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COMMONWEALTH OF KENTUCKY
SUPREME COURT
2006-SC-830-DR

AMERICAN GENERAL HOME EQUITY, INC.

MOVANT

VS.

AMICUS CURIAE BRIEF FOR THE
KENTUCKY JUSTICE ASSOCIATION

TERESA R. KESTEL

RESPONDENT

GIVHAN & SPAINHOUR, PSC

By


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I certify a copy of the within brief has been mailed this 2nd day of May, 2007 to Hon. Katherine K. Yunker, Hon. Benjamin D. Allen, Yunker & Associates, P.O. Box 21784, Lexington, KY 40522-1784, Attorney for Respondent, Teresa Kestel; Hon. Matthew W. Breetz, Hon. Bethany A. Breetz, Stites & Harbison, PLLC, 400 West Market Street, Suite 1800, Louisville, KY 40202, Attorneys for Movant; and Hon. Darren Peckler, Judge, Mercer Circuit Court, 238 Courthouse, 221 West Main Street, Danville, KY 40422.


John E. Spainhour

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Kentucky Justice Association

May it please the court:

INTRODUCTION

The Kentucky Justice Association appears as *Amicus Curiae* in support of the Respondent, Teresa R. Kestel. It urges this court to affirm the opinion of the Kentucky Court of Appeals insofar as it holds Movant has waived its right to enforce mandatory pre-dispute binding arbitration. It urges this Court to reverse so much of the opinion of the Court of Appeals as holds Respondent to the terms of mandatory arbitration on the foreclosure of a note she did not execute.

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**THE FEDERAL ARBITRATION ACT APPLIES TO THIS CLAIM,
BUT DOES NOT PRE-EMPT STATE CONTRACT LAW** 1

Federal Arbitration Act (“FAA”), 9.U.S.C. §1, *et seq.* 1

Allied-Bruce Terminix Companies v. Dobson, 513 U.S. 265,
115 S.Ct.834, 130 L. Ed. 2d 753 (1995). 2

Dean Witter Reynolds, Inc. V. Byrd, 470 U.S. 213, 219,
105 S. Ct. 1238, 1242, 04 L. Ed. 2d 158 (1985) 2

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**STATE CONTRACT LAW PRECLUDES A FINDING THAT THE
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Oakwood Mobile Homes, Inc. V. Sprowls, 82 S.W.3d 193 (Ky. 2002) 2

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Conseco Finance Servicing Corp. V. Wilder 47 S.W.3d 335 (Ky. App. 2001) 3, 4

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COUNTERSTATEMENT OF THE CASE

American General (hereafter "Bank") seeks to invoke the provisions of a later executed note that contains mandatory pre-dispute binding arbitration provisions ("the November note"), in order to impose arbitration on the foreclosure of an earlier note not signed by Ms. Kestel ("the October note").¹

The Bank sued on the October note to foreclose its mortgage lien securing the October note in the Mercer Circuit Court. Only after Ms. Kestel counterclaimed for truth in lending violations and fraud, did the Bank assert as an affirmative defense its position that Ms. Kestel's counterclaim was subject to mandatory arbitration. The Bank then responded to Ms. Kestel's motion to strike those defenses, filing a memorandum in opposition. The Mercer Circuit Court ultimately struck the arbitration defense on August 19, 2004. Ms. Kestel then filed a motion for summary judgment, resisted by the Bank. It was not until Ms. Kestel filed discovery requests that the Bank brought its motion to compel arbitration, denied by the Mercer Circuit Court and affirmed by the Court of Appeals.

Kentucky Justice Association asserts that either the contractual basis to deny arbitration, or the waiver of the right to arbitration are appropriate resolutions. As below argued, either ground is an appropriate basis for the result obtained.

ARGUMENT

I. The Federal Arbitration Act applies to this claim, but does not pre-empt state contract law.

As much as Kentucky Justice Association wishes it were not the case, it does appear that the provisions of the Federal Arbitration Act ("FAA"), 9.U.S.C. §1, *et seq.*, will apply to virtually all

¹The rescission of the October Note by John Kestel appears to be a factually disputed issue.

