ARBITRATION: WHAT'S A TRIAL LAWYER TO DO?

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CHAPTER 4

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In the legal field, Mr. Bayer has worked as a trial lawyer, in a wide range of cases including personal injury, business, intellectual property and land use. Mr. Bayer has been a guest lecturer at the University of Monterrey Law School and Anahuac Law School in Mexico City in international negotiations and alternative dispute resolution. He is a Fellow at the Center for Public Policy Dispute Resolution and a guest lecturer at The University of Texas School of Law in alternative dispute resolution, trial tactics, negotiation, and professional responsibility. Mr. Bayer received the 1998 Community Peacemaker Award from the Travis Country Dispute Resolution Center. His primary focus these days is on mediation and arbitration.

Mr. Bayer has been a frequent CLE presenter and also writes the popular legal blog ***Disputing: Conversations about Dispute Resolution***. The blog just celebrated its 4th anniversary and has been cited by the Wall Street Journal and law review articles. At Disputing, Mr. Bayer discusses articles, court cases, legislation, and news relating to alternative dispute resolution. Disputing also features commentary from leading practitioners and scholars. You may visit Disputing at www.karlbayer.com/blog. Mr. Bayer's complete resume is at www.karlbayer.com/KBres.pdf.

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I. INTRODUCTION

Ironically, although arbitration was intended to keep disputes out of court, collateral lawsuits about arbitration remain an active area of litigation in American courts.[1] This past term, the United States Supreme Court decided several arbitration cases, which included: *Vaden v. Discover Bank*,[2] *Arthur Anderson LLP v. Carlisle*,[3] and *14 Penn Plaza LLC v. Pyett*.[4] The case law overwhelmingly demonstrates a judicial deference to arbitration. More and more types of cases seem to become arbitrable. That is, subject to binding arbitration at the expense of a jury trial each day and arbitral awards seem to become more and more insulated from judicial scrutiny each day.[5] Perhaps one of the best examples of this limited judicial review of arbitral awards is the 2008 United States Supreme Court case *Hall Street v. Mattel*,[6] in which the Court held that the exclusive grounds for vacating or modifying arbitral awards are those stated by the Federal Arbitration Act (FAA). Thus, overruling common-law grounds for judicial review of arbitral awards under the FAA.

At the same time, the American Arbitration Association (AAA) and the International Chamber of Commerce (ICC) report increasing arbitration filings in 2008. The AAA arbitration case filings in 2008 rose to 138,447, up 8.4 percent from a year earlier and its international cases rose 13 percent.[7] Similarly, the ICC shows that the court's workload has been growing during the recent years, with the number of cases registered jumping to 663 last year from 599 in 2007.[8] In addition, 407 awards were rendered in 2008, compared with 349 in 2007.[9]

On the other hand, a general sense seems to be emerging, among some at least, that the arbitration tidal wave may be going too far, and a legislative movement at the Federal level has emerged that promotes the so-called Arbitration Fairness Act of 2009[10], which, if passed, would limit the use of binding arbitration in consumer, employment, franchise, and civil rights disputes. A similar bill was introduced at the 81st Regular Session of the Texas Legislature (S.B. 222).[11] However, the bill did not make it out of committee.[12]

The summer of 2009 has seen no shortage of changes in the area of consumer arbitration. In a surprising move, the National Arbitration Forum (NAF) —the country's largest administrator of credit card and consumer collections arbitrations— has agreed on to step aside from the credit card and consumer debt arbitration business.[13] This agreement came only a few days after Minnesota's Attorney General sued NAF on July14 alleging consumer, deceptive trade practices, and false advertisement.[14]

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[1] *See* Donald Philbin, *Trends in Litigating Arbitration: Using Motions to Compel Arbitration and Motions to Vacate Arbitration Awards*, 76 DEF. COUNS. J. 338 (2009) *available at* http://adrtoolbox.com/docs/Trends_in_Litigating_Arbitration.pdf; *see also* Litigating Alternative Dispute Resolution in the Fifth Circuit, 41 TEX. TECH L. REV. 739 (2009) *available at* http://adrtoolbox.com/docs/Litigating_in_the_Fifth_Circuit_2009.pdf (discussing noteworthy arbitration cases decided by the Fifth Circuit Court of Appeals).

[2] Vaden v. Discover Bank, 129 S.Ct. 1262 (2009) (federal court may look through a petition to compel arbitration to determine whether it has jurisdiction).

[3] Arthur Anderson LLP v. Carlisle, 129 S.Ct. 1896 (2009) (third party to arbitration agreement could invoke stay provision if state contract law allowed him to enforce agreement).

