."); RESTATEMENT (SECOND) OF CONTRACTS §§ 2 cmt. e; 77 cmt. a. Valid consideration exists if a party reserves the right to terminate an agreement with notice. *See* RESTATEMENT (SECOND) OF CONTRACTS § 77 cmt. b, illus. 5. But, a termination clause that allows a party to terminate the contract at will makes performance optional, and thus, makes any promise illusory. *See Light*, 883 S.W.2d at 645; *see also, Tenet Healthcare Ltd. v. Cooper*, 960 S.W.2d 386, 388-89 (Tex. App.–Houston [14th Dist.] 1998, pet. dism'd w.o.j.).

Here, the ADR Policy reserves Davidson's right to "unilaterally abolish or modify any personnel policy without prior notice." Under the plain language of the contract, Davidson

reserved the right to abolish or modify *any* personnel policy. As explained above, the unilateral termination right would also apply to the agreement to arbitrate all claims. By retaining the right to terminate the ADR Policy at any time, Davidson can avoid arbitration. Thus, Davidson is not bound to its promise to arbitrate, and its promise to avoid litigation does not amount to consideration. *See In re Halliburton*, 80 S.W.3d 566, 570 (Tex. 2002) (reciprocal promises are not sufficient if one party can avoid its promise). Because there is no consideration for the ADR Policy, the agreement is illusory and unenforceable.

2. Davidson's attempts to create consideration fail.

In an attempt to create consideration where none exists, Davidson claims that the language regarding the unilateral termination right complied with contractual mutuality requirements because, "If...Davidson changed the ADR policy, or abolished it altogether, the changes would have applied to both parties." However, because Davidson alone had the unilateral right to terminate or change the agreement, the agreement is illusory. It is irrelevant that any changes made by Davidson would apply to both parties.

Davidson also argues that the promise to arbitrate is not illusory because, under *Halliburton*, 80 S.W.3d at 570, it is bound to resolve any dispute according to the ADR plan in effect at the time the dispute arises. However, the express contract terms we relied on to find the *Halliburton* agreement enforceable are missing here. The plain language of the Halliburton ADR plan required the employer to provide notice before enacting any modifications or terminating the plan. Davidson suggests that because the agreement we upheld in *Halliburton*

required notice and prospective application, the same protective language can be implied here. I disagree.

In *Halliburton*, we relied on the ADR policy's notice provisions to conclude that Halliburton could not "avoid its promise to arbitrate by amending the [policy] or terminating it altogether." *Halliburton*, 80 S.W.3d at 570. Here, we cannot imply the obligations that precluded Halliburton from avoiding its promise to arbitrate. The agreement's plain language establishes Davidson's unhindered right to modify or terminate the agreement without notice. It is not proper to imply terms that contradict the express contract language. *See Haws & Garret Gen. Contractors, Inc. v. Gorbett Bros. Welding Co.*, 480 S.W.2d 607, 609-610(Tex. 1972) (the terms of an implied contract are inferred from the circumstances).

Davidson further attempts to explain the unilateral termination language as simply acknowledging an employer's right to make changes to at-will employment terms, as in *Hathaway v. Gen. Mills, Inc.*, 711 S.W.2d 227, 229 (Tex. 1986). But, the arbitration agreement's language contradicts Davidson's explanation.

In *Hathaway*, we held that an employer may enforce changes to an at-will employment contract if the employer unequivocally provides notice of a definite change and the employee accepts the change by continuing employment. *Hathaway*, 711 S.W.2d at 229. Here, the contract expressly allows Davidson to effect a change in the ADR plan's terms without notice. Thus, it is inconsistent to explain the reservation language as merely restating our holding in *Hathaway*, because the arbitration agreement's terms contradict the *Hathaway* requirements.

Additionally, whether an employer has satisfied the *Hathaway* requirements is a separate inquiry from the determination of whether the arbitration agreement is enforceable under traditional contract principles. If an employer seeks to change the terms of an employment relationship by implementing an agreement to arbitrate all disputes, the employer must show the arbitration agreement, standing alone, satisfies all requisite elements of a valid contract. *See Light*, 883 S.W.2d at 645-46; *Halliburton*, 80 S.W.3d at 569. This showing is separate from the employer's duty to meet the *Hathaway* requirements of notice and acceptance. *Id*.

Davidson's attempts to create consideration *via* an alternate reading of the language of the agreement are not reasonable. When the meaning of an agreement is plain and unambiguous, a party's construction is immaterial. *718 Associates, Ltd.*, 1 S.W.3d at 360. I would find the contract unenforceable because it fails for lack of consideration and is illusory.

3. The Court incorrectly concludes that the unilateral termination right is ambiguous.

The Court sends this case back for the trial court to consider parol evidence, finding that a fact issue exists concerning the applicability of the language in question to the arbitration agreement. But, as discussed above, the language unambiguously gives Davidson the right to unilaterally terminate any part of the agreement. Thus, there is no fact issue to be determined by the trial court and there is no need for parole evidence to be taken.

