STATE BAR LITIGATION SECTION REPORT

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EDITOR'S COMMENTS

LONNY S. HOFFMAN

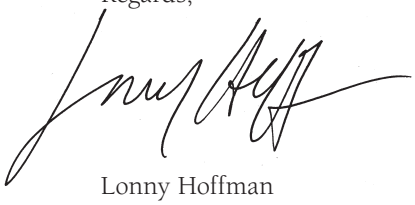
A DECADE AGO, IN MY FIRST FULL YEAR as Editor of THE ADVOCATE, we devoted one of our first symposium issues to the subject of binding arbitration. Re-reading that issue today, I'm struck by how many developments in arbitration we've witnessed in the last decade. Think, for instance, about consumer arbitration. Back then one of the Supreme Court's landmark arbitration cases, *Green Tree Fin. Corp. – Alabama v. Randolph*, was still of recent vintage. In that 5-4 decision the Court found the consumer arbitration agreement in that case to be enforceable but even the majority recognized that other agreements might impose unduly burdensome costs on consumer that could render such agreements unenforceable. In the ensuing years, we've witnessed an even further proliferation and judicial endorsement of consumer arbitration agreements. The Court's recent decision in *American Express Co. v. Italian Colors Restaurant* surely drives home how far the pendulum has swung.

In this Winter 2013 symposium contributors take a fresh look at current arbitration doctrine and developments, both in general and in several key substantive arenas. As is always our goal, we endeavor to put together an issue that offers practical guidance to lawyers and judges who confront arbitration questions.

Thanks again to our regular contributors Rob Ramsey and Luke Soules for their quarterly Procedure and Evidence Updates, and to Judge Randy Wilson for his latest installment of *From My Side of the Bench* column.

As always, I welcome your feedback. My email is lhoffman@uh.edu.

Regards,



Lonny Hoffman
Editor in Chief

CHAIR'S REPORT

CHRISTY AMUNY

TODAY I ATTENDED FUNERALS FOR TWO OUTSTANDING and distinguished Jefferson County attorneys. I have looked up to and admired them both throughout my career. Over the past week, I have thought about the great impacted they had on the careers of the lawyers around them. They belonged to a different generation of lawyers than myself and as I think of them both, I realize how much we could, and should, learn from the generations of lawyers before us. With these two men, when they began practicing law, someone's word was truly a bond and a deal actually could be sealed with a handshake. I know it sounds hokey, but I am told it is the truth. When there was a dispute, they picked up their files, went to the courthouse, tried their case and let the jury decide. They did not spend countless months, or sometimes years, endlessly strategizing and filing motions to undermine and chip away at the other side's case or playing tactical games to see who could get the upper hand, they just tried their case. It seems so simple, yet it has become something we rarely do these days.

I have been practicing law for a little over 22 years and in that relatively short time, the practice of law has changed. It seems "CYA" is the prevailing motto. We make sure we have a Rule 11 Agreement for everything single thing because no one can trust the other side, we take depositions of every possible person for fear that if we don't, someone down the road may question why we didn't take that deposition, we draft a 20 page document for something that probably could be done in 5 pages or less, and it goes on and on. In a way it is understandable how we have developed into this, especially when you drive down the highway and see the billboards of the nice firms that advertise "We Sue Lawyers." No one wants to get sued or second-guessed, so we overdo everything.

The truth is that society as a whole has become much more complex and the legal community, with all of its changes, is part of a much bigger picture. The more our world progresses and the more advances we make, the more intricate and complicated things become. I do understand that a number of the changes in the practice of law are necessitated by the changing world we live in, but it does not keep me from longing for a kinder, simpler time, even if I did miss those times by a generation or two.

When I think about the careers of the two attorneys who passed away, I am inspired by their dedication and all they achieved. I was lucky enough to have had a number of cases with one of them in the first 10 years or so of my career. And truth be told, when I was a baby lawyer, he scared the dickens out of me. He was much older, very gruff and straight to the point – a very no-nonsense man. As I got to know him over the years, I realized this was just who he was, his bark was much worse than his bite and he was a truly good man. He never wanted to

hear my justification of why I could not offer what he demanded or hear about the problems I saw in his case – he only wanted to know how much I was going to pay him and if it was not enough, we would move on to the next step. Short. Sweet. Simple. I miss those days.

With that, I will throw in a plug for the Litigation Section's Texas Legends project. Over the past several years, a number of talented and distinguished attorneys have been inducted as Texas Legends. As part of the induction ceremony, each Legend gives a speech, often to a room full of law students. Their wisdom is immeasurable and the lessons imparted are invaluable. Each Legend has been videotaped and those videos are available on our website (and will be more easily accessible on the new and improved website – currently in the making). If you get a chance, watch some of the videos – they will make you laugh, they will make you think and they will inspire you.

Christy Amuny
Chair, Litigation Section

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ARBITRATION

WHO DECIDES ARBITRABILITY (SCOPE): THE COURT OR ARBITRATORS?

BY BEN H. SHEPPARD, JR.

DISPUTES OVER THE SCOPE OF THE ARBITRATION agreement (commonly referred to as the "arbitrability" issue) have generated more reported court decisions than any other aspect of the arbitration process. The arbitrability issue typically arises when one of the parties to a contract containing an arbitration clause files a lawsuit in state or federal court asserting claims for tort, statutory violations or other non-contractual claims in an effort to circumvent the application of the arbitration agreement. The defendant, in order to preserve its rights under the arbitration agreement, is obliged to file a motion for a stay of the lawsuit based upon the arbitration agreement. At its option, the defendant may also move for an order compelling arbitration.

When presented with a motion to stay a lawsuit or to compel arbitration, courts in the United States have ordinarily undertaken to resolve disputes over the scope.

The resolution of disputes over arbitrability in this context has traditionally been viewed as a matter for the court. When presented with a motion to stay a lawsuit or to compel arbitration, courts in the United States have ordinarily undertaken to resolve disputes over the scope. Even if ultimately successful in securing an order staying the lawsuit and compelling arbitration, the party seeking to enforce the arbitration agreement must endure the delay and expense of proceedings in the trial court and, depending upon the ruling of the trial court, the delay and expense of an appeal.

Fortunately, there is a viable alternative in many cases—referral of the arbitrability issue to the arbitrators for determination—based upon a recognized exception to the general rule that the court determines arbitrability.

The General Rule: The Court Determines Arbitrability.
Section 3 of the Federal Arbitration Act provides that "the *court* in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration" shall stay the action pending arbitration. 9 U.S.C. Section 3 (emphasis added). This includes the determination of the scope of the arbitration clause—the "arbitrability" issue. *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649 (1986).

The Texas General Arbitration Act provides that the court shall order the parties to arbitrate on the application of a party showing an agreement to arbitrate and in the event of a dispute over the application of the arbitration agreement "the *court* shall summarily determine the issue." Tex. Civ. Prac. & Rem. Code Ann., Section 171.021 (b) (emphasis added). The Texas Supreme Court has admonished trial courts to determine summarily issues on a motion to stay or compel arbitration under a streamlined procedure generally applicable to cases under the Texas Act or the Federal Arbitration Act. *Jack B. Anglin Co., Inc. v. Tipps*, 842 S.W.2d 266, 269 (Tex. 1992).

The Exception: Clear and Unmistakable Delegation to the Arbitrators.
The Supreme Court of the United States has expressly recognized that parties to an arbitration agreement may agree that arbitrators should decide arbitrability if there is "clear and unmistakable" evidence that they did so. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995).

Delegation of arbitrability to the arbitrators can have two distinct advantages for the party requesting arbitration. First, the party avoids the delay and expense of court proceedings to determine whether the disputes are arbitrable. Second, if the parties have agreed to arbitrate arbitrability, the decision of the arbitrators on arbitrability is subject to limited, deferential judicial review; "the court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances." *Id*. at 942.

Parties may delegate arbitrability to the arbitrators by express delegation in their arbitration clause or by their

adoption of arbitral rules conferring such jurisdiction.

Express Delegation to the Arbitrators in the Arbitration Clause.
The parties may "clearly and unmistakably" agree to arbitrate arbitrability through an express delegation in their arbitration agreement. For example:

"Disputes Subject to Arbitration. Any dispute or difference of any kind whatsoever arising out of, relating to or in connection with this contract, whether in contract, tort, statutory or otherwise, *including any question about the scope of this agreement to arbitrate*, or any questions regarding the validity, existence, breach or termination of this contract, shall be resolved by final and binding arbitration pursuant to the procedures set forth herein." (Emphasis added).

Delegation to the Arbitrators Under Arbitral Rules.
Most arbitral rules, including rules applicable to non-administered ("ad hoc") arbitration proceedings (*e.g.*, CPR Rules for Non-Administered Arbitrations, UNICITRAL Arbitration Rules) vest arbitrators with jurisdiction to determine their own jurisdiction. Rule 7(a) of the Commercial Arbitration Rules of the American Arbitration Association is representative, providing that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement."

Several lower courts have held that the adoption of such arbitral rules constitutes clear and unmistakable evidence that the parties agreed to arbitrate arbitrability. *E.g., Petrofac, Inc. v. DynMcDermott Pet. Op. Co.,* 687 F.3d 671 (5th Cir. 2012); *Fallo v. High-Tech Inst.*, 559 F.3d 874 (8th Cir. 2009); *Sys. Research & Applications Corp. v. Rohde & Schwarz Fed. Sys., Inc.,* 840 F. Supp.2d 935 (E.D. Va. 2012); *Schlumberger Tech. Corp. v. Baker Hughes, Inc.,* 355 S.W.3d 791 (Tex. App.—Houston [1st Dist.] 2011).

Litigation Strategy.
A party seeking to preserve its rights to arbitrate should promptly file a motion to stay the lawsuit and, if also sought, a motion to compel arbitration. As primary relief, the motion should request that the court refer the dispute over arbitrability to the arbitrators based upon either an express clause in the contract or upon the parties' adoption of arbitral rules vesting the arbitrators with such jurisdiction, or upon both if applicable. In order to establish that the parties "clearly and unmistakably" agreed at the time of contracting to arbitrate arbitrability, a party relying upon the adoption of arbitral rules should submit evidence of the arbitral rules in effect at the time of the contract. The motion should request that the court stay the suit pending the arbitrators' ruling on whether the parties agreed to arbitrate the merits, maintaining the case on its docket in the event the arbitrators determine that any or all of the claims are not subject to arbitration.

In the alternative, and without waiving the motion to refer the arbitrabilty dispute to the arbitrators, the movant should assert that the claims in the lawsuit are arbitrable, citing the strong national policy favoring arbitration and the principle that all doubts about the scope of an ambiguous arbitration clause are to be resolved in favor of arbitration. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). There are two reasons to request the alternative relief. First, the trial court may not accept that the adoption of arbitral rules constitutes a clear delegation to the arbitrators absent controlling precedent from the highest court in its jurisdiction. Second, a persuasive argument in favor of the application of the arbitration agreement may provide some degree of comfort to the trial judge that the referral of the arbitrability issue to the arbitrators is an appropriate course of action.

Conclusion.
Parties seeking to enforce their arbitration agreements have an effective method to move disputes over arbitrability out of the court system and into arbitration.

Ben H. Sheppard, Jr. is a Distinguished Lecturer and the Director of the A.A. White Dispute Resolution Center at The University of Houston Law Center. From 1969-2005, he practiced law with Vinson & Elkins L.L.P., where he was a partner and co-chair of the firm's international dispute resolution practice. ★

CURRENT TOPICS IN INTERNATIONAL ARBITRATION

BY SAMUEL W. COOPER, JOSEPH R. PROFAIZER & CHRISTIE A. MATHIS

THIS ARTICLE DISCUSSES WHAT THE AUTHORS REGARD as four important topics of current interest in the field of international arbitration: Implications of the Growth of Filings and Fora, Increasing Controversy Surrounding Investment Treaty Arbitrations, Refusal to Enforce Arbitration Awards, and Arbitrator Conflicts of Interest.[1]

Implications of the Growth of Filings and Fora

The continued increase in the number of international arbitration matters filed is not a new phenomenon. According to International Arbitration Institute figures, virtually every major arbitral forum experienced substantial increases in filings over the last five years. London Court of International Arbitration ("LCIA") filings, for example, numbered 137 in 2007 and 265 in 2012.[2] International Chamber of Commerce ("ICC") filings grew from 599 in 2007 to 759 in 2012.[3]

Related to this increase in filings is another trend that has received less attention: the development and expansion of arbitration centers and offices around the globe. For example, in 2012 the Singapore International Arbitration Centre ("SIAC") opened an office in Mumbai with the express intent of driving SIAC filings from India.[4] In 2013, the ICC opened an office in New York City for the administration of its North American arbitrations,[5] and new arbitration centers opened in both Nigeria and Rwanda over the last year with the hope of attracting arbitration work in Africa.[6]

Related to this increase in filings is another trend that has received less attention: the development and expansion of arbitration centers and offices around the globe.

The expansion in both the number of matters filed and the number of institutions (and therefore fora) available to hear those matters has several implications. The first is the potential for increased variation in arbitration practices due to regional differences in methods of handling and deciding disputes. We are not aware of any systematic study of regional differences in handling and outcome of matters, although certain trends—such as differences in enforcement of interim measures by region—have been the subject of discussion.[7]

A second implication of the growth in filings and fora is the potential for competition among institutions to secure new cases. Those familiar with the U.S. courts may recall the development of the patent practice in the United States District Court for the Eastern District of Texas. In the year 2000, just over 1% of all U.S. patent cases filed were filed in the Eastern District.[8] However, through innovative changes to the local court rules, the Eastern District turned itself into a preferred venue for such filings—securing over 10% of patent cases filed in the U.S. courts by 2008,[9] and the highest number of new patent cases of any federal district court in 2012.[10] Recently, the United States District Court for the Northern District of Texas began a pilot program to resolve patent lawsuits more cheaply and quickly, which commentators expect to lead to an increase in patent filings in that district.[11]

A species of that competition can be seen among arbitration institutions as well. For example, in 2012, the ICC adopted new rules that provided for, among other things, procedures for securing emergency relief from an arbitral tribunal instead of having to resort to a national court system. Notably, after the adoption of these rules, the ICC touted them in a press release entitled "New rules attract international arbitration cases."[12] It likely is not a coincidence that in 2013, the Hong Kong International Arbitration Centre ("HKIAC") established its own process for the appointment of emergency arbitrators, and Hong Kong legislators modified Hong Kong's laws governing the enforcement of relief granted by such arbitrators.[13]

Although it is difficult to say how competition among institutions and fora will impact practitioners, as competition to attract international arbitrations grows, increasing interest in developing procedures that address practitioner concerns—such as the adoption of rules governing interim relief measures—will hopefully follow. For instance, procedural mechanisms designed to limit costs of arbitrations and increase their speed would be another area for innovation

and competition. As new institutional rules are established, individual fora will be pressured to adapt or run the risk of being seen in an unfavorable light, resulting in a decrease in case loads. Whether the proliferation of arbitral institutions will increase or decrease regional variations remains to be seen.

Increasing Controversy Surrounding Investment Treaty Arbitrations

The adoption of international investment agreements ("IIAs") exploded in the late 1990s.[14] As a result, foreign investors now depend on, and many have structured their businesses around, the availability of treaty protections and the dispute resolution procedures contained in those agreements. The comparative predictability and stability these agreements seemed to promise may, however, be disappearing. On January 24, 2012, Venezuela became the third country to denounce the Convention on the Settlement of Investment Disputes (the "ICSID Convention") and withdraw from the International Centre for the Settlement of Investment Disputes ("ICSID"). Ecuador and Bolivia withdrew from ICSID in 2009 and 2007, respectively. Nicaragua has also threatened departure, and legislation in Argentina could result in that country's withdrawal as well.[15]

In addition to its recent withdrawal from ICSID, in 2008, Venezuela notified the Netherlands of its intent to terminate the Venezuela–Netherlands bilateral investment treaty ("BIT"), the basis for at least ten recent arbitrations against Venezuela. Under the terms of the BIT's savings clause, however, the treaty will not formally end until 2023.[16] Likewise, Ecuadorian lawmakers introduced a bill in March 2013, seeking to annul its investment treaty with the United States.[17] A member of Ecuador's ruling party further stated the country intends to withdraw from all of its BITs in 2013.[18] Ecuadorian leaders have already approved termination of 13 BITs.[19] Both Venezuela and Ecuador have had substantial arbitration awards issued against them.

While angry withdrawal by countries suffering from adverse awards may not be surprising, the reevaluation of IIAs is spreading. For example, the U.S. announced revisions to its model IIA in early 2012.[20] Later that year, South Africa reported that it had undertaken review of its BITs and investor-state dispute resolution provisions and processes and intended to cancel 13 BITs with European Union member states.[21] South Africa has since terminated BITs with Belgium, Luxemburg, and Spain.[22] Although South Africa has proposed a foreign investment bill to replace the treaty regime protecting foreign investors' rights, that bill still requires approval.[23]

The rate at which new IIAs are being signed has slowed substantially from the mid-1990s high, and the future will bring opportunities to modify, perhaps substantially, the structure established over the last 20 years. Of the 3,196 IIAs in force in 2012, roughly 1,300 will be terminable in 2013. An additional 350 IIAs will reach the end of their initial governing periods between 2014 and 2018, with 103 in 2014 alone.[24] At the same time, academics from both developed and developing countries have offered harsh indictments of the current investment treaty regime, claiming IIAs hamper the ability of governments to take actions for their people.[25] Several academics now claim there are strong moral and policy rationales for withdrawing from IIAs (including their arbitration provisions) altogether.[26]

The termination of IIAs does not mean an immediate loss of protection for investors—most IIAs have 10 to 15-year survival clauses during which the host country remains bound by the treaty for investments made prior to termination.[27] Nor does a country's withdrawal from ICSID necessarily deprive a foreign investor of the opportunity to settle disputes outside the host country's domestic court system, as most BITs include advance consent to raise disputes in several arbitral forums.[28] Nonetheless, major foreign investments are rarely short term affairs and often require significant initial investment before returns materialize. It remains to be seen whether the increasing uncertainty surrounding investor protections will dampen global investment activity and the disputes that may follow.

Refusal to Enforce Arbitration Awards

Even if an IIA is in effect when a dispute arises, and assuming an investor secures an arbitration award in its favor, challenges to collecting those awards are increasingly prevalent. At a time when investor-state disputes are at an all-time high,[29] a growing number of countries are refusing to honor or enforce arbitration awards.

In January 2012, Former President Hugo Chavez claimed that Venezuela "will not recognize any ICSID decisions."[30] Chavez also described as "impossible" Exxon's requests that Venezuela pay the US$908 million award from an International Chamber of Commerce ("ICC") tribunal.[31] Rather Venezuela has declared it will pay only US$255 million, a little more than a quarter of the awarded sum.[32] A total of 37 cases against Venezuela have been filed before ICSID alone, 27 of which are still pending.[33]

Similarly, Argentina—which has had more than 50 investor-state arbitrations filed against it, 25 of which are pending

before ICSID[34]—has refused to pay numerous ICSID awards related to the country's 2001 default on US$95 billion in foreign debt. Those awards amount to more than US$300 million owed to U.S. companies alone, and have resulted in a March 2012 Presidential Proclamation suspending Argentina's benefits under the U.S. Generalized System of Preferences ("GSP").[35]

Refusal to enforce awards obtained under IIAs is not limited to South American countries. For the second time within the last year, a South Korean court refused to enforce an arbitration award against a state-owned entity.[36]

These events raise the concern that a refusal to voluntarily abide by an IIA award will lose whatever stigma surrounds it as refusal becomes more common. It is not clear how, or whether, global investors will react to such events. Will the United States or European Union countries impose penalties against other countries for repeated refusals to enforce awards? Because that is unlikely, claimants must evaluate the value of a multi-million dollar investment in an arbitration award against not only the likelihood of success on the merits but the likelihood any judgment awarded can actually be secured.[37] That calculus may, in the long-run, effect investor willingness to engage in high-risk ventures lacking any meaningful treaty protection (unless other methods of protecting the investment are made) and also reduce the number of arbitrations.

Arbitrator Conflicts of Interests

Although not a new topic, increasing scrutiny is being given to arbitrator conflicts, particularly in the area of investment treaty arbitration. The criticism is primarily focused on so-called "issue conflicts" arising from the same group of lawyers serving both as advocates and arbitrators in investment treaty arbitration proceedings.[38]

In an area of the law often chided for its "clubiness"—a recent study noted that a group of 15 individuals held at least one of the arbitrator seats in 55 percent of the 450 investment-treaty disputes panels prior to 2012 and that most of those individuals also serve as legal counsel for parties involved in investor-state disputes[39]—such fears do not appear to be entirely unfounded. In at least one case, an arbitrator serving as counsel to a foreign investor relied heavily on an opinion issued by a panel on which he sat, and which he coauthored, while the other dispute was underway.[40]

On the other hand, critics of requiring lawyers to choose between advocate and arbitrator roles caution that such rules would shrink an already small pool of experienced arbitrators, particularly in investment arbitration.[41] In a system founded on the advantages (perceived or real) of parties having their disputes decided by one or more subject-matter experts, depleting that pool of experts would be troubling. Moreover, unless such protections were system-wide, *i.e.*, adopted by all international arbitral institutions—a vanishingly small prospect—they would likely fail to correct the perceived problem: the same individuals will continue to serve as both arbitrators and advocates in cases involving the same issues, the only difference being that the arbitrations are administered by different fora.

Thus, while we expect conflict of interest rules reform to remain a topic of much conversation, we see little likelihood that more than marginal change will occur in the near future.

Samuel W. Cooper is a partner at Paul Hastings LLP in the firm's Houston office. Mr. Cooper has tried cases to decision on behalf of plaintiffs and defendants before juries, arbitrators and judges in forums ranging from state courts to three-judge federal panels and international arbitration tribunals, where he has represented both corporations and foreign states.

Joseph R. Profaizer is a partner at Paul Hastings LLP in the firm's Washington, DC office. Mr. Profaizer specializes in international arbitration and litigation related to international arbitration. He has successfully represented clients in state and federal courts at both the trial and appellate levels, as well as in over 50 arbitrations under the rules of the ICC, the AAA/ICDR, the LCIA, the SIAC, the HKIAC, ICSID, JAMS, and UNCITRAL.

Christie A. Mathis is an associate at Paul Hastings LLP in the firm's Houston office. ✯

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1 Due to limitations of space, this is not a comprehensive analysis of all important trends in the field, and we expect that our colleagues will have views on additional current important trends.

2 London Court of International Arbitration, *Register's Report 2012* (2013), at 1, *available at* http://www.lcia.org/LCIA/Casework_Report.aspx; PriceWaterhouseCoopers, *Corporate Choices in International Arbitration: Industry Perspectives* (2013), at 10, *available at* http://www.pwc.com/gx/en/arbitration-dispute-resolution/assets/pwc-international-arbitration-study.pdf.

3 International Chamber of Commerce, *Statistics*, http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Introduction-to-ICC-Arbitration/Statistics/ (last visited Sept. 13, 2013).

4 Nirmala Ganapathy, *Arbitration Centre Opens 1st Overseas Office in Mumbai*, STASIAREPORT.COM (Apr. 29, 2013), http://www.stasiareport.com/the-big-story/asia-report/india/story/arbitration-

centre-opens-1st-overseas-office-mumbai-20130429.

5 Press Release, International Court of Arbitration, *International Court of Arbitration Establishes Presence in New York*, ICCWBO.ORG (Sept. 10, 2013), http://www.iccwbo.org/News/Articles/2013/International-Court-of-Arbitration-establishes-presence-in-New-York/.

6 Kenneth Agutamba, *Rwanda: Center Promotes Arbitration Courts*, ALLAFRICA.COM (Feb. 2, 2013), *available at* http://allafrica.com/stories/201302042018.html; Lagos Court of Arbitration, *About Us*, http://lagosarbitration.org/?p=about (last visited Sept. 13, 2013).

7 Ingrid Burke, *Emerging Trends of International Arbitration*, RAPSINEWS.COM (Oct. 9, 2012), http://rapsinews.com/judicial_analyst/20121009/264915877.html.

8 Carlos Perez-Albuerne & Gwen G. Nolan, *Eastern District of Texas—Plaintiffs' Paradise Lost?* LAW360.COM (Sept. 15, 2010), http://www.law360.com/articles/190606/.

9 *Id.*

10 Mark Curriden, *Patent Lawsuits Skyrocket in Texas*, DALLASNEWS.COM (Feb. 12, 2013), http://www.dallasnews.com/business/headlines/20130212-patent-lawsuits-skyrocket-in-texas.ece.

11 *Id.*

12 Press Release, International Court of Arbitration, *New Rules Attract International Arbitration Cases*, ICCWBO.ORG (Apr. 28, 2013), http://www.iccwbo.org/News/Articles/2013/New-rules-attract-international-arbitration-cases/.

13 Pinsent Masons LLP, *Hong Kong Amends Arbitration Law to Allow Enforcement of Relief Granted by "Emergency" Arbitrators*, OUT-LAW.COM (Aug. 5, 2013), http://www.out-law.com/en/articles/2013/august/hong-kong-amends-arbitration-law-to-allow-enforcement-of-relief-granted-by-emergency-arbitrators/.

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15 Kathryn Rimpfel, *Treat Shopping and Expansive Jurisdiction: Causes and Effects of Venezuela's Denunciation of the ICSID Convention*, 5 Y.B. ON ARB. & MEDIATION 371, 373 (2013).

16 Sergey Ripinsky, *Venezuela's Withdrawal from ICSID: What it Does and Does Not Achieve*, INVESTMENT TREATY NEWS (Apr. 13, 2012), http://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/.

17 Eduardo Garcia, *Ecuador Seeks to End Investment Treaty with U.S.*, REUTERS UK (Mar. 12, 2013), http://uk.reuters.com/article/2013/03/12/ecuador-us-treaty-idUKL1N0C401C20130312.

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19 *Id.*

20 Press Release, Office of the United States Trade Representative, *United States Concludes Review of Model Bilateral Investment Treaty* (Apr. 20, 2012), http://www.ustr.gov/about-us/press-office/press-releases/2012/april/united-states-concludes-review-model-bilateral-inves.

21 Mark Allix, *EU Treaties cancellation hangs over SA-Spain meeting*, BUSINESS DAY (Oct. 9, 2012), *available at* http://www.bdlive.co.za/business/trade/2012/10/09/eu-treaties-cancellation-hangs-over-sa-spain-meeting.

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23 Linda Ensor, *Appropriation compensation on foreign investment under review*, HOZWIT MSN NEWS (Feb. 18, 2013), http://news.howzit.msn.com/appropriation-compensation-on-foreign-investment-under-review-1 (last visited Sept. 11, 2013).

24 UNCTAD, *World Investment Report 2013 - Global Value Chains: Investment and Trade for Development* (June 26, 2013), at 109, *available at* http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

25 Gus Van Harten, et al., *Public Statement on the International Investment Regime* (Aug. 31, 2010), at Introduction, *available at* http://www.osgoode.yorku.ca/public-statement/documents/Public%20Statement%20%28June%202011%29.pdf.

26 *See id.* ¶ 8 ("There is a strong moral as well as policy case for governments to withdraw from investment treaties and to oppose investor-state arbitration, including by refusal to pay arbitration awards against them where an award for compensation has followed from a good faith measure that was introduced for legitimate purposes.").

27 *See* UNCTAD, *Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims*, No. 2 IIA Issues Notes (Dec. 2010), at 3, *available at* http://unctad.org/en/Docs/webdiaeia20106_en.pdf; *see also id.* at Annexes 1 & 2 for summary of survival clauses of Ecuadorian and Bolivian BITs.

28 *Id.* at 4; *see also* Ripinsky, *supra* note 16 (observing that 24 of Venezuela's 26 other BITs currently enforce designate a dispute resolution body other than or in addition to ICSID).

29 *See* ICSID, The ICSID Caseload Statistics, ICSID.WORLDBANK.ORG (Issue 2013-2), at 8, *available at* https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English42 (last visited Sept. 9, 2013) (noting that 58 investor-State claims were commenced in 2012, the largest number of claims filed in one year).

30 Kejal Vyas, *Venezuela's Chávez: Won't Accept Rulings by ICSID Court*, WALL STREET JOURNAL (Jan. 8, 2012), http://online.wsj.com/article/BT-CO-20120108-703460.html (last visited Sept. 9, 2013).

31 Rimpfel, *Treat Shopping*, *supra* note 15, at 374.

32 *Id.*

[33] ICSID, ICSID.WORLDBANK.ORG, https://icsid.worldbank.org/ICSID/FrontServlet (follow "Cases"; then follow "Search Cases" hyperlink; then follow "Click here for advanced search options" hyperlink; then search respondent "Venezuela"; then select "All") (last visited Sept. 13, 2013).

[34] *Id.*

[35] Press Release, U.S. House of Representatives, Ways and Means Committee, Camp, Brady Statements on Suspension of Argentina's GSP Benefits (Mar. 26. 2012), http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=287172.

[36] Douglas Thomson, *Seoul Court Rejects Lone Star Enforcement*, Global Arbitration Review (Sept. 6, 2013), *available at* www.globalarbitrationreview.com.

[37] So far, even countries that have refused to enforce awards have not seen those actions create an effective shield against new claims. *See* Sarah Downey, *Repsol files 10.5 billion ICSID claim*, CDR-NEWS.COM (Dec. 5, 2012) (discussing $10.5 billion claim filed against Argentina before ICSID at the end of 20102), http://www.cdr-news.com/categories/arbitration-and-adr/featured/repsol-files-10.5-billion-icsid-claim (last visited Sept. 11, 2013).

[38] The other main area of concern centers on the possibility that arbitrators, who also serve as lawyers, may rule more favorably for parties they expect to appear before in the future. This worry underpins the rules prohibiting U.S. judges from practicing law and served as the basis for the 2009 Court of Arbitration for Sport rule prohibiting lawyers from serving as both advocates and arbitrators before it. *See* Dennis H. Hranitzky & Eduardo Silva Romero*, The "Double Hat" Debate in International Arbitration: Should Advocates and Arbitrators Be in Separate Bars?* N.Y.L.J. (June 14, 2010), at 1.

[39] Pia Eberhardt & Cecilia Olivet, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom* (Transnational Institute & Corporate Europe Observatory Nov. 2012), at 8, *available at* http://www.tni.org/sites/www.tni.org/files/download/profitingfrominjustice.pdf.

[40] Hranitzky & Romero*, supra* note 38, at 2; *see also* Uzma Baikiss Sulaiman, *London Barrister Opposes Arbitrators Acting as Counsel*, GLOBAL ARB. REV. (Oct. 7. 2009) (quoting one arbitrator's experience where counsel sought to rely on their own awards), http://globalarbitrationreview.com/news/article/18979/ (last visited Sept. 13, 2013).

[41] Sulaiman, *supra* note 40.

CONTRACTUAL AND OTHER DEFENSES TO ARBITRATION

BY BILL MORRISON & CHRISTOPHER A. ROGERS

ARBITRATION IS A CREATURE OF CONTRACT. Increasingly, parties contract to arbitrate disputes that otherwise would be litigated. Often when one party demands arbitration, the other side—whether reflexively or strategically—opts to pursue a litigation strategy.

Determining whether a dispute can be compelled to arbitration requires several layers of analysis: First, does a valid agreement to arbitrate exist that covers the type of dispute at issue?[1] This type of substantive, threshold question is typically reserved for the court to decide in a motion to compel arbitration but can be submitted to the arbitrator by agreement.[2]

By contrast, there are also procedural defenses to arbitration, such as whether the arbitration provision mandates an unfair process or whether the party seeking to compel arbitration complied with applicable notice requirements, time limits, or other prerequisites to arbitration. These procedural defenses are typically appropriate for the arbitrator, rather than the court, to decide.[3]

A key consideration, then, for parties seeking to compel or challenge an arbitration clause is which decision maker will determine if arbitration is appropriate. Parties seeking to compel arbitration might prefer to have an arbitrator decide, while their opponents might prefer the judge.

This article describes these defenses and, where possible, identifies the likely umpire for each type of dispute.

I. Governing Law

There are two statutes—The Federal Arbitration Act (FAA) and the Texas Arbitration Act (TAA)—that can govern the arbitration of disputes that arise in Texas.[4] The FAA applies to any arbitration agreement that "involves [interstate] commerce."[5] Where the FAA applies, it preempts state laws that are hostile to arbitration or that provide conflicting procedures for compelling arbitration or enforcing arbitration awards. The TAA applies to arbitrations that arise in Texas but are not subject to the FAA.

The two statutes have many similarities. Both require a court, upon a showing that an arbitration agreement exists and is enforceable, to stay pending litigation and order parties to arbitration.[6] Both express a preference for arbitration. Under both, many of the defenses to arbitration will ultimately rest on questions of state contract law.

II. Arbitrability – The Existence of an Agreement to Arbitrate

A court will determine whether a valid arbitration agreement exists in ruling on a motion to compel arbitration.[7] The party compelling arbitration bears the burden of proving the existence of the arbitration agreement.[8] Once the movant proves that an agreement exists, the burden shifts to the party opposing arbitration to establish some ground to nullify the arbitration agreement.[9]

Courts treat arbitration agreements like other contracts when applying legal rules of interpretation.[10] Courts do not impose any specific requirement that an arbitration agreement contain specific language, appear in a particular place, or even be signed.[11] However, at a minimum, an agreement to arbitrate must exist – i.e., an agreement to submit a claim to an outside party to decide the liability of the parties in dispute. For example, an agreement to submit employment disputes to a pool of "arbitrators" made up solely of company employees was found not to be an arbitration agreement as it restricted the identity of potential arbitrators in a manner that frustrated the purpose of arbitration.[12]

One type of argument successfully used to defeat an arbitration clause arises when the promise to arbitrate lacks mutuality of obligation. If both parties to an arbitration agreement commit to arbitrate disputes between them (or agree to exchange some other valuable consideration for the agreement to arbitrate), and the agreement to arbitrate is not revocable, then mutuality of obligation exists and the arbitration agreement is likely enforceable.[13] However, if either party to the arbitration agreement does not obligate itself to arbitrate—or the promise to arbitrate is revocable in a manner that renders the promise illusory—the absence of mutuality can render the arbitration agreement unenforceable.

Mutuality of obligation exists when the promise to arbitrate is mutual or is supported by other consideration. For example, where both an employee and employer promise to arbitrate claims between them, and where those commitments cannot be unilaterally rescinded, the Texas Supreme Court has found sufficient consideration to enforce an arbitration agreement.[14]

By contrast, this mutuality of obligation can be absent if only one party is bound to arbitrate.[15] Likewise, mutuality of obligation may be absent if one party's promise to arbitrate or to be bound by the result of arbitration can be unilaterally revoked at any time.[16] That is not to say that an arbitration agreement can never be amended. In some circumstances, if the right to amend does not apply retroactively to injuries arising before any change, an arbitration agreement can be subject to amendment while not being illusory.[17]

III. Defenses to Arbitration

Even if an enforceable agreement exists, parties can still contest the arbitration provision using the same types of challenges that are raised against contracts in general. Defenses such as fraud, unconscionability, and waiver can apply in the context of arbitration agreements.[18]

The Texas Supreme Court has held that "the burden of proving a defense to arbitration is on the party opposing arbitration."[19] This is unsurprising since the defenses typically asserted are affirmative defenses to the enforcement of an agreement.