[4] 14 Penn Plaza LLC v. Pyett, 129 S.Ct. 1456 (2009) (collective bargaining agreement that clearly and unmistakably required union members to arbitrate ADEA claims was enforceable as a matter of federal law).

[5] *See* The Honorable Royal Furgeson, *Civil Jury Trials R.I.P.? Can It Actually Happen In America?* 40 ST.MARY'S L.J. 795, 869-70 (2009).

[6] Hall Street Associates, L.L.C. v. Mattel, Inc., 128 S.Ct. 1396, 1405 (2008).

[7] Deborah L. Cohen and Julie Kay, *Where the Work Is*, ABA Magazine, August 2009, *available at* http://www.abajournal.com/magazine/where_the_work_is/.

[8] *New ICC Arbitration Court Members Named*, June 9, 2009, *available at* http://www.iccwbo.org/iccdafdg/index.html.

[9] *Id.*

[10] H.R. 1020; S. 931. In addition to the Arbitration Fairness Act, several alternative dispute resolution bills are currently pending in the U.S. Congress, *see* Victoria VanBuren, *U.S. Dispute Resolution Update*, June 23, 2009, *available at* http://www.karlbayer.com/blog/?p=2693.

[11] *See* Victoria VanBuren, *Texas Legislature Update: Alternative Dispute Resolution Bills*, June 6, 2009, *available at* http://www.karlbayer.com/blog/?p=2227.

[12] *Id.*

[13] Victoria VanBuren, *National Arbitration Forum Settles with Minnesota's Attorney General*, July 20, 2009, *available at* http://www.karlbayer.com/blog/?p=3682.

[14] The Complaint and press releases can be found at www.karlbayer.com/blog/?p=3448.

Following a U.S. Congressional Hearing[15] on consumer arbitration held on July 22, the American Arbitration Association (AAA) said that it will not initiate arbitrations to collect from consumers until new guidelines are established.[16] Soon after, JPMorgan Chase[17]and Bank of America[18] announced that they will no longer require mandatory arbitration on customers' credit card disputes. For recent developments in the area of dispute resolution, we invite you to read our legal blog ***Disputing*** at http://www.karlbayer.com/blog.

With all of that said, please accept as the context for this paper a judicial climate in which a case is likely arbitrable if an arbitration clause is anywhere near the dispute, including non-parties to the arbitration agreement and in which the arbitrator's final decision, that is the arbitral award, will likely be un-appealable. Once you accept this version of the world, the next logical question becomes: what now? While numerous reported cases explain parties' potential rights and applicable standards of review both before and after the arbitration proceeding, we get much more limited guidance from the courts with respect to how the arbitration itself is conducted, and what to do if we do not think it's been conducted appropriately.

This paper is not an exhaustive review on the topic of arbitration, but instead seeks to simply expose Texas litigators to some issues at play. Accordingly, Part II outlines the issue of arbitrability, that is, whether or not a party to a dispute can force the dispute into binding arbitration. Part III discusses recent case law about whether nonsignatories are bound by an arbitration agreement. Part IV examines discovery issues in arbitration proceedings. The authors would like to note that this section is an update on a paper presented on that topic. Next, Part V addresses the enforceability of arbitral awards; that is, how one can either reduce an arbitration award to judgment or seek to have an arbitral award vacated. Part VI considers noteworthy cases in employment arbitration. Finally, Part VII concludes the paper.

II. ARBITRABILITY: MOTIONS TO COMPEL ARBITRATION

Arbitrability is a term used to describe whether or not a dispute can be forced from litigation into binding, private, arbitration. It comes up chiefly in appellate opinions on mandamus or interlocutory appeal of trial court orders refusing to compel arbitration, since a trial court order compelling arbitration is unappealable.[19] In the most common scenario, a party sues another party in a traditional court setting, and the Defendant asks that trial court to either abate or dismiss the case in favor of an order compelling the parties to arbitrate their dispute.