consumer transactions, *Allied-Bruce Terminix Companies v. Dobson*, 513 U.S. 265, 115 S.Ct.834, 130 L. Ed. 2d 753 (1995). It is sometimes said, as does Movant in its brief (pg. 11), that the FAA embodies a policy of presumption in favor of arbitration. Such claim is inaccurate and overbroad. The FAA merely favors the enforcement of agreements to arbitrate when such agreements exist. The FAA was not enacted to force arbitration on parties, but merely to enforce voluntary agreements to arbitrate. *Dean Witter Reynolds, Inc. V. Byrd*, 470 U.S. 213, 219, 105 S. Ct. 1238, 1242, 04 L. Ed. 2d 158 (1985). The FAA policy in favor of enforcing arbitration does not come into play in determining whether an agreement to arbitrate exists. To the contrary, questions of contract to arbitrate are governed by state contract and common law principles. The FAA itself recognizes that it does not pre-empt state law grounds at law or in equity for the revocation of any contract. 9 U.S.C. §2

II. State contract Law precludes a finding that the parties agreed to arbitrate

The issue of whether Ms. Kestel agreed to arbitrate is clearly a question of state law to be adjudicated by the Courts of this state.

This Court recognized the need to determine a contractual meeting of the minds on whether to arbitrate. *Oakwood Mobile Homes, Inc. V. Sprowls*, 82 S.W.3d 193 (Ky. 2002). In fact, the decision cited by the Court of Appeals as controlling, *Louisville Peterbilt, Inc. v. Cox* 132 S.W.3d 850, specifically dealt with cases in which fraudulent inducement and unconscionability of the underlying contract were insufficient to void an arbitration clause.

KJA believes that the Court of Appeal's reading of *Louisville Peterbilt* is overbroad. In the case before this court, the very issue is whether there was a meeting of the minds as to the applicability of the arbitration clause in the November note. The Supreme Court itself cautioned against reading *Peterbilt* too broadly. "...we do not mean to insinuate that every arbitration

agreement will be broad enough to encompass all claims of fraud, misrepresentation, etc. Our holding today is confined to the arbitration clauses in the cases at bar.” id at 857

No meeting of the minds necessary to the formation of an obligation to arbitrate is evident here. Judge Knopf, in his concurring opinion, agreed with the majority that “any previous loan could be understood as covering loans between Teresa Kestel and Appellant.” He goes farther, indicating that this is the *only* reasonable interpretation. (emphasis supplied). Movant argues Ms. Kestel agreed to arbitrate on Mr. Kestel’s loan. The plain language of the arbitration provisions in the November note does not go that far. The October note is not a loan to Ms. Kestel.

Arbitration is undoubtedly favored, but as stated by Judge Knopf “that policy should not distort well established principles of contract interpretation.” It is far from clear how Respondent could have derived from the language in the November loan that she was agreeing to arbitrate all issues surrounding a loan to which she was not a party.

III. American General waived its rights under the arbitration clause in the November note.

Movant availed itself of the judicial forum to such an extent prior to moving to compel arbitration, that it would be inequitable for the Court to allow it to pursue arbitration at this stage of the proceedings.

The Court of Appeals in *Conseco Finance Servicing Corp. V. Wilder* 47 S.W.3d 335 (Ky. App. 2001) recognized that lenders may avail themselves of the option to pursue some issues before a court, while restricting borrowers to arbitration of their claims. However this right is not unfettered.

The right to compel arbitration may be waived and may be waived by implication. In *Conseco*, id at 345 the Court of Appeals declined to find waiver, noting that waiver may be inferred when the “...belated assertion of such rights prejudiced the opposition, either by imposing undue

delay and expense or by conferring an unfair tactical advantage such as pretrial discovery not available in arbitration.”

The facts in this case clearly establish the Bank’s belated assertion of the right to insist on arbitration. It responded to Ms. Kestel’s motion to strike its arbitrability defense, it defended her motion for summary judgment. While these matters were in litigation, it availed itself of the trial court by moving for a default judgment against Mr. Kestel, the signer of the October note. Clearly aware of arbitration procedures which deny discovery, the Bank waited until Ms. Kestel sought to compel the production of information to attempt to compel arbitration.

The *Conseco* court found no waiver since there was only a three month delay and “little activity in the case” id at 345. That is not the case before this court. The court below found a nine month delay in pursuing the right to compel arbitration unreasonable, noting that *substantial* litigation activity took place and that changing the forum at this time would be unfair.

CONCLUSION

While arbitration is favored, it is manifestly unfair to infer that a contract was formed to arbitrate issues under a note Ms. Kestel never signed. The clause in the note she did sign could only reasonably be construed as compelling arbitration only of contracts with the Bank that she herself signed.

Even if this was not true, Movant’s use of the court to litigate matters for an unreasonable length of time before trying to force arbitration constitutes a waiver of its arbitration right.

The Court of Appeals decision should be affirmed.

Respectfully submitted,

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