With each specific defense, the appropriate forum may vary. To be submitted to the court and not the arbitrator, the defenses must specifically relate to the arbitration provision in the contract, not the contract as a whole or to other provisions.[20] If the defense relates to the enforceability of the contract as a whole, it is generally reserved for the arbitrator.

a. Waiver

An arbitration agreement can be waived only if the party seeking arbitration substantially invoked the judicial process to its opponent's detriment before seeking arbitration.[21] Detriment, or prejudice, arises when a party forces an opponent to litigate an issue and later seeks to arbitrate the same dispute.[22]

Waiver is an issue for the court to decide.[23] And there is a strong presumption against waiver. It must be intentional, and the party pursuing waiver bears a "heavy burden of proof" with all doubts resolved in favor of arbitration.[24]

Determining whether a party has substantially invoked the litigation process in a manner that prejudiced its opponent requires a case-by-case assessment on the totality of the circumstances, including factors such as:

- whether the movant was plaintiff (who chose to file in court) or defendant (who merely responded);
- how long the movant delayed before seeking arbitration;
- whether or when the movant knew of the arbitration clause;
- how much discovery has been conducted;
- how much pretrial activity related to the merits rather than arbitrability or jurisdiction;
- how much time and expense has been incurred in litigation;
- whether the movant sought or opposed arbitration earlier in the case;
- whether the movant filed affirmative claims or dispositive motions;
- what discovery would be unavailable in arbitration;
- whether activity in court would be duplicated in arbitration; and
- when the case was to be tried.[25]

Even if some factors suggest waiver, courts still disfavor finding waiver of an arbitration provision. Texas courts have concluded that no waiver occurred in situations where the party moving to compel arbitration had:

- filed suit;
- moved to dismiss a claim for lack of standing;
- moved to set aside a default judgment and requested a new trial;
- opposed a trial setting and sought removal;
- moved to strike an intervention and opposed discovery;
- sent 18 interrogatories and 19 requests for production;
- requested an initial round of discovery, noticed (but did not take) one deposition, and agreed to reset the trial date;
- sought initial discovery, took four depositions, and moved for dismissal based on standing.[26]

Thus, even though the Texas Supreme Court found waiver in *Perry Homes v. Cull*, it did so only after observing that it had rejected the waiver defense in eight prior cases.[27] The *Perry Homes* decision held that the plaintiff there waived arbitration by: filing suit; conducting extensive discovery on the merits

of its case over 14 months; resisting the defendant's earlier motion to compel arbitration; and requesting arbitration only on the eve of trial.[28] Ultimately, the court held that prejudice would attach if the plaintiff were allowed to discover its case under one set of rules and then force the defendant to try the case in arbitration, subject to different standards of appeal and review.[29]

b. Fraud

Fraud claims that invalidate the entire contract are subject to arbitration, while claims of fraudulent inducement of the arbitration agreement may be reserved for the court.[30] In *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 444 (2006), the Supreme Court affirmed its statement of a similar ruling, explaining that an arbitration provision is severable from the remainder of a contract. Unless the party challenging arbitration articulated a claim of fraud that related to the arbitration clause itself, the issue of fraud that related to the broader contract would be determined by the arbitrator.[31] The Texas Supreme Court has recognized this rule, holding that state law defenses that relate to the enforcement of an agreement that contains an arbitration clause "must specifically relate to the [arbitration provision] itself, not the contract as a whole."[32]

Courts have found economic duress where an employer withheld payment for work performed until the employee signed an employment agreement containing an arbitration clause.

c. Duress

Similarly, duress can be a defense to a specific arbitration provision. If the duress relates to the entire agreement, it will be a question reserved for the arbitrator to decide. But if the duress was specifically related to the arbitration provision, it may be a question for the court to decide. Courts have found economic duress where an employer withheld payment for work performed until the employee signed an employment agreement containing an arbitration clause.[33] On the other hand, refusal to do business without entering into a contract containing an arbitration provision does not constitute duress.[34]

d. Unconscionability

Arbitration agreements that are unconscionable are unenforceable. Unconscionability is one of the most commonly raised defenses to enforcement of arbitration provisions. Unfortunately, there is no easy definition of unconscionability.

Under Texas law, a party who wants to avoid arbitration on unconscionability grounds bears the burden to prove both procedural and substantive unconscionability.[35] While both are required, the test presents a sliding scale—having more of one type requires less of the other.[36]

i. Procedural Unconscionability.

Procedural unconscionability examines whether the party resisting arbitration faced an absence of meaningful choice in agreeing to arbitrate. Fine print, complicated language, or a lack of understanding can lead to an assertion of procedural unconscionability. However, the test requires more than a showing of differences in bargaining power—"adhesion contracts are not automatically unconscionable."[37] As the Fifth Circuit observed, "[t]he only cases under Texas law in which an agreement was found procedurally unconscionable involve situations in which one of the parties appears to have been incapable of understanding the agreement."[38] Other states have far different standards for procedural unconscionability.[39]

ii. Substantive Unconscionability.

While procedural unconscionability refers to the fairness of the circumstances surrounding the adoption of the arbitration provision, substantive unconscionability refers to the fairness of the arbitration provision itself.[40] Generally, a contract is substantively unconscionable if "given the parties' general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract."[41]

Factors that may lead a court to find substantive unconscionability might be disregarded in the context of another set of facts. An arbitration agreement could be—but is not necessarily—unconscionable if a party asserts:

- The costs of arbitration render it unconscionable.[42]
- Insufficient remedies are available, for example in an arbitration agreement prohibiting punitive damages or requiring the waiver of statutory rights.[43]
- Discovery is unfairly limited.[44]
- The agreement unfairly demands waiver of the right to a jury trial.[45]

e. Illegality

An arbitration agreement contained in a contract that is void for illegality can be unenforceable. If the challenge goes to

the illegality of the contract as a whole, the matter should be determined by the arbitrator, not the court.[46] However, if the illegal provision in the contract is not central to the agreement or can be severed, courts can enforce the arbitration provision separately.[47]

f. Lack of Mental Capacity

Lack of mental capacity can serve as a defense to an arbitration agreement just like any other contract. When mental capacity is raised as a defense to enforcement of a contract, the existence of the agreement is at issue. Therefore, courts are the proper forum to decide challenges to a party's mental capacity to enter into a valid, binding agreement containing an arbitration provision.[48]

IV. Conclusion

Arbitration has been a favored method of adjudicating disputes under Texas law since the right was acknowledged by the Texas Supreme Court in 1856.[49] Recently, federal law has adopted a similar national policy favoring arbitration.[50]

Despite these statements of policy, there are arguments available to the litigant who prefers the courtroom to arbitration. With appropriate facts, a party can avoid an arbitration by carefully selecting a winning argument to present—to the court or to the arbitrator.

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1 *Carey v. 24 Hour Fitness, USA, Inc.,* 669 F.3d 202, 205 (5th Cir. 2012); *In re Kellogg Brown & Root, Inc.,* 166 S.W.3d 732, 737 (Tex. 2005).

2 *Rent-A-Center West, Inc. v. Jackson,* 561 U.S. 63, 130 S. Ct. 2772, 2777-79 (2010). Parties must unmistakably agree to delegate such gateway issues to an arbitrator. *Rent-A-Center,* 130 S. Ct. at 2777-78; *see also Forest Oil Corp. v. McAllen,* 268 S.W.3d 51, 61 (Tex. 2008); *McGehee v. Bowman,* 339 S.W.3d 820 (Tex. App.—Dallas 2011, no pet. h.).

3 *Howsam v. Dean Witter Reynolds Inc.,* 537 U.S. 79, 83-85 (2002).

4 9 U.S.C. § 1, *et seq.*; TEX. CIV. PRAC. & REM. CODE § 171.001, *et seq.*

5 *Allied-Bruce Terminix Cos. v. Dobson,* 513 U.S. 265, 281 (1995); *see also Iberia Credit Bureau Inc. v. Cingular Wireless LLC,* 379 F.3d 159, 166 (5th Cir. 2004).

6 9 U.S.C. § 3; TEX. CIV. PRAC. & REM. CODE § 171.025.

7 An exception to this general rule may exist if the parties agree to submit questions of arbitrability to the arbitrator – for example, by incorporating the American Arbitration Association rules, which empower the arbitrator to determine arbitrability. *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co.,* 687 F.3d 671, 675 (5th Cir. 2012)("We agree with most of our sister circuits that the express adoption of these rules presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability").

8 *In re AdvancePCS Health L.P.,* 172 S.W.3d 603, 605 (Tex. 2005); *Ellis v. Schlimmer,* 337 S.W. 3d 860, 861 (Tex. 2011).

9 *In re AdvancePCS Health L.P.*, 172 S.W.3d at 605; *J.M. Davidson, Inc. v. Webster,* 128 S.W.3d 223, 227 (Tex. 2003).

10 *In re Olshan Foundation Repair Co., LLC,* 328 S.W.3d 883, 889 (Tex. 2010).

11 *See In re AdvancePCS Health L.P.*, 172 S.W.3d at 606 (signing not required as long as the arbitration agreement is written and between the parties); *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 781 (Tex. 2006) (arbitration agreements may be incorporated by reference).

12 *In re Phelps Dodge Magnet Wire Co.*, 225 SW.3d 599 (Tex. App.—El Paso 2005, orig. proceeding).

13 *See In re AdvancePCS Health L.P.*, 172 S.W.3d at 606.

14 *In re 24R, Inc., et al.*, 324 S.W.3d 564 (Tex. 2010).

15 *Labor Ready Central III, L.P. v. Gonzalez,* 64 S.W.3d 519, 524 (Tex. App.—Corpus Christi 2001, orig. proceeding) (where employer required employees to arbitrate but accepted no such limitation, the employer "gave no consideration for the purported arbitration agreement").

16 *Morrison v. Amway Corp.*, 517 F. 3d 248, 257 (5th Cir. 2008); *In re C&H News Co.*, 133 S.W.3d 642 (Tex. App.—Corpus Christi 2003, orig. proceeding).

17 *In re Odyssey Healthcare, Inc.*, 310 S.W. 3d 419, 421, 424 (Tex. 2010).

18 *Doctors Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

19 *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 756 (Tex. 2001).

20 *In re FirstMerit Bank, N.A.*, 52 S.W.3d at 756 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395, 403-04 (1967)); *see also In re RLS Legal Solutions, LLC,* 221 S.W.3d. 629, 631 (Tex. 2007).

21 *Williams v. CIGNA Financial Advisors Inc.*, 56 F.3d 656, 661 (5th Cir. 1995); *Perry Homes v. Cull*, 258 S.W.3d 580, 589-90 (Tex. 2008).

22 *Perry Homes v. Cull*, 258 S.W.3d 580, 597 (Tex. 2008) (citing *Republic Ins. Co. v. PAICO Receivables, LLC,* 383 F.3d 341, 346 (5th Cir. 2004)).

23 *Perry Homes*, 258 S.W.3d at 587-88; *see also In re Bruce Terminix Co.*, 988 S.W.2d 702 (Tex. 1998).

24 *In re Sun Comm's*, 86 S.W. 3d 313 (Tex. App.—Austin 2002, orig. proceeding).

25 *Perry Homes*, 258 S.W.3d at 591-92 (citations omitted).

26 *Perry Homes*, 258 S.W.3d at 590.

27 *Id.*

28 *Id.* at 597-98.

29 *Id.* at 597.

30 *Forest Oil Corp. v. McAllen,* 268 S.W.3d 51, 56 (Tex. 2008).

31 *Buckeye Check Cashing, Inc.,* 546 U.S. at 445-46.

32 *In re FirstMerit Bank, N.A.,* 52 S.W.3d at 756.

[33] *In re RLS Legal Solutions LLC,* 156 S.W.3d 160 (Tex. App.—Beaumont 2005, no pet. h.).
[34] *In re First MeritBank, N.A.*, 52 S.W.3d at 749.
[35] *Carter v. Countrywide Credit Indus., Inc.,* 362 F.3d 294 (5th Cir. 2004).
[36] 15 WILLISTON ON CONTRACTS § 1763A, at 226 (3d ed.).
[37] *In re AdvancePCS Health, L.P.,* 172 S.W.3d at 603; *see also Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 33 (1991).
[38] *Fleetwood Enters., Inc. v. Gaskamp,* 280 F.3d 1069, 1077 (5th Cir. 2002).
[39] *Carter,* 362 F.3d at 301, n.5 (5th Cir. 2004).
[40] *In re Palm Harbor Homes, Inc.,* 195 S.W.3d at 677; *In re Halliburton Co.*, 80 S.W.3d at 571.
[41] *In re FirstMerit Bank, N.A.*, 52 S.W.3d at 757.
[42] *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000) (finding the plaintiff had failed to support her assertion that arbitration costs were high and she lacked the resources to arbitrate); *see also In re FirstMerit Bank N.A.*, 52 S.W.3d at 756 (holding that "some specific information of future costs is required").
[43] *In re Poly-America, L.P.*, 262 S.W.3d 337, 348-53 (Tex. 2008) (limiting punitive damages and the statutory right to reinstatement under the Texas Worker's Compensation Act found unconscionable); *Hadnot v. Bay, Ltd.*, 344 F.3d 474 (5th Cir. 2003) (affirming district court's decision to sever punitive damages provision and enforce arbitration agreement); *cf. Investment Partners L.P. v. Glamour Shots Licensing, Inc.,* 298 F.3d 314, 318 n. 1 (5th Cir. 2002) ("Provisions in arbitration agreements that prohibit punitive damages are generally enforceable." (citing *Mastrobuono v. Shearson Lehman Hutton, Inc.,* 514 U.S. 52, 56–57 (1995)).
[44] *See In re Poly-America, L.P.,* 262 S.W.3d at 357-58 (limiting discovery to one deposition, 25 interrogatories, and 25 requests for production per side did not render arbitration agreement unconscionable); *cf. Walker v. Ryan's Family Steak Houses, Inc.,* 400 F.3d 370 (6th Cir. 2005) (limiting discovery to one deposition created impermissible unfairness to plaintiffs).
[45] Texas courts have generally rejected claims that waiver of a jury trial gives rise to unfairness. *See, e.g., American Heritage Life Ins. Co. v. Orr,* 294 F.3d 702, 710-11 (5th Cir. 2002). On a related point, the Supreme Court of Texas has confirmed that contractual jury waivers are enforceable. *In re Prudential Ins. Co.*, 148 S.W.3d 124 (Tex. 2004).
[46] *See Buckeye Check Cashing, Inc.,* 546 U.S. at 449; *In re FirstMerit Bank N.A.*, 52 S.W.3d at 756.
[47] *See, e.g., In re Poly-America, L.P.*, 262 S.W.3d at 359-60.
[48] *In re Morgan Stanley,* 293 S.W.3d 182 (Tex. 2009).
[49] *County of Brazoria v. Knutson*, 176 S.W.2d 740, 743 (Tex. 1944) (citing *Forshey v. The Galveston H. & H. R. Co.*, 16 Tex. 516 (1856)).
[50] *Granite Rock Co. v. Int'l Brotherhood of Teamsters*, 561 U.S. 287, 130 S.Ct. 2847, 2855 (2010).

AVOIDING CLASS ARBITRATIONS: *ITALIAN COLORS* AND BEYOND

BY JEFFREY L. OLDHAM & YVONNE Y. HO

IN *AMERICAN EXPRESS CO. V. ITALIAN COLORS RESTAURANT,*[1] the U.S. Supreme Court held that the Federal Arbitration Act ("FAA") requires strict enforcement of contractual provisions waiving the right to class arbitrations ("class-arbitration waivers"), even as applied to a federal statutory claim, and even if the cost of litigating on an individualized basis is economically infeasible. It is open to debate whether *Italian Colors* was a necessary outgrowth of the Court's decision in *AT&T Mobility LLC v. Concepcion*,[2] which invalidated state-law unconscionability grounds for voiding class-arbitration waivers. But there is little doubt that *Italian Colors* severely limits the potential grounds for challenging the enforceability of such waivers. The ramifications of the decision for class-arbitration waivers in other contexts are already being explored in court.

This article discusses the history and substance of the *Italian Colors* decision, as well as recent federal cases applying its principles. Some practical implications of *Italian Colors* are also summarized below. In particular, businesses no longer need to worry about having their waiver clauses voided on policy grounds, although challenges targeting the threshold existence of an agreement to arbitrate remain viable. Changes on the legislative or regulatory front, however, may be forthcoming.

I. The *Italian Colors* decision

A. Factual background

In *Italian Colors*, a group of merchants filed a putative class action against American Express ("AmEx") under Section 1 of the Sherman Act. According to the merchants, AmEx used its monopoly power in the charge-card market to force merchants to accept its credit cards, which charged a much higher fee than credit cards of other companies.[3] The merchants' agreements with AmEx included a broadly-worded arbitration clause and an express waiver of any right to arbitrate claims on a class-basis.[4]

B. The (three) Second Circuit opinions

The district court compelled arbitration, but the Second Circuit reversed in a series of three opinions. In the first one, *In re Am. Express Merchants' Litig.* ("*AmEx I*"),[5] the Second Circuit held the class-arbitration waiver was unenforceable based on evidence that non-compensable expert-witness costs essential to proving an antitrust violation would far exceed any potential recovery. Citing a judicial doctrine referenced in prior Supreme Court cases, the Second Circuit noted that arbitration clauses are enforceable so long as a litigant "'effectively may vindicate its statutory cause of action in the arbitral forum.'"[6] In the court's view, this "effective vindication" doctrine precluded enforcing the waiver clause because it was economically infeasible for the merchants to litigate their claims on an individual basis.[7] And giving effect to the waiver would "grant Am[E]x de facto immunity from antitrust liability" for small-value claims.[8]

After the Supreme Court granted review from *AmEx I* and vacated and remanded for reconsideration[9] in light of *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,[10] the Second Circuit issued its second opinion (*AmEx II*).[11] *Stolt-Nielsen* held that the arbitrators exceeded their powers by granting class arbitration when the parties had no agreement authorizing it.[12] In *AmEx II*, the Second Circuit found nothing in *Stolt-Nielsen* to suggest that class-arbitration waivers are always enforceable, so it reaffirmed its holding in *AmEx I*.[13]

Two weeks later, the Supreme Court issued its landmark decision in *Concepcion*,[14] holding the FAA preempts state-law grounds for invalidating class-arbitration waivers as unconscionable. In response to *Concepcion*, the Second Circuit *sua sponte* reconsidered *AmEx II*, but again concluded the class-arbitration waiver was unenforceable.[15] The court distinguished *Concepcion* as dealing with preemption of state contract law, and not the vindication of federal statutory rights.[16]

C. The Supreme Court's opinion

In a 5-3 decision,[17] the Court reversed and held that a class-arbitration waiver is enforceable even if the expense of pursuing the claim on an individualized basis would be prohibitive.[18] Justice Scalia's majority opinion makes clear that, except in narrow circumstances, arbitration agreements will be enforced as written regardless of their practical impact

on a claimant's ability to vindicate a federal statutory right.

The opinion reflects three core principles. First, the FAA requires enforcement of class-arbitration waivers against federal statutory claims absent a "contrary congressional command."[19] Here, "the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim," nor do they bar class-action waivers.[20] As the majority noted, Federal Rule of Civil Procedure 23 was not enacted until decades after the Sherman Act, and the rule also does not guarantee an opportunity to use its class-action procedures for federal statutory claims.[21]

Second, little remains of the "effective vindication" doctrine as a basis for voiding class-arbitration waivers on public-policy grounds. The Court agreed that waivers of substantive rights—like the right to pursue a statutory remedy—are not enforceable.[22] The opinion also suggests, but does not fully embrace the notion, that the doctrine *might* prohibit enforcement of arbitration agreements if the administrative and filing costs of arbitration impede *access* to an arbitral forum.[23] But the Court concluded that a waiver of a procedural mechanism for vindicating those rights—like the ability to proceed as a class—is different. According to the Court, "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[24]

The Court read *Concepcion* as establishing that the FAA's directive to give effect to arbitration agreements "trumps any interest in ensuring the prosecution of low-value claims."

Third, the Court viewed its holding as a logical outgrowth of the *Concepcion* decision. As the majority saw it, the Court in *Concepcion* had "already rejected" the notion that federal law guarantees litigants an opportunity to vindicate federal statutory rights through class-arbitration proceedings.[25] The Court read *Concepcion* as establishing that the FAA's directive to give effect to arbitration agreements "trumps any interest in ensuring the prosecution of low-value claims."[26] *Concepcion* also stressed that the complexity and expense of class-wide litigation would interfere with the objectives of arbitration to achieve resolution more quickly and efficiently.[27] The Court observed that requiring federal courts to conduct a full-blown analysis of the evidence and costs necessary to prove a claim, just to determine if arbitration can proceed, similarly interferes with the FAA's objectives of ensuring speedy resolution of disputes.[28]

II. Case Developments

The Court's broad reasoning in *Italian Colors* strongly signals its applicability to claims outside the antitrust context. Recognizing this, lower courts have already begun to apply *Italian Colors* to uphold class-arbitration waivers for other types of claims.

A. FLSA Collective Actions

Most recently, the Second Circuit held that *Italian Colors* required enforcement of a clause waiving the right to pursue a collective action under the Federal Labor Standards Act ("FLSA").[29] That opinion joined the approach of numerous pre-*Italian Colors* decisions from the Third, Fourth, Fifth, Eighth, Ninth, and Eleventh Circuits, giving effect to similar provisions.[30]

Notably, the National Labor Relations Board ("NLRB") has taken a contrary position. In 2012, the NLRB ruled that home-builder D.R. Horton, Inc. violated the National Labor Relations Act ("NLRA") by requiring its employees to sign arbitration agreements that waived the right to bring joint, class, or collective FLSA actions in court or in arbitration.[31] The NLRB construed Section 7 of the NLRA to confer a substantive right on employees to engage in collective activities not only in the workplace, but also through litigation.[32] D.R. Horton appealed the ruling to the Fifth Circuit, and that court heard argument in February.[33]

Since then, the parties submitted letter briefs addressing the impact of *Italian Colors*. The NLRB, in particular, argued that the waiver's restriction on *substantive* rights protected by the NLRA distinguishes this case from *Italian Colors*, in which the antitrust statutes did not protect class-based procedures.[34] So far, courts have overwhelmingly rejected the NLRB's view.[35] The Fifth Circuit appeal remains pending.

B. Agreements incorporating rules forbidding arbitration of class- or collective-actions

Another interesting follow-on to *Italian Colors* is *Zeltser v. Merrill Lynch & Co.*,[36] which reflects a collision between the freedom-of-contract and preference-for-arbitration principles underlying *Italian Colors*. There, the District Court for the Southern District of New York refused to compel individual arbitration of a putative class- and collective-action suit under state and federal wage-and-hour laws because the arbitration agreement incorporated rules forbidding arbitration of class- and collective-actions. The plaintiff, a financial analyst, had

registered with the Financial Industry Regulatory Authority ("FINRA"). As part of that registration, the plaintiff signed a form agreeing to arbitrate disputes that are "required to be arbitrated" under FINRA rules "as may be amended from time to time."[37]

FINRA is a self-regulatory organization comprised of securities firms in the United States.[38] By statute, FINRA has authority to promulgate rules that, upon adoption by the SEC, carry the force of law.[39] FINRA Rule 13200 generally requires arbitration of disputes between industry members and associated persons. But since 1992, the FINRA Code (and its predecessor, the NASD rules) has barred arbitration of class-action suits among industry members, for the stated reason that such disputes are "better handled by the courts."[40] Rule 12304(a) prohibits arbitration against a member of a certified or putative class action until certification is denied or decertified, or until the member is either excluded from, elects not to participate in, or withdraws from the class.[41] The rule was amended in 2012 to add a subpart (b) that similarly bars arbitration of pending putative or certified collective actions.[42] The amended Rule 12304(b) applies to all claims that are part of a certified or putative class action as of July 9, 2012.[43]

In *Zeltser*, after the plaintiff filed suit, the defendants moved to compel arbitration on an individualized basis. The district court sided with plaintiff, based on the explicit language of FINRA Rule 13204 and the SEC's interpretation of the rule to delegate resolution of class-actions to the courts.[44] The court acknowledged *Italian Colors*'s "favorable view" towards enforcing waivers of class- and collective-action under the FAA, but the court distinguished *Italian Colors* because it did not address a circumstance where FINRA rules bind the parties.[45]

On one level, the *Zeltser* opinion appears faithful to *Italian Colors*'s core principle that arbitration agreements must be enforced as written. A long line of authority recognizes that parties are bound by arbitration rules incorporated by reference in their arbitration agreements, including rules that delegate to the arbitrator questions of arbitrability that are otherwise reserved for the court.[46] By this rationale, the parties in *Zeltser* agreed to arbitrate only those disputes that were arbitrable under the FINRA rules, thereby excluding class- and collective-action suits that may not be arbitrated under the rules.

Yet the district court was arguably too quick to dismiss other language in *Italian Colors* stressing that the FAA's presumption favoring arbitration can only be overridden by express congressional command. For instance, the FINRA rules contradict the weight of authority holding that the FLSA—the basis of one of plaintiff's claims—does not guarantee a substantive right to pursue a collective action.[47] It is uncertain whether FINRA rules promulgated with the approval of the SEC—even if agreed to by the parties—can override the FAA's presumption in favor of arbitration.

The defendant in *Zeltser* also argued that the FAA's mandate and FINRA rules can be reconciled.[48] According to the defendant, the only way to adhere to both the FAA and the FINRA rules barring arbitration of pending class actions is to compel arbitration, but on an individualized basis.[49] This approach would indeed give effect to the FAA's presumption favoring arbitration, but arguably, it would read into the rules a class-*action* waiver that may never have been bargained for. Thus, the defendant's argument highlights the tension between the freedom-of-contract and preference-for-arbitration principles underlying *Italian Colors* and the FAA itself. The district court did not expressly address the issue.

Notably, the court also did not address a recent ruling suggesting that FINRA rules cannot trump the FAA's preference for arbitration. A FINRA hearing panel held that FINRA rules hostile to arbitration are preempted by the FAA, at least to the extent they prohibit members from including class-action waivers in their arbitration agreements with customers.[50] In addition to barring arbitration of pending class actions, the FINRA Rules prohibit members from imposing "limits" on a party's ability to file a "claim" in court that is otherwise permitted to be filed in court under the FINRA rules.[51] Although the hearing panel found that a class-action waiver violates FINRA rules by barring customers from bringing judicial class actions that they would otherwise be entitled to bring, the panel concluded that FINRA's promulgation of the rules with the SEC's approval "is not the same as a *congressional* command creating an exception to the FAA" and, under *Concepcion*, those rules "must give way to the FAA's mandate" requiring that the waiver be enforced.[52] That decision has been appealed to the FINRA National Adjudicatory Council,[53] and a ruling by that body may be appealed to the SEC and eventually to a federal court.[54] So even if the underlying questions about the enforceability of FINRA's rules excluding class- or collective-actions from arbitration are not resolved in the appeal from *Zeltser*, they are likely to be the subject of future judicial decisions.[55]

III. General implications for class-arbitration waivers

The *Italian Colors* decision reinforces the Supreme Court's

approach of giving full effect to arbitration agreements and substantially narrows the potential grounds for avoiding class-arbitration waivers. There are several practical implications of this holding.

First, businesses do not need to include consumer-friendly provisions to ensure their class-arbitration waivers survive judicial scrutiny. Before *Italian Colors*, many large consumer-oriented companies had begun incorporating provisions offering to cover administrative fees, providing for attorneys' or expert fees to successful claimants, or even promising a premium payment if an award exceeds the last-best offer.[56] One example is the clause in *Concepcion*, which required AT&T to pay all arbitration costs for non-frivolous claims and, if the award exceeds the amount of AT&T's last settlement offer, required AT&T to pay a minimum recovery of $7,500, double the amount of the claimant's attorneys' fees, and all the claimant's reasonable expert fees.[57] Although there may be sound business reasons for including similar friendly provisions, the absence of such provisions should not be a barrier to enforcing a waiver clause.

Second, given *Italian Colors*'s curtailment of policy-based challenges to enforcing waivers, future challenges are likely to focus on general contract-formation principles. Regarding *Concepcion* and *Italian Colors*, they do not foreclose general contract defenses to the existence of an agreement to arbitrate, like fraud or duress. Such defenses fall within the FAA's "saving clause," which permits arbitration agreements to be avoided on "such grounds as exist at law or in equity for the revocation of any contract."[58]

Third, *Italian Colors* may prompt lawmakers to step in, and there is some movement on this front already. For instance, the House of Representatives and the Senate recently introduced bills that would amend the FAA to invalidate pre-dispute arbitration agreements for consumer, investor, employment, and civil rights claims.[59] The likelihood of such sweeping legislation becoming law, however, is probably remote. Similar bills proposed in recent years have died in committee.[60] It is unclear whether narrower, more targeted efforts aimed at class-arbitration or class-action waivers would be acted upon.

The most significant change seen thus far is under the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 ("Dodd-Frank Act").[61] The Dodd-Frank Act bars enforcement of pre-dispute arbitration agreements in whistleblower-retaliation suits under Sarbanes-Oxley.[62] It also created the Consumer Financial Protection Bureau ("CFPB"), and vested the CFPB with the authority to restrict or prohibit use of mandatory pre-dispute arbitration agreements in consumer contracts for financial products or services.[63] The CFPB has already exercised this authority by promulgating rules under the Truth In Lending Act that prohibit pre-dispute arbitration clauses in contracts for mortgage and home equity loans for which applications are received on or after June 1, 2013.[64] Pursuant to its statutory authority, the CFPB is also conducting a broader study about the use of arbitration agreements in a wide array of contracts for consumer financial products and services.[65] This study could precipitate further restrictions on the enforceability of arbitration clauses.

* * *

Italian Colors answered a lingering question regarding class-arbitration waivers by reinforcing prior Supreme Court FAA jurisprudence and perhaps ending the uncertainty surrounding the enforceability of such waivers. The decision narrows the focus for businesses seeking to use class-arbitration waivers in their arbitration agreements and circumscribes future challenges to those waivers, but related questions will continue.

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1 133 S. Ct. 2304 (2013).
2 131 S. Ct. 1740 (2011).
3 133 S. Ct. at 2308.
4 *Id.*
5 554 F.3d 300, 317-20 (2d Cir. 2009).
6 *Id.* at 319-20 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985)).
7 *Id.* at 320.
8 *Id.*
9 *Am. Express Co. v. Italian Colors Rest.*, 130 S. Ct. 2401 (2010).
10 130 S. Ct. 1758 (2010).
11 *In re Am. Express Merchants' Litig. ("AmEx II")*, 634 F.3d 187 (2d Cir. 2011).
12 130 S. Ct. at 1767-68, 1775-77.
13 *AmEx II*, 634 F.3d at 193-94, 199-200.
14 131 S. Ct. at 1746-53.

[15] *In re Am. Express Merchants' Litig.*, 667 F.3d 204, 206 (2d Cir. 2012).

[16] *Id.* at 212-13.

[17] Justice Sotomayor recused because she was a member of the panel that decided *AmEx I*.

[18] 133 S. Ct. at 2307-12.

[19] *Id.* at 2309.

[20] *Id.*

[21] *Id. at* 2309-10.

[22] *Id.* at 2310.

[23] *Id.* at 2310-11.

[24] *Id.* at 2311.

[25] *Id.* at 2310 (citing *Concepcion*, 131 S. Ct. at 1748).

[26] *Id.* at 2312 n.5.

[27] *Id.* at 2312.

[28] *Id.*

[29] *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 295-99 (2d Cir. 2013).

[30] *See Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1054-55 (8th Cir. 2013); *Vilches v. The Travelers Cos.*, 413 F. App'x 487, 494 & n.4 (3d Cir. 2011); *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1366, 1378-79 (11th Cir. 2005); *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 298-99 (5th Cir. 2004); *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 503 (4th Cir. 2002); *Horenstein v. Mortgage Mkt., Inc.*, 9 F. App'x 618, 619 (9th Cir. 2001).

[31] *In re D.R. Horton, Inc.*, 357 NLRB No. 184 (2012).

[32] *Id.*

[33] *D.R. Horton Inc. v. NLRB*, 12-60031 (5th Cir.) (argued Feb. 5, 2013).

[34] Rule 28(j) Letter *D.R. Horton, Inc. v. NLRB* (5th Cir. June 26, 2013) (No. 12-60031).

[35] *See, e.g.*, *Sutherland*, 726 F.3d at 297 n.8 (adopting the Eighth Circuit's view in *Owen*, 702 F.3d at 1053-54, that the NLRB's ruling is owed no deference). Further complicating the NLRB's position is the D.C. Circuit's ruling that President Obama's recess appointments to the Board in 2012 were invalid, a decision that the Supreme Court is reviewing this term. *See Noel Canning v. NLRB*, 705 F.3d 490, 499 (D.C. Cir. 2013), *cert. granted*, 133 S. Ct. 2861 (2013). One of the three NLRB members who decided the case was the subject of an earlier recess appointment in 2010, and D.R. Horton asserts that his appointment was likewise void. Rule 28(j) Letter *D.R. Horton, Inc. v. NLRB* (5th Cir. Jan. 29, 2013) (No. 12-60031); *see also Sutherland*, 726 F.3d at 297 n.8 (cautioning that *D.R. Horton* may not have been decided with a proper quorum).

[36] No. 13 CV 1531 (HB), 2013 WL 4857687 (S.D.N.Y. Sept. 11, 2013).

[37] *Id.* at *1.

[38] *See* FINRA website, *available at* http://www.finra.org/.

[39] *See McDaniel v. Wells Fargo Invs., LLC*, 717 F.3d 668, 673 (9th Cir. 2013) (citing 15 U.S.C. § 78s(b)).

[40] *See* Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions From Arbitration Proceedings, 57 Fed. Reg. 52659-02, 52661 (Nov. 4, 1992) (approving predecessor National Association of Securities Dealers, Inc.'s rule to exclude class action matters from arbitration proceedings).

[41] *Zeltser*, 2013 WL 4857687, at *1 (quoting FINRA Rule 12304(a)).

[42] *Id.* (quoting FINRA Rule 12304(b)(4)); *see also* Order Granting Accelerated Approval of Proposed Amendment to Rule 13024, 77 Fed. Reg. 22374 (Apr. 13, 2013).

[43] FINRA Regulatory Notice 12-28 (June 2012), *available at* http://www.finra.org/Industry/Regulation/Notices/ 2012/P126871.

[44] *Zeltser*, 2013 WL 4857687, at *2-3.

[45] *Id.* at *3.