These orders to compel arbitration are most commonly requested pursuant to either the Federal Arbitration Act (FAA) or the Texas Arbitration Act (TAA).[20] Texas also has an International Arbitration Act (TIAA), which contains some interesting and potentially useful features absent from the TAA or FAA, but international arbitration is beyond the scope of this paper.[21] The FAA allows parties to initiate independent, distinct proceedings in a federal district court solely for the purpose of asking that court to compel arbitration against a party resisting arbitration.[22] The TAA contains a similar provision.[23] The TAA also allows parties to initiate independent proceedings to stay arbitrations "commenced or threatened" so that a court can decide the question of arbitrability.[24]

A. FAA or TAA: Which One Applies?

As a threshold matter, a party seeking to compel arbitration should consider whether or not the FAA or the TAA applies to his, her or its case. The first place to look, as in any arbitration question, is the arbitration clause itself. Parties are free to specify which statute should apply in an arbitration clause. However, if the arbitration clause is silent as to which statute applies, the clause can be said to potentially invoke both federal

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[15] Find the prepared testimony by witnesses at http://www.karlbayer.com/blog/?p=3797 and the videos of the hearing at http://www.karlbayer.com/blog/?p=4954.

[16] Find the AAA press release at http://www.karlbayer.com/blog/?p=3768.

[17] Ashby Jones, *The Revolution Rolls On: JPMorgan Chase Suspends Arbitration Activity*, July 24, 2009, The WALL STREET JOURNAL'S LAW BLOG, *available at* http://blogs.wsj.com/law/2009/07/24/the-revolution-rolls-on-jpmorgan-chase-suspends-arbitration-activity/.

[18] Dionne Searcey, *Bank of America Says 'No Mas' To Arbitration*, THE WALL STREET JOURNAL'S LAW BLOG, August 13, 2009, *available at* http://blogs.wsj.com/law/2009/08/13/bank-of-america-says-no-mas-to-arbitration/?mod=djemWEB&reflink=djemWEB&reflink=djemWLB.

[19] *See Perry Homes v.Cull,* 258 S.W.3d 580, 586 (Texas 2008).

[20] 9 U.S.C. §§1-16; TEX. CIV. PRAC. & REM. CODE §§ 171.001-098.

[21] *See* TEX. CIV. PRAC. & REM. CODE §§ 172.001-215.

[22] 9 U.S.C. §4.

[23] *See* TEX. CIV. PRAC. & REM. CODE §171.024.

[24] TEX. CIV. PRAC. & REM. CODE §171.023.

and state law.[25] In order to determine if the FAA can apply in a state-court proceeding, Texas courts look at the relationship between the parties and extend the FAA "to any contract affecting commerce, as far as the Commerce Clause of the United States Constitution will reach."[26]

In other words, the FAA can be said to apply to many disputes, given the state of current Commerce Clause jurisprudence. In *Nexion*, for example, the Texas Supreme Court found the FAA to apply to a Texas medical malpractice case brought by a Texan, against Texans, in a Texas state court, for torts committed in Texas because Medicare had paid for some of the plaintiff's medical expenses.[27]

However, the simple fact that the FAA can be said to apply to a dispute does not deprive a Texas court of TAA jurisprudence. Both, the TAA and the FAA, can simultaneously apply to a dispute, and the FAA only preempts the TAA in cases where the TAA is inconsistent with the FAA.[28] Most Texas litigants will be able to choose which statute they wish to apply, whether or not the federal courts have jurisdiction over the claim, since the FAA is designed to be enforceable and enforced in state courts. Indeed, the FAA itself does not confer federal question jurisdiction; in order to be brought in federal court, a petition under the FAA to compel arbitration must have some independent basis for federal court jurisdiction.[29]

Court actions brought to either compel arbitration or to enforce an arbitral award are brought pursuant to either state or federal statute, but they may be brought for the most part in either state court or federal court, regardless of which statute applies. The result is a number of opinions where Texas state courts interpret the FAA, and where Texas federal courts analyze Texas state common law as it pertains to arbitral contracts.

B. Must a Court Compel Arbitration? The Basic Test

According to the Texas Supreme Court, "a party seeking to compel arbitration under the FAA must establish that (1) there is a valid arbitration agreement, and (2) the claims raised fall within that agreement's scope."[30] Whether or not a valid arbitration agreement exists is determined by state contract law and is determined as a legal question by the trial court. [31] Once a valid agreement to arbitrate is found, the trial court, in considering the scope question, "should not deny arbitration 'unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue.'"[32] If both prongs are met, then the party opposing arbitration may offer any affirmative defense to the arbitration clause that would apply in any other kind of contract dispute, such as duress, unconscionability, fraudulent inducement, or the like.[33]

The basic test under the TAA is more or less the same as under the FAA, and like FAA analysis is ultimately governed by common-law concepts of Texas contract law:

> A party attempting to compel arbitration must first establish that the dispute in question falls within the scope of a valid arbitration agreement. If the other party resists arbitration, the trial court must determine whether a valid agreement to arbitrate exists. The trial court's determination of the arbitration agreement's validity is a legal question subject to de novo review. If the trial court finds a valid agreement, the burden shifts to the party opposing arbitration to raise an affirmative defense to enforcing arbitration.[34]

Again, under either statutory scheme, a court determines whether an agreement to arbitrate exists, whether the dispute in question is within the agreement's scope, and, finally, whether the affirmative defenses to arbitration have any merit.