4. The unilateral termination right does not only apply prospectively.

Although I agree with Justice Smith that the contract is unambiguous and the arbitration agreement is a personnel policy subject to Davidson's unilateral termination right, I cannot agree that the right to abolish or modify personnel policies only applies prospectively with

contemporaneous notice. The ADR Policy allows Davidson to unilaterally abolish or modify any personnel policy "without prior notice." Justice Smith looks to England to determine how to interpret the phrase "without prior notice."

However, applicable precedent can be found closer to home. For example, in *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890 (Tex. 1991), we held that the language "without prior notice" waived the right to all notice. 801 S.W.2d at 893-94. Similarly, in *Musgrave v. HCA Mideast, Ltd.*, 856 F.2d 690 (4th Cir. 1988), the court interpreted a contract providing that the employer had the right to terminate an employee's service "without prior notice." The Fourth Circuit concluded that this language "states simply that [the employee] could be terminated during the probation period without notice." 856 F.2d at 694. Justice Smith's interpretation that "without prior notice" means "with contemporaneous notice" is not supported–and indeed, is contradicted–by caselaw from American jurisdictions.

Justice Smith is essentially inserting a qualifying phrase into Davidson's unilateral, unqualified right to terminate. Even though the ADR Policy permits Davidson to "unilaterally abolish or modify any personnel policy without prior notice," Justice Smith interprets this as requiring contemporaneous notice. The agreement contains no such limitation.

Justice Smith also attempts to distinguish our holding in *Hathaway* by noting that in that case, while we required an employer making a change to an at-will employment policy to provide notice, we did not specify that the notice had to be given before the change was made. Justice Smith contends that under our decision in *Hathaway*, notice could be "either in advance of or contemporaneous with the policy change." However, Justice Smith misunderstands our

holding in *Hathaway*. In *Hathaway*, we explained the employee must have knowledge of the employer's proposed modification to an at-will employment policy to constitute effective notice; that is, the employee must "know the nature of the changes and the certainty of their imposition." *Hathaway*, 711 S.W.2d at 229. Requiring the employer to prove unequivocal notification of changes to the employment terms was based, in part, on fairness to the employee. *See id.* The requirement that an employee be aware that changes to the employment policy are certain to be imposed implies that there must be prior notice. It is unreasonable to conclude contemporaneous notice of a policy change is permissible under *Hathaway*. Indeed, permitting an employer to give contemporaneous notice of changed employment terms undermines *Hathaway's* concerns for fairness to an employee and stretches our holding in *Hathaway* too far.

Moreover, Justice Smith confuses the *Hathaway* requirements for changes to an at-will employment agreement with the requirements for a valid, enforceable arbitration agreement. They are two separate inquiries. Even assuming Justice Smith is correct that Davidson may give contemporaneous notice of a change to the terms of Webster's employment terms under *Hathaway*, the arbitration clause of the ADR Policy remains illusory and unenforceable. If contemporaneous notice to cancel the arbitration agreement is permissible, Davidson retains the right to discontinue performance at any time. Under this scenario, there is no consideration, as Davidson is not giving up a benefit or suffering a detriment. *See e.g., In re C&H News Co.*, No. 13-02-529-CV, 2003 WL 131770 at *4 (Tex. App.–Corpus Christi 2003, orig. proceeding). Thus, the arbitration clause would still be illusory and unenforceable.

D. Enforceable arbitration agreements must bind both the employer and the employee.

There is no mystery to drafting an enforceable arbitration agreement. Capable counsel know that limitations on an employer's right to terminate the agreement are necessary so the agreement is not illusory. *See, e.g., In re Tenet Healthcare, Ltd.*, 84 S.W.3d at 766-67 (arbitration provision was enforceable because the right to terminate the agreement specifically excepted the arbitration agreement); *In re Kellogg Brown & Root*, 80 S.W.3d 611, 616 (Tex. App.–Houston [1st Dist.] 2002, orig. proceeding) (arbitration agreement enforceable because it provided that it could be amended or terminated by the company by giving at least 10 days notice to employees and that such amendment would not apply to a dispute that had been initiated); *In re Jebbia*, 26 S.W.3d 753, 758 (Tex. App.–Houston [14th Dist.] 2000, orig. proceeding).

In this agreement, however, there was no limitation to Davidson's right to terminate, amend, or cancel the agreement. The only consideration for the agreement was continued at-will employment, which amounts to no consideration. *Light*, 883 S.W.3d at 644. Thus, the arbitration agreement is illusory and unenforceable.

CONCLUSION

I disagree with the Court's determination that the arbitration agreement is ambiguous. I also believe the agreement is illusory. In *Halliburton*, we said that an arbitration agreement's terms must bind both the employer and employee if the agreement relies on mutual promises to arbitrate for consideration. Davidson's ADR Policy lacks the protections we relied on in *Halliburton* to find the promises to arbitrate mutually binding. The unilateral right to modify or terminate the agreement without notice allows Davidson to avoid its promise at any time.

Accordingly, I would hold that the arbitration agreement between Davidson and Webster fails to bind Davidson, and thus, the promise is illusory and the agreement is unenforceable for want of consideration. I would affirm the court of appeals' judgment.

MICHAEL H. SCHNEIDER
JUSTICE

OPINION DELIVERED: December 31, 2003