[46] *See, e.g.*, *Oracle Am., Inc. v. Myriad Group A.G.*, 724 F.3d 1069, 1072-75 (9th Cir. 2013) ("Virtually every circuit to have considered the issue has determined that incorporation of the American Arbitration Association's (AAA) arbitration rules constitutes clear and unmistakable evidence that the parties agreed to arbitrate arbitrability."); *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co.*, 687 F.3d 671, 675 (5th Cir. 2012) ("express adoption" of AAA rules "presents clear and unmistakable evidence that the parties agreed to arbitrate arbitrability"); *Fallo v. High-Tech Inst.*, 559 F.3d 874, 878 (8th Cir. 2009) (same); *Qualcomm Inc. v. Nokia Corp.*, 466 F.3d 1366, 1373 (Fed. Cir. 2006) (same); *Terminix Int'l Co. v. Palmer Ranch LP*, 432 F.3d 1327, 1332 (11th Cir. 2005) (same); *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208 (2d Cir. 2005) (same). *But see Riley Mfg. Co. v. Anchor Glass Container Corp.*, 157 F.3d 775, 777 & n.1 (10th Cir. 1998) (resolving question of arbitrability without analyzing the impact of the agreement's incorporation of AAA rules).

[47] *See supra* Part III.A & nn. 29-30.

[48] Memorandum In Support Of Defendants' Motion To Compel Individual Arbitration at 7-8, *Zeltser v. Merrill Lynch & Co.*, 2013 WL 4857687 (S.D.N.Y. Sept. 11, 2013) (No. 13 CV 1531 (HB)).

[49] *Id.*

[50] *Dep't of Enforcement v. Charles Schwab & Co.*, Disciplinary Proceeding No. 2011029760201, at 33-41 (FINRA OHO Feb. 21, 2013), *available at* http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=33101.

[51] *Id.* at 13-16.

[52] *Id.* at 23-26, 33-41.

[53] *See* Susan Antilla, Schwab *Case Casts a Spotlight on Securities Arbitration and Its Flaws*, N.Y. TIMES, Sept. 5, 2013, at B5.

[54] Rulings on disciplinary actions by the FINRA National Adjudicatory Council can be appealed to the SEC, 15 U.S.C. § 78s(d)(1), (d)(2), (e)(1), and then to a federal court, *id.* § 78y(a)(1).

[55] The defendant in *Zeltser* filed an interlocutory appeal, but the appellate docket number had not been assigned as of the submission of this paper.

[56] *See* Myriam Gilles, *Killing Them With Kindness: Examining Consumer-Friendly Arbitration Clauses After* AT&T Mobility v. Concepcion, 88 NOTRE DAME L. REV. 825, 829, 850-59 (2013).

[57] 131 S. Ct. at 1744; *see also* Gilles, *supra* note 56, 844 n.76.

[58] 9 U.S.C. § 2; *see also Concepcion*, 131 S. Ct. at 1748 (FAA saving clause "preserves generally applicable contract defenses").

[59] Arbitration Fairness Act of 2013, H.R. 1844, 113th Cong.; Arbitration Fairness Act of 2013, S. 878, 113th Cong.

[60] *See, e.g.*, Arbitration Fairness Act, S. 987, 112th Cong.; Arbitration Fairness Act, H.R. 1873, 112th Cong.; Arbitration Fairness Act, H.R.

1020, 111th Cong.; Arbitration Fairness Act, S. 931, 111th Cong.; Arbitration Fairness Act, H.R. 3010, 110th Cong.; S.R. 1782, 110th Cong.

[61] Pub. L. 111-203, 124 Stat. 1376 (codified in scattered sections).

[62] 18 U.S.C. § 1514A(e)(2).

[63] 12 U.S.C. §§ 5491, 5518 (Supp. 2010).

[64] 12 C.F.R. § 1026.36(h); *see also* Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 32547-01 (May 31, 2013) (setting effective date of June 1, 2013).

[65] 12 U.S.C. §§ 5491, 5518 (Supp. 2010); *see CFPB Launches Public Inquiry Into Arbitration Clauses* (Apr. 24, 2012), *available at* http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-launches-public-inquiry-into-arbitration-clauses/; *see also* Agency Information Collection Activities; Comment Request, 78 Fed. Reg. 34352 (June 7, 2013) (proposed telephone survey of 1,000 consumers regarding perceptions and preferences regarding arbitration clauses in credit-card agreements).

TEXAS COURTS SHOULD LOOK TO THE BASIC PRINCIPLES OF VENUE WHEN FACING UNCONSCIONABILITY CHALLENGES TO ARBITRATION AGREEMENTS

BY ALEJANDRO ACOSTA III

A BASIC PRINCIPLE OF U.S. LAW IS THAT A CIVIL ACTION will be decided by a court in the locality where the dispute occurred. Venue deals with the propriety of prosecuting a suit in a particular county. Typically, the plaintiff makes the initial determination of where suit is to be brought. The general venue rule states that if no mandatory venue provision applies, all lawsuits shall be brought: (1) in the county in which all or a substantial part of the events or omissions giving rise to the claim occurred; (2) in the county of defendant's residence at the time the cause of action accrued if defendant is a natural person; (3) in the county of the defendant's principal office in this state, if the defendant is not a natural person; or (4) if Subdivisions (1), (2), and (3) do not apply, in the county in which the plaintiff resided at the time of the accrual of the cause of action.[1] Certainly, the promulgators of the general venue rule proposed the preceding venue options for a reason. Whether it is convenience of the parties, proximity concerns, subpoena power of the courts, or just plain common sense, it is clear the Texas Legislature wants to ensure that the county where the lawsuit is to occur has some relation to either the parties themselves or the events giving rise to the claims.

> Venue provisions in arbitration agreements are usually drafted with the convenience of the employer, business, or location of the arbitration firm taking top priority.

Similarly, the Fifth Circuit follows private and public interests factors in deciding venue related issues such as a motion to transfer venue.[2] The private interest factors are: "(1) the relative ease of access to sources of proof; (2) the availability of compulsory process to secure the attendance of witnesses; (3) the cost of attendance for willing witnesses; and (4) all other practical problems that make trial of a case easy, expeditious and inexpensive.[3] The public interest factors are: "(1) the administrative difficulties flowing from court congestion; (2) the local interest in having localized interests decided at home; (3) the familiarity of the forum with the law that will govern the case; and (4) the avoidance of unnecessary problems of conflict of laws [or in] the application of foreign law."[4]

In addressing the enforcement of arbitration agreements, an important question needs to be asked: Do venue provisions in arbitration agreements mirror the basic principles of venue discussed by the courts and the intents expressed by the legislators? The reality is that the drafters of the arbitration agreements, mainly businesses or employers (more likely their respective counsel), are under no obligation to follow legislative intent in drafting an agreement binding an employee or consumer to arbitration. Venue provisions in arbitration agreements are usually drafted with the convenience of the employer, business, or location of the arbitration firm taking top priority. It is more common than not to see an arbitration agreement mandating venue for a dispute to take place where the arbitration firm is headquartered. A common example is an arbitration agreement between an El Paso, Texas employee and El Paso, Texas employer requiring claims that occurred in El Paso, Texas to be arbitrated over 500 miles away in Dallas, Texas where the arbitration firm is located. Proponents of arbitration have, and always will, argue that in the private world of business, parties to an agreement should be allowed to choose and agree to terms of a contract, including venue. But as the voices of inequity in the employment and consumer context become louder and louder and challenges to the arbitration contracts increase[5], will the basic principle of venue provide opponents of arbitration any ammunition to attack the enforceability of arbitration agreements? The surprising answer is that the Texas Supreme Court has not shut the door completely on the opponent's ability to attack venue provisions when challenging the enforceability of the arbitration agreement.

Currently, the most common and effective argument attacking

a venue provision is the argument that the arbitration agreement is unconscionable because it will force a claimant to arbitrate in a venue that will cause claimant to incur substantial expenses and hinder effective vindication of the claimant's statutory rights.[6] Both the United States and Texas Supreme Court have recognized that the existence of large arbitration costs could preclude litigants from effectively vindicating their rights in an arbitral forum.[7] In *In re Odyssey Healthcare, Inc.*, the employee argued that the arbitration clause was unconscionable because it would force her to arbitrate in Dallas, and she would incur substantial expense by having to produce witnesses in Dallas.[8] The Texas Supreme stated that "when a party contests arbitration due to substantial expense, that party bears the burden of proving the likelihood of incurring such costs, and must provide some specific information concerning those future costs."[9] Although the Texas Supreme Court found that the record in that case failed to show any specific information or evidence about what costs would be incurred and that nothing in the agreement required the arbitration to occur in Dallas, the Court left the door open for future challenges with perhaps a more complete record of expenses or an agreement with compulsory venue provisions.[10] Questions still remain as to what evidentiary showing needs to be made, how detailed the showing of prohibitive expense must be, and how to prove the likelihood of incurring such expense.[11] However, it is clear that reviewing courts defer to the trial court's factual determinations when reviewing the trial court's decision concerning the unconscionability of an arbitration agreement. [12]

As for who should assess whether the cost provision in a case will hinder effective vindication of the claimant's statutory rights, the logical choice for a decision maker should be the courts.

> "While arbitrators are capable of considering the unconscionability of arbitral costs, deferring this issue to an arbitrator assumes, as a matter of circular logic, that the matter should be arbitrated. Instead, it would appear preferable that the issue that large arbitration costs could preclude litigants from effectively vindicating their rights in an arbitral forum should be submitted to, and decided by, the courts as a gateway matter. Moreover, deferring the decision as to the alleged excessiveness and unconscionability of the costs of arbitration to an arbitrator in a future proceeding, where the arbitrator might, or might not, adjust the costs, is speculative and fails to ensure that a claimant is not giving up substantive rights in an arbitral forum."[13]

The Texas Supreme Court disagrees with the above logic and instead entrusts the arbitrator with deciding unconscionability of arbitral costs.[14] As a result, do employees seeking to earn a living or consumers seeking to make a purchase now have to familiarize themselves with legal concepts such as severability and a "savings clause"? The current answer is yes.

Senator Al Franken (D-MN) and Representative Hank Johnson (D-GA)[15] are not alone in their efforts to ban predispute forced arbitration. Some Texas trial courts are also sensitive to the inequities of requiring employees, many of which are minimum wage earners, to give up their rights in order to get or keep their jobs. An El Paso County Court at Law judge recently issued an *Order Denying Motion to Compel Arbitration with Findings of Fact and Conclusions of Law*.[16] The order contained twenty seven findings of fact and eleven conclusions of law.[17] The court found that the facts and the record in the case overwhelmingly showed unconscionability.[18] The conclusions of law specified the following:

5. It is hard for this court to think of anything more repulsive than permitting a system that lets large corporations lavishly buy their way out of judicial accountability and into a system more favorable to their side.
6. Another unconscionable part of the policy is paragraph 5.01 which states that all arbitration hearings shall take place in Dallas unless the parties otherwise agree in writing. Obviously, Whataburger employees earning $7.40 per hour in El Paso would never be able to go to Dallas and bring witnesses there.
7. There was no written agreement to waive the Dallas provision, but counsel for Whataburger conceded, at the hearing, that this particular arbitration could occur in El Paso.
8. If Whataburger were ever to use the Dallas requirement to preclude an employee from pursuing a claim, that would be unconscionable. If Whataburger would always waive it and allow employees to have a hearing in their home community, then the Court can think of no reason to have it in the policy other than to discourage employees, and plaintiff's lawyers, from bringing claims in the first place. That is also unconscionable.[19]

By continuing to favor the enforcement of arbitration agreements, are courts considering the fact that many arbitration agreements purposefully mandate venue in counties with no

relationship to the parties, the likely witnesses, the tangible evidence, or the events giving rise to the claim? The current precedent makes little if no effort to comport with the basic principles of venue when enforcing arbitration agreements. Venue provisions that clearly evidence the disparity in bargaining power between the parties or serve as an initial deterrent to litigation should be used offensively by challengers to enforceability.

The harsh reality is that courts up until now have placed the employee and consumer on equal footing with the employer and business, almost as if the employee/consumer and employer/business sat down in a board room and negotiated the terms of the contract and came to the mutual conclusion that venue in Dallas, Texas, per se, was agreeable in the event the employee/consumer suffered injury/harm as a result of employer's/business' negligence/wrongdoing and employee/consumer wanted to adjudicate those claims sometime in the unknown future. The typical setting in which most of these agreements are signed or allegedly assented to is not a model of level ground. How can courts reconcile this? By revisiting the legislators' carefully crafted general venue options and the federal courts' private and public interests analysis, Texas courts should look carefully at the venue provisions of the challenged arbitration agreement and decide, as a whole, if they are forwarding a legal doctrine toward equality or inequality.

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1 V.T.C.A., Civil Practice & Remedies Code § 15.002 (a)(1-4).

2 *In re Volkswagen of America, Inc.* 545 F.3d 304 (5th Cir. 2008).

3 *Id.* at 315.

4 *Id.* at 315; *See Atl. Marine*, 701 F.3d 736, 740 (5th Cir. 2012); *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22, 31 (1988) (concluding that a forum-selection clause "should receive neither dispositive consideration . . . nor no consideration"); *Zamora-Garcia v. Moore,* 2006 WL 3341034, 1 (S.D. Tex. 2006) (denying a motion to transfer despite the existence of a forum-selection clause).

5 S.878/H.R. 1844, The Arbitration Fairness Act (AFA) of 2013.

6 *In re Poly-America, L.P.,* 262 S.W.3d 337, 357 (Tex. 2008); The Texas Arbitration Act also specifically acknowledges unconscionability as a defense and provides that a court may not enforce an arbitration agreement "if the court finds the agreement was unconscionable at the time the agreement was made." V.T.C.A., Civil Practice & Remedies Code § 171.022; *see In re Palm Harbor Homes, Inc.,* 195 S.W.3d at 677; *In re Weeks Marine, Inc.*, 242 S.W.3d 849, 860-61 (Tex. App.—Houston [14th Dist.] 2007, orig. proceeding).

7 *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90 (2000); *In re FirstMerit Bank*, N.A., 52 S.W.3d 749, 756 (Tex. 2001).

8 *In re Odyssey Healthcare, Inc.* 310 S.W.3d 419, 422 (Tex. 2010).

9 *Id. ; see also In re First Merit Bank*, N.A., 52 S.W.3d 749, 756 (Tex. 2001) ("[T]here is no doubt that *some* specific information of future costs in required.")

10 *Id.*

11 *See Olshan Found. Repair Co. v. Ayala,* 180 S.W.3d 212, 214-16, & n.4 (Tex. App.—San Antonio 2005, pet. denied) (determining that the trial court properly denied arbitration where the arbitration costs were almost three times the amount of the original contract at issue, and the claimants' share of the arbitration costs was over twenty-five percent of the family's annual gross income).

12 *Olshan Foundation Repair*, 180 S.W.3d at 214; see also *Delfingen US-Texas, L.P. v. Valenzuela* 2013 WL 444927, *7 (Tex. App.—El Paso 2013).

13 *Caballero v. Contreras,* 2010 WL 3420527, *10 (Tex. App.—Corpus Christi,2010).

14 *In re Poy-America, L.P.*, 262 S.W.3d 337, 356-57 (Tex. 2008); *In re Odyssey Healthcare, Inc.*, 310 S.W.3d 419, 422-23 (Tex. 2010) ("arbitrator is better situated to assess whether the cost provision in this case will hinder effective vindication of [the claimant's] statutory rights and, if so, to modify the contract's terms accordingly.").

15 S.878/H.R. 1844, The Arbitration Fairness Act (AFA) of 2013.

16 *Cardwell v. Whataburger Restaurants, LLC., et al,* No. 2013DCV0910 (County Court no. 7, El Paso County, Texas, Aug. 28, 2013)(order denying motion to compel arbitration).

17 *Id.*

18 *Id.*

19 *Id.*

HOWEVER "GOOD, BAD, OR UGLY"— THE SUPREME COURT'S RECENT ARBITRATION CASES

BY EVAN A. YOUNG

FEW PROBLEMS ARISE WHEN ALL PARTIES to an arbitration agreement want to arbitrate. Case law develops when one party doesn't. Since 2010, the U.S. Supreme Court has decided ten significant cases under the Federal Arbitration Act (FAA) that, taken together, provide six key points that lawyers and judges in state and federal courts need to know.

1. If the parties have agreed to arbitrate, not much is going to stand in the way—even if it requires piecemeal litigation.

Three out of the ten arbitration cases since 2010 are "summary reversals"—unanimous decisions reversing a lower court without even asking for full briefs of the merits, much less oral argument.[1] While summary reversals made up 30% of the recent arbitration cases, they were only 6% of all cases this past Term—5 out of 78. The unusual frequency of summarily reversed arbitration cases—all coming from state courts—demonstrates the Supreme Court's frustration that courts continue to hunt for ways to dodge the Court's arbitration jurisprudence.

The Court has not been coy about its displeasure. "[T]he Supreme Court of Appeals of West Virginia," the U.S. Supreme Court declared in *Marmet Health Care Center, Inc. v. Brown*, "by misreading and disregarding the precedents of this Court interpreting the FAA, did not follow controlling federal law" that requires state court to "enforce" the FAA.[2] Relatives of nursing home residents who had died after allegedly negligent conduct wanted to bring lawsuits, despite having signed arbitration agreements.[3] The West Virginia court, citing public policy, said, in effect, *litigate away.* In holding such arbitration agreements invalid across the board, the Supreme Court observed, the state court "found unpersuasive this Court's interpretation of the FAA, calling it 'tendentious,' and 'created from whole cloth.'"[4] The Supreme Court did not accept the rebuke from West Virginia. "The [FAA's] text includes no exception for personal-injury or wrongful-death claims," it held, and it sent the cases back.[5]

The Oklahoma Supreme Court came in for similar criticism in *Nitro-Lift Technologies, L.L.C. v. Howard*. Employees had signed a confidentiality and non-compete agreement, including an arbitration clause, with Nitro-Lift.[6] The employees filed suit in state court, seeking to void their contract. Despite the arbitration clause, the Oklahoma Supreme Court claimed the authority to scrutinize the underlying agreement.[7] It even contended that its decision was immune from U.S. Supreme Court review because it "rest[ed] on adequate and independent state grounds."[8] This was obviously wrong; Nitro-Lift's contention that the FAA precluded state-court resolution of the claims was a federal issue that Oklahoma courts could not conclusively resolve. The state court's insistence to the contrary, the Supreme Court observed, "is all the more reason for this Court to assert jurisdiction."[9]

The Supreme Court was equally harsh when it reached the merits. As with the West Virginia court in *Marmet*, the Justices unanimously condemned the Oklahoma court, not merely for error, but for ignoring precedent: "The Oklahoma Supreme Court's decision disregards this Court's precedents on the FAA. . . . [W]hen parties commit to arbitrate contractual disputes, it is a mainstay of the Act's substantive law that attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration clause itself, are to be resolved by the arbitrator in the first instance, not by a federal or state court."[10] In other words, it is irrelevant that the Oklahoma Supreme Court, as the highest state court, presumably correctly assessed the contract's validity. Because the parties contracted for arbitration, the state court's only role should have been to dismiss the case and send it straight to the arbitrator, who got to make the call.

The Supreme Court's third summary reversal was of the Florida Court of Appeal's decision in *KMPG LLP v. Cocchi*. Plaintiffs had brought four claims against KPMG. Two of the claims, the state court held, were not arbitrable—plaintiffs had not assented to the relevant arbitration agreements.[11] The problem was that the state court stopped there. It "refus[ed] to compel arbitration on *any* of the four claims based solely on a finding that two of them . . . were non-arbitrable."[12] Why was that wrong? If two of four claims definitely are *not* subject to arbitration, efficiency presumably counsels resolving all

claims in court. But the FAA can trump efficiency, and it "requires courts 'to compel arbitration of pendent arbitrable claims . . . even where the result would be the possibly inefficient maintenance of separate proceedings in different forums.'"[13] Even our aversion to piecemeal litigation must yield to the national policy favoring arbitration.

2. Arbitration is *never* required absent actual agreement to arbitrate—and courts usually get to decide whether that agreement was made.

Like the yin and the yang, the Supreme Court's arbitration cases fit together even when they seem to point in opposite directions. Yes, arbitration must be ordered when the parties contractually agreed to it, but the inverse is also true: If the parties have *not* contractually bound themselves to arbitrate, courts may *not* order arbitration. Both principles derive from the "first principle" of all arbitration law—that "[a]rbitration is strictly a matter of consent, and thus is a way to resolve those disputes—*but only those disputes*—that the parties have agreed to submit to arbitration."[14]

Analogous to the district court's "gatekeeping" function for expert testimony, therefore, "whether parties have agreed to submit a particular dispute to arbitration is typically an issue for *judicial* determination."

Analogous to the district court's "gatekeeping" function for expert testimony, therefore, "whether parties have agreed to submit a particular dispute to arbitration is typically an issue for *judicial* determination."[15] Courts (not arbitrators) resolve disputes about the preliminary "gateway" question of *whether the parties agreed* to arbitrate, as distinct from the merits of any underlying dispute. And "courts should order arbitration of a dispute only where the court is satisfied that neither the formation of the parties' arbitration agreement *nor* (absent a valid provision specifically committing such disputes to an arbitrator) its enforceability or applicability to the dispute is in issue."[16] Without consent or formation, the arbitrator has no power in the first place.

In *Granite Rock v. International Brotherhood of Teamsters*, the Court reiterated those basic principles, and took them a step further. There was no real question that the union and the employer had an agreement with an arbitration clause, but that didn't resolve whether a particular dispute was covered by it.[17] "For purposes of determining arbitrability, *when* a contract is formed can be as critical as *whether* it was formed."[18] Arbitration is not a binary question; as *KPMG* emphasized, some claims might be arbitrable, and others might not, even between the same parties. Thus, in *Granite Rock*, the Court continued, "a court may order arbitration of a particular dispute only where the court is satisfied that the parties agreed to arbitrate *that dispute*."[19]

That does not mean that courts *invariably* rule on arbitrability. Parties can flip the presumption by delegating the arbitrability determination to the arbitrator, so long as they are absolutely, crystal clear that they indeed want such a result.[20] That was the situation in *Rent-A-Center, West, Inc. v. Jackson*. Instead of a substantive contract (about employment, for example) with an arbitration clause, *Rent-A-Center* involved a contract that was nothing but an arbitration agreement—with another arbitration agreement built into it. That secondary agreement read as follows:

> The Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable.[21]

Despite signing that agreement, Jackson wanted out. To get out, he was required to show not that the larger agreement, but the narrow arbitration agreement *governing arbitrability*, was void. The "saving clause" of the FAA permits such a showing.[22] "Like other contracts," therefore, arbitration clauses "may be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability."[23] Courts effectively "sever" the arbitration clause, and treat it as independent of the rest of the contract.[24] By contrast, if the challenge is to the *whole* agreement—including but not limited to the arbitration clause—then the *arbitrator* gets to decide the matter, because the challenge is not *specifically* to the arbitration clause.[25]

Ordinarily, this means that a larger, substantive agreement (that itself has nothing to do with arbitration) is "severed" from an arbitration agreement. But in Jackson's case, the court had to sever one arbitration agreement from *a larger arbitration agreement*. Under those circumstances, could he just challenge the *entire* arbitration agreement in court? Jackson argued that the entire agreement was void because it was "unconscionable"—a traditional state-law basis applicable to any contract.

The Justices said no. "An agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party

seeking arbitration asks the federal court to enforce, and the FAA operates on this additional arbitration agreement just as it does on any other."[26] Therefore, Jackson's "challenge to . . . the contract as a whole, does not prevent a court from enforcing a specific agreement to arbitrate."[27] "Jackson challenged only the validity of the contract as a whole," despite the "whole" of it being about arbitration, and challenges to the "whole" must remain with the arbitrator.[28] Jackson had expressly delegated questions about the legitimacy of the contract as a whole *to the arbitrator*, and it is *that* provision—not the whole agreement—that Jackson must attack. But "none of Jackson's substantive unconscionability challenges was specific to the delegation provision."[29]

Could he have realistically separated the two arbitration agreements, and separately attacked as unconscionable only the one that delegated to the arbitrator challenges ordinarily reviewed by a court? The Court said that it would be *possible*, albeit more difficult. For example, Jackson alleged that the requirement that arbitration fees be split between him and Rent-A-Center was substantively unconscionable; to use that contention to challenge just the "delegation" agreement, Jackson would have to show that splitting fees for arbitrating *just* the narrow question of the overall agreement's validity was unconscionable.[30] That would, unsurprisingly, be more difficult than showing that it was unconscionable to require splitting fees for arbitrating on the merits the employment-discrimination claim that Jackson ultimately wanted to bring. Nonetheless, the challenge to arbitration must "be directed specifically to the agreement to arbitrate before the court will intervene," even if the entire agreement is presumably invalid for that reason.[31]

To be clear, Jackson certainly retained the right to contend that the overall fee-splitting provision, and other features of the agreement as a whole, made it unconscionable, and therefore unenforceable. But his failure to specifically show that delegating that decision to the arbitrator was void meant he would have to make the unconscionability argument to the arbitrator, not the court.[32]

3. Congress alone can change the rules—but only if it speaks clearly.
The framework for arbitration described above is set in stone for everybody—except Congress. If it so desires, Congress can provide that federal causes of action not be subject to arbitration even when parties have signed arbitration agreements.

In *CompuCredit Corp. v. Greenwood*, a putative class of consumers contended that Congress had done just that in the Credit Repair Organizations Act (CROA).[33] Each class member had obtained a credit card from CompuCredit, which had marketed them as a means of assisting in the repair of poor credit history. Cardholders became disenchanted upon discovering the huge fees that CompuCredit charged, along with the meager benefits to their credit that came with holding the card.[34] In their applications, each class member had agreed to arbitrate all disputes. Nonetheless, they wanted to pursue a federal class action, and argued that CROA permitted just that. It required "credit repair organizations" to include mandatory disclosures, including that "'You have a right to sue a credit repair organization that violates'" CROA; it also prohibited the waiver of rights included in CROA.[35] Congress, they argued, plainly meant both to give them a "right to sue," which meant a right to go to court, and to make it impossible for them to waive that right.

The Court acknowledged that Congress *could* do so. But it concluded that the disclosure's reference to "the right to sue" did not itself *create* any right; it simply ensured that consumers would be told, in clear language, about their ability to enforce whatever protections CROA did create (that is, outside of the disclosure provision).[36] Moreover, the mere use of the phrase "right to sue" did not lock enforcement into *judicial* proceedings; parties remained free to resolve disputes under CROA through arbitration. "It is utterly commonplace for statutes that create civil causes of action to describe the details . . . in the context of a court suit," and if merely referring to a lawsuit was enough to displace the FAA, then "valid arbitration agreements covering federal causes of action would be rare indeed."[37]

The general principles favoring arbitration are sufficiently strong, in other words, that courts will not displace them unless Congress removes *all doubt* on the matter.

4. Even if arbitration is required, that does not mean that *class* arbitration is permitted, much less required.
If a plaintiff can show that the requirements of Rule 23 are satisfied, an individual case can become a class action as a matter of course. Is that true of arbitration? The Supreme Court has yet to nail down exactly when class arbitration is permissible (and who gets to decide that—the court or the arbitrator[38]), but its decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.* suggests that the Court will make it difficult for bilateral arbitrations to morph into class arbitrations.

In *Stolt-Nielsen*, the parties to a maritime contract both stipulated that their contract was silent on the matter—that

no agreement had been reached.[39] That conceded *lack* of agreement made all the difference. Arbitration is wholly a creature of consent. Parties have the right to "specify *with whom* they choose to arbitrate their disputes," as well as which particular disputes will be subject to arbitration.[40] Thus, absent some showing of consent, class arbitration is impermissible. "[A] party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."[41]

By attempting to require class arbitration here, the Court held, the arbitral panel did not simply make a mistake; it exceeded its powers as a matter of law. Instead of confining itself to its only legitimate function—reading and interpreting the contractual agreement between the parties—the panel of arbitrators veered off course, and ultimately "the panel simply imposed its own conception of sound policy."[42] Given the parties' stipulation that they did *not* agree to (or disagree to) class arbitration, the panel could have stopped there, but instead it "proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied" in cases where multiple plaintiffs might have similar claims.[43]

Sometimes the Supreme Court resolves a case seemingly for no purpose other than to remind the bench and bar of how much parties really give up when they agree to arbitration.

5. Buyer beware: Agreeing to arbitration means agreeing to the possibility of really bad decisions that courts can do nothing about.

Sometimes the Supreme Court resolves a case seemingly for no purpose other than to remind the bench and bar of how much parties really give up when they agree to arbitration. That seems to have been the gist of *Oxford Health Plans LLC v. Sutter*. At issue in this health-care reimbursement case was whether the arbitrator wrongly decided to treat Sutter's claim—which everyone agreed was arbitrable—as a *class* arbitration, including other physicians who may have been inadequately reimbursed. This case differs from *Stolt-Nielsen* because Oxford Health did not contend that there never had been any agreement about class arbitration. Nor did it argue that the availability of class arbitration was always a question of arbitrability for the court. Instead, it "agreed that the arbitrator should decide whether [the] contract authorized class arbitration, and he determined that it did."[44]

The arbitrator probably was wrong, and the Court all but acknowledged that he was.[45] Justice Alito's concurrence expressly said so; the arbitrator did nothing more than "improperly infer[] '[a]n implicit agreement to authorize class action arbitration . . . from the fact of the parties' agreement to arbitrate.'"[46] Nothing in the plain-vanilla agreement, beyond its mere existence, suggested any agreement to *class* arbitration.[47]

But what can the courts do about an arbitrator getting something terribly wrong? The answer of the unanimous Court was: *Not much*. "[T]he sole question for us is whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong."[48] True, Section 10 of the FAA provides for judicial review of arbitration awards, but that review is nothing like an appeal from a district court to the court of appeals. "[R]eview under § 10 focuses on misconduct rather than mistake."[49]

That left Oxford Health out in the cold. Even if the arbitrator made a serious mistake, he engaged in no misconduct. He did, albeit poorly, just what the parties asked of him. Both sides had *agreed* to let the arbitrator decide whether class arbitration was valid under the contract. As the court of appeals had correctly explained, "[s]o long as an arbitrator makes a good faith attempt to interpret a contract, even serious errors of law or fact will not subject his award to vacatur."[50]

The key message of *Oxford Health*, like many cases before it, is that those who decide to arbitrate must be prepared to take the bitter with the sweet. "So long as the arbitrator was 'arguably construing' the contract—which this one was—a court may not correct his mistakes under §10(a)(4). The potential for those mistakes is the price of agreeing to arbitration. … The arbitrator's construction holds, however good, bad, or ugly."[51] "Oxford chose arbitration," it concluded, "and it must now live with that choice."[52]

6. It doesn't matter if arbitration is far more burdensome than litigation.

Finally, the Court has examined several cases in which arbitration might be seen as an impediment to justice. Without disputing that bilateral arbitration may sometimes be inconvenient, inefficient, or burdensome compared to litigating in court, the Supreme Court nonetheless firmly holds parties to their agreement. In a sense, therefore, this last point brings us full circle to the beginning.

In *AT&T Mobility LLC v. Concepcion*, the Supreme Court found that the FAA preempts a California rule that would invalidate all class-action waivers in certain consumer cases,

whether in court or in arbitration. The Concepcions had responded to AT&T advertisements offering "free phones," but later "were charged $30.22 in sales tax based on the phones' retail value."[53] The Concepcions had signed an arbitration agreement that included a provision precluding class treatment of any dispute.[54] As a general rule, California found any consumer contract that waived class actions "unconscionable" if it did not "adequately substitute[] for the deterrent effects of class actions."[55]

Although the California rule formally applied to all contracts, not just arbitration agreements, and might therefore appear to fit within the saving clause of Section 2 of the FAA,[56] the Supreme Court was unpersuaded. While it might be neutral in theory, it explained, "[i]n practice, of course, the rule would have a disproportionate impact on arbitration agreements," and therefore become an obstacle to the FAA.[57] After all, "[t]he same argument might apply to a rule classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury," all of which might formally appear neutral, but which really target the unique features of arbitration.[58] In the end, the FAA's saving clause could not save a state rule "that stand[s] as an obstacle to the accomplishment of the FAA's objectives."[59] The FAA invites speedy, informal, bilateral resolution of all manner of disputes; "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[60]

Bilateral arbitration and class arbitration, the Court suggested, differed more than ordinary litigation differs from class actions.[61] Unlike trial judgments, arbitration generally has no appellate review, and certainly no judicial appellate review. Errors will inevitably arise, and go unchecked. Perhaps "[d]efendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes," the Court explained; but *class* arbitrations considerably raise the stakes, to approximate what could happen in court.[62] "We find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision."[63] States cannot force cases into court when the parties agree to arbitration; and states cannot force parties to accept class arbitration when they have expressly agreed to forgo it.

The last of the ten cases considered a slightly different objection to arbitration. In *American Express Co. v. Italian Colors Restaurant*, the Court considered an antitrust claim, in which Italian Colors alleged an illegal "tying arrangement" whereby American Express, with effective monopoly power for charge cards, forced merchants to accept certain credit cards at far higher fee rates than they had to pay for competing credit cards.[64] As part of its contract with American Express, Italian Colors had agreed that all disputes would be resolved by arbitration and that no arbitrations would be conducted on a class basis.[65]

The problem was that a limitation to bilateral arbitration effectively precluded bringing antitrust claims as a practical matter. The burden facing Italian Colors was of an order of magnitude different from the burden facing the Concepcions in *AT&T*. The Concepcions *preferred* to litigate rather than arbitrate, but AT&T's arbitration procedures ensured that, if the Concepcions had arbitrated and won, they would have profited; if they received an award greater than what AT&T had offered them in settlement talks, for example, the Concepcions would have won a minimum recovery of $7,500, plus a payment that doubled their attorney fees.[66] But Italian Colors faced a very different calculus. It was estimated that the expert economic and econometric study necessary to prove American Express's monopoly power and the consequences of its "tying arrangement" would cost around $1 million, but that *no* merchant would receive more than $40,000 (even *after* the damages were trebled).[67] As Justice Kagan observed in dissent, this all would make "pursuit of [Italian Colors'] antitrust claim a fool's errand."[68]

Based on that premise, Italian Colors sought to invoke a judicial gloss on the FAA—the "effective vindication" rule.[69] How could a party "effectively vindicate" its rights under the antitrust laws if the only way to pursue the claim would be economically ruinous?

The Court held that this analysis, while perhaps attractive at first glance, missed the point of the "effective vindication" exception. If an arbitration agreement "forb[ade] the assertion of statutory rights," or perhaps insisted on "filing and administrative fees . . . that are so high as to make access to the forum impracticable," then it *would* preclude "effective vindication" of a statutory right, and the courts could decline to enforce the arbitration clause.[70] But those examples—in which one party undertakes to contractually block a claim, and thereby immunize itself from liability—have nothing to do with a particular claim turning out to be economically infeasible. That happens all the time. "[T]he fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[71]

In other words, "the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim."[72] And how could class-action status be essential to the Sherman and Clayton Acts, when those statutes considerably predate the availability of class actions for *any* federal claim?[73] But suppose the Court were to agree with Italian Colors. What *rule* could it fashion to explain when arbitration blocked "effective vindication," and when it didn't? Italian Colors' case might be an extreme example, but ruling for it would open *every* case to the potential of lengthy proceedings in court to ascertain exactly how much success could bring in damages, and trying to determine from that data whether bilateral arbitration provided a sufficiently effective remedy.[74] "Such a preliminary litigating hurdle would undoubtedly destroy the prospect of speedy resolution that arbitration in general and bilateral arbitration in particular was meant to secure."[75] Thus, if an arbitration agreement leaves undisturbed a party's *right* to pursue a federal claim, it cannot be held to deprive that party of "effective vindication" of that claim simply because it may be economically unwise to follow through.

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1 *See Nitro-Lift Techs., L.L.C. v. Howard*, 133 S. Ct. 500 (2012) (*per curiam*); *Marmet Health Care Center, Inc. v. Brown*, 132 S. Ct. 1201 (2012) (*per curiam*); *KPMG LLP v. Cocchi*, 132 S. Ct. 23 (2011) (*per curiam*).

2 132 S. Ct. at 1202.

3 *Id.* at 1203.

4 *Id.* (quoting *Brown v. Genesis Healthcare Corp.*, 724 S.E.2d 250 (W. Va. 2011)).

5 *Id.*

6 133 S. Ct. at 501-02.

7 *Id.* at 502.

8 *Id.*

9 *Id.* at 503.

10 *Id.* (internal quotation omitted).

11 *KPMG*, 132 S. Ct. at 25.

12 *Id.* (emphasis added).

13 *Id.* at 26 (quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 217 (1985)).

14 *Granite Rock Co. v. Int'l Brotherhood of Teamsters*, 130 S. Ct. 2847, 2857 (2010) (internal quotations and citations omitted).

15 *Id.* at 2855 (internal quotations omitted) (emphasis added).

16 *Id.* at 2857-58.

17 *Id.* at 2855 (arbitration principles are "well settled in both commercial and labor cases").

18 *Id.* at 2860.

19 *Id.* at 2856 (citations omitted).

20 "Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator." *AT&T Techs., Inc. v. Comms. Workers of America*, 475 U.S. 643, 649 (1986).

21 *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2775 (2010) (quoting Mutual Agreement to Arbitrate Claims).

22 The saving clause of the Federal Arbitration Act provides that arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2012).

23 *Rent-A-Center*, 130 S. Ct. at 2776 (internal quotations omitted).

24 *See Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006).

25 *Id.* at 445-46.

26 *Rent-A-Center*, 130 S. Ct. at 2777-78.

27 *Id.* at 2778.

28 *Id.* at 2779.

29 *Id.* at 2780.

30 *Id.*

31 *Id.* at 2778.

32 Justice Stevens was not convinced. "The notion that a party may be bound by an arbitration clause in a contract that is nevertheless invalid may be difficult for any lawyer—or any person—to accept, but that is the law" as established in Supreme Court precedents. *Id.* at 2787 (Stevens, J., dissenting).

33 15 U.S.C. § 1679 et seq. (2006).

34 *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 668 (2012).

35 *Id.* at 669 (quoting 15 U.S.C. § 1679c(a)).

36 *Id.* at 669-70.

37 *Id.* at 670.

38 *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1772 (2010) (no need to resolve whether arbitrator or court is empowered to decide whether contract permits class arbitration).

39 *Id.* at 1766.

40 *Id.* at 1774.

41 *Id.* at 1775.

42 *Id.* at 1769.

43 *Id.*

44 *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2067-68 & n.2 (2013).

45 *Id.* at 2070 ("Nothing we say in this opinion should be taken to reflect any agreement with the arbitrator's contract interpretation, or any quarrel with Oxford's contrary reading.").

46 *Id.* at 2071 (Alito, J., concurring) (quoting *Stolt-Nielsen*, 559 U.S. at 685).

47 *Id.* at 2067.

48 *Id.* at 2068.

49 *AT&T Mobility LLC v. Concepcion,* 131 S. Ct. 1740, 1752 (2011).

50 *Oxford Health*, 133 S. Ct. at 2070.

51 *Id.* at 2070-71.

52 *Id.* at 2071.

53 *AT&T*, 131 S. Ct. at 1744.

54 *Id.*

55 *Id.* at 1745.

[56] *See supra* n.22 (quoting the saving clause).
[57] *AT&T*, 131 S. Ct. at 1747.
[58] *Id.*
[59] *Id.* at 1748.
[60] *Id.*
[61] *Id.* at 1750-52.
[62] *Id.* at 1752.
[63] *Id.*
[64] *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2308 (2013).
[65] *Id.*
[66] *AT&T*, 131 S. Ct. at 1744.
[67] *American Express*, 133 S. Ct. at 2308.
[68] *Id.* at 2313 (Kagan, J., dissenting).
[69] *Id.* at 2310.
[70] *Id.* at 2310-11.
[71] *Id.* at 2311.
[72] *Id.* at 2309.
[73] *Id.*
[74] *Id.* at 2312.
[75] *Id.*

DRAFTING AN EMPLOYMENT ARBITRATION AGREEMENT

BY CLARA B. BURNS

ARBITRATION OF EMPLOYMENT DISPUTES can be a preferred method of dispute resolution for employers and employees alike, with the ability to have a speedier resolution than the parties may receive in a courthouse, relaxed rules of evidence and procedure, and other factors. However, arbitration cannot be imposed simply by inserting a provision in an employment handbook or adopting a policy that refers to arbitration. Arbitration is a creature of contract—that is, both sides must agree to arbitrate and their agreement must be otherwise enforceable. This article will highlight the requirements for drafting an enforceable employment arbitration agreement.

A. Contractual Requirements

1. Offer and Acceptance: Notice and Intent to be Bound

Some employment relationships are formed through written contracts, but in Texas, the majority of employment relationships are traditional at-will relationships. Arbitration can exist in an at-will employment relationship. In re Halliburton, 80 S.W.3d 566, 569-70 (Tex. 2002). In the context of an at-will relationship, an employer is required to give notice to the employee when changes to the employment relationship occur. In the case of arbitration, the employer must give adequate notice of any arbitration provision. The employee is considered to have accepted arbitration as a term of employment if the employee continues to work after notice of the arbitration position. Halliburton, 80 S.W.3d at 569. This is true even if the arbitration provision does not require the employee's signature. Again by continuing to work after notice of the arbitration provision is given, the employee is deemed to have accepted it as a term of employment and is bound by it. However, ensuring that the arbitration agreement has been signed provides evidentiary support of notice and the intent to be bound.

2. Consideration

As a creature of contract, an agreement to arbitrate must be supported by consideration, and therefore the agreement should recite the consideration that supports it. See J.M. Davidson, Inc. v. Webster, 128 S.W.3d 223, 227 (Tex. 2003). Consideration is generally something that the parties are not otherwise entitled to receive, absent their agreement. Payment of money can serve as consideration; however, withholding money an employee is otherwise entitled to receive is not consideration. In re RLS Legal Solutions, LLC, 156 S.W.3d 160 (Tex. App.—Beaumont 2005, orig. proceeding).

A mutual agreement by both parties to arbitrate their disputes is a common way to address consideration and is considered by Texas courts to be sufficient. Halliburton, 80 S.W.3d at 569-70. Arbitration agreements which give the right to the employer to unilaterally amend or terminate an arbitration requirement generally are considered illusory and thus not supported by consideration. J.M. Davidson, 128 S.W.3d at 230 n.2.

B. Unconscionability

1. Substantive Unconscionability

An arbitration agreement should be drafted to avoid arguments that it is substantively or procedurally unconscionable and thus unenforceable. Substantive unconscionability occurs when an agreement is so one-sided, given the parties' backgrounds and circumstances, that it would be unconscionable to enforce it. In the context of employment arbitration agreements, substantive unconscionability can occur when the costs of arbitration are prohibitive to the employee and would deter enforcement of statutory rights in an arbitral forum, when the agreement attempts to limit damages or remedies that are recoverable under the substantive law governing the dispute, or when the agreement imposes discovery limitations that deny an employee the fair opportunity to develop his or her claims. See In re Poly-America, L.P., 262 S.W.3d 337, 351-59 (Tex. 2006).

To avoid these types of issues, an arbitration agreement should not be drafted with the intent to limit a party's substantive or procedural rights. Thus, a party should be able to recover in arbitration what the party would be entitled to recover under the law if in court, should that party prevail. Similarly, undue restrictions on limitations periods and discovery procedures should be avoided.

2. Procedural Unconscionability

Procedural unconscionability refers to the circumstances surrounding the adoption of the arbitration agreement. It is difficult to prove and generally only occurs when a party is incapable of understanding the agreement. See Fleetwood Enters., Inc. v. Gaskamp, 280 F.2d 1069, 1077 (5th Cir. 2002). One circumstance that can create such incapability is when an agreement is not written or explained in a language that the employee understands. Courts have struck down as procedurally unconscionable, for example, arbitration agreements written only in English but imposed on employees who neither understand or read English. See , e.g., Prevot v. Phillips Petroleum Co., 133 F. Supp. 2d 937, 940 (S.D. Tex. 2001) (refusing to enforce arbitration agreement written in English against Spanish-only speaking employees).

If an agreement is silent as to the selection method, a party can ask a court at law to appoint an arbitrator, thus taking the selection process out of the parties' hands.

Accordingly, particularly in workforces where employees may not speak or read English, arbitration agreements should be translated into other applicable languages and presented to employees in their preferred language to ensure that those employees are signing or otherwise accepting an agreement they are capable of understanding.

C. Scope of Agreement

An arbitration agreement should identify the nature of the claims that are subject to the agreement. Virtually every type of employment-related claim, including employment discrimination claims, wage and hour claims, family and medical leave claims, and others, can be arbitrated if the language of the agreement is broad enough to cover the claim. See e.g.,Gilmer v. Interstate/Johnson Lane Corp., 532 U.S. 105 (1991) (federal law discrimination claims); EZ Pawn Corp. v. Macias, 934 S.W.2d 87 (Tex. 1996) (state law discrimination claims). However, parties are not required to arbitrate claims that do not fall within the scope of the agreement; thus it is important that the language of the agreement properly identify the claims that are covered. See In re Kellogg Brown & Root, Inc., 166 S.W.3d 732, 738 (Tex. 2005).

While an agreement could attempt to list every statutory cause of action, common law claims, and any other type of claim intended to be covered, courts have held that language such as "all claims and disputes I may now have or in the future have against the Company …" and all claims "arising out of" the parties' relationship are sufficiently broad to cover all claims relating to an employment relationship. See In re Choice Homes, Inc., 174 S.W.3d 408 (Tex. App.—Houston [14th Dist.] 2005, orig. proceeding); see also Nauru Phospate Royalties, Inc. v. Drago Daic Interests, Inc., 138 F.3d 160, 164-65 (5th Cir. 1998).

D. Other Drafting Points

1. Administration of the Arbitration

An arbitration agreement should establish how arbitration will be administered, whether self-administered by the parties or administered by an independent source, such as the American Arbitration Association or JAMS. Independent administrators typically have their own established rules and procedures, some of which are deemed incorporated into the parties' arbitration agreement by virtue of using that administrator. Consequently, if designating an administrator in an agreement, it is important to know that administrator's rules and procedures and whether and how they are incorporated into the agreement.

The method for arbitrator selection also can be covered in an arbitration agreement. If an agreement is silent as to the selection method, a party can ask a court at law to appoint an arbitrator, thus taking the selection process out of the parties' hands. 9 U.S.C. §5. However, if the agreement provides for the selection mechanism, a court must enforce the method if requested to do and cannot appoint its own arbitrator. In re Nat'l Health Ins., 109 S.W.3d 552, 556 (Tex. App.—Tyler 2002, orig. proceeding).

2. Federal Arbitration Act/Texas Arbitration Act

The Federal Arbitration Act ("FAA") governs contracts providing for arbitration when the contract (or employment) involves interstate commerce and preempts state law to the contrary. Jack B. Anglin Co. v. Tipps, 842 S.W.2d 266, 269-70 (Tex. 1992). It is not difficult to establish interstate commerce; it can be shown in a variety of ways including something as simple as the use of interstate mail and telephone calls in support of the employer's business. In re Profanchik, 31 S.W.3d 384-85 (Tex. App.—Corpus Christi 2000, orig. proceeding). Moreover, parties are not required to establish interstate commerce if the agreement specifically provides that it is governed by the FAA. In re Kellogg Brown &Root, 80 S.W.3d 611, 617 (Tex. App.—Houston [1st. Dist.] 2002, orig. proceeding). If the agreement does not invoke the FAA and there is otherwise insufficient evidence of interstate commerce, the Texas Arbitration Act ("TAA") may

apply. It governs written arbitration agreements to arbitrate a controversy that exists at the time the agreement is made or arises after the date of the agreement. Tex. Civ. Prac. & Rem. Code § 171.001(a). The TAA prohibits arbitration of personal injury claims, unless the parties and their attorneys agree in writing to such arbitration. Id. §171.002(a) & (c). The FAA contains no such prohibition, so if it otherwise applies, then personal injury claims against employers are subject to arbitration, as the FAA preempts contrary provisions of state law.

3. Appellate Review

Under the FAA, the arbitration award is subject to limited vacatur and cannot be appealed on grounds such as insufficient evidence, as a jury verdict or court decision can be. See 9 U.S.C. §10(a) (identifying limited grounds for vacatur). Moreover, the United States Supreme Court has held that under the FAA, parties may not contract, through their arbitration agreement, to expand the scope of judicial review beyond that allowed under the FAA. Hall Street Assoc., LLC v. Mattel, Inc., 552 U.S. 576, 578 (2008).

Under the Texas Arbitration Act, the result can be different though. The Texas Supreme Court held in Nafta Traders, Inc. v. Quinn,339 S.W.3d 84 (2009) that the TAA does not preclude an agreement for judicial review, and that the FAA does not preempt such an enforcement of such an agreement under the TAA. Id. at 97, 101.

Accordingly, if the parties want the option of judicial review, the agreement should reference the TAA, which may allow for judicial review beyond that allowed under the FAA.

4. Class Actions

A final point to address in an arbitration agreement is whether class or collective actions are permitted or whether they are waived. The United States Supreme Court has held that state laws which void class or collective action waivers in arbitration agreement are preempted by the FAA and that under the FAA, such waivers are enforceable. American Express Co. v. Italian Colors Restaurant, 570 U.S. __ , 133 S. Ct. 2304, 2311-12 (2013); AT&T Mobility LLC v. Concepcion, 563 U.S. __, 131 S. Ct. 1740, 1753 (2011). However, the National Labor Relations Board, the federal agency responsible for enforcement of the National Labor Relations Act ("NLRA"), the statute which gives employees rights to engage in concerted activities, has held that class action waivers are invalid under Sections 7and 8 of the NLRA because they attempt to limit employees' ability to collectively challenge employment decisions, such as wage and hour claims. D.R. Horton Inc., 2012 WL 36274 (N.L.R.B. Jan. 3, 2012). A number of federal courts have refused to follow the NLRB's ruling and have continued to enforce class action waivers. See Richards v. Ernst & Young LLP, __ F.3d __, 2013 WL 4437601 *2 (9th Cir. 2013) (joining four other courts in holding class action waivers are valid in the context of wage and hour claims and refusing to follow D.R. Horton).

Accordingly, if the exposure of a class or collective arbitration action is of concern, as it would be to most employers, an arbitration agreement should contain a clear waiver of class or collective actions, stating that the arbitrator has no authority to hear such actions.

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ADVOCACY IN INTERNATIONAL COMMERCIAL ARBITRATION

BY JOHN P. BOWMAN

EFFECTIVE ADVOCACY IN INTERNATIONAL commercial arbitration requires, to start, acquiring a comprehensive knowledge of the five building blocks of international arbitration: the arbitration agreement, arbitration rules, international conventions concerning the enforcement of arbitration agreements and awards, national arbitration laws, and pertinent decisions and procedures of relevant national courts. These five building blocks constitute the legal framework – the arena – in which the advocate in international arbitration operates. This framework defines and governs the arbitral process making up the practice of international arbitration, and the practitioner must know this framework inside and out, just as the trial lawyer in the federal courts in the United States must have thorough knowledge of the Federal Rules of Civil Procedure, local court rules, and the Federal Rules of Evidence in order to perform successfully in that arena. Until the advocate masters these five building blocks, he or she cannot hope to function effectively, let alone be taken seriously by arbitral tribunals and other counsel, in the arena of international arbitration.

A narrow form clause attempts to "carve out" certain controversies for a different form of dispute resolution, such as expert determination, if the controversy concerns technical issues, or determination by the courts.

The agreement to arbitrate constitutes the dispute resolution contract, or bargain, between the parties to a written commercial agreement. Absent inclusion of an agreement to arbitrate in a commercial agreement, or the willingness to enter into a submission agreement once a dispute arises, the parties must by default apply to the courts when they need a third party to decide their dispute. In some agreements, the dispute resolution bargain may provide a multiple step (or tiered) process, starting for example with submission of the dispute to senior company executives, followed by a formal mediation process, and if these steps fail to resolve the dispute, culminating in binding arbitration. When the client first contacts a lawyer for advice about a contractual dispute, as an essential initial step the lawyer must consult the contract in order to determine if the parties agreed to submit future disputes to arbitration. If their agreement contains an arbitration clause, the advocate must ask six questions about the clause.

First, does the agreement to arbitrate contain a broad form clause? A broad clause provides for submission to arbitration of "all disputes arising out of or relating to" the parties' contract, or other expansive language to the same effect. This broad language covers virtually all types of disputes relating to the underlying contract, including disputes sounding in tort, such as fraud in the inducement, and disputes over whether the underlying contract has terminated. A narrow form clause attempts to "carve out" certain controversies for a different form of dispute resolution, such as expert determination, if the controversy concerns technical issues, or determination by the courts. As with any "surgical" procedure, this carve out must be done with great precision, or the parties may only succeed in creating a dispute over what matters must be determined in arbitration. In the United States, unlike most other countries, the Supreme Court has ruled that a dispute over the arbitrability of a particular controversy must be submitted to the courts, unless the parties have clearly stipulated that disputes over arbitrability should be decided by the arbitrators.

Second, what set of arbitral procedures have the parties agreed to follow to resolve their dispute? In most cases, and certainly when commercially sophisticated parties have entered into an agreement to arbitrate, the parties agree on a set of procedures by incorporating by reference the rules containing those procedures in the arbitration clause. For example, the clause may state: "Any dispute arising out of or relating to this Agreement shall be settled by binding arbitration in accordance with the Arbitration Rules of the ICC International Court of Arbitration." Arbitration rules take two forms: administered rules, such as the ICC rules, and non-administered rules, such as the UNCITRAL Arbitration Rules. An arbitral institution, such as the American Arbitration

Association, administers an arbitration conducted under its rules, and charges a fee for this service. By contrast, a set of non-administered rules governs the parties' arbitration, but without involvement of an arbitral institution, except perhaps in the capacity as an appointing authority, in the event a party fails to appoint an arbitrator or the parties cannot agree on the third arbitrator. As a general rule, the parties should never enter into a truly *ad hoc* arbitration provision, in which the parties do not incorporate any set of arbitral rules, whether administered or non-administered, but either remain silent on the procedure to be followed or, worse still, attempt to set forth the arbitral procedure in the agreement to arbitrate. Once the advocate identifies the applicable arbitration rules, the advocate should read those rules before ever calling back the client, unless he or she already knows those rules well. The first questions the client will usually ask its attorney relate to the procedure defined by the arbitral rules.

Third, what does the parties' arbitration agreement say about the number and method of appointment of the arbitrators? Typically, the agreement specifies the number and method of appointment in terms such as: "Any dispute arising out of or relating to this Agreement shall be settled by binding arbitration by three arbitrators in accordance with the Arbitration Rules of [X]. Each party shall appoint an arbitrator, and the arbitrators so-appointed shall appoint the third arbitrator, who shall serve as Chair of the Tribunal." If the arbitration clause does not address arbitrator appointment, the advocate must consult the arbitration rules incorporated by the parties in their arbitration clause. These rules will state the number of arbitrators in the event the parties did not agree on the number and will provide how they will be appointed or, in the case of the ICC and LCIA rules, nominated by the parties. If the parties failed to incorporate a set of arbitration rules, and cannot agree once a dispute arises on the appointment procedure, then the party desiring appointment of an arbitrator must consult the national arbitration law at the seat of arbitration and apply to the courts at the seat to make the appointment.

Fourth, what place did the parties designate as the seat of arbitration in their arbitration clause? For the advocate in international arbitration, the seat of arbitration carries tremendous significance. Most importantly, in almost every situation only the courts at the seat of arbitration can vacate (nullify or set aside) the award. Stated differently, only the courts in the country of the origin of the award – recognized by U.S. courts as the courts with "primary jurisdiction" over the award – can set it aside. The failure to specify a seat in a Contracting State to an international arbitration convention or treaty may have potentially fatal consequences for enforcement of an award, as a consequence of the reciprocity reservation explained below. The national arbitration law at the seat of arbitration, the *lex arbitri*, governs the arbitration process, and the courts at the seat of arbitration will have personal jurisdiction over the parties with respect to actions related to the arbitration by virtue of the parties' choice of seat. Under the laws of some countries, including the United States, choice of seat of arbitration in those countries may be deemed to constitute waiver of sovereign immunity from the personal jurisdiction of their courts. If the parties neglected or were unable to agree on the seat of arbitration, the arbitral tribunal may usually exercise its discretion to determine the seat, in the absence of any post-dispute agreement of the parties.

Fifth, does the arbitration agreement specify the language of arbitration? The language of arbitration will naturally have importance for the client's selection of counsel. For the client, agreeing to arbitration in a language other than the native language of the client's executives may mean that they will need to listen to the proceedings at least in part through an interpreter. They may also have to rely on translations of the parties' written submissions to the arbitral tribunal. The advocate will have to pay careful attention to this choice of language, and plan accordingly.

Last but not least, the advocate in "fly-specking" the agreement to arbitrate must determine, as a threshold matter, if reasons exist to believe that the arbitration agreement cannot be enforced. Frequently, lawyers and commercial representatives make mistakes when drafting arbitration agreements. As a reliable rule of thumb, for every paragraph in an arbitration agreement, there occurs at least one drafting mistake. These mistakes add up. Certain types of mistakes can render the arbitration agreement "pathological" – fatally defective. In the initial intake of the arbitration clause, the lawyer must "scrub" its terms thoroughly to ascertain whether the agreement to arbitrate should be followed or can be ignored. Leading causes of pathological clauses include: failing to designate the arbitration rules accurately; attempting to "modify" a set of administered arbitration rules by incorporating them as a guide while explicitly rejecting administration of the arbitration by the administering institution; and incorporating more than one set of arbitration rules.

International commercial arbitration works successfully, as a method for resolving cross-border commercial disputes, principally because of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also

known as the New York Convention. Adopted by the UN General Assembly in June 1958, the New York Convention today deserves its reputation as the most successful international commercial treaty ever. The United States ratified this Convention in 1970. With almost 160 countries having ratified or acceded to the New York Convention, including all major trading countries, it requires Contracting States to recognize and enforce agreements to arbitrate and foreign (and non-domestic) arbitral awards. It makes enforcement of awards a generally easy and speedy task, specifying that the party seeking to enforce an award need only provide the original or certified copy of the agreement to arbitrate and arbitral award to the enforcement court. Under its widely emulated Article V, which has been included often verbatim in many national arbitration laws, the Convention empowers enforcement courts to refuse to enforce an award falling under the Convention on only limited, mainly due process grounds.

Apart from the New York Convention, a number of regional arbitration conventions exist, most notably for advocates based in Texas the Inter-American Convention on International Commercial Arbitration, also known as the Panama Convention, adopted by the Organization of American States ("OAS") in 1975. Today 19 countries have become Contracting States to the Panama Convention, including the United States, which entered into this Convention in 1990. A unique feature of the Panama Convention: as provided in Article 3, in the absence of an express agreement by the parties on the rules of procedure to govern their arbitration, the Rules of Procedure of the Inter-American Commercial Arbitration Commission shall apply. Uniquely, the United States publishes these rules in the Federal Register. In entering into the New York and the Panama Conventions, the United States did so on the basis of a reciprocity reservation. It will only enforce arbitral awards rendered in a Contracting State to the relevant Convention.

The advocate must be able to advise the client regarding the applicable arbitration law(s) relevant to the arbitration with which the advocate has been entrusted. In the United States, Chapter 1 of the Federal Arbitration Act ("FAA") governs domestic arbitration, Chapter 2 of the FAA implements the New York Convention, and Chapter 3 of the FAA implements the Panama Convention. Unlike applications to the federal courts relating to domestic arbitration agreements and awards, which must establish an independent grounds for federal court jurisdiction, the federal courts have original subject matter jurisdiction pursuant to Section 203 of the FAA over actions relating to arbitral agreements and awards falling under the New York and Panama Conventions. In an interesting and occasionally over-looked procedural twist, Section 205 declares that an action falling under these Conventions can be removed from state to federal court "at any time before the trial thereof." When an action under the FAA falls under both Conventions, Section 305 provides that the Panama Convention governs if a majority of the parties to the agreement to arbitrate are citizens of countries which are Contracting States to the Panama Convention that are also members of the OAS. The national arbitration law at the seat, as previously noted, governs the arbitration process taking place at the seat, but other nations' arbitration laws may also be relevant to enforcement of the agreement to arbitrate, to interim judicial remedies in aid of arbitration, to discovery of documents located outside the country of the arbitration seat, and especially to enforcement of an arbitral award. For these reasons, the advocate must be prepared to advise the client early and often about relevant national arbitration laws as the proceeding unfolds, consulting local counsel for this purpose when necessary.

The fifth and final building block of international commercial arbitration – the national courts – often presents the most challenges or problems for the advocate. The national courts provide the "muscle" – the coercive force – to enforce arbitration agreements and awards. In contrast to investment arbitration, where arbitration between investors and host governments often takes place under the auspices of the International Centre for Settlement of Investment Disputes, a division of The World Bank, and the governing international convention provides a self-contained procedure that specifically prohibits resort to national courts, in international commercial arbitration the parties to arbitration may call upon the courts both in aid of and in opposition to the arbitration process. The potential for misuse of the courts makes designation of the arbitral seat particularly important. In that regard, the advocate will want to see that the parties chose a seat in a country with a neutral, pro-arbitration judiciary.

At the outset of the engagement, the advocate must begin to educate the client regarding the arbitral process and to manage client expectations. The advocate should walk the client through the 12 stages of an international commercial arbitration. This can be done three ways: take the client through the 12 stages during the initial meeting, briefly describing how the process typically works; create a timeline showing each stage and the approximate time it takes; and submit a preliminary budget providing estimates of fees and expenses for each stage. The 12 stages consist of:

1. Initial review and analysis of claims and defenses
2. Preparation of Request for Arbitration, Response, Counterclaim, Reply
3. Appointment of arbitral tribunal
4. Preliminary hearing, Terms of Reference, and Procedural Order No. 1
5. Witness interviews and preparation of written witness statements
6. Expert witness selection and preparation of expert reports
7. Document disclosure and review
8. Pre-Hearing Memorials, comprised of legal briefs, witness statements, expert reports, documentary evidence, and legal authorities
9. Preparation of witnesses for the hearing on the merits
10. Preparation of cross examination and opening statement
11. Hearing on the merits in front of the arbitral tribunal
12. Post-hearing Memorials and Submission of Costs

Needless to say, the successful advocate must possess the skills needed for each stage. In broad terms, effectively navigating the arbitral process through to a winning award requires four basic skills.

First and foremost, like the successful trial lawyer, the international disputes lawyer must be able to identify and evaluate the strengths and weaknesses of each party's case, formulate a strategy for presenting and explaining the evidence, especially unfavorable evidence, employ outstanding inter-personal and managerial skills in order to elicit the best performance from colleagues and witnesses, and implement the strategy in a dynamic setting as the arbitral process moves forward, while constantly anticipating opposing counsel's arguments and procedural maneuvers, as well as the key concerns and questions of the arbitral tribunal. Adding to the challenge, the international advocate almost never works on cases involving the substantive law in which he or she was trained, often deals with documents written in different languages, interacts with witnesses and client representatives from diverse cultures, life experiences, and regions of the world, and normally must persuade a tribunal made up of three arbitrators with varying technical, legal, and linguistic backgrounds who often come from markedly different legal traditions (civil or common law).

Unlike at the courthouse, the claimant usually submits its entire case-in-chief in writing, as does the respondent with its statement of defense and counterclaim. Replies also come in in writing. This reliance on written submissions means that the advocate should have all the writing talent of the finest appellate lawyer. No amount of courtroom razzle-dazzle or gravitas will compensate for poorly written briefs. Without delving into details, the essential elements of persuasive legal writing in this context require the advocate to: master the subject matter; identify, describe the client for the tribunal; begin with a clear, concise statement of the case; articulate an overarching consistent theme; set out a logical, lucid marshaling of the argument; ensure effective use of documentary and witness evidence in the written briefs; expose the opponent's flaws, fallacies, and falsehoods; and establish both legal and equitable grounds for the result desired. Use simple, plain language; eliminate all unnecessary words; avoid "legalese"; use active, not passive, constructions; do not lose focus; use transitions to reject, restate, reaffirm; choose words that inform, explain, challenge, persuade, and live; make every word count! The advocate's goal should be to write with compelling clarity, to render the client's case understandable, believable, and irrefutable, and to use words to strip the opponent's case of all validity. When done right, the other side has lost the case before the hearing on the merits begins. Similarly, well written post-hearing briefs have carried the day at the end of many hard-fought arbitrations.

Unfortunately, with increasing frequency these critical opportunities for the advocate to connect with the tribunal have devolved into lengthy power point presentations with tedious recitations of interminable bullet points.

At the hearing on the merits, as well as before in the initial preliminary hearing and in connection with requests for interim measures, oral advocacy skills naturally take center stage. Surprisingly, at the preliminary hearing, some counsel are ill-prepared to explain their client's case. Those attorneys ready with a concise, cogent statement regarding the claims and relief requested can make a lasting impression on the tribunal, and certainly begin the continuing process of building credibility with the tribunal.

Opening statements at the commencement of the hearing on the merits, as well as closing arguments at the end, also demand the ability to articulate a clear, well organized, and compelling justification for the outcome requested. Unfortunately, with increasing frequency these critical opportunities for the advocate to connect with the tribunal have devolved into lengthy power point presentations with

tedious recitations of interminable bullet points. This form of advocacy has the potential to deter members of the tribunal from asking the nagging questions that they have wanted answered over the months and even years leading up to the merits hearing, or at the very least to cause them to be less attentive to the lawyer's argument as it progresses, knowing they can fall back later on the power point, which has been dutifully handed out to the tribunal in advance. Counsel should be careful not to squander the opportunity for genuine dialogue with the tribunal that oral opening and closing statements offer. The right balance must be struck between visual aids, computerized documents with highlighted passages and excerpted quotations, and power point outlines of the skeleton of the argument, on the one hand, and actual eye contact, voice inflection, and physical gestures that use to be the hallmark of the trial lawyer, and may still be in the courtroom, on the other hand.

In international arbitration, the form of oral advocacy that reveals the greatest difference among legal traditions remains the cross-examination of witnesses. In this arena, lawyers from the common law courtroom tradition have typically had a distinct advantage over their civil law counterparts. The latter come from a tradition where the trial judge asks most of the questions of the witnesses and the documentary evidence carries more weight than live testimony by witnesses whom the civil law trained lawyer may dismiss out of hand as untrustworthy and biased. While this gap between civil and common lawyer may be closing, it often comes to the fore in the course of the merits hearing. Like judo, cross examination consists of the art of using the witness' own weight and momentum against him; in other words, it entails using the witness' own assumptions, evidence, logic, and conclusions to demonstrate their insufficiency, inconsistency, inherent contradiction, falseness, and deliberate contrivance. Committing the witness to his testimony, and then methodically proceeding to confront and dissect that testimony with all its implications, in the process unmasking the witness as inept, misguided, dishonest, or malicious, seems much easier for the common law lawyer, whether from the United States, England, or India, than the civil law lawyer from Continental Europe or Latin America. But noteworthy exceptions to this over-generalization certainly exist.

The importance of the fourth and final basic advocacy skill in international commercial arbitration cannot be over emphasized – the ability of the lawyer to build and maintain credibility with the tribunal and with the client. The process of building credibility starts with the client with the initial attorney-client communications and first meeting, by demonstrating thorough knowledge of the arbitral process and procedures. The client wants and needs an advocate it can trust to lead it through what for the client will likely be an uncertain, unfamiliar, and possibly harrowing arbitration proceeding. The tribunal wants and needs an advocate that it can trust to present an honest, above-board case in a logical, methodical, and transparent manner.

The advocate can build and protect his or her credibility with both client and tribunal by being consistent in analysis and argument, giving advice and making arguments supported by the facts and law, recognizing, explaining, and conceding weaknesses in the case, avoiding personal attacks on the adversary, being firm, measured, and helpful, always being prepared, and anticipating the client's and the tribunal's questions, concerns, and requests. Perhaps nothing better exemplifies this level of anticipation and preparation than meeting with the client representative in the morning in advance of a full day of testimony, identifying areas of concern and questions that may be asked by the tribunal that day, discussing how the advocate will respond to those questions, calling back to the client's headquarters to make sure someone is standing by in case the tribunal needs additional information, and then being able when the Tribunal asks an anticipated question to respond fully and honestly and to offer, if the Tribunal seeks any more information, to have it transmitted by the end of the day. Above all, to protect the advocate's and the client's credibility with the tribunal, advocate and client must recognize any weaknesses in evidence or legal argument in the case and be fully prepared to explain why that weakness will not stand in the tribunal's way as it reaches the fair and just decision and final award for which advocate and client have worked throughout the proceeding. ★

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CHALLENGING ARBITRATION AWARDS IN TEXAS AFTER *HALL STREET* AND *NAFTA TRADERS*

BY C. JEFFREY PRICE

I. Introduction

Imagine, at the conclusion of a long and exhausting arbitration proceeding, the arbitrator issues an award in your client's favor. You feel elated, and the slap on the back from your client feels great too. But you soon learn that the other side is a sore loser, and refuses to pay up. How do you make sure the award is enforced?

Now imagine instead, after an exhausting arbitration proceeding, the arbitrator issues an award against your client. The arbitrator was presented with binding legal authority that contolled the outcome in the case, but he chose to ignore it. You are certain that if a trial court had issued a similar decision, it would be reversed on appeal. As opposing counsel gets a slap on the back from his client, your client tells you that he thinks the arbitration has been nothing short of a farce, and so he does not intend to pay a penny. He directs you to do what you can to challenge the so-called award. What are the grounds for challenging the arbitration award, and how do you go about doing that?

In this article, I will answer these and other questions that may arise as you seek to enforce, modify, or vacate an arbitration award in Texas. I start by providing a general overview of the laws that govern the enforcement of an arbitration award in Texas. It is important to know which law governs because the U.S. Supreme Court's recent decision in *Hall Street*[1] has made it more difficult to challenge the award under federal law. Meanwhile, the Texas Supreme Court's recent decision in *Nafta Traders*[2] has kept the door open to challenging the merits of the award.

I will then summarize the procedures required to confirm the arbitration award, and, when necessary, to modify or correct the award. I conclude by focusing on the possible grounds that a court in Texas may vacate, or refuse to enforce, the award. The primary grounds to vacate are set forth in controlling state and federal statutes. They include reasons that would typically shock the conscience because the award was obtained unjustly or it was outside the scope of the arbitrator's power. The statutory grounds, however, do not provide for an "appeal" of the arbitrator's decision on the merits. If you can argue, however, that the arbitration award is subject to Texas law, you may have arguments that the court should review the merits of the decision and vacate it.

II. Which Law Governs and Where Do You File?

A. Which Law: Federal, State, Both?

The seemingly simple question of what law governs the enforcement of an arbitration award in Texas is far from straight forward. If your arbitration is between two Texans, you may be tempted to assume that only the Texas General Arbitration Act ("TAA")[3] applies. And, if your arbitration involves at least one non-Texan, you may think that the Federal Arbitration Act ("FAA"),[4] and not the TAA, applies. In either case, you might be wrong, and in some situations both may apply.

Unless your agreement to arbitrate specifies otherwise, the enforcement of the award could be governed by the FAA, the TAA, as well as Texas common law.[5] The FAA governs an arbitration agreement in any contract that involves interstate commerce, to the full extent of the U.S. Constitution's Commerce Clause.[6] The TAA applies generally to any written arbitration agreement, unless the agreement is one of the few explicitly excluded from the statute's coverage.[7] And in addition to the TAA, Texas still recognizes common law arbitration.[8]

Because Texas recognizes that an arbitration agreement is a matter of contract, the parties may agree to choose to limit the law that governs the enforcement of the resulting arbitration award.[9] If, after you review the parties' agreement, you conclude that it does not specify the law governing their agreement to arbitrate, then enforcement of the award will be governed by the FAA—if applicable—and the TAA and Texas common law by default.[10]

The wording of the choice-of-law provision is significant. For example, if the agreement contains a clause that designates

Texas law as governing, but does not exclude the FAA, then the FAA and Texas law apply concurrently.[11] The Texas Supreme Court has held that a clause that states generally that Texas law governs should not be construed to select the TAA to the exclusion of the FAA, unless the clause "specifically exclude[s] the application of federal law."[12]

In short, once you decide to challenge an arbitration award, you must first carefully review the agreement's choice-of-law provision and determine whether the FAA, the TAA, Texas common law, or a combination of all three will provide the substantive laws with respect to the enforcement of the award. If, after your review, you determine that the arbitration award is governed by the FAA, and not Texas law, then, as explained below, your grounds for challenging the award may be limited.

B. Which Venue: Federal or State Court?

No matter what substantive law governs the enforcement of your award, you may have the option to enforce or challenge the arbitration award in either federal or state court. The FAA does not confer subject-matter jurisdiction on federal courts, so both state and federal courts can hear disputes arising under the FAA.[13]

If you want to file in federal court because you think it will give you a tactical advantage, you must establish some independent ground for jurisdiction, such as diversity among the parties.[14] That is, the fact that your arbitration is governed by the FAA does not, by itself, create federal subject-matter jurisdiction.[15] Indeed, in theory, it is possible to file the enforcement suit in federal court, even if the the FAA is excluded and only Texas state law applies, as long as there is an independent ground for subject-matter jurisdiction, such as diversity.

If you believe state court will give you the advantage, there are essentially no limitations for filing your enforcement suit there. Indeed, even if only federal law applies to the arbitration award, you may be limited to filing in state court if there are no independent grounds for subject-matter jurisdiction in federal court. Consequently, as a practical matter, the enforcement of the FAA is left in large part to the state courts.[16]

If you file in state court, the procedural matters are governed by the TAA, even if only the FAA provides the substantive law.[17] Likewise, if you file in federal court, the procedural matters are governed by the FAA, even if only state law provides the substantive law.

III. How Do You Confirm the Arbitration Award?

A. Confirmation of the Award under the TAA.

On application of a party, a Texas court "shall confirm the award," unless grounds are offered for vacating, modifying, or correcting the award.[18] In other words, confirmation is the default result, unless a party challenges the award.[19] A party must make an application for vacating, modifying, or correcting the award within 90 days of receipt of a copy of the award.[20] There appears to be no deadline in the TAA for a party to file an application for the confirmation of the award. If, however, a party brings an application to vacate, modify, or correct the award, and it is denied, the court "shall confirm the award."[21]

On granting an order that confirms an award, the court must render a judgment that is in conformity with the award.[22] The judgment may include an award for costs incurred in the judicial proceedings.[23] The judgment may then be enforced like any other judgment or decree.[24]

B. Confirmation of the Award under the FAA.

Much like under the TAA, under the FAA, the court is required to grant a confirmation order unless another party seeks or obtains an order vacating, modifying, or correcting the award.[25] However, unlike the TAA, the FAA requires that the confirmation application must be filed within one year after the award is made.[26] After entry of judgment confirming the arbitration award, the judgment has the same force and effect as a judgment in an action, and it may be enforced "as if it had been rendered in an action in the court in which it is entered."[27]

IV. How Do You Modify or Correct the Arbitration Award?

A. Modification of the Award under the TAA.

If you find an evident mistake on the face of the arbitration award, either the arbitrator or the court may correct it under the TAA. That is, if the arbitration award contains a miscalculation or an evident mistake, it has an imperfection that does not affect the merits, or it simply needs clarification, there is a procedure under the TAA to have the arbitrator or the court address the problem.[28] To seek a modification or correction from the arbitrator, the party must submit an application to the arbitrator within 20 days from delivery of the award.[29] The party making the application for a modification or correction to the arbitrator must promptly give written notice to the opposing party and the opposing party must serve any objections to the application within 10 days from the date of notice.[30] Any modification or correction by an arbitrator is then treated the same as the original award for

purposes of confirming, correcting, modifying, or vacating the award by a court.[31]

The court may also modify or correct the arbitration award, so long as the application to modify is made within 90 days of the parties' receipt of the award.[32] Other than to clarify the award, the court can modify or correct the award for the same limited circumstances that are available to the arbitrator, such as miscalculation or evident mistake.[33] For example, inserting a missing date to enable the calculation of pre-judgment interest is a permissible modification pursuant to the TAA.[34] When you seek to modify or correct the award, you should also seek to vacate the award (assuming grounds for vacatur exist) in a joint application.[35] If you do not make a joint application, and the application to modify or correct is denied, the TAA provides that the court "shall confirm the award."[36]

B. Modification of the Award under the FAA.
Under the FAA, there is no procedure for seeking a modification or correction from the arbitrator. An application to modify or correct the award can be made to the court, but notice must be served on the opposing party within three months after the award is filed or delivered.[37] The grounds for seeking a court order modifying or correcting the award under the FAA are similar to those available under the TAA.[38] The FAA arguably gives the court more leeway in modifying and correcting the award, as the statute states that the court may modify or correct the award "to effect the intent thereof and promote justice between the parties."[39]

V. Can you vacate the Award?

If you want to challenge the award, and have it vacated, you will face an uphill battle. First, the party seeking to vacate an arbitration award bears the ultimate burden of proving the grounds for vacatur.[40] This burden may require bringing forth a complete record from the arbitration that establishes the basis for vacating the award.[41] As one court recently explained: "A reviewing court must have a sufficient record of the arbitration proceedings and the party challenging the award must have properly preserved its complaint 'just as if the award were a court judgment on appeal.'"[42] In short, without a complete record of the evidence presented to the arbitrator at the arbitration proceedings, there can be no appellate review of the arbitrators' decision.[43]

Even assuming you have a supporting record, the grounds for vacating, especially on the merits of the decision, are limited. Indeed, the U.S. Supreme Court's decision in *Hall Street* has effectively restricted grounds to vacate under the FAA to those specifically set forth in the statute.[44]

A. Statutory Grounds for Vacating the Arbitration Award.
Both the FAA and the TAA provide specific grounds for vacatur of an arbitration award. Section 10(a) of the FAA lists four statutory grounds, as follows:

(1) where the award was procured by corruption, fraud, or undue means;
(2) where there was evident partiality or corruption in the arbitrators, or either of them;
(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[45]

The statute's use of terms such as "corruption, fraud, or undue means," "evident partiality," being "guilty of misconduct," and exceeding its powers make it apparent that the court must find conduct that goes beyond an arbitrator's honest mistake before vacatur is proper.

Before discussing these specific statutory grounds in more detail it is important to note that prior to *Hall Street*, federal courts had read into the FAA additional grounds for vacatur—grounds that could go to the merits of the arbitrator's decision. For example, federal courts recognized "manifest disregard of the law," which does not appear anywhere in the language of the FAA. Manifest disregard of the law is a concept used to define conduct when an arbitrator is advised of the law, recognizes its applicability, and consciously disregards it.[46]

Recently, though, the Supreme Court rejected all non-statutory grounds for vacatur under the FAA. In *Hall Street*, the Supreme Court was asked to consider whether the statutory grounds for vacatur under the FAA could be supplemented by the parties' agreement for a more expansive review of the merits of the arbitration award.[47] The Court concluded that Sections 10 and 11 provide the "exclusive regimes for the review provided by the statute."[48] But the Court limited its holding to the FAA, leaving open the possibility that state statutory or common law may provide "judicial review of different scope."[49] In response to the argument that the

Court had recognized extra-statutory grounds for vacatur, including manifest disregard, the Court acknowledged the vagueness of the expression, but refused to address squarely whether it would continue to be a viable basis for vacatur.[50] Accordingly, circuit courts have not consistently determined whether manifest disregard remains viable. In the Fifth Circuit, manifest disregard under federal law is no longer a basis for vacatur.[51]

Consequently, if your arbitration agreement is governed only by federal law, you may be limited to challenging the award only on the grounds set forth in Section 10 of the FAA.

1. Award Obtained by Corruption, Fraud, or Other Undue Means

Under the FAA, a court must vacate an award where it "was procured by corruption, fraud, or undue means."[52] A party who seeks vacatur because of corruption, fraud, or undue means must demonstrate that the improper behavior was (1) not discoverable by due diligence before or during the arbitration hearing, (2) materially related to an issue in the arbitration, and (3) established by clear and convincing evidence.[53] Although "fraud" and "undue means" are not defined in the statute, courts interpret the terms together.[54] Fraud requires a showing of bad faith during the arbitration proceedings, such as bribery, an arbitrator's failure to disclose bias, or a party willfully destroying or withholding evidence.[55] "Undue means" connotes behavior that is "immoral if not illegal" or otherwise in bad faith.[56] For this provision to apply, there must be a nexus between the alleged fraud or undue means and the basis for the arbitrator's decision.[57]

The Fifth Circuit has held that a party's late production of evidence to the other side does not constitute fraud, at least when there is no showing that the evidence was intentionally or recklessly withheld.[58] Also, a party's shredding of documents that were unrelated to the claims did not justify vacatur because the shredding was not materially related to any issue in the arbitration.[59] However, as a less obvious example of fraud that leads to vacatur, the Eleventh Circuit held that an expert witness's falsification of his credentials constituted fraud and it warranted partial vacatur of the resulting award.[60]

2. Rights of Party Prejudiced by Arbitrator's Evident Partiality or Corruption

The FAA also authorizes courts to vacate arbitration awards "where there was evident partiality or corruption in the arbitrators, or either of them."[61] A party can establish evident partiality by either demonstrating (1) that the arbitrator failed to disclose relevant facts, or (2) that he displayed actual bias during the arbitration.[62]

In a failure to disclose case, the integrity of the process by which the arbitrator was chosen is in question. An arbitrator who fails to disclose certain past dealings or contacts with any of the parties or attorneys to the arbitration may be found to be biased. Arbitrators are not, however, required to disclose all the details of their prior arbitrations and contacts.[63] Indeed, the parties to the arbitration have a reasonable duty to investigate information of potential partiality and make objections to potential bias at the time the arbitrator is selected.[64] Waiting until after an unfavorable award, after having partial information about a potential bias, is disfavored by the courts.

For example, in one recent case before the Fifth Circuit, the court reversed a lower court's decision to vacate an arbitration award on the grounds that there was evident partiality.[65] The party seeking vacatur argued that one of the members of a panel did not make complete disclosures about a previous arbitration that involved the other party, after simply marking a box "yes" without explanation.[66] The Fifth Circuit reversed vacatur, stating that even without specific information about the previous arbitration, the "disclosures were sufficient to put [the party] on notice of a potential conflict... [p]articularly, in light of [the party's] duty to reasonably investigate."[67]

A party may also seek vacatur due to actual bias by the arbitrator during the proceeding, but the burden on that party is onerous.[68] The question of whether an arbitrator acted with actual bias is decided using an objective standard. That is, the party must establish with specific facts that a reasonable person would conclude that the arbitrator was partial to one party.[69] The facts in support of bias must be direct, definite, and capable of demonstration, as opposed to remote, uncertain or speculative.[70]

3. Arbitrator's Misconduct Leading to an Unfair Hearing

An award can be vacated under the FAA if the arbitrator is guilty of misconduct in denying postponement of an arbitration hearing.[71] To establish an arbitrator was guilty of misconduct, the party seeking vacatur must show that there was no reasonable basis for refusing to postpone the hearing.[72] In addition, the party seeking vacatur must establish that it suffered prejudice as a result of the refusal to postpone.[73] And to establish prejudice, the party must "prove a continuance might have altered the outcome of the arbitration."[74]

One case, *Laws v. Morgan Stanley Dean Witter*, suggests that proving the arbitrator was guilty of misconduct in refusing to postpone a hearing could be difficult. In that case, Laws, an individual, was sued in arbitration by his brokerage firm, Morgan Stanley, to recover a deficit in his margin account. Laws served requests for documents on Morgan Stanley two months before the scheduled hearing, but three years after the case was first instituted.[75] One week before the hearing, the arbitration panel granted Laws's motion to compel and ordered the documents produced no later than two days prior to the hearing.[76] The day before the hearing, Laws moved for a continuance of at least thirty days to review the materials produced by Morgan Stanley.[77] After the arbitrator denied the motion and ruled against Laws, he sought vacatur of the award, arguing the panel had committed misconduct in denying the continuance.[78] The Fifth Circuit found that, regardless of whether Laws had shown he would have benefitted from a continuance, he could not show misconduct.[79] The court stated "Laws was not denied a fair hearing because the record supports several bases on which the panel reasonably could have denied him a continuance."[80] The court concluded that "in light of these reasonable bases for denying Laws's continuance, the panel did not deny him a fair hearing" and therefore was not guilty of misconduct.[81]

Finally, although the statute appears to limit "misconduct" to cases in which an arbitrator denies a postponement of the hearing or refuses to hear material evidence, the provision's phrase "other misbehavior" has been found to be a catch-all for other procedural irregularities in conducting the arbitration or receiving evidence.[82]

4. Arbitrator Exceeded His Powers

Finally, under the FAA, a court may vacate an award to the extent that the arbitrator has exceeded his authority.[83] An arbitrator's authority is limited to disposition of matters expressly covered by the agreement or implied by necessity.[84] Arbitrators, therefore, exceed their powers when they decide matters not properly before them.[85] The issue to be decided is whether the arbitrator had the authority, based on the arbitration clause and the parties' submissions, to reach a certain issue, not whether the arbitrator correctly decided the issue.[86] Section 10(a)(4) does not authorize an arbitration award to be vacated for errors in interpretation or application of the law or facts.[87] As long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, the decision will not be overturned even if the reviewing court is convinced that the arbitrator made a serious error.[88]

C. Non-Statutory Grounds Available Under Texas Law.

If your arbitration agreement is governed by Texas law, and not limited to the FAA, you may have several other grounds for vacating the award, some of which could go to the merits of the decision. In *Nafta Traders, Inc. v. Quinn*, the Texas Supreme Court was faced with the same question faced by the U.S. Supreme Court in *Hall Street*.[89] But the Texas court decided that the TAA "presents no impediment to an agreement that limits the authority of an arbitrator in deciding the matter and thus allows for judicial review of an arbitration award for reversible error."[90] Thus, it appears that all previously recognized non-statutory grounds for vacatur under Texas law, including public policy and constitutional grounds, common law grounds, and contractual agreement, are available.

1. Public Policy and Constitutional Grounds for Vacatur

Parties moving a court to vacate an arbitration award under Texas law may do so based on the limited and narrow grounds that the award would violate Texas public policy or the Texas Constitution.[91] Courts have held that an arbitration award can be set aside "in an extraordinary case in which the award clearly violates carefully articulated, fundamental policy."[92] One example would be "an arbitration award made in direct contravention" of "the special protections in the Texas Constitution" given to the homestead.[93] To support vacatur of an arbitration award, a public policy concern must be "well defined and dominant" and not derived "from general considerations of supposed public interests."[94]

2. Common Law: Manifest Disregard of the Law and Gross Mistake

The scope of review under common law is slightly broader than that found in either the FAA or the TAA. Arbitration awards subject to Texas common law may be vacated for either manifest disregard of the law or gross mistake.[95]

Manifest disregard is a very narrow standard of review.[96] Manifest disregard of the law is more than a mere error or misunderstanding with respect to the law.[97] Instead, the error must be "obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator."[98] Under this standard, the arbitrator recognizes a clearly governing principle and ignores it.[99] In other words, the issue is not whether the arbitrator correctly interpreted the law, but whether the arbitrator, knowing the law and recognizing that the law required a particular result, simply disregarded the law.[100]

Gross mistake is conceptually analogous to manifest

disregard.[101] A gross mistake is a mistake that implies bad faith or a failure to exercise honest judgment and results in a decision that is arbitrary and capricious.[102] A judgment rendered after honest consideration given to conflicting claims, no matter how erroneous, is not arbitrary and capricious.[103] "Gross mistake implies bad faith or failure to exercise honest judgment" resulting "in a decision that is arbitrary or capricious."[104] If the arbitrator gave due consideration to all claims and reached an honest judgment, then even an erroneous award will be confirmed.[105]

3. Expansion of Judicial Review by Contract

Finally, you will have the greatest chance of vacating an arbitration award on the merits due to an honest mistake if the parties' arbitration agreement contains an intent to expand judicial review. Generally, judicial review of an arbitration award "is so limited that even a mistake of fact or law by the arbitrator in the application of substantive law is not a proper ground for vacating an award."[106] But, unlike under the FAA, Texas law allows the parties to agree to expand judicial review for reversible error.[107]

The provision expanding judicial review may simply state that the arbitrator may not render a decision that contains reversibile error. For example, in *Nafta Traders* the provision in the parties' arbitration agreement stated that the arbitrator appointed to resolve disputes "does not have authority (i) to render a decision which contains a reversible error of state or federal law, or (ii) to apply a cause of action or remedy not expressly provided for under existing state or federal law."[108] Since the *Nafta Traders* decision, it is likely that more arbitration agreements will contain a provision calling for expanded judicial review. If you want to challenge an arbitration award on the merits, such a provision governed by Texas law may be your golden ticket.

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1 *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008).

2 *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011).

3 Tex. Civ. Prac. & Rem. Code, Chapter 171.

4 9 U.S.C. §§ 1-16.

5 *See, e.g.*, *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 780 (Tex. 2006) ("The mere fact that a contract affects interstate commerce, thus triggering the FAA, does not preclude enforcement under the TAA as well."). It is possible that other federal or state statutes could apply to certain arbitration agreements, such as collective bargaining agreements and international arbitrations. This article focuses on the enforcement of domestic, commercial arbitrations.

6 9 U.S.C. § 2; *Allied–Bruce Terminix Co. v. Dobson*, 513 U.S. 265, 277–81 (1995); *In re L & L Kempwood Assocs.*, 9 S.W.3d 125, 127 (Tex.1999).

7 Tex. Civ. Prac. & Rem. Code §§ 171.001–.002. Agreements explicitly excluded from the TAA include certain collective bargaining agreements, certain agreements involving an individual for $50,000 or less, and certain personal injury claims. *Id.*, § 171.002(a).

8 *See, e.g.*, *Callahan & Assocs. v. Orangefield Indep. Sch. Dist.*, 92 S.W.3d 841, 844 (Tex. 2002) (upholding an arbitration award under both the TAA and common law arbitration); *Blue Cross Blue Shield of Texas v. Juneau*, 114 S.W.3d 126, 134 n.5 (Tex. App.—Austin 2003, no pet.) ("Two coexisting schemes govern arbitration in Texas: common law and the Texas Arbitration Act.... [T]he legislature did not intend for the act to supplant common-law arbitration....") (citations omitted).

9 *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 87, 95–96 (Tex. 2011) ("[A]rbitration is simply a matter of contract between the parties," and Texas law ensures that "men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced.").

10 *Nafta Traders,* 339 S.W.3d at 98 n.64 ("The TAA and the FAA may both be applicable to an agreement, absent the parties' choice of one or the other."); *In re D. Wilson Constr. Co. v. Brownsville Indep. Sch. Dist.*, 196 S.W.3d 774, 778-80 (Tex. 2006) (interpreting contract language referencing neither the FAA nor the TAA as invoking both federal and state arbitration law).

11 *Baylor Health Care Sys. v. Equitable Plan Servs., Inc.*, -- F. Supp. 2d --, 2013 WL 3367401, at *12 (N.D. Tex. July 5, 2013) ("When an agreement contains a clause that designates Texas law but does not exclude the FAA, the FAA and Texas law, including the TAA, apply concurrently."); *see also Freudensprung v. Offshore Tech. Servs., Inc.*, 379 F.3d 327, 338 n.7 (5th Cir. 2004); *Long. v. BDP Int'l Inc.*, 919 F. Supp. 2d 832, 850 (S.D. Tex. 2013).

12 *In re L & L Kempwood Assocs., L.P.*, 9 S.W.3d 125, 127–28 (Tex.1999) (per curiam).

13 *See Oteeva, L.P. v. X-Concepts L.L.C.*, 253 F. Appx. 349, 350 (5th Cir. 2007) (per curiam) (citing *Smith v. Rush Retail Ctrs., Inc.*, 360 F.3d 504, 506 (5th Cir. 2004)).

14 *Palisades Acquisition XVI, LLC v. Chatman*, 288 S.W.3d 552, 555 (Tex. App.—Houston [14th Dist.] 2009, no pet.).

15 *Id.; see also Specialty Healthcare Mgmt. v. St. Mary Parish Hosp.,* 220 F.3d 650, 655 n.5 (5th Cir. 2000).

16 *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 n.32 (1983).

17 *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 266, 272 (Tex.1992) ("[F]ederal procedure does not apply in Texas courts, even when Texas courts apply the [FAA]."); *see also Hamm v. Millennium Income Fund, L.L.C.*, 178 S.W.3d 256, 262 n.3 (Tex. App.—Houston [1st Dist.] 2005, pet. denied).

[18] Tex. Civ. Prac. & Rem. Code § 171.087.
[19] *Hamm*, 178 S.W.3d at 262.
[20] Tex. Civ. Prac. & Rem. Code §§ 171.088, 171.091.
[21] *Id.*, §§ 171.088(c), 171.091(d).
[22] *Id.*, § 171.092(a).
[23] *Id.*, § 171.092(b).
[24] *Id.*, § 171.092(a).
[25] 9 U.S.C. § 9; *Hamm*, 178 S.W.3d at 269 (holding a motion to vacate untimely if filed after entry of judgment confirming award).
[26] 9 U.S.C. § 9.
[27] *Id.*, § 13.
[28] The arbitrator or the court may modify or correct an award, if:

> (1) the award contains:
> (A) an evident miscalculation of numbers; or
> (B) an evident mistake in the description of a person, thing, or property referred to in the award;
> (2) the arbitrators have made an award with respect to a matter not submitted to them and the award may be corrected without affecting the merits of the decision made with respect to the issues that were submitted; or
> (3) the form of the award is imperfect in a manner not affecting the merits of the controversy.

Tex. Civ. Prac. & Rem. Code §§ 171.054(a), 171.091(a). The arbitrator may also modify the award "to clarify" it. *Id.*, § 171.054(a)(2); but see *Sydow v. Verner, Liipfert, Bernhard, McPherson and Hand*, 218 S.W.3d 162, 168–169 (Tex. App.—Houston [14th Dist.] 2007, no pet.) (finding that the arbitrator's adding of hundreds of thousands of dollars in attorneys' fees to a modified award was a substantive change and not permitted).
[29] Tex. Civ. Prac. & Rem. Code § 171.054(c) ("A party may make an application under this section no later than the 20th day after the date the award is delivered to the applicant.").
[30] *Id.*, § 171.054(d).
[31] *Id.*, § 171.054(e).
[32] *Id.*, § 171.091(b).
[33] *Id.*, § 171.091(a).
[34] *Baker Hughes Oilfield Ops., Inc. v. Hennig Prod. Co., Inc.*, 164 S.W.3d 438, 447 (Tex. App.—Houston [14th Dist.] 2005, no pet.).
[35] Tex. Civ. Prac. & Rem. Code § 171.091(d).
[36] *Id.*, § 171.091(c).
[37] 9 U.S.C. § 12. The FAA's deadline has been applied in state court where the FAA governs. *See Broemer v. Houston Lawyer Referral Service*, 407 S.W.3d 477, 480 (Tex. App.—Houston [14th Dist.] 2013, no pet. h.).
[38] 9 U.S.C. § 11. Section 11 provides the following grounds for modification or correction:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

[39] 9 U.S.C. § 11(d).
[40] *See, e.g.*, *Eurocapital Group, Ltd. v. Goldman Sachs & Co.*, 17 S.W.3d 426, 429 (Tex. App.—Houston [1st Dist.] 2000, no pet.); *see also Mariner Fin. Group, Inc. v. Bossley*, 79 S.W.3d 30, 35 (Tex. 2002) (indicating that losing party bears ultimate burden of proving arbitrator's partiality as a ground of vacatur); *Hamm*, 178 S.W.3d at 268 (likening grounds for vacatur to affirmative defenses under Texas Rule of Civil Procedure 94).
[41] *See Statewide Remodeling, Inc. v. Williams*, 244 S.W.3d 564, 568 (Tex. App.—Dallas 2008, no pet.) ("When there is no transcript of the arbitration hearing, the appellate court will presume the evidence was adequate to support the award."); *see also Glenn A. Magarian, Inc. v. Nat'l Fin. Corp.*, No. 05–97–00663–CV, 1999 WL 814289, at *2 (Tex. App.—Dallas Oct. 13, 1999, pet. denied) (not designated for publication) ("Likewise, if the appellant brings a record showing only a portion of the proceedings, we presume the remaining evidence supports the award.").
[42] *Quinn v. Nafta Traders, Inc.*, 360 S.W.3d 713, 719 (Tex. App.—Dallas 2012, pet. denied) (citing *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 101 (Tex.), *cert. denied*, ––– U.S. ––––, 132 S.Ct. 455, 181 L.Ed.2d 295 (2011)).
[43] *Williams*, 244 S.W.3d at 568; *see also Thomas Petroleum, Inc. v. Morris*, 355 S.W.3d 94, 98 (Tex. App.—Houston [1st Dist.] 2011, pet. denied) ("lack of a record cripples the review of the arbitration panel's order").
[44] *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008).
[45] 9 U.S.C. § 10(a). The TAA has almost identical statutory grounds for vacatur. Although worded slightly differently, it appears no court has found any significant difference in the interpretation of the two. Section 171.088 of the TAA states a court shall vacate an award if:

> (1) the award was obtained by corruption, fraud, or other undue means;
> (2) the rights of a party were prejudiced by:
> (A) evident partiality by an arbitrator appointed as a neutral arbitrator;
> (B) corruption in an arbitrator; or
> (C) misconduct or wilful misbehavior of an arbitrator;
> (3) the arbitrators:
> (A) exceeded their powers;
> (B) refused to postpone the hearing after a showing of sufficient cause for the postponement;
> (C) refused to hear evidence material to the controversy; or
> (D) conducted the hearing, contrary to Section 171.043, 171.044, 171.045, 171.046, or 171.047, in a manner that substantially prejudiced the rights of a party; or
> (4) there was no agreement to arbitrate, the issue was not adversely determined in a proceeding under Subchapter B, and the party did not participate in the arbitration hearing without raising the objection.

[46] *Montes v. Shearson Lehman Brothers*, 128 F.3d 1456, 1461–62 (11th Cir. 1997).
[47] *Hall Street*, 552 U.S. at 578.

[48] *Id.* at 590.
[49] *Id.*
[50] *Id.* at 585–86.
[51] *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 353 (5th Cir. 2009).
[52] 9 U.S.C. § 10(a)(1).
[53] *See Roehrs v. FSI Holdings, Inc.*, 246 S.W.3d 796, 810–11 (Tex. App.—Dallas 2008, pet. denied); See also *Trans Chem. Ltd. v. China Nat'l Machinery Import & Export Corp.*, 161 F.3d 314, 319 (5th Cir. 1998) (adopting the analysis of *In re Arbitration Between Trans Chem. Ltd. & China Nat'l Machinery Import & Export Corp.*, 978 F. Supp. 266, 304 (S.D. Tex. 1997); *Gingiss Int'l, Inc. v. Bormet*, 58 F.3d 328, 333 (7th Cir. 1995)).
[54] *Trans Chem.*, 978 F. Supp. at 304.
[55] *Roehrs*, 246 S.W.3d at 812; *Trans Chem.*, 978 F. Supp. at 304.
[56] *Trans Chem.*, 978 F. Supp. at 304; *A.G. Edwards & Sons, Inc. v. McCollough*, 967 F.2d 1401, 1403–04 (9th Cir. 1992).
[57] *Trans Chem.*, 978 F. Supp. at 304; *Forsythe Int'l S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1022 (5th Cir. 1990).
[58] *Trans Chem.*, 978 F. Supp. at 304, *aff'd and adopted in pertinent part*, 161 F.3d 314 (5th Cir. 1998).
[59] *Henry v. Halliburton Energy Services, Inc.*, 100 S.W.3d 505, 510 (Tex. App.—Dallas 2003, no pet.).
[60] *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1383–84 (11th Cir. 1988).
[61] 9 U.S.C. § 10(a)(2).
[62] *Weber v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 455 F. Supp. 2d 545, 549 (N.D. Tex. 2006).
[63] *Dealer Computer Servs., Inc. v. Michael Motor Co., Inc.*, 485 F. App'x 724, 728 (5th Cir. 2012).
[64] *Id.* at 728 n.4.
[65] *Id.* at 728.
[66] *Id.*
[67] *Id.*
[68] *Weber v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 455 F. Supp. 2d 545, 549 (N.D. Tex. 2006).
[69] *Id.*
[70] *Id.*
[71] 9 U.S.C. § 10(a)(3).
[72] *Laws v. Morgan Stanley Dean Witter*, 452 F.3d 398, 400 (5th Cir. 2006); *SunGard Energy Sys., Inc. v. Gas Transmission Nw. Corp.*, 551 F. Supp. 2d 608, 613 (S.D. Tex. 2008).
[73] 9 U.S.C. § 10(a)(3); *Laws*, 452 F.3d at 401; *SunGard*, 551 F. Supp. 2d at 613.
[74] *SunGard*, 551 F. Supp. 2d at 613 (quoting *Laws*, 452 F.3d at 400).
[75] *Laws*, 452 F.3d at 400.
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.* at 401.
[82] *Totem Marine Tug & Barge, Inc. v. N. Am. Towing, Inc.*, 607 F.2d 649, 652–53 (5th Cir. 1979); *Weinberg v. Silber*, 140 F. Supp. 2d 712, 720 (N.D. Tex. 2001), *aff'd*, 57 F. App'x 211 (5th Cir. 2003).
[83] 9 U.S.C. § 10(a)(4).
[84] *Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc.*, 294 S.W.3d 818, 829 (Tex. App.—Dallas 2009, no pet.).
[85] *Id.*
[86] *Id.*; *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1323 (5th Cir. 1994).
[87] *Ancor Holdings*, 294 S.W.3d at 830.
[88] *United Paperworkers Int'l Union, AFL–CIO v. Misco, Inc.*, 484 U.S. 29, 38 (1987).
[89] 339 S.W.3d 84, 97 (Tex. 2011).
[90] *Id.*
[91] *Crossmark, Inc. v. Hazar*, 124 S.W.3d 422, 429 (Tex. App.—Dallas 2004, pet. denied).
[92] *CVN Group, Inc. v. Delgado*, 95 S.W.3d 234, 239 (Tex. 2002).
[93] *Id.* (citing Tex. Const. art. XVI, §50; Tex. Prop. Code Ann. §53.254 (Vernon 2005)).
[94] *Id.* at 239–40 (quoting *Misco*, 484 U.S. at 44); *see Lee v. Daniels & Daniels*, 264 S.W.3d 273, 278 (Tex. App.—San Antonio 2008, pet. denied).
[95] *Home Owners Mgmt. Enters., Inc. v. Dean*, 230 S.W.3d 766, 768 (Tex. App.—Dallas 2007, no pet.) (manifest disregard); *Bailey & Williams v. Westfall*, 727 S.W.2d 86, 90 (Tex. App.—Dallas 1987, writ ref'd n.r.e.) (gross mistake).
[96] *Xtria L.L.C. v. Int'l Ins. Alliance Inc.*, 286 S.W.3d 583, 594 (Tex. App.—Texarkana 2009, pet. denied); *Dean*, 230 S.W.3d at 768–69.
[97] *Dean*, 230 S.W.3d at 768 (quoting *Perry Homes v. Cull*, 173 S.W.3d 565, 572 (Tex. App.—Fort Worth 2005), *rev'd on other grounds*, 2008 WL 1922978 (Tex. May 2, 2008)).
[98] *Xtria L.L.C.*, 286 S.W.3d at 594.
[99] *Id.*
[100] *Id.*; *Pheng Invs., Inc. v. Rodriquez*, 196 S.W.3d 322, 332 (Tex. App.—Fort Worth 2006, no pet.)).
[101] *See Int'l Bank of Commerce v. Int'l Energy Dev. Corp.*, 981 S.W.2d 38, 48 (Tex. App.—Corpus Christi 1998, pet. denied).
[102] *Xtria L.L.C.*, 286 S.W.3d at 598; *Werline v. E. Tex. Salt Water Disposal Co.*, 209 S.W.3d 888, 898 (Tex. App.—Texarkana 2006), *aff'd*, 307 S.W.3d 267, 268 (Tex. 2010); *Teleometrics Int'l, Inc. v. Hall*, 922 S.W.2d 189, 193 (Tex. App.—Houston [1st Dist.] 1995, writ denied).
[103] *Xtria L.L.C.*, 286 S.W.3d at 598.
[104] *Bailey & Williams*, 727 S.W.2d at 90.
[105] *Id.*
[106] *Centex/Vestal v. Friendship W. Baptist Church*, 314 S.W.3d 677, 683 (Tex. App.—Dallas 2010, pet. denied).
[107] *See Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 97 (Tex. 2011).
[108] *Id.* at 91.

EVIDENT PARTIALITY

BY CHRISTOPHER D. KRATOVIL & ANNE M. JOHNSON

THIS PAPER FOCUSES ON A SINGLE BASIS for vacating arbitration awards—"evident partiality" in the arbitrators—and how that concept is defined and applied by federal courts and Texas state courts.[1] While there is little dispute that "evident partiality conveys a stern standard,"[2] courts have struggled to define the contours of that standard and apply it uniformly to a broad spectrum of arbitrator conduct and relationships with parties, lawyers, witnesses and other arbitrators.[3]

I. Evident Partiality in the Federal Courts

The Supreme Court's leading decision on evident partiality under the Federal Arbitration Act, *Commonwealth Coatings Corp. v. Continental Casualty Co.*,[4] ultimately guides all other federal courts in their understanding of this key basis for vacatur. But, notwithstanding their common reliance on *Commonwealth Coatings*, the federal circuits have come to different understandings of the concept of evident partiality.[5]

Because the Supreme Court's decision in *Commonwealth* is considered a plurality opinion, and therefore nonbinding, the federal circuit courts have struggled in interpreting it and are split on the standard for evident partiality.

A. Supreme Court's Plurality Opinion in *Commonwealth Coatings Corp. v. Continental Casualty Co.*

In *Commonwealth Coatings Corp. v. Continental Casualty Co.*, the Supreme Court, in a plurality opinion written by Justice Black, concluded that evident partiality occurs when an arbitrator fails to "disclose to the parties any dealings that might create an impression of possible bias."[6] Stated more simply, evident partiality protects parties from an arbitrator who *might* favor one party over the other.

The plaintiff subcontractor, Commonwealth Coatings Corporation, sued the prime contractor to recover money for a painting project.[7] The contract between Commonwealth and the prime contractor contained an arbitration agreement. Following the agreement, Commonwealth appointed one arbitrator and the prime contractor appointed the second.[8] These two non-neutral arbitrators appointed the third arbitrator—the so-called "neutral arbitrator"—to decide the controversy. But during the arbitration, the third arbitrator failed to disclose to Commonwealth that one of his regular customers in his engineering consulting business was the prime contractor. Commonwealth, the losing party at the arbitration, challenged the award based on the third arbitrator's failure to disclose his relationship with the opposing/prevailing party.

The Supreme Court concluded that the third arbitrator's dealings with the prime contractor (the prevailing party at arbitration) were significant. The "neutral" arbitrator was paid $12,000 by the prevailing party during a four to five year period that included services for projects connected to the painting project at issue. On this basis, the arbitration award was vacated. In vacating the award, the Supreme Court explained that "[w]e cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another."[9] Additionally, the Court noted the importance of safeguarding the impartiality of arbitrators even more than judges, because "[arbitrators] have completely free rein to decide the law as well as the facts and are not subject to appellate review."[10] Therefore, despite any finding that the "neutral" arbitrator's decision was fraudulent or that he was actually biased against the Commonwealth, the Court reasoned that it was necessary to vacate the award because the third arbitrator's nondisclosure created an "appearance of bias."[11]

Because the Supreme Court's decision in *Commonwealth* is considered a plurality opinion, and therefore nonbinding, the federal circuit courts have struggled in interpreting it and are split on the standard for evident partiality.[12] "Reasonable minds can agree that *Commonwealth Coatings*, like many plurality-plus Supreme Court decisions, is not pellucid."[13] Justice White wrote the concurring opinion, which was joined by Justice Marshall, and Justices Fortas, Harlan, and Stewart dissented.[14]

While Justice White states in the first sentence of his concurring opinion that he is "glad to join" the plurality opinion[15], some lower courts have interpreted White's opinion as requiring a narrower standard for vacating awards based on evident partiality than Justice Black's broader "appearance of" or "impression of possible bias" standard. For example, the Fifth Circuit has concluded that Justice White's concurring opinion differs from the majority opinion by requiring that an arbitrator must only disclose those relationships where the arbitrator has a "significant compromising connection to the parties."[16] Conversely, the Eleventh Circuit's standard is not as specific: an arbitration award will be vacated when an actual conflict exists or when "the arbitrator knows of, but fails to disclose, information which would lead a reasonable person to believe that a potential conflict exists."

Beginning with the Fifth Circuit's interpretation of *Commonwealth Coatings*, the following sections will survey the different standards applied in different circuits for evident partiality.

B. Fifth Circuit

1. Positive Software Solutions, Inc. v. New Century Mortgage Corp.

The leading case in the Fifth Circuit is *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, in which the en banc court held that vacatur of an arbitrator's award based on evident partiality must involve an arbitrator's nondisclosure of a "significant compromising relationship" to one of the parties.[17] Plaintiff Positive Software Solutions ("Positive Software") filed suit against Defendant New Century Mortgage Corporation ("New Century") for breach of contract and misappropriation of trade secrets, among other causes of action. Positive Software alleged that New Century had copied an automated software support program.

Pursuant to contract, the parties entered into arbitration and selected arbitrator Peter Shurn. Following a seven-day hearing, Arbitrator Shurn issued a take-nothing judgment in favor of Defendant New Century and awarded New Century $11,500.00 in actual damages for its counterclaims and $1.5 million for its attorneys' fees.[18]

After losing the arbitration, Positive Software investigated Arbitrator Shurn and discovered that he and his former law firm had, ten years prior, worked alongside New Century's primary counsel, Susman Godfrey, L.L.P., to represent a joint client, Intel Corporation, in a major piece of patent litigation. Specifically, one of Susman Godfrey's attorneys in the Positive Software arbitration was the same Susman Godfrey lawyer working with Arbitrator Shurn's law firm in the earlier Intel patent case. The earlier Intel patent litigation involved seven different law firms and about 34 lawyers, including Shurn and the Susman Godfrey lawyer, even though they never met, spoke, or directly worked together on the massive Intel patent case. Indeed, there was no evidence that Shurn had any personal contact with any Susman Godfrey attorney in the ten-year interval between the Intel case and the arbitration. Nonetheless, in the context of the subsequent New Century arbitration, Arbitrator Shurn failed to disclose that he and the Susman Godfrey lawyer had at least nominally been co-counsel together in a major piece of litigation for a common client, Intel.

Having belatedly discovered the former co-counsel relationship between Arbitrator Shurn and opposing counsel, Positive Software filed a post-arbitration motion to vacate the arbitration award, alleging that because of Shurn's professional connection with Susman Godfrey, he had been biased in favor of New Century, the arbitration was procured by fraud, and Shurn had manifestly disregarded the applicable laws. The district court vacated the award based only on the evident partiality claim—Shurn "failed to disclose a significant prior relationship."[19] A Fifth Circuit panel then affirmed the district court's vacatur, concluding that Shurn's prior co-counsel relationship with the Susman Godfrey lawyer "might have conveyed an impression of possible partiality to a reasonable person."[20] Importantly, neither the district court nor the Fifth Circuit panel found that Shurn was *actually biased*.[21]

In overturning the district court's vacatur of the arbitration award and the panel opinion affirming it, the en banc Fifth Circuit opted to follow Justice White's narrower concurring opinion in *Commonwealth Coatings* as its guide in defining evident partiality; "Justice White's concurrence, pivotal to the judgment, is based on a narrower ground than Justice Black's opinion, and it becomes the Court's effective ratio decidendi."[22] The Fifth Circuit found that Arbitrator Shurn and the Susman Godfrey lawyer's professional relationship contacts were not significant—they never directly spoke, met in person or attended the same hearings in the Intel matter—but were rather "tangential, limited, and stale."[23] The en banc Fifth Circuit emphasized that vacatur based on evident partiality must be limited to an arbitrator who has failed to disclose "a significant compromising relationship."[24] The merely nominal co-counsel relationship between Arbitrator Shurn and Susman Godfrey simply did not rise to this high level, rendering vacatur of the arbitration award entered by Shurn improper.

2. Evident Partiality in the Fifth Circuit Following *Positive Software Solutions*

More recent Fifth Circuit cases interpretive the evident partiality standard have followed the precedent set by the en banc court in *Positive Software Solutions*. For example, in *Ameser v. Nordstrom, Inc.*, a former employee of Nordstrom department stores sued that company for violations of the Family and Medical Leave Act of 1993 ("FMLA").[25] Following an arbitration at which Nordstrom prevailed, the district court denied the vanquished employee's motion to vacate the arbitration award. In affirming the district court's denial of the motion to vacate, the Fifth Circuit held that an arbitrator's nondisclosure of prior service as an arbitrator in an earlier arbitration involving one of the parties did not meet the "high threshold" set in *Positive Software Solutions* for vacating an award based on evident partiality.[26]

More recently, the Western District of Texas applied *Positive Software Solutions* and held that undisclosed campaign contributions from a party to the Arbitrator while the Arbitrator held elected office as a judge did not rise to the level of evident partiality.[27] The district court reasoned that:

> Taking Plaintiff's argument to its logical conclusion, no individual who ran for public office could preside over an arbitration impartially unless that person first disclosed every campaign contribution he or she ever received—irrespective of the amount or date given—from any person associated with the law firms or parties appearing before him or her. This would be a heavy burden indeed.[28]

In sum, in the wake of the en banc Fifth Circuit's decisive holding in *Positive Software Solutions,* vacating an arbitration award based on evident partiality in the federal courts of Texas, Louisiana and Mississippi is a daunting task. A party considering seeking vacatur in the federal district courts of the Fifth Circuit should only bring a motion based on evident partiality if it has concrete evidence of a meaningful but undisclosed relationship—professional or personal—between the arbitrator and the opposing party or its counsel.

3. Evident Partiality in other Federal Circuits

While each federal appellate court has its own interpretation[29] of what constitutes evident partiality, most agree that there must be something more than a mere failure to disclose.[30] The First, Second, Third, Fourth, Sixth, Seventh, Eighth, Tenth, and District of Columbia Circuits all require more than a "mere appearance of bias" and thus appear to be more aligned with the Fifth Circuit's demanding *Positive Software Solutions* evident partiality standard, as well as with Justice White's concurring opinion in *Commonwealth Coatings*. These courts all require that the undisclosed relationship be more than trivial in order to warrant vacatur. In contrast, the Ninth Circuit appears to follow the "reasonable impression of partiality" standard established by Justice Black in his *Commonwealth Coatings* plurality opinion. What does seem to be clear is that most federal courts will vacate an arbitration award if a substantial financial interest is shared (or was previously shared) between the arbitrator and one of the parties.[31] Other factors the courts view as significant include the timing of the arbitrator's previous contacts with the parties, as well the extent of the arbitrator's business and law firm ties to the parties in an arbitration.[32]

a. First Circuit

The First Circuit's definition of evident partiality is more closely aligned with Justice White's interpretation in *Commonwealth Coatings* than Justice Black's. "Evident partiality is more than just the appearance of possible bias. Rather, evident partiality means a situation in which a reasonable person would have to conclude that an arbitrator was partial to one party to an arbitration."[33] In the First Circuit, remote connections are not enough to establish evident partiality.[34]

b. Second Circuit

The Second Circuit's holds that evident partiality will be found when "a reasonable person . . . conclude[s] that an arbitrator was partial to one party to the arbitration."[35] The relationship between the arbitrator and one of the parties must be "material."[36] The Second Circuit's standard requires a fact specific inquiry, and the reasonable person must "consider[] all of the circumstances" when determining whether the arbitrator is biased.[37] "In assessing a given relationship, courts must remain cognizant of peculiar commercial practices and factual variances."[38]

c. Third Circuit

The Third Circuit requires more than a mere appearance of partiality. Relationships between the arbitrator and the parties must be more than trivial. "Justice White's concurrence in Commonwealth Coatings fully envisions upholding awards when arbitrators fail to disclose insubstantial relationships."[39] Evident partiality only occurs if a reasonable person concludes that the arbitrator's bias for one side is "ineluctable, the favorable treatment unilateral," and "direct, definite, and capable of demonstration."[40]

d. Fourth Circuit

The Fourth Circuit more closely follows Justice White's con-

curring opinion than Justice Black's "reasonable person" rule. "To demonstrate evident partiality under the FAA, the party seeking vacation has the burden of proving that a reasonable person would have to conclude that an arbitrator was partial to the other party to the arbitration."[41] The court further states that the "alleged partiality must be direct, definite, and capable of demonstration rather than remote, uncertain or speculative."[42] The party claiming evident partiality must establish "specific facts that indicate improper motives on the part of an arbitrator."[43] The Fourth Circuit has also listed four factors that courts should consider when determining whether evident partiality exists:

(1) [A]ny personal interest, pecuniary or otherwise, the arbitrator has in the proceeding;

(2) [T]he directness of the relationship between the arbitrator and the party he is alleged to favor;

(3) [T]he connection of the relationship to the arbitration; and

(4) [T]he proximity in time between the relationship and the arbitration proceeding.[44]

e. Sixth Circuit

The Sixth Circuit has rejected the appearance of bias standard from Justice Black's plurality opinion and requires that the arbitrator's "alleged partiality must be direct, definite, and capable of demonstration, and the party asserting [it] ... must establish specific facts that indicate improper motives on the part of the arbitrator."[45]

f. Seventh Circuit

The Seventh Circuit defines evident partiality as "more than a mere appearance of bias."[46] The bias must be "definite and capable of demonstration rather than remote, uncertain or speculative."[47]

g. Eight Circuit

The Eighth Circuit, like the Fifth Circuit, also places importance on whether there was a significant relationship between the arbitrator and the parties that was not disclosed. That court has concluded that an arbitrator's undisclosed substantial business relationship with one of the parties is enough to vacate an arbitration award.[48] Evident partiality exists when an arbitrator's relationship with one of the parties creates "an impression of possible bias" *and* that relationship—at least in the context of financial interests with the party—must be "more than trivial."[49]

h. Ninth Circuit

The Ninth Circuit follows Justice Black's interpretation, but that does not offer much guidance for the practitioner. The Ninth Circuit concludes that an arbitrator is evidently partial "when undisclosed facts show a reasonable impression of partiality."[50] More recent Court opinions do not offer more.[51]

i. Tenth Circuit

The Tenth Circuit's definition of evident partiality is more clear and requires more than a reasonable impression of partiality: "[E]vident partiality . . . means evidence of bias or interest of an arbitrator [that is] direct, definite and capable of demonstration rather than remote, uncertain, or speculative."[52]

j. Eleventh Circuit

The Eleventh Circuit has held that evident partiality can occur in two separate situations: "when either (1) an actual conflict exists, or (2) the arbitrator knows of, but fails to disclose, information which would lead a reasonable person to believe that a potential conflict exists."[53]

k. District of Columbia Circuit

The D.C. Circuit also requires more than "a mere appearance of bias."[54] Instead, the party seeking vacatur "must establish specific facts that indicate improper motives on the part of an arbitrator."[55]

II. Evident Partiality in Texas State Courts

While the Fifth Circuit and most federal circuits have adopted a strict standard for evident partiality that is less likely to result in vacatur, the Texas Supreme Court has taken a different approach.[56] Texas state courts apply a lenient "reasonable impression of partiality" standard adopted by the Texas Supreme Court in 1997.

A. Burlington Northern Railroad Co. v. TUCO, Inc.

Any analysis of evident partiality in Texas must begin with the Texas Supreme Court's opinion in *Burlington Northern Railroad Co. v. TUCO, Inc.*[57] At issue in *TUCO* was an undisclosed connection between two arbitrators on a three-arbitrator panel. The arbitration clause permitted each party to select an arbitrator, and those arbitrators selected a third neutral arbitrator. Burlington Northern selected Emried Cole with the law firm of Venable-Baetjer, TUCO selected Richard Hardy, and George Beall was selected as the neutral arbitrator.

During the course of the arbitration, an attorney with Venable-Baetjer referred a client to Beall. Beall accepted representation of the client, but did not disclose the referral to TUCO or

Hardy. Beall did mention the referral to Cole (Burlington Northern's chosen arbitrator and Venable-Baetjer partner) in Hardy's presence. Shortly thereafter, the panel issued an opinion in favor of Burlington Northern (authored by Cole and Beall). Hardy submitted a dissenting opinion in which he accused Beall of bias, contending that Beall had made up his mind on key issues before the hearing. This was the first time that TUCO learned of the Venable-Baetjer referral to Beall.[58]

TUCO filed suit to set aside the arbitration award on the ground that Beall was evidently partial to Burlington Northern as a result of the undisclosed referral, made during the course of the arbitration, from the law firm of Burlington Northern's chosen arbitrator. The trial court affirmed the arbitration award, but the Amarillo Court of Appeals reversed, concluding that a fact issue remained as to whether Beall was evidently partial. The Texas Supreme Court accepted review to determine the scope of the "evident partiality" standard.

Relying on *Commonwealth Coatings Corp. v. Continental Casualty Co.*,[59] the Texas Supreme Court adopted the following standard for establishing evident partiality:

> [A] prospective neutral arbitrator selected by the parties or their representatives exhibits evident partiality if he or she does not disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality. We emphasize that this evident partiality is established from the non-disclosure itself, regardless of whether the nondisclosed information necessarily establishes partiality or bias.[60]

The court further held that the duty to disclose relationships that might create a reasonable impression of partiality is an ongoing obligation that continues throughout the arbitration.[61]

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Based on this standard, the Supreme Court ruled that the referral to Beall by Venable-Baetjer "might have conveyed an impression of Beall's partiality to a reasonable person."[62] The court reasoned that an "objective observer could still reasonably believe that a person in Beall's position, grateful for the referral, may have been inclined to favor Venable-Baetjer as an entity. . . in the arbitration proceedings . . . ."[63] Consequently, the court vacated the arbitration award based on Beall's evident partiality and remanded the case for further arbitration.[64]

B. *Mariner Financial Group v. Bossley*

Five years later, in *Mariner Financial Group v. Bossley*,[65] the Texas Supreme Court again addressed the evident partiality standard. This time, the issue was whether an arbitrator was evidently partial because he did not disclose an adverse relationship with one of the parties' expert witnesses.

Prior to the arbitration, the arbitrator (one of three on the panel) disclosed that he had a social relationship with one of the Bossleys' witnesses, but did not mention any connection to the Bossleys' expert witness. The expert witness testified, and the arbitration panel found in favor of Mariner. About two months after the arbitration, the expert was reviewing files at her office when she found a deposition she had given in a malpractice action against the arbitrator almost two and half years before the arbitration. In that deposition, the expert testified that the arbitrator committed malpractice in seven different ways. The suit was eventually settled, and the settlement documents were sealed. The expert had not previously revealed the connection to the arbitrator because she did not remember him until finding the deposition.[66] The arbitrator did not attend the expert's deposition, and had never met or saw the expert witness before the arbitration.[67]

The Bossleys moved to vacate the arbitration award for evident partiality. The trial court confirmed the award, but the court of appeals reversed. On appeal, Mariner argued that the Bossleys waived any complaint about the neutral arbitrator's partiality because they did not object prior to submission of the case to arbitration. They also argued that the neutral arbitrator had no duty to disclose his relationship with the expert witness because the Bossleys could have easily discovered it.

The Texas Supreme Court's analysis in *Mariner* emphasized that an arbitrator's knowledge is relevant to the issue of evident partiality based on the standard set forth in *TUCO*:

> Under this objective test, the consequences for nondisclosure are directly tied to the materiality of the unrevealed information. [*TUCO*, 960 S.W.2d] at 637 (stating a "neutral arbitrator need not disclose relationships or connections that are trivial."). The relationship in *TUCO* arose from a lucrative business

> referral to one of the arbitrators and thus was not trivial. *Id.* The undisclosed relationship was obviously known to the arbitrator, and we concluded that his failure to disclose the referral was a material fact that objectively created a reasonable impression of his partiality.[68]

Because the record was "silent" in *Mariner* about whether the arbitrator remembered the expert witness or ever knew her, the supreme court concluded that it could not determine whether the undisclosed relationship was material to the issue of evident partiality.[69] As a result, summary confirmation of the award was inappropriate and the court remanded the case to the trial court.[70]

In a detailed concurring opinion, Justice Owen (joined by Justices Hecht and Jefferson) criticized the majority's application of a subjective test ("what the arbitrator knew and when he knew it") to determine evident partiality. The concurrence advocated for an objective test: whether an arbitrator could reasonably believe that the undisclosed facts were known to the party seeking to set aside the arbitration award.[71] The concurrence also discussed the arbitrator's duty to investigate, noting that "the circumstances in which the failure to conduct an investigation can constitute evident partiality should be limited."[72]

C. Evident Partiality in Texas Courts of Appeal.
Relying on the supreme court's pronouncements in *TUCO* and *Mariner*, Texas intermediate appellate courts have applied the evident partiality analysis to a broad spectrum of factual allegations ranging from arbitrators making false disclosures to failing to disclose remote connections to parties and lawyers.

False Arbitrator Disclosures. If an arbitrator has a relationship with a party or its counsel and misrepresents that relationship in his disclosures, evident partiality is shown. In *Karlseng v. Cooke*,[73] the arbitrator answered a question in his disclosure statement that he did not have a significant personal relationship with a party or a party's counsel. In fact, the arbitrator had an ongoing relationship with one of the party's lawyers that spanned more than a decade. Further, the arbitrator and the lawyer falsely "presented themselves . . . as complete strangers" at the arbitration hearing.[74] The arbitrator issued an arbitration award of $22 million in favor of his lawyer-friend's client, including $6 million in attorney's fees. The award was confirmed by the trial court, but the appellate court disagreed: "Our examination of the entire record in this case shows a direct, personal, professional, social, and business relationship . . . . [the arbitrator's] failure to disclose the relationship constitutes evident partiality."[75]

Similarly, in *Alim v. KBR*,[76] the arbitrator answered in his sworn notice of appointment that he had diligently done a conflicts check and no party representative had appeared before him in past arbitration cases. In fact, one of the party's lawyers had appeared before him as a party representative of a related entity six years earlier. The court concluded that this was a fact that might, to an objective observer, create a reasonable impression of partiality. In particular, the arbitrator's "failure to amend or correct his answer to the question specifically inquiring as to that fact" demonstrated evident partiality.[77]

Undisclosed Arbitrator Relationships. Undisclosed arbitrator/party connections that have resulted in vacatur of arbitration awards for evident partiality by Texas appellate courts include:

- Arbitrator was lead counsel for one of the parties, six years earlier, in a $1.5 million lawsuit over an unpaid promissory note.[78]
- Arbitrator's law firm represented an affiliate of one of the parties to the arbitration.[79]
- Arbitrator's law firm was simultaneously representing a client who was suing one of the arbitrating parties. Arbitrator did not know of the representation because the National Association of Securities Dealers had misspelled a party name that the arbitrator used to run a conflicts check.[80]
- Arbitrator's law firm listed a party as a representative client in its Martindale-Hubbell listing, and the arbitrator had personally given advice to the party and made a presentation to the party's legal department.[81]

In contrast, Texas courts have rejected a number of evident partiality claims where the alleged nondisclosure was a remote, non-pecuniary connection between an arbitrator and a party or a lawyer. Examples of arbitrator nondisclosures that have not resulted in vacatur include:

- The law firm (but not the lawyer) representing one of the parties was counsel to an unrelated party in litigation involving the arbitrator's prior law firm,

but the arbitrator had no pecuniary interest in the unrelated litigation and did not know of the connection to his prior firm.[82]

- A law firm for which the arbitrator had worked on a temporary contract assignment had formerly represented companies affiliated with one of the parties to the arbitration, but the arbitrator did not know of the firm's representation, which ended one month before the arbitrator's contract assignment.[83]

- Arbitrator had a friendship with a partner in a law firm that was listed as counsel of record but had no role in the arbitration, and the relationship was not significant or pecuniary.[84]

- Arbitrator had previously represented a vendor that supplied materials to one of the parties.[85]

- The vice-president and general counsel of a related company served on the American Arbitration Association's board of directors, but there was no evidence that the arbitrator knew of the makeup of the AAA board and the party did not directly employ the board member.[86]

Partial or Incomplete Arbitrator Disclosures. When an arbitrator discloses some, but not all, details of a material relationship, some Texas courts have found evident partiality. In *Houston Village Builders, Inc. v. Falbaum*, the arbitrator disclosed he was a member of a trade group in which a party was a prominent member but failed to disclose that he was the trade group's attorney and had advised the group on the very issues involved in the arbitration.[87] Based on those facts, the court concluded that "the Arbitrator's ongoing service as counsel for the GHBA might create a reasonable impression of partiality toward [the parties], two sizeable members of that trade group" and the arbitrator's statement that he "worked with" the trade association "did not satisfy his duty to disclose."[88]

In contrast, the following cases involve alleged "incomplete" disclosures where Texas courts found no evident partiality:

- In *Skidmore Energy, Inc. v. Maxus (U.S.) Exploration Co.*, the court held that, when an arbitrator disclosed he served on a company's board of directors, there was no evident partiality when he failed to disclose he owned stock in the company and that the company had a business relationship with one of the parties. [89]

- In *Ponderosa Pine Energy, LLC v. Tenaska Energy, Inc*, the court found that an arbitrator's disclosure of prior arbitrations and business dealings with one of the party's lawyers, without disclosing that he had an ownership interest in the business at issue or that the individual lawyers involved were his contacts, did not establish evident partiality.[90] Note: Just as this issue went to press, the Texas Supreme Court granted review in *Ponderosa Pine*.

- In *Las Palmas Medical Center v. Moore*, the court found no evident partiality where the arbitrator disclosed her professional relationship and familiarity with one of the party's attorneys, but did not disclose that she had listed one of the attorneys as a reference on her resume or the details of her prior professional dealings with the attorneys.[91]

Evident Partiality Based on Arbitrator Conduct and Rulings. Texas courts have generally rejected attempts to establish evident partiality based on an arbitrator's conduct and procedural rulings during the arbitration:

- In *Roe v. Ladymon*, the court found no evident partiality based on an arbitrator's denial of a continuance and the arbitrator's comment that a party needed to finish presenting evidence and set a briefing schedule so that the arbitrator could "finally get [a party] some relief."[92]

- In *W. Dow Hamm III Corp. v. Millennium Income Fund, L.L.C.*, the court found no evident partiality because the arbitrator allowed a party to designate an additional witness after issuing an initial order resolving the dispute.[93]

- In *Williams v. Flores*, the court found no evident partiality based on exclusion of evidence, alleged miscalculation of damages, or a letter written by one of the party's witnesses to a partner in the arbitrator's law firm, copied to the arbitrator, that alleged the partner made slanderous remarks about the witness.[94]

- In *FCA Construction Co., LLC v. J & G Plumbing Services, LLC*, the court found no evident partiality based on allegations that the arbitrator asked more questions of one side's witnesses or that the arbitrator expressed "displeasure" with the testimony of those witnesses.[95]

3. Waiver of Evident Partiality.

Implicit in *TUCO* 's full disclosure principle, as well as in the broader concept of arbitration as a consensual dispute resolution process, is that parties can agree to arbitrate a dispute, or continue arbitrating a dispute, despite knowledge of possible bias or partiality by the arbitrator.[96] In fact, as the Texas Supreme Court recognized, capable arbitrators chosen on the basis of expertise and experience in a given industry will often have had some prior dealings with the parties and witnesses to an arbitration.[97] Rather than mandating a per se rule of disqualification in such situations, parties are instead allowed to use their own judgment to balance the competing interests of avoiding a risk of partiality and obtaining the arbitrator's expertise or other benefits of proceeding before the arbitrator.

In fact, as the Texas Supreme Court recognized, capable arbitrators chosen on the basis of expertise and experience in a given industry will often have had some prior dealings with the parties and witnesses to an arbitration.

Consistent with these principles, a party can waive an otherwise valid objection to the partiality of the arbitrator by proceeding with arbitration despite knowledge of facts giving rise to such an objection.[98] Several Texas appellate courts have addressed waiver of evident partiality challenges.

In *Kendall Builders*, the arbitrator mentioned to one party during a break at the arbitration that he had bought stock from Vignette, the company who employed that party, and then asked whether the stock was "ever going to go up." After ruling against the vignette employee in the arbitration, the employee learned that the arbitrator had lost more than $5,000 due to a decrease in Vignette stock price, about a one-percent decrease in the arbitrator's net worth. The court of appeals nevertheless concluded the complaining party had waived its complaint of evident partiality: "Having elected to proceed with arbitration in the face of their knowledge of the arbitrator's losses in Vignette stock, [the complaining party] cannot now complain of the outcome."[99]

In *Skidmore*, the arbitrator disclosed he was on the board of directors of Transocean but did not know at the time of his disclosures that drilling equipment owned by Transocean had been utilized by one of the parties in connection with the drilling of a well whose lease was the subject of the arbitration.[100] No party or attorney objected or raised a question about the arbitrator's service as an arbitrator when the evidence about Transocean's drilling equipment was adduced.[101] Further, other evidence showed that the complaining party and its counsel had known for years of the business relationship between the other party and Transocean.[102] The court concluded that the complaining party had waived its complaint of evident partiality "by failing to raise the issue prior to issuance of the arbitration award."[103]

In *Ponderosa Pine Energy, LLC v. Tenaska Energy, Inc.,* the court found that an arbitrator's disclosure of four arbitrations in which a party's law firm (Nixon Peabody) had been involved was sufficient even though the arbitrator did not disclose that the individual lawyers at Nixon Peabody representing the party in the arbitration were involved in all four prior arbitrations.[104] The court also found that the arbitrator's disclosure that, as a member of a corporate advisory board of a legal outsourcing company, he had "participated in a general discussion" at Nixon Peabody's offices was "sufficient to place [the other party] on notice of the facts giving rise to what they now complain create a reasonable possibility of partiality respecting the Nixon Peabody relationship."[105] Accordingly, the court held that the complaining party had waived its complaint of evident partiality. The Texas Supreme Court has granted review in this case.

Conclusion

In conclusion, there is little consensus among courts regarding when an arbitrator's nondisclosure rises to the level of "evident partiality" requiring vacatur of an arbitration award. As a result, the venue in which an evident partiality challenge is brought remains an important consideration. In some jurisdictions, evident partiality provides perhaps the most promising and most viable basis for challenging an arbitration award. However, regardless of venue, and as with any challenge to an arbitration award, moving to vacate based on evident partiality presents an uphill battle.

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v. New Century Mortgage. Ms. Johnson is greatly indebted to Kelli Bills of Haynes and Boone for her assistance with this article. ✯

[1] 9 U.S.C. § 10(a)(2) (an arbitration award shall be vacated when "there was evident partiality . . . in the arbitrators"); TEX. CIV. PRAC. & REM. CODE § 171.088(a)(2)(A) (arbitration awards vacated where the rights of a party were prejudiced by "evident partiality of an arbitrator appointed as a neutral arbitrator").

[2] *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278, 281 (5th Cir. 2007) (en banc) [hereinafter *Positive Software*].

[3] It is important to note that evident partiality and actual bias are distinct concepts. Evident partiality concerns the failure of an arbitrator to disclose a relationship with one of the arbitrating parties that could be construed as possible bias. In contrast, actual bias occurs when the arbitrator was "actually guilty of fraud or bias in deciding th[e] case." *See Commonwealth Coatings Corp. v. Continental Cas. Co.,* 393 U.S. 145, 147 (1968) (plurality opinion).

[4] 393 U.S. 145 (1968).

[5] *Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 51 F.3d 157, 159 (8th Cir. 1995) (stating that because the concurring opinion presents an arguably narrow standard and the votes of concurring Justices White and Marshall were needed to create a majority, there is some uncertainty among the courts of appeals about the holding of *Commonwealth Coatings*).

[6] 393 U.S. at 149 (plurality opinion).

[7] *Id.* at 146.

[8] *Id.*

[9] *Id.* at 150.

[10] *Id.* at 149.

[11] *Id.* at 150.

[12] *See Montez v. Prudential Sec., Inc.,* 260 F.3d 980, 983 (8th Cir. 2001) ("The absence of a consensus on the meaning of 'evident partiality' is evidenced by the approaches adopted by the different circuits."); *see* Steven K. Huber, *Addressing Undisclosed Arbitrator Bias: The Law of "Evident Partiality"*, 39 The Advocate (Texas) 49 (2007) ("The meaning of *Commonwealth Coatings* is disputed because there was not a majority opinion.").

[13] *Positive Software*, 476 F.3d at 281.

[14] *See Commonwealth Coatings,* 393 U.S. at 150-55 (concurring and dissenting opinions).

[15] *Id.* at 150 (White, J., concurring).

[16] *Positive Software*, 476 F.3d at 282-83.

[17] *Id.* at 284-86.

[18] *Id.* at 280.

[19] *Positive Software*, 337 F. Supp. 2d 862, 865 (N.D. Tex. 2004), *rev'd on reh'g en banc*, 476 F.3d 278 (5th Cir. 2007).

[20] *Positive Software Solutions, Inc. v. New Century Mortg.*, 436 F.3d 495, 504 (5th Cir. 2006), *rev'd on reh'g en banc*, 476 F.3d 278 (5th Cir. 2007).

[21] *Positive Software*, 476 F.3d at 284, 280.

[22] *Id.* at 282 (quoting *Marks v. United States*, 430 U.S. 188, 193-94 (1977)) ("When a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds.") (internal quotation marks omitted).

[23] *Id.* at 284-85.

[24] *Id.* at 286.

[25] *Ameser v. Nordstrom, Inc.,* 442 F. App'x 967, 968 (5th Cir. 2011) (per curiam).

[26] *Id.* at 970.

[27] *InfoBilling, Inc. v. Transaction Clearing, LLC*, SA-12-CV-01116-DAE, 2013 WL 1501570, at *4 (W.D. Tex. Apr. 10, 2013).

[28] *Id.* at *4.

[29] *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 137 (2d Cir. 2007) ("[T]he fractured court in *Commonwealth Coatings* and our precedent provided us with little guidance concerning what standard is to be applied in construing the evident partiality language of the statute.") (quoting *Morelite Const. Corp. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 83 (2d Cir. 1984)).

[30] *See Positive Software*, 476 F.3d at 282-83; *see also* Merrick T. Rossein & Jennifer Hope, *Disclosure and Disqualification Standards for Neutral Arbitrators: How Far to Cast the Net and What Is Sufficient to Vacate Award*, 81 ST. JOHN'S L. REV. 203, 215-16 (2007) ("Many courts are unwilling to apply a per se rule of vacation where an arbitrator fails to disclose information that a party subsequently objects to as evidencing partiality. Many courts will look to the nature of the nondisclosure to determine evident partiality.").

[31] *Montez*, 260 F.3d at 983 (finding that a financial interest must be substantial); *Positive Software*, 476 F.3d at 284, 280; *Crow Constr. v. Jeffrey M. Brown Assoc. Inc.*, 264 F. Supp. 2d 217, 225 (E.D. Pa. 2003) ("Certainly any time money changes hands directly between an arbitrator and a representative of one of the parties involved in a pending arbitration before that arbitrator, disclosure must take place."); Rossein & Hope, *supra* note 30, at 222 ("Financial Interest or evidence that the arbitrator had anything to gain from the outcome of the arbitration is strong evidence of partiality.") (citing *Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring)).

[32] *Consol. Coal Co. v. Local 1643, United Mine Workers of Am.*, 48 F.3d 125, 130 (4th Cir. 1995) (finding that "the proximity in time between the relationship and the arbitration proceeding" is an important consideration) (citing *Hobet Mining, Inc. v. Int'l Union, United Mine Works of Am.*, 877 F. Supp. 1011, 1021 (S.D.W. Va. 1994)); *Schmitz v. Zilveti*, 20 F.3d 1043, 1045-46 (9th Cir. 1994) (finding evident partiality and vacating the award when an arbitrator fails to disclose his firm's past representation of the parenting company of the winning arbitration party); *Positive Software*, 476 F.3d at 279-84 (concluding that trivial law-firm relationships with an arbitration party do not warrant vacating an arbitration award); *see also* Rossein & Hope, *supra* note 30, at 222-227 (detailing various cases that constitute evident partiality).

[33] *JCI Commc'ns, Inc. v. Int'l Bhd. of Elec. Workers, Local 103*, 324 F.3d 42, 51 (1st Cir. 2003) (citing *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 278 F.3d 621, 626 (6th Cir. 2002)).

[34] *ALS & Assocs., Inc. v. AGM Marine Constructors, Inc.*, 557 F. Supp. 2d 180, 183 (D. Mass. 2008) (citing *JCI Commc'ns*, 324 F.3d at 51).
[35] *Morelite Const. Corp. (Div. of Morelite Elec. Serv., Inc.) v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d Cir. 1984).
[36] *Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi*, A.S., 492 F.3d 132, 137 (2d. Cir. 2007).
[37] *Id.*
[38] *Morelite Const. Corp.*, 748 F.2d at 84.
[39] *Freeman v. Pittsburgh Glass Works, LLC*, 709 F.3d 240, 256 (3d Cir. 2013) (quoting *Positive Software*, 476 F.3d at 281-82).
[40] *Id.* at 253 (quoting *Anderson, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 329 (6th Cir. 1998)).
[41] *Consol. Coal Co. v. Local 1643, United Mine Workers of Am.*, 48 F.3d 125, 129 (4th Cir. 1995) (quoting *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 991 F.2d 141, 145 (4th Cir. 1993)).
[42] *Peoples Sec. Life Ins. Co.*, 991 F.2d at 146 (citing *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253, 1258 n.3 (7th Cir. 1992)).
[43] *Id.*
[44] *Consol. Coal Co.*, 48 F.3d at 130 (citing *Hobet Mining, Inc.*, 877 F. Supp. at 1021).
[45] *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644-45 (6th Cir. 2005) (quoting *Consol Coal Co.*, 48 F.3d at 129).
[46] *Health Servs. Mgmt. Corp.*, 975 F.2d at 1264.
[47] *Id.* (quoting *Tamari v. Bache Halsey Stuart Inc.*, 619 F.2d 1196, 1200 (7th Cir. 1980)).
[48] *Olson,* 51 F.3d at 159-60.
[49] *Montez*, 260 F.3d at 983 (quoting *Olson*, 51 F.3d at 158-59) (internal quotation marks omitted).
[50] *Schmitz*, 20 F.3d at 1046 (quoting *Middlesex Mut. Ins. Co. v. Levine*, 675 F.2d 1197, 1201 (11th Cir. 1982)) (internal quotation marks omitted).
[51] *Fidelity Fed. Bank, FSB v. Durga Ma. Corp.,* 386 F.3d 1306, 1312 (9th Cir. 2004) ("Evident partiality is present when facts that are not disclosed by an arbitrator create a 'reasonable impression of partiality.'") (quoting *Schmitz*, 20 F.3d at 1046 (internal quotation marks omitted)).
[52] *Legacy Trading Co., Ltd. v. Hoffman*, 363 F. App'x 633, 635 (10th Cir. 2010) (quoting *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140, 1147 (10th Cir. 1982)) (internal quotation marks omitted).
[53] *Univ. Commons-Urbana, Ltd. v. Universal Constructors Inc.*, 304 F.3d 1331, 1339 (11th Cir. 2002) (quoting *Gianelli Money Purchase Plan & Trust v. ADM Investor Servs., Inc.,* 146 F.3d 1309, 1312 (11th Cir. 1998)) (internal quotation marks omitted)).
[54] *Hammad v. Lewis*, 638 F. Supp. 2d 70, 75 (D.D.C. 2009).
[55] *Id.* (citing *Al-Harbi v. Citibank, N.A.*, 85 F.3d 680, 683 (D.C. Cir. 1996)).
[56] *Positive Software*, 476 F.3d at 282.
[57] 960 S.W.2d 629 (Tex. 1997). The *TUCO* opinion resolved conflicts within Texas and federal courts concerning the proper standard for evident partiality. *See TUCO*, 960 S.W.2d at 632–37. Both section 171.088 of the Texas Civil Practice and Remedies Code and *TUCO* date from 1997. Accordingly, when analyzing claims of evident partiality, many Texas courts look to Texas authority from 1997 forward. *See, e.g., Karlseng v. Cooke,* 346 S.W.3d 85, 95 (Tex. App.—Dallas 2011, no pet.).
[58] *Id.* at 631.
[59] 393 U.S. 145.
[60] *TUCO,* 960 S.W.2d at 636.
[61] *Id.* at 636-37.
[62] *Id.* at 637.
[63] *Id.*
[64] *Id.* at 639-40.
[65] 79 S.W.3d 30 (Tex. 2002).
[66] *Id.* at 32.
[67] *Id.* at 33.
[68] *Id.* at 32-33.
[69] *Id.* at 33.
[70] *Id.*
[71] *Id.* at 35.
[72] *See id.* at 47. The majority expressly did not decide whether there was a duty to investigate to determine potential arbitrator bias because there was no evidence that the Bossleys could have discovered the relationship any sooner than they did. *Id.* at 33.
[73] 346 S.W.3d 85 (Tex. App.—Dallas 2011, no pet.).
[74] *Id.* at 86, 92, 99.
[75] *Id.* at 100.
[76] 331 S.W.3d 178 (Tex. App.—Dallas 2011, no pet.).
[77] *Id.* at 182. The court also concluded that the complaining party had not waived its claim of evident partiality because the arbitrator's "innocuous comment" at the beginning of the arbitration that he had "come across" the other party's lawyers was not sufficient to support a finding that the complaining party had knowledge of undisclosed facts and intentionally waived its right to object to the arbitrator. *Id.*
[78] *Tex. Commerce Bank v. Universal Technical Inst. of Tex., Inc.*, 985 S.W.2d 678 (Tex. App.—Houston [1st Dist.] 1999, pet. dism'd w.o.j.).
[79] *Amoco D.T. Co. v. Occidental Petroleum Corp.*, 343 S.W.3d 837 (Tex. App.—Houston [14th Dist.] 2011, pet. denied).
[80] *Judd v. Texakoma Oil & Gas Corp.,* No. 05-99-00039-CV, 2000 WL 19534 (Tex. App.—Dallas Jan. 13, 2000, no pet.).
[81] *J.D. Edwards World Solutions Co. v. Estes, Inc.,* 91 S.W.3d 836 (Tex. App.—Fort Worth 2002, pet. denied).
[82] *Port Arthur Steam Energy LP v. Oxbow Calcining LLC*, No. 01-12-01165-CV, 2013 WL 5727544 (Tex. App.—Houston [1st Dist.] Oct. 22, 2013, no pet.).
[83] *Am. Allied Secs., Inc. v. Am. Gen. Secs., Inc.*,No. 14-99-01082-CV, 2000 WL 1357209, at *2-3 (Tex. App.—Houston [14th Dist.] Sept. 21, 2000, no pet.).
[84] *Int'l Bank of Commerce-Brownsville v. Int'l Energy Dev. Corp.*,981 S.W.2d 38, 45-47 (Tex. App.—Corpus Christi 1998, pet. denied, cert. denied). The court also rejected the allegation that the arbitrator was biased against banks because of a grand jury investigation twenty years before into the arbitrator's alleged trouble with financial institutions. *Id.*
[85] *BPA Fabrication, Inc. v. Jamak Fabrication, Inc.*, No. 01-98-00765-

CV, 1999 WL 977819, at *6 (Tex. App.—Houston [1st Dist.] Oct. 28, 1999, no pet.).

[86] *GE Commercial Distrib. Fin. Corp. v. Momentum Transp. Servs., L.L.C.*, No. 09-09-00162-CV, 2009 WL 6327471, at *8 (Tex. App.—Beaumont Apr. 8, 2010, no pet.).

[87] 105 S.W.3d 28 (Tex. App.—Houston [14th Dist.] 2003, pet. denied).

[88] *Id.* at 34-35.

[89] 345 S.W.3d 672, 679-80, 684 (Tex. App. —Dallas 2011, pet. denied).

[90] 376 S.W.3d 358 (Tex. App.—Dallas 2012, pet. granted).

[91] 349 S.W.3d 57 (Tex. App.—El Paso 2012, pet. denied).

[92] 318 S.W.3d 502, 522-23 (Tex. App.—Dallas 2010, no pet.).

[93] No. 01-12-00313-CV, 2013 WL 978263, at *6 (Tex. App.—Houston [1st Dist.] Mar. 12, 2013, pet. denied).

[94] No. 13-01-00545-CV, 2004 WL 1797574, at *2-3 (Tex. App.—Corpus Christi Aug. 12, 2004, pet. denied).

[95] No. 01-10-01034-CV, 2012 WL 761147, at *2-3 (Tex. App.—Houston [1st Dist.] Mar. 8, 2012, no pet.).

[96] *Tuco*, 960 S. W. 2d at 637.

[97] *Id.* at 635.

[98] *Kendall Builders, Inc. v. Chesson*, 149 S.W.3d 796, 804 (Tex. App.—Austin 2004, pet. denied); *TUCO*, 960 S.W.2d at 637 n. 9 ("Of course, a party who learns of a conflict before the arbitrator issues his or her decision must promptly object to avoid waiving the complaint."); *see also Roehrs v. FSI Holdings, Inc.*, 246 S.W.3d 796, 806 (Tex. App.—Dallas 2008, pet. denied) ("A party that learns of a basis for objecting to an arbitrator must promptly object in the arbitration proceeding to avoid waiving the complaint.").

[99] *Kendall Builders, Inc.*, 149 S.W.3d at 806.

[100] 345 S.W.3d at 679.

[101] *Id.* at 680.

[102] *Id.* at 681.

[103] *Id.* at 684.

[104] 376 S.W. 3d 358, 372-73 (Tex. App. —Dallas 2012, pet. granted).

[105] *Id.*

FINRA ARBITRATION: FIGHTING TO SURVIVE

BY DAVID BISSINGER AND GERALD SIEGMYER

LAWYERS FAMILIAR WITH THE SECURITIES BUSINESS know about mandatory arbitration. As a practical matter, every investor must agree to mandatory arbitration before industry-sponsored arbitration panels governed by the Financial Industry Regulatory Authority ("FINRA") – or forgo investing in the public markets.

For years, FINRA arbitration panels consisted of two "public" arbitrators (typically business people or professionals not affiliated with the industry) and one "industry" or "non-public" arbitrator (that is, a registered representative of a FINRA broker-dealer firm). FINRA's control over investor complaints has come under increasing attack, particularly following the bear markets collapse of the internet bubble in the early 2000s and the collapse of the subprime credit markets in 2007-2009.

In response to these criticisms, FINRA has modified its system to allow for panels consisting of three "public" arbitrators, eliminating the requirement of a non-public or industry arbitrator. As this article goes to press, FINRA has made the three-public-arbitrator option permanent. Although this modification fails to address many other complaints about FINRA arbitration, it will likely placate policy makers and regulators for the foreseeable future – at least until the next bear market.

The removal of investor disputes from the courts: the 1920s to 1990s

The past century has witnessed a transition from the courts to arbitration. In 1925, Congress enacted the Federal Arbitration Act. Securities firms began adding mandatory arbitration provisions to their customer agreements. All disputes between the customer and firm thus became arbitrable until the U.S. Supreme Court decision in *Wilko v. Swan* in 1953.[1] In *Wilko*, the plaintiff alleged that he was induced to purchase a security through misrepresentations of the broker under Section 12(2) of the Securities Act of 1933 ("the 1933 Act").[2] The Court concluded that the arbitration clause was void as to the misrepresentation claim because plaintiff's right of action could not be waived due to the anti-waiver provisions of the 1933 Act.

From the 1960s to the 1980s, investors seeking relief could avoid arbitration by alleging misrepresentation and fraud against the broker under the 1933 Act. That option, however, came to an end in 1987 with the Supreme Court's decision in *Shearson/American Express, Inc. v. McMahon*. In *McMahon*, the Court held that misrepresentation and fraud claims under the Exchange Act were arbitrable under a pre-dispute arbitration agreement. The Court reasoned that the concerns about arbitration in *Wilko* no longer held true:

> [T]he mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities laws. Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.[3]

The dissenters in *McMahon* disputed the faith of the majority in SEC regulation and arbitration fairness. For example, the dissent observed that mandatory arbitration "leaves such claims to the arbitral forum of the securities industry at a time when the industry's abuses towards investors are more apparent than ever." In particular, writing in the merger mania of the 1980s, the dissent noted that "the Court's complacent acceptance of the Commission's oversight is alarming when almost every day brings another example of illegality on Wall Street."[4]

Decline of awards, and decline in filings

Fast-forwarding to the present, FINRA arbitration activity has slowed dramatically. According to FINRA's Dispute Resolution Statistics through July 13, 2013, new case filings are down 20% based upon comparable data for 2012.[5] New case filings have steadily declined since 2009 when over 7,000

new cases were filed as compared with the 2012, when only slightly over 4,000 new cases were filed. Through July 2013, only 18% of new cases that are filed go to a full hearing and 60% settle, either by direct action of the parties, or through mediation. The rest of the cases are either withdrawn or disposed of in some other way. The statistics are comparable to data going back as far as 2008.

Filings have declined for at least three reasons: first, the bull market of 2009-2013 has no doubt kept investors from substantial out-of-pocket losses. Second, Wall Street has abandoned the commission-based model in favor of a fee-based model in which broker-dealers manage funds in large managed accounts that often mimic major market indicies. The fee-based approach has reduced many of the kinds of disputes that arose under the old broker-centric model such as churning, unsuitable recommendations, and unauthorized trading. Third, many claims are too small to justify hiring a lawyer to pursue, or would be brought against fringe broker-dealers who typically have only a bare minimum net-capital and would be unable to pay an award.[6]

The fee-based approach has reduced many of the kinds of disputes that arose under the old broker-centric model such as churning, unsuitable recommendations, and unauthorized trading.

Mounting investor criticism

Mandatory arbitration has come under attack from investors, their lawyers, much of the financial press, legal scholars, and policy makers. "This upfront agreement by millions of Americans to submit to a FINRA arbitration process . . . constitutes one of the largest ongoing abdications of legal rights in the U.S., and nobody seems to be bothered enough to rectify it."[7]

Investor criticism focuses on at least three aspects of the process: (1) the mandatory nature of the process[8]; (2) the perceived bias of the panels, at least relative to a state- or Federal-court jury; and (3) the removal of procedural rights, such as the relaxation of the rules of evidence and the lack of the right to appeal.

Two of the complaints—mandatory nature of the process and the lack of procedural safeguards—are derivative of the third complaint of anti-investor, pro-industry bias. Few investors would complain about mandatory arbitration or the lack of procedural safeguards if the investors were satisfied with the result. Indeed, the streamlined procedure favors investors because investors avoid motion practice and depositions allowed in court. Arbitrators make decisions based on equity rather than what might be required by strictly enforcing the law. Hence, the common phrase that arbitrators will "split the baby."[9]

Arbitrators who consistently rule against the securities industry risk finding themselves out of a job, leaving those arbitrators who are more sympathetic to the broker's side of the story. Columnist William Cohan of Bloomberg cited the case of FINRA's termination of three arbitrators after they awarded customers more than $520,000, "a large amount by arbitration standards."[10]

As criticism mounts, FINRA responds

As the credit crisis unfolded, some members of Congress began to question mandatory arbitration.[11] At the same time, empirical studies began to show widespread investor dissatisfaction with arbitration.[12] A group of state securities regulators urged FINRA to remove industry arbitrators from arbitration panels.[13]

FINRA responded by implementing a pilot program that allowed some investors to avoid the so-called "industry" arbitrator.[14] FINRA's pilot program seemed to confirm the allegations of pro-industry bias. Panels with three public arbitrators consistently ruled in favor of customers more than traditional panels. For example, in 2012, arbitration panels with all public arbitrators awarded claimants damages in 49% of cases versus 33% for traditional panels. The year before, 2011, the all-public panels ruled for claimants 54% of the time versus 18% for traditional panels.[15] According to FINRA, "the awards issued during the first two years since implementation show that customers were awarded damages significantly more often when an all-public panel decided their case."[16]

Effective September 30, 2013, the SEC at FINRA's request approved rule changes to make the public option permanent. Any party has the option of an all-public panel by striking all of the non-public arbitrator names on the list sent by FINRA.[17] The all-public arbitrator option may placate congressional and other critics, but pressure on regulators and Congress will likely continue. The SEC has the authority to make arbitration optional. Section 921 of Dodd-Frank amends the Exchange Act and gives the Securities & Exchange Commission the authority to regulate or prohibit mandatory arbitration clauses in broker-dealer contracts, "if it finds that such prohibition, imposition of conditions, or limitation, would be in the public interest and for the protection of investors."[18] Many

believe that securities arbitration will not be truly fair until it is optional with the parties.

While the SEC has the authority to make arbitration optional, nothing the SEC has said or done suggests that will happen. In October 2013, SEC Chairperson Mary Jo White declared that the SEC is "striving to 'be everywhere'" by using "leverage" and "force multipliers" such as technology, whistleblowers, and enforcement actions against auditors and other "gatekeepers" to foster a stronger culture of compliance in the securities markets. Nowhere in her speech did she mention arbitration despite the obvious "force multiplier" effect that jury trials would have on enforcement of the securities laws. This omission came just days before a Texas jury refused to side with the SEC in its civil enforcement action to hold Dallas billionaire Mark Cuban liable for insider trading.[19] If the SEC wishes to "leverage" its enforcement policies with "force multipliers," what better place to start than to allow private investors to pursue their remedies with private lawyers before state-court jurors, instead of mandatory arbitration? Only one commissioner, Luis Aguilar, has advocated making arbitration optional, stating in a recent speech that "investors should not have their option of choosing between arbitration and the traditional judicial process taken away from them at the very beginning of their relationship with their brokers and advisers."[20]

FINRA appears to oppose giving investors the option of going to court because a court option would jeopardize FINRA's franchise over the process and the risk that court cases would lead to large verdicts against its member firms. If jury trials favored broker-dealers, broker-dealers would give investors the option to go to court.

Conclusion

FINRA wants more time to study results from the all public arbitrator option before the SEC considers making arbitration truly optional. Until then, investors will have to resolve their disputes in arbitration with the incremental reforms of all-public panels and large-case option available to them. At least until the next bear market.

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1 *Wilko v. Swan*, 346 U.S. 427 (1953).
2 Securities Act of 1933, 15 U.S.C. § 77a.
3 *Shearson/American Express, Inc., v. McMahon,* 482 U.S. 220, 238 (1987) (O'Connor, J.).
4 482 U.S. at 265-66 (Blackmun, J., dissenting).
5 FINRA Dispute Resolution Statistics, July 2013.
6 *FINRA to Consider Requiring Brokerage Firms to Carry Insurance*, Wall Street Journal, Oct. 4, 2013 (interview with Susan Axelrod, FINRA Executive V.P. of Regulatory Operations ("FINRA said $51 million of arbitration awards granted in 2011 haven't been paid or 11% of the total awards.").
7 William D. Cohan, *Wall Street's Captive Arbitrators Strike Again*, Bloomberg, July 8, 2012.
8 The Dodd-Frank Act addressed concerns that that were raised over the fairness of pre-dispute arbitration clauses in the Senate Committee on Banking, Housing and Urban Affairs. S.3217, S. Rep. No. 111-176, at 110 ("there have been concerns over the past several years that mandatory pre-dispute arbitration is unfair to the investors").
9 *See, e.g.*, Letter from Barbara Black, University of Cincinnati College of Law, dated Aug. 16, 2010.
10 Cohan, *supra* note 8.
11 Letter from Rep. Barney Frank, Chairman of the House Committee on Financial Services, to SEC Chairman Christopher Cox, dated April 25, 2007.
12 Jill Gross and Barbara Black, Perceptions of Fairness of Securities Arbitration: An Empirical Study, Feb. 15, 2008, p. 3.
13 State Securities Regulators Say New Study Clearly Shows Investors View Securities Arbitration as Biased and Unfair, Press Release 2008.
14 FINRA to Launch Pilot Program to Evaluate All-Public Arbitration Panels, FINRA News Release, July 24, 2008.
15 FINRA Summary Arbitration Statistics July 2013.
16 FINRA Regulatory Notice 13-3, p.2.
17 FINRA Regulatory Notice 13-30 (Sept. 30, 2013).
18 SEC Staff Study on Investment Advisers and Broker-Dealers, Jan. 2011.
19 Andrew Harris & Tom Korosek, *SEC Loses as Mark Cuban Triumphs in Insider-Trading Trial*, Bloomberg, Oct. 17, 2013.
20 North American Securities Administrators Association, Annual NASAA/SEC 19(d) Conference in Washington D.C., Apr. 2013.

ARBITRATION OF EMPLOYMENT CLAIMS: CHALLENGES AND LIMITS ON ENFORCEABILITY IN TEXAS

BY KARL G. NELSON & BENJAMIN D. WILLIAMS

ARBITRATION OF WORK-RELATED DISPUTES has long been a staple of traditional unionized workplaces. Outside of the collective bargaining realm, however, the jurisprudence surrounding pre-dispute agreements to arbitrate employment claims is more recent and still evolving. Yet, even while the law controlling such agreements continues to develop, employers are increasingly implementing private, contractual processes to adjudicate employee disputes.

Just over a decade ago, the Texas Supreme Court in *In re Halliburton Company*[1] reaffirmed that both Texas and federal law favor pre-dispute employment arbitration agreements In doing so, the Court clarified the principles governing enforceability of those agreements. The court also articulated the standards by which Texas courts will invalidate employment arbitration clauses based on illusoriness[2] or unconscionability.[3] The U.S. Supreme Court has recently reinforced *Halliburton*'s general principles in two landmark cases.[4] Although those decisions arose in commercial, rather than employment, contexts, their reach undeniably extends to employment-related arbitration agreements as well. At the same time, a growing line of lower-court decisions in Texas continues to buttress the validity of employment arbitration agreements generally.

Given that both Texas and federal law favor arbitration of employment claims, the grounds on which to challenge a properly structured agreement in Texas can be narrow. Nevertheless, a few arguments—principally drawing on the unconscionability and illusoriness principles *Halliburton* addressed—have found some success in Texas courts.

A. *Halliburton* Sets the Stage

In *Halliburton*, the employer adopted a dispute-resolution program with binding arbitration as the exclusive final step for resolving employment disputes. The employer's notice informed employees that accepting continued employment would constitute acquiescence to the new program.[5] James Myers, an at-will employee who continued to work after the new program's effective date, filed a lawsuit after the company demoted him, and Halliburton sought to compel arbitration of his claim.

Myers raised a host of anti-arbitration defenses, including that the arbitration agreement was illusory, and that it was both procedurally and substantively unconscionable. The Texas Supreme Court rejected those arguments, holding that the trial court should have compelled arbitration.[6] In the decade since that decision, Texas's lower courts have followed and refined *Halliburton*'s controlling standards.

B. Unconscionability and Arbitration Agreements

In *Halliburton*'s wake, the most frequent challenges to employment arbitration agreements have invoked theories of unconscionability, which can be divided generally into two categories: procedural unconscionability and substantive unconscionability.

1. Procedural Unconscionability

Procedural unconscionability refers to the conditions surrounding the adoption of an arbitration provision itself.[7] While Texas courts have considered a variety of inventive arguments in this regard, plaintiffs continue to face considerable headwinds: "The only cases under Texas law in which an agreement was found procedurally unconscionable involve situations in which one of the parties appears to have been incapable of understanding the agreement."[8] Despite such broad pronouncements claimants have had some success invalidating an agreement where they can show that they were misled or not adequately informed of the arbitration obligation.

For example, in *Delfingen US-Texas, L.P. v. Valenzuela*,[9] the employee-plaintiff was unable to read English. The employer gave a presentation in Spanish concerning various company policies but later asked the plaintiff to sign an arbitration agreement written in English. The employee alleged that the company never explained the agreement's provisions to her, even though its representative had promised to do so. After finding that the employee willingly signed the agreement,

the court noted that standing alone, illiteracy in English is insufficient to render an arbitration agreement procedurally unconscionable.[10] But the court nevertheless declined to enforce the agreement, finding that the company misled the plaintiff by failing to explain the important provision as promised.[11]

An agreement might be procedurally unconscionable if the employer illegally coerces the employee to sign or if the employee signs under duress. In Texas, however, claims of duress have generally failed where the agreement to arbitrate is made a condition to continued employment. In *In re Frank Motor Company*,[12] an at-will employee claimed a jury-waiver was unconscionable because the employer threatened to terminate him if he refused to sign the agreement. The court, in rejecting the employee's duress claim, held that an employer's threat to exercise its legal right to terminate an employee "cannot amount to coercion that invalidates a contract."[13]

Parties have also challenged as procedurally unconscionable arbitration provisions for which the employer provided insufficient notice of the arbitration obligation.[14] In *Okocha v. Hospital Corporation of America, Inc.*,[15] for example, the employer sought to enforce an amended arbitration agreement over an employee's testimony that he had never received it. The employer claimed that it had distributed notice by e-mail. The court noted that for an e-mail to supply sufficient notice, it must state explicitly that arbitration is mandatory and that continued employment is conditioned on acceptance of the agreement.[16] The employer also must be able to demonstrate that the employee received the e-mail.[17] The e-mail in *Okocha* was inadequate because it did "not notify an employee that his decision to continue employment will constitute legal acceptance of a mandatory arbitration process."[18] The court held that postings in employee common areas were likewise insufficient to demonstrate notice absent proof that the employee had seen and accepted the notice. Finally, the court held that including notice with the employee's paycheck, providing voluntary information sessions on the new policy, and posting an update on the company's internal website were all insufficient to demonstrate notice under the particular facts because the evidence failed to show that the employee specifically received notice through those means.[19]

2. Substantive Unconscionability

Whereas procedural unconscionability focuses on the circumstances giving rise to an agreement, substantive unconscionability "refers to the fairness of the arbitration provision itself."[20] Arbitration agreements can be substantively unconscionable, for example, where "the terms of the agreement are themselves legally impermissible."[21] Plaintiffs frequently assert substantive unconscionability where the employer's arbitration agreement allegedly limits procedural or substantive rights to the point that the agreement could be considered one-sided and unfair.[22]

a. Temporal Restrictions as Substantively Unconscionable

Where an arbitration agreement shortens the time to bring claims to such an extent that it impedes an employee's ability to assert his or her rights, the agreement may be vulnerable to judicial invalidation. In *Long v. BDP International, Inc.*,[23] the plaintiff challenged an agreement that subjected all claims, including those brought under the Fair Labor Standards Act (FLSA), to a one-year limitation period. The court held that although FLSA claims can be arbitrable, the employer's imposition of a shortened time limit for bringing those claims was unconscionable. By providing only a one-year limitation period, the agreement ran counter to the remedial and humanitarian purposes undergirding the FLSA, which require liberal application and full enforcement.[24] The court, however, did not invalidate the whole agreement, but merely severed the limitations provision.

Where an arbitration agreement shortens the time to bring claims to such an extent that it impedes an employee's ability to assert his or her rights, the agreement may be vulnerable to judicial scrutiny.

Similarly, in *Mazurkiewicz v. Clayton Homes, Inc.*,[25] the court held invalid a provision limiting the period for bringing ADA and FLSA claims. There, the agreement required that such claims be asserted within six months. The court noted that a contract might validly shorten the time for bringing an action to less than that prescribed by statute, but such a limitation is invalid if it effectively eliminates the substantive right to recovery or otherwise completely bars relief.[26] As to the ADA claim, the court held the contractual period effectively barred plaintiff from suing. Because the EEOC may take up to six months to perform its own investigation, a six-month limitation for all ADA claims could conflict with the EEOC's statutory pre-suit investigation and conciliation obligations. The FLSA limitation was likewise unconscionable because it drastically curbed the damages the plaintiff might be entitled to under a continuing-violation theory. Enforcing the arbitration agreement's limitation period

could therefore effectively "do away with the congressional determination that employers who willfully violate the statute should be subject to greater liability than those whose violations are inadvertent."[27]

b. Challenges to Restrictions on Substantive Rights of Recovery

Parties have also challenged arbitration agreements as unconscionable where they limit the recovery that would be available in a judicial forum. For example, in *Venture Cotton Cooperative v. Freeman*,[28] the plaintiff argued an arbitration agreement was substantively unconscionable because it capped the amount of attorney's fees, consequential damages, and punitive damages a party could recover. The agreement, was therefore unconscionable because it markedly limited a party's rights. The court also held unconscionable a provision allowing one side to collect attorney's fees if successful at arbitration, but preventing the other side from doing the same.[29]

Parties have also challenged arbitration agreements as unconscionable where they limit substantive rights that would be available in a judicial forum.

Similarly, in *Pickens v. ITT Educational Services, Inc.*,[30] the court took issue with an arbitration agreement that limited recovery to actual damages for certain statutory claims. While an arbitration clause that restricts available remedies is not necessarily improper, the court noted that, where parties agree to arbitrate a statutory claim, "'a party does not forgo the substantive rights afforded by the statute; it only submits their resolution in an arbitral, rather than a judicial, forum.'" [31] Because the clause at issue in *Pickens* was not part of the arbitration provision itself, however, the court noted the clause was likely severable and the arbitration agreement was therefore otherwise valid.[32]

c. Challenges to Procedural Limitations: the *D.R. Horton* Dichotomy

Plaintiffs have also challenged as unconscionable those arbitration agreements that limit a party's procedural rights—for example, where an arbitration agreement prohibits employees from bringing class or collective claims against the employer. A growing dissonance has emerged between the National Labor Relations Board (NLRB) and the judiciary over whether arbitration agreements affecting employees covered under the National Labor Relations Act (NLRA) can limit those employees' class-action rights. In *In re D.R. Horton, Inc. and Michael Cuda*,[33] the Board found that an employer violated Section 8(a)(1) of the NLRA when it required NLRA-covered employees to sign a mandatory arbitration agreement that prohibited them from filing joint, class, or collective claims in any forum.[34] The Board determined that by preventing collective claims for employment-related disputes, the employer interfered with employees' rights under NLRA Section 7 to engage in "concerted activities for the purpose of . . . mutual aid or protection."[35] A series of subsequent NLRB decisions have reached a similar result, noting that *D.R. Horton* is "controlling Board law."[36] As of this writing, the NLRB's *D.R. Horton* decision is on appeal before the U.S. Fifth Circuit Court of Appeals.[37]

Perhaps foreshadowing the prospects for the NLRB's *D.R. Horton* decision before the Fifth Circuit, courts have generally tended to disagree with the Board's position and upheld employment arbitration agreements containing class-action waivers. The Supreme Court's holding in *Italian Colors*—that arbitration agreements under the Federal Arbitration Act may not be invalidated simply because they expressly exclude class-wide arbitration of a federal claim—seems to weaken the NLRB's position.[38] Indeed, the U.S. Courts of Appeal for the Second, Eighth, and Ninth Circuits have said as much.[39]

The District Court for the Southern District of Texas came to a similar conclusion in *Mazurkiewicz*.[40] The employment agreement there barred the employee from taking part in class action litigation against the employer. Recognizing that courts enforce arbitration clauses that expressly contain waivers of collective actions, the court held that a "contractual waiver on [the employee's] ability to serve as a representative party for others similarly situated [did] not affect his substantive rights and [was] thus enforceable."[41] The court therefore enforced the employment agreement's class-action waiver provision and dismissed the plaintiff's collective action allegations.[42]

The U.S. District Court for the Northern District of Texas has taken a slightly different approach. In *Jones v. JGC Dallas LLC*,[43] the court distinguished the NLRB ruling, holding that it applied only where an employment agreement restricted access to collective action in *any* forum. Because the *Jones* agreement's provisions waived class or collective action only with respect to claims brought in a judicial forum, the court found the limitation on class relief was permissible.[44]

d. Challenges Based on Expenses Associated with Arbitration

Another line of substantive unconscionability challenges concerns shifting arbitration-related expenses to employees.

Like most unconscionability contests, those based on allocation of expenses are fact-dependent, with courts frequently applying some form of reasonableness analysis to determine whether expenses are excessive or unfair.

In *Sharpe v. AmeriPlan Corporation*,[45] the court invalidated a provision that required, as a condition to filing a claim, that each party deposit $25,000 into an escrow account. The agreement also required all parties to bear their own arbitration-related expenses. The court reiterated the maxim that a party asserting an unconscionable financial burden must demonstrate it is likely to incur those costs,[46] but it noted that an arbitration agreement that denies an employee access to a judicial forum, while at the same time making the arbitral forum prohibitively expensive, puts an employee "between the proverbial rock and a hard place."[47] The court found that the financial requirements under the agreement would represent a "significant financial burden" for many individuals, and the $25,000 fee in particular was a "roadblock standing between each Plaintiff and the arbitral forum . . . ."[48]

By contrast, in *Long*,[49] the plaintiffs argued that an employee handbook provision was unconscionable because it required employees to bear certain arbitration costs that might be greater than those they would otherwise incur in federal court. But the plaintiffs could not meet their burden to show that they were likely to incur those prohibitively high costs. Under the arbitration agreement, which was governed by the American Arbitration Association's Model Employment Arbitration Procedure, plaintiffs were obligated to pay only a $175 filing fee, and the employer would bear all other costs. The court found such an arrangement not unconscionable.[50] Where, between the facts in *Sharpe* and those in *Long*, cost-shifting provisions will become unconscionable remains unclear. But some courts outside Texas have suggested that the dividing line may be closer to the latter than the former.[51]

C. Illusoriness and Arbitration Agreements

Another basis on which parties attack arbitration agreements is illusoriness. Under Texas law, an agreement is illusory "when it fails to bind the promisor, who retains the option of discontinuing performance."[52] An arbitration agreement may be illusory where the employer enjoys the unilateral power to alter or terminate the agreement, or where the employer alone can avoid the arbitration's result.[53]

In *Carey v. 24 Hour Fitness*,[54] the plaintiff-employee challenged the validity of an arbitration agreement, arguing his employer had retained the unilateral right to amend it—including the ability to retroactively modify its provisions. The agreement gave the employer the "right to revise, delete, and add to the employee handbook,"[55] including the arbitration agreement, subject to providing employees with notice of any changes. The court affirmed that the touchstone for illusoriness is whether "one party can escape its obligations under the agreement."[56] Because the employer in *Carey* could retroactively change its policy, the notice provisions were not enough to overcome illusoriness.[57]

In *Aviles v. Russell Stover Candies, Inc.*,[58] an employee similarly challenged an arbitration agreement as illusory because the employer retained the right to amend or terminate the agreement. But that right was qualified by a guarantee that modification "would not reduce any Plan benefit then due a Participant . . . on account of [events] that occurred before the amendment or termination."[59] The court held this clause sufficiently prohibited retroactive amendment, defeating plaintiff's claims of illusoriness. The court also noted that even if the agreement could be modified retroactively, a provision requiring the parties' mutual consent weighed against illusoriness.

The Southern District of Texas further clarified *Carey*'s holding in *Gonzales v. Brand Energy & Infrastructure Services*.[60] There, the challenged arbitration agreement granted the employer the right to "amend or modify the [agreement] as needed," but guaranteed that "no amendment shall apply to a dispute of which [the employer] had notice of intent to arbitrate on the date of the amendment."[61] The agreement also allowed the employer to terminate the arbitration agreement, but the termination would not apply to disputes that had arisen before the date of termination. The court held these guarantees were sufficient to prevent illusoriness because they cabined the employer's right to avoid arbitration retroactively. The court rejected the plaintiff's argument that the employer's ability to amend an agreement "for *potential* disputes that have not been instigated" rendered the agreement illusory.[62]

The Fourth Court of Appeals in San Antonio went a step further in *Nabors Drilling USA, LP v. Pena*.[63] There, as in *Gonzales*, the employer retained the right to amend or terminate the arbitration agreement. But unlike the agreement in *Gonzales*, the *Pena* agreement barred the employer from retroactively avoiding arbitration only for those disputes for which arbitration had been formally *initiated*. The employer was still free to terminate or amend the arbitration agreement as to claims the employer had knowledge of, as long as it acted before the "initiation of arbitration."[64] The court held this was sufficient to shield the agreement from illusoriness,

rejecting a California court's finding that, under Texas law, a similar arbitration agreement was illusory.[65]

D. Arguments of Invalidity Under Statute

Parties also occasionally seek to invalidate arbitration agreements where arbitration is arguably inconsistent with a specific statute's enforcement scheme. Where the statute is silent on alternative dispute resolution methods, such arguments fare poorly in Texas courts, provided the arbitration agreement does not unfairly curtail a claimant's substantive rights under the relevant statute.[66] Rather, as *Concepcion* and *Italian Colors* reinforce, the preemptive effect of the Federal Arbitration Act and well-established policy favoring contractual dispute resolution arrangements have generally prevailed over arguments that statutorily granted causes of action cannot be resolved privately.

Where a party argues that federal law expressly precludes arbitration, Texas courts have taken a narrow approach. In *James v. Conceptus, Inc.*,[67] for example, the plaintiff alleged his employer had improperly terminated him in violation of the False Claims Act after he raised concerns about potential Medicaid fraud within the company. The employer moved to compel arbitration under its employment agreement with the plaintiff, but the plaintiff argued that Dodd-Frank's whistleblower protections rendered the agreement unenforceable. The court disagreed, holding that Dodd-Frank's anti-arbitration provisions did not extend to the False Claim Act's anti-retaliation provisions.[68]

The court in *In re ReadyOne Industries, Inc.*[69] reached a similar result. After the employee sued her employer for work-related injuries, the employer moved to compel arbitration under the parties' arbitration agreement. The plaintiff opposed arbitration, arguing that the Franken Amendment prevented enforcement of arbitration agreements related to tort claims "arising out of negligent hiring, supervision, or retention." The court disagreed. Applying traditional statutory interpretation rules, the court concluded the Franken Amendment applied only to claims arising out of sexual assault or harassment, and not to plaintiff's personal injury. Thus, the plaintiff could not rely on the Amendment to invalidate her arbitration obligation.

E. Conclusion

Deciding whether to adopt a pre-dispute agreement to arbitrate employment-related claims requires careful consideration, and to be sure, such agreements may not be desirable in every employment setting. But the developing law in Texas continues to favor the enforceability of such agreements. If the agreement is carefully fashioned to avoid the most common pitfalls, employers can be increasingly confident that, should an employment dispute arise, it will be resolved outside the traditional judicial system.

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1 *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002).
2 *Id.* at 568–70.
3 *Id.* at 571–72.
4 *See Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).
5 80 S.W.3d at 568.
6 *Id.* at 569–73.
7 *Id.* at 571.
8 *Long v. BDP Int'l, Inc.*, 919 F. Supp. 2d 832, 845 (S.D. Tex. 2013) (internal quotation omitted).
9 407 S.W.3d 791 (Tex. App.—El Paso 2013, no pet.).
10 *Id.* at 801 ("Illiteracy is not a defense to enforcement of a contract and will not relieve a party of the consequences of the contract.").
11 *Id.* at 801–03.
12 361 S.W.3d 628 (Tex. 2012).
13 *Id.* at 632.
14 To establish effective notice, an employer must show that it unequivocally notified the employee of definite changes in employment terms and prove that the employee accepted those terms. *In re Halliburton Co.*, 80 S.W.3d at 568.
15 2011 WL 4944577 (N.D. Tex. Oct. 18, 2011).
16 *Id.* at *4.
17 The court noted that it was unclear whether the presumption that applies to letters—that is, that letters properly addressed, stamped, and mailed are presumed to be received by the addressee—also applies to e-mail. But even if the court applied the presumption, evidence that at least some employees did not receive the e-mail rebutted that presumption. *Id.* at *3 & nn.7 & 8.
18 *Id.* at *4.
19 *Id.* at *5–6. *Compare Johnson v. Coca-Cola Refreshments USA, Inc.*, 2012 WL 695837, at *3–4 (E.D. Tex. Feb. 3, 2012) (finding sufficient notice where employer presented evidence of employee's signature on a sign-in sheet for a mandatory presentation where the employer delivered information concerning the new policy).
20 *Halliburton*, 80 S.W.3d at 571.
21 *Long*, 919 F. Supp. 2d at 845.
22 *Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272, 274 (Tex.

App.—Eastland 2013, pet. filed) ("The test for substantive unconscionability is whether, given the parties' general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract.") (citation and quotation omitted).

[23] 919 F. Supp. 2d 832 (S.D. Tex. 2013).

[24] *Id.* at 846.

[25] 2013 WL 3992248 (S.D. Tex. Aug. 2, 2013).

[26] *Id.* at *3.

[27] *Id.* at *8. The FLSA allows "plaintiffs to recover damages for pay periods as far back as the statute of limitations will reach." *Id.* at *7 (internal quotation omitted). Although there is a two-year statute of limitations for inadvertent violations of FLSA, the statute mandates a three-year limitations period for willful violations. *Id.* at *7–8. The employment agreement's limitation, then, artificially decreased the recovery a plaintiff was potentially entitled to, and supplanted the distinction between inadvertent and willful violators, rendering the limitations provision unconscionable. *Id.*

[28] 395 S.W.3d 272 (Tex. App.—Eastland 2013, pet. filed).

[29] *Id.* at 274–75.

[30] 2012 WL 5198332 (S.D. Tex. Oct. 19, 2012). Although the *Pickens* case involved an arbitration agreement between a student and an educational institution, one might expect similar judicial treatment of contractual limitations on remedies in employment arbitration agreements.

[31] *Id.* at *4 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth*, 473 U.S. 614, 628 (1985)). Even so, the court noted that the U.S. Supreme Court has recognized that a clause limiting remedies does not automatically foreclose the possibility of arbitration. *Id.* (citing *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528 (1995)).

[32] *Id.* The court noted that the arbitrator would decide whether to sever the remedies-limiting provision.

[33] 2012 WL 36274 (N.L.R.B. Jan. 3, 2012).

[34] *Id.* at *6–8.

[35] *Id.* at *2–5.

[36] *Gamestop Corp.*, 2013 WL 4648418 (N.L.R.B. Aug. 29, 2013) (company's mandatory arbitration program, which required employees to waive their right to resolution of employment-related disputes by collective, representative, or class action, violated Section 8(a)(1) of the NLRA); *Everglades College, Inc.*, 2013 WL 4140317 (N.L.R.B. Aug. 14, 2013) (relying on the NLRB's decision in *D.R. Horton* and finding that employer violated Section 8(a)(1) of the NLRA where employer's agreement prohibited employees from seeking judicial redress of any kind and prohibited class or collective actions in arbitration); *JP Morgan Chase & Co.*, 2013 WL 4499144 (N.L.R.B. Aug. 21, 2013) (same); *Cellular Sales of Mo.*, 2013 WL 4427452 (N.L.R.B. Aug. 19, 2013) (same). *But see Chesapeake Energy Corp.*, 2013 WL 5984336 (N.L.R.B. Nov. 8, 2013) (the NLRB's stance on class waivers "cannot be sustained" in light of the Supreme Court ruling in *Italian Colors*).

[37] *D.R. Horton, Inc. v. NLRB*, No. 12-60031 (appeal filed Jan. 13, 2012).

[38] *Italian Colors*, 133 S. Ct. at 2310. An important related question is who decides whether claims can be brought collectively where an arbitration agreement is silent on the subject. In *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013), the Supreme Court noted that it had "not yet decided whether the availability of class arbitration" is presumptively a gateway issue for a court, rather than the arbitrator, to decide. Subsequently, in *Reed Elsevier, Inc. v. Crockett*, --- F.3d ---, 2013 WL 5911219 (6th Cir. Nov. 5, 2013), the Sixth Circuit has held that whether an arbitration agreement provides for class arbitration is presumptively an issue for the court to decide unless the parties have clearly authorized the arbitrator to answer that question.

[39] *See, e.g.*, *Raniere v. Citigroup Inc.*, --- F. App'x ---, 2013 WL 4046278 (2d Cir. Aug. 12, 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2d Cir. 2013); *Richards v. Ernst & Young, LLP*, --- F.3d ---, 2013 WL 4437601 (9th Cir. Aug. 21, 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1053–54 (8th Cir. 2013).

[40] 2013 WL 3992248 (S.D. Tex. Aug. 2, 2013).

[41] *Id.* at *8 (citing *Italian Colors*, 133 S. Ct. at 2310).

[42] *Id.*

[43] 2012 WL 4119994 (N.D. Tex. Aug. 17, 2012).

[44] *Id.* at *6; *see also Gonzales*, 2013 WL 1188136 at *4–5 (arbitrator, not trial judge, should determine whether the agreement permitted the plaintiff to bring his FLSA claims on behalf of a class); *Norman v. AlliantGroup, LP*, 2011 WL 4862945, at *1 (S.D. Tex. Oct. 13, 2011) (arbitration agreement could be enforced even though plaintiff had brought FLSA claims as a judicial class action).

[45] 2013 WL 3927620 (N.D. Tex. July 30, 2013).

[46] *Id.* at *6 (citing *In re Odyssey Healthcare, Inc.*, 310 S.W.3d 419, 422 (Tex. 2010)). The court found the *Sharpe* plaintiffs met that burden "because the plain language of the arbitration agreement makes [the $25,000] deposit a necessary condition to arbitration." *Id.* at *7. The fact that the defendant company was "similarly bound to make a deposit does not render the provision conscionable," because a sizeable cash deposit would represent more of a financial burden for individuals. *Id.*

[47] *Id.* (internal quotation omitted).

[48] *Id.*

[49] *Supra* note 8, at 847.

[50] *Id.*

[51] For example, the Ninth Circuit recently affirmed a finding of unconscionability in *Chavarria v. Ralphs Grocery Co.*, --- F.3d ---, 2013 WL 5779332 (9th Cir. Oct. 28, 2013). Among other deficiencies, the court upheld the district court's finding that the policy's arbitrator-fee-apportionment provision would effectively price employees out of the dispute resolution process. *Id.* at *6–7.

[52] *Vandeventer v. All Am. Life & Cas. Co.*, 101 S.W.3d 703, 719 (Tex. App.—Fort Worth 2003, no pet.) (citation and quotation omitted).

[53] *See, e.g.*, *Mendivil v. Zanios Foods, Inc.*, 357 S.W.3d 827, 832 (Tex. App.—El Paso 2012, no pet.) (invalidating arbitration agreement where the "[employer] never expressly agreed to arbitrate its disputes with [the employee] nor to be bound by the result of such arbitration"); *Carey v. 24 Hour Fitness, USA, Inc.*, 669 F.3d 202, 205 (5th Cir. 2012) ("Put differently, where one party to an

arbitration agreement seeks to invoke arbitration to settle a dispute, if the other party can suddenly change the terms of the agreement to avoid arbitration, then the agreement was illusory from the outset.").

[54] 669 F.3d 202 (5th Cir. 2012).

[55] *Id.* at 206.

[56] *Id.* at 209.

[57] *Id.* at 207–08.

[58] 2012 WL 5508378 (N.D. Tex. Nov. 13, 2012).

[59] *Id.* at *5.

[60] 2013 WL 1188136 (S.D. Tex. Mar. 20, 2013).

[61] *Id.* at *3.

[62] *Id.*

[63] 385 S.W.3d 103 (Tex. App.—San Antonio 2012, pet. denied).

[64] *Id.* at 107. In so holding, the court observed, "Since *Halliburton*, the Supreme Court has consistently held that when an arbitration agreement contains a savings clause that makes any amendment or termination operate prospectively only, it is not an illusory agreement."

[65] *Id.* at 109.

[66] *See* Section B, *supra*.

[67] 851 F. Supp. 2d 1020 (S.D. Tex. 2012).

[68] *Id.* at 1029 ("Dodd–Frank's antiarbitration amendments to other statutes cannot be extended by implication to the antiretaliation provisions of the False Claims Act, especially when Dodd–Frank amended other parts of the False Claims Act but not the provision at issue."); *see also Holmes v. Air Liquide USA, LLC*, 498 F. App'x 405, 406–07 (5th Cir. 2012) (holding that Dodd–Frank prohibitions on arbitration agreements were irrelevant where no actual Dodd–Frank claim was brought).

[69] --- S.W.3d ---, 2012 WL 6643692 (Tex. App.—El Paso Dec. 21, 2012, orig. proceeding).

EVIDENCE & PROCEDURE UPDATES

UPDATES ON CASE LAW pertaining to procedure and evidence as compiled by Luther H. Soules III, of Soules & Wallace and Robinson C. Ramsey, of Langley & Banack, Inc.

ARBITRATION

EVIDENCE UPDATE

BY LUTHER H. SOULES III & ROBINSON C. RAMSEY

RULE 408: SETTLEMENT OFFERS

Certain Underwriters at Lloyd's, London v. Chicago Bridge & Iron Co., 406 S.W.3d 326, 339-40 (Tex. App.—Beaumont 2013, pet. denied) "Evidence of settlement negotiations is inadmissible to prove liability for or invalidity of a claim or its amount. Exclusion is not required when the evidence is offered for another purpose, such as proving bias, prejudice, or interest of a witness or party, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution. Whether documents constitute an offer of settlement depends on whether something is given up by one of the parties to avoid litigation where some concession is made by one or both of the parties."

The record here did not demonstrate that the appellee "sought to admit the exhibits into evidence for purposes of showing [the appellant]'s liability," nor could the documents be construed as "a concession by either party." Furthermore, they "were not offered as evidence that [the appellee] made an agreement with [the appellant] acknowledging liability." Under these circumstances, the court of appeals held that the trial court "properly exercised its discretion when concluding that the evidence was being offered by [the appellee] for a purpose other than liability, invalidity of a claim, or the amount of a claim."

RULE 702: EXPERT TESTIMONY

Williams v. State, 406 S.W.3d 273, 283-84 (Tex. App.—San Antonio 2013, pet. filed) "The proponent of expert testimony must show it to be reliable. Expert appraisal testimony is no different. The reliability of expert scientific evidence is generally judged by the factors laid out in *Robinson*. But the courts have recognized that the considerations listed in *Robinson* for assessing the reliability of scientific evidence cannot always be used with other kinds of expert testimony. And in some cases, courts are justified in deciding that experience alone provides a sufficient basis for an expert's testimony."

"Even without the aid of the *Robinson* factors, courts must still gauge the reliability of an appraiser's testimony. Expert testimony is unreliable if the expert uses an improper methodology or misapplies established legal rules and principles. … Courts will also hold an appraiser's testimony to be unreliable if the appraiser violated well-established legal rules of valuation." Furthermore, courts are not required "to accept or take as true an expert's mere *ipse dixit*, but will determine whether there is simply too great an analytical gap between the data and opinion proffered. So too, even if an expert says something would be a 'wild-assed guess,' [courts] look at the substance of the opinion to determine its reliability."

> Because all appraisal opinions are "at best something of a speculation" the determination of market value "is peculiarly one for the fact finding body."

Because all appraisal opinions are "at best something of a speculation" the determination of market value "is peculiarly one for the fact finding body." Therefore, Texas courts have allowed appraisers "a wide degree of latitude based on their experience when determining admissibility." Accordingly, an expert's opinion testimony "is not legally insufficient because it lacks market data to support the opinion," and competing expert opinions "are not legally insufficient because they contradict each other, but they do raise fact issues for the jury to resolve."

City of Alton v. Sharyland Water Supply Corp., 402 S.W.3d 867, 875-76, 884, 885-86, 887 (Tex. App.—Corpus Christi 2013, no pet.) "A two-prong test governs whether expert testimony is admissible: (1) the expert must be qualified, and (2) the testimony must be relevant and based on a reliable foundation. If the expert's scientific testimony is not reliable, it is not evidence."

"Expert testimony lacking a proper foundation is incompetent, and its admission is an abuse of discretion." For example, expert testimony about repair estimates as well as "testimony of the person making the estimates or performing the repairs, or approval of the repairs by a third party has been held sufficient to support an award of damages based on the cost of repairs. However, an estimate without the testimony

of the person who made it or other expert testimony is no evidence of the necessity of the repair or the reasonableness of the cost of the repair."

The contractors here urged that the damages award could not stand because the plaintiff "offered no competent evidence that the cost of the repairs, past or future, was reasonable" and did not prove "the reasonableness of future repair costs." They also argued that "[t]he jury, therefore, had no basis for determining whether the future repair costs were reasonable." But the court of appeals disagreed.

The plaintiff presented the testimony of its expert "who had developed a repair estimate" and who testified that he "(1) utilized his past experience, (2) took [the] projected … costs that were based on a contractor's information and some of [the] known information on how to repair these lines, and (3) applied a price increase factor to determine what "a current figure would be to hire a contractor and have it done." He also testified that "as to the number of crossings checked and the percentage found to be in violation, the number of crossings to be dug up, the estimated number of crossings to be repaired, and the estimated costs for digging up each crossing and making those repairs."

This evidence allowed the jury "to infer the reasonableness of the estimates and to award future repairs," the amount of which the court of appeals held was "legally sufficient for reasonable and fair-minded jurors to find that the cost of future repairs awarded was reasonable."

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PROCEDURE UPDATE

BY LUTHER H. SOULES III & ROBINSON C. RAMSEY

MOTION TO SHOW AUTHORITY

In re Guardianship of Benavides, 403 S.W.3d 370, 373, 375, 376, 377 (Tex. App.—San Antonio 2013, no pet.) "Rule 12 allows a party to argue before the trial court that a suit is being prosecuted or defended without authority. When a party files a rule 12 motion to show authority, the challenged attorney must appear before the trial court to show his authority to act on behalf of his client. The motion may be heard and determined at any time before the parties have announced ready for trial. The primary purpose of rule 12 is to enforce a party's right to know who authorized the suit. At the hearing on the motion, the burden of proof is on the challenged attorney to show his authority to prosecute or defend the suit."

"Amendments to rule 12 removed the restriction that only defendants could challenge the authority of a plaintiff's attorney. These amendments took effect in 1981. The current version of rule 12 allows either a defendant or a plaintiff to file a rule 12 motion."

Here, the appellees "presented testimony from two experts indicating [the litigant] did not have the capacity to contract for legal services." In one expert's opinion, the litigant's dementia "had progressed over the course of many years, and there was no way that [his] cognitive function was significantly better in 2011," at which time he "did not have the capacity to hire an attorney."

Another expert testified that the litigant had a condition "called perseveration, which means he does the same thing over and over again without thinking about it" and that as a result of that condition he answered "Yes" to "virtually every question he is asked." Therefore, this expert's opinion was that the client ""was severely impaired over the course of the last year" and "did not have the capacity to contract for legal services in September 2011."

Based on this evidence, the court of appeals concluded that the trial court "was well within its discretion in finding that [the attorney] had no authority to represent [the party] in the underlying guardianship proceedings."

RULE 11 AGREEMENTS

Kanan v. Plantation Homeowner's Ass'n Inc., 407 S.W.3d 320, 329 (Tex. App.—Corpus Christi 2013, no pet.) "Even where parties enter into a valid Rule 11 agreement to settle a case, the parties must consent to the agreement at the time the trial court renders judgment. The trial court cannot render an agreed judgment after a party has withdrawn its consent to a settlement agreement. When a trial court has knowledge that one of the parties to a suit does not consent to a judgment, the trial court should refuse to sanction the agreement by making it the judgment of the court. Nevertheless, a written settlement agreement may be enforced as a contract even though one party withdraws consent before judgment is rendered on the agreement."

The appellants here complained that the Rule 11 agreement was not enforceable because the trial court rendered judgment on the agreement after the appellants had revoked their consent. The trial court, however, "did not enter an agreed judgment." Instead, the judgment specifically acknowledged that the trial court was "prohibited from entering an agreed judgment" because the appellants had withdrawn their consent. Therefore, the court of appeals overruled the appellants' complaint.

PLEADINGS

Flowers v. Flowers, 407 S.W.3d 452, 457-58 (Tex. App.—Houston [14th Dist.] 2013, no pet.) "Pleadings must give reasonable notice of the claims asserted." Nevertheless, courts "liberally construe the petition to contain any claims that reasonably may be inferred from the specific language used in the petition and uphold the petition as to those claims, even if an element of a claim is not specifically alleged." They cannot, however, "use a liberal construction of the petition as a license to read into the petition a claim that it does not contain."

In this family law case, the petition "did not request any modification to the geographic restriction on [the mother]'s

exclusive right to determine the children's primary residence. Nonetheless, in its final order, the trial court deleted this restriction. Therefore, the final order did not conform to the pleadings, and the trial court erred in granting such relief unless the issue was tried by consent. If issues not raised by the pleadings are tried by express or implied consent of the parties, these issues shall be treated as if they had been raised by the pleadings." Because the record here did not reflect that this issue had been tried by consent, the court of appeals concluded that the trial court abused its discretion by removing the geographic restriction.

Aldous v. Bruss, 405 S.W.3d 847, 857, 858 (Tex. App.—Houston [14th Dist.] 2013, no pet.) In his special exceptions to the plaintiff's petition, the defendant complained that the plaintiff "failed to set out enough factual details regarding his claim." It is not valid, however, "to generally complain that the pleading does not set out enough factual details if fair notice of the claim is given." Therefore, the court of appeals could not say that the trial court had abused its discretion in denying these special exceptions.

Riner v. City of Hunters Creek, 403 S.W.3d 919, 921-22 (Tex. App.—Houston [14th Dist.] 2013, no pet.) "A special exception is a procedural vehicle used to point out defects or insufficiencies in a pleading. The usual procedural vehicle used to challenge the sufficiency of the pleader's jurisdictional allegations or the existence of jurisdictional facts is a plea to the jurisdiction."

Here, the defendant "specially excepted" to the plaintiff's second amended petition on the ground that it "failed to establish the trial court's subject-matter jurisdiction over their claims." Therefore, in substance, this was a plea to the jurisdiction, which courts construe "liberally in favor of the pleader and look to the pleader's intent to determine whether the facts alleged affirmatively demonstrate the trial court's jurisdiction to hear the cause." On the other hand, "[i]f the pleadings affirmatively negate the existence of jurisdiction, then the trial court may grant the plea to the jurisdiction without allowing the plaintiffs an opportunity to amend."

The pleadings here affirmative negated subject-matter jurisdiction because they demonstrated that the complaint was not yet ripe. "Ripeness is a component of subject-matter jurisdiction. As such, it cannot be established by waiver or by estoppel. To evaluate ripeness, courts consider whether, at the time a lawsuit is filed, the facts are sufficiently developed so that an injury has occurred or is likely to occur, rather than being contingent or remote. Although a claim need not be fully ripened at the time suit is filed, the facts still must be developed sufficiently for the court to determine that an injury has occurred or is likely to occur. [I]f a party cannot demonstrate a reasonable likelihood that the claim will soon ripen, the case must be dismissed." Id.

To evaluate ripeness, courts consider whether, at the time a lawsuit is filed, the facts are sufficiently developed so that an injury has occurred or is likely to occur, rather than being contingent or remote.

NONSUIT

Roberts v. Wells Fargo Bank, N.A., 406 S.W.3d 702, 706 (Tex. App.—El Paso 2013, no pet.) "Rule 162 permits a plaintiff to nonsuit at any time before introducing all of her evidence other than rebuttal evidence. However, under the rule, the dismissal shall not prejudice an adverse party's right to be heard on a pending claim for affirmative relief. As long as the defendant has not made a claim for affirmative relief, the plaintiff's right to take a nonsuit is unqualified and absolute. Granting a nonsuit is a ministerial act, and a plaintiff's right to a nonsuit exists from the moment a written motion is filed or an oral motion is made in open court, unless the defendant has, prior to that time, sought affirmative relief."

"When nonsuit is filed after an unfavorable partial summary judgment has been entered against the claimant, the nonsuit is with prejudice as to those claims of which the judgment has disposed. This concept promotes judicial efficiency, protects parties from multiple lawsuits, and prevents inconsistent judgments through the preclusion of matters that have already been decided or which could have been litigated in a prior suit."

The trial court here rendered a partial summary judgment when it "officially announced its decision by memorandum, which was filed with the clerk on the following day." Because the trial court rendered this partial summary judgment against the appellant before she filed her nonsuit, "the trial court properly dismissed with prejudice [her] claims adjudicated by the summary judgment."

SUMMARY JUDGMENT

Henning v. OneWest Bank FSB, 405 S.W.3d 950, 962-63 (Tex. App.—Dallas 2013, no pet.) "The supreme court has stated that a no-evidence motion for summary judgment must be specific in challenging the evidentiary support for an element of a claim or defense and paragraph (i) does not authorize

conclusory motions or general no-evidence challenges to an opponent's case. The underlying purpose of this requirement is to provide the opposing party with adequate information for opposing the motion, and to define the issues for the purpose of summary judgment. The supreme court has analogized this purpose to that of 'fair notice' pleading requirements."

Here, the defendant's no-evidence motion for summary judgment "unambiguously stated the elements of each of [the plaintiff]'s claims and identified the elements as to which it contended there was no evidence." Furthermore, the record revealed "no confusion as to [the] claims or [the] assertions of no evidence." Therefore, the court of appeals concluded that this motion afforded the plaintiff "fair notice" of what the defendant was challenging.

DISCOVERY SANCTIONS

In re M.J.M., 406 S.W.3d 292, 297, 298 (Tex. App.—San Antonio 2013, no pet.) "A 'death penalty sanction' is any sanction that adjudicates a claim and precludes the presentation of the merits of the case." Texas Rule of Civil Procedure 215.2(b)(5) "expressly authorizes 'death penalty' sanctions, including 'an order striking out pleadings,' an order 'dismissing with or without prejudice the action or proceedings,' or an order 'rendering judgment by default against the disobedient party.' Depending on the circumstances, an order excluding essential evidence may constitute a death penalty sanction."

"Death penalty sanctions are limited by constitutional due process. [A] death penalty sanction cannot be used to adjudicate the merits of claims or defenses unless the offending party's conduct during discovery justifies a presumption that its claims or defenses lack merit. Before assessing death penalty sanctions, trial courts must first consider the availability of less stringent sanctions and whether such lesser sanctions would be adequate to promote compliance, deterrence, and punishment of the offender. The record in such a case must show that the trial court considered the availability of less stringent sanctions, and in all but the most exceptional cases, that the trial court tested a less stringent sanction before striking a party's pleadings. To show that the trial court has considered less stringent sanctions, the record should contain some explanation of the appropriateness of the sanctions imposed."

The record here did not show that the trial court "tested less stringent sanctions" because it did not demonstrate the trial court "attempted to obtain [the plaintiff]'s compliance with the discovery rules by imposing a less stringent sanction before imposing death penalty sanctions." The record contained "no previous orders sanctioning [the plaintiff] for discovery abuse," nor did the agreed scheduling order qualify as "an order imposing a less stringent sanction." The agreed scheduling order, "which simply ordered both parties to comply with all outstanding discovery requests by May 31, 2011, imposed no discovery sanction."

Furthermore, the record did not show that the trial court "considered less stringent sanctions before imposing death penalty sanctions." When the court granted the defendant's motion, "it failed to explain the appropriateness of imposing death penalty sanctions." Therefore, the court of appeals held that the trial court "erred in imposing death penalty sanctions without first testing or considering less stringent sanctions."

JURY CHARGE

Kelley & Witherspoon, LLP v. Hooper, 401 S.W.3d 841, 852-53 (Tex. App.—Dallas 2013, no pet.) "The Texas Supreme Court has held that it is error for the trial court to submit a broad-form jury question on damages that includes valid and invalid elements of damages, and that such an error is harmful because it prevents the appellate court from determining whether the jury based its damages finding on valid or invalid elements. An element of damages is 'invalid' if it is not supported by any evidence. The supreme court has elaborated that the inclusion of a 'factually unsupported claim' is not automatically harmful error, but that the inclusion is harmful unless the appellate court is reasonably certain that the jury was not significantly influenced by the inclusion of the erroneous issue."

In this legal malpractice case arising from representation in a personal injury suit, "[a] single blank for damages was provided, followed by an instruction that the jury could consider certain categories of damages such as [the plaintiff]'s past medical expenses and his past and future physical pain and mental anguish, loss of earning capacity, physical impairment, loss of consortium, and loss of household services." The trial court overruled the defendants objection to the judge's "refusal to submit a separate damages blank for each category of damages."

There was no probative evidence here "that any of [the plaintiff]'s lost-earning-capacity damages were caused by the underlying auto accident." One of the jury questions, however, "allowed the jury to award amounts for both past and future lost earning capacity." Because these were "invalid elements of damages," the appellants "were entitled to a separate damages blank for each element of damages so that they could properly present their appeal as to each invalid

element." Therefore, the trial judge "erred by overruling appellants' objection to the submission of a single damages blank in Question 2 instead of a separate damages blank for each element." Furthermore, this error prevented the court of appeals "from determining whether the jury's damages finding was based on valid or invalid elements."

Because the appellant presented evidence of "significant lost-earning-capacity damages" but no "probative evidence of causation," the court of appeals could not be "reasonably certain that the jury was not influenced by the inclusion of past and future lost earning capacity in the damages question." Therefore, this error was reversible.

MOTION FOR NEW TRIAL

Felt v. Comerica Bank, 401 S.W.3d 802, 807, 808 (Tex. App.—Houston [14th Dist.] 2013, no pet.) "When a motion for new trial requires the judge to exercise his discretion, the judge must have an opportunity to exercise that discretion before that discretion can be abused." In this no-answer default judgment case, the record did not indicate that the appellant or any of the co-defendants "ever attempted to set the motion for new trial for hearing or submission."

"[W]hen a movant alleges that he had no notice of the trial setting, he must prove the lack of notice. In order to do so, he must obtain a hearing on his motion." The motion and evidence here were "facially insufficient," and because the appellant "failed to obtain an evidentiary hearing to prove his lack of notice," the court of appeals affirmed the judgment against him.

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STATE BAR LITIGATION SECTION REPORT
THE ADVOCATE

FROM MY SIDE OF THE BENCH

Motions to Dismiss

by Hon. Randy Wilson
157th District Court,
Harris County, Texas

ARBITRATION

FROM MY SIDE OF THE BENCH

Motions to Dismiss

BY HON. RANDY WILSON

IN 2011, THE TEXAS LEGISLATURE enacted §22.004(g) of the Texas Government Code which provided:

> The Supreme Court shall adopt rules to provide for the dismissal of causes of action that have no basis in law or fact on motion and without evidence. The rules shall provide that the motion to dismiss shall be granted or denied within 45 days of the filing of the motion to dismiss. The rules shall not apply to actions under the Family Code.[1]

The matter was referred to the Supreme Court Advisory Committee, who, in turn, referred it to a subcommittee chaired by Hon. David Peeples, which prepared a proposed rule. In addition, a second proposal was submitted by a voluntary Working Group of representatives from the Texas Chapters of the American Board of Trial Advocates, the Texas Association of Defense Counsel, and the Texas Trial Lawyers Association. A third proposal was submitted by the State Bar Rules Committee.[2]

> **"If the plaintiff's suit is not permitted by law, the defendant may file special exceptions and a motion to dismiss."**

The various drafts were discussed at length by the full Supreme Court Advisory Committee on November 18, 2011,[3] and again on December 9, 2011.[4] The full committee then referred the proposed rule to the Supreme Court who made extensive changes in the final rule 91a.

The rule, as adopted, permits a party to move for the dismissal of a cause of action that "has no basis in law or fact."[5] No basis in fact is defined to mean "no reasonable person could believe the facts pleaded."[6] Although the rule looks a bit like Federal Rule 12(b)(6), the Supreme Court Advisory Committee and its subcommittee went out of their way to make clear that the dismissal rule is not merely a little rule 12(b)(6).

Perhaps the biggest difference between Rule 91a and 12(b)(6) is that the trial court must award attorneys' fees to the prevailing party. Thus, unlike federal court where 12(b)(6) motions are filed as a matter of course, a defendant must consider the consequences of filing a Rule 91a motion. To date, I've had only encountered two motions to dismiss under Rule 91a and the defendant won one and lost the other. The losing defendant was required to pay attorneys' fees to defend the motion.

No Basis in Law. Rule 91a authorizes dismissal of actions where there is no basis in law. Presumably, this is meant to cover situations where a plaintiff pleads a cause of action not recognized under Texas law, e.g., negligent infliction of emotional distress. The problem with the rule, however, as previously noted, is that it requires an award of attorneys' fees to the party who prevails on the motion. If you file a rule 91a motion and lose, you must pay the other side's attorneys' fees. There is a much cheaper alternative, however—file special exceptions. A special exception can be filed to challenge pleadings that allege no viable cause of action. "If the plaintiff's suit is not permitted by law, the defendant may file special exceptions and a motion to dismiss."[7] The prevailing party is not entitled to attorneys' fees for special exceptions. A special exception is a viable alternative to a rule 91a motion.

No Basis in Fact. The second ground for a rule 91a motion is when there is no basis in fact for the pleading, i.e., no reasonable person could believe the facts pleaded. The facts must be so outrageous as to be unbelievable. This is intentionally different from the federal requirement that the facts be "plausible." The "plausibility" standard of *Twombly*[8] and *Iqbal*[9] should not be imported into Rule 91a.

Rule 91a is a useful tool to dismiss the occasional nut suits that we sometimes encounter. For example, one Harris County judge recently dismissed a case under rule 91a where the handwritten petition stated she was murdered by defendants, resurrected by God at jail where she had been incarcerated

for 330 years. "It took a time machine and Jesus Christ to get [me] out of jail."

It remains to be seen how frequently rule 91a is used. For a suit alleging a claim with no basis in law, it is largely redundant to special exceptions. Rule 91a is useful to dismiss the pro se nut suits, but, of course, even if you are awarded attorneys' fees for preparing such a motion, collecting such fees could prove challenging.

Judge Randy Wilson is judge of the 157th District Court in Harris County, Texas. Judge Wilson tried cases at Susman Godfrey for 27 years and taught young lawyers at that firm before joining the bench. He now offers his suggestions of how lawyers can improve now that he has moved to a different perspective. ★

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1 Tex. Gov't Code §22.004(g).

2 http://www.supreme.courts.state.tx.us/MisDocket/12/12919100.pdf

3 Transcript of hearing of Supreme Court Advisory Committee can be found at http://www.supreme.courts.state.tx.us/rules/scac/2011/transcripts/sc11182011.pdf

4 Transcript of hearing of Supreme Court Advisory Committee can be found at http://www.supreme.courts.state.tx.us/rules/scac/2011/transcripts/sc12092011.pdf

5 Tex. R. Civ. P. Rule 91a.1.

6 Id.

7 Wayne Duddlesten, Inc. v. Highland Ins. Co., 110 S.W.3d 85, 96-97 (Tex. App.—[1st Dist.] 2003, pet. denied)

8 Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).

9 Ashcroft v. Iqbal, 556 U.S. 662 (2009).

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