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[25] *See* In re D. Wilson Constr. Co., 196 S.W.3d 774, 779 (Tex. 2006).

[26] In re: Nexion Health at Humble, Inc., 173 S.W.3d 67, 69 (Tex. 2005); *see also* Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 56-57, 123 S.Ct. 2037, 156 L.Ed.2d 46 (2003) (interpreting the meaning of "commerce" within the FAA).

[27] *Nexion*, 173 S.W.3d at 69.

[28] *Wilson*, 196 S.W.3d at 779-780.

[29] *See* 9 U.S.C. §4.

[30] In re Dillard Dept. Stores, Inc., 186 S.W.3d 514, 515 (Tex. 2006), quoting In re: Kellogg Brown & Root, Inc., 166 S.W.3d 732, 737 (Tex. 2005) (hereinafter "*Dillard I*", since the Texas Supreme Court actually handed down opinions on two separate mandamus petitions in early 2006 involving Dillard Department Store's arbitration clause).

[31] *Id.*

[32] *Id.* at 516, quoting Prudential Sec. Inc. v. Marshall, 909 S.W.2d 896, 899 (Tex. 1995).

[33] In re: FirstMerit Bank, N.A., 52 S.W.3d 749, 756 (Tex. 2001). *See also* In re Poly-America, *L.P.*, 262 S.W.3d 337 (Tex. 2008).

[34] J.M. Davidson, Inc. v. Webster, 128 S.W.3d 223, 227 (Tex. 2003) (internal citations, including to the TAA, omitted).

C. Does an Agreement to Arbitrate Exist?

Numerous recent opinions have discussed employers' imposition of arbitration agreements on their at-will employees. The landmark case is *Halliburton*. In that case, a Brown & Root employee for thirty years named James Myers received a notice that his employer --now a subsidiary of Halliburton-- had adopted a binding arbitration program for resolving employment disputes.[35] The notice stated that by continuing to come to work after a short time had passed, Myers would be deemed to have accepted the new program.[36] Myers kept coming to work, but eventually he was demoted.[37] Myers claimed that the demotion was discrimination based on his age and race, and filed a lawsuit under the Texas Commission on Human Rights Act.[38] Halliburton asked the trial court to compel arbitration and the trial court denied the motion.[39] The Court of Appeals denied the subsequent mandamus petition, and the Texas Supreme Court stepped in.[40]

According to Texas contract law, an at-will employer can change the terms of an at-will employment contract by providing notice of the change and proving the employee's acceptance of the change.[41] "When an employer notifies an employee of changes to the at-will employment contract and the employee 'continues working with knowledge of the changes, he has accepted the changes as a matter of law.'"[42]

In early 2006, the Texas Supreme Court re-affirmed the *Halliburton* rule in *Dillard I*, but the Court added a potential wrinkle.[43] In that case, the court notes that "the arbitration agreement and the 2000 rules do not provide Dillard any right to unilaterally modify the agreement.[44] For that reason, and because the parties agreed to and signed the agreement, the agreement is binding on Martinez."[45] In other words, presumably not even an at-will employer can impose an arbitration agreement on an employee that gives the employer the unilateral right to change the rules or procedures governing arbitration.[46]

Several months later, the court wrote another opinion on the same arbitration policy.[47] In *Dillard II*, the El Paso store had presented its arbitration policy to its employees at a meeting in August 2000.[48] Later, an employee named Delia Garcia sued the company for retaliatory discharge, claiming that she was fired after applying for workers' compensation insurance benefits.[49] The store offered evidence that it had given its employees notice of the policy at the meeting, but it could not produce a signed acknowledgment form for Ms. Garcia, and it could not find any witness who could testify that Ms. Garcia had been at the meeting and received the forms.[50]

Ms. Garcia testified that at some point she was presented with a document about the arbitration program, but that she refused to sign it because she did not wish to be bound by mandatory arbitration.[51] According to the Supreme Court, since Ms. Garcia had clearly been given some sort of notice of the arbitration plan, she was bound to the plan by her decision to continue coming to work every day; her refusal to sign, therefore, had no legal significance.[52]

Dillard II also, in a sideways fashion, addresses the issue of whether Dillard's right to unilaterally modify the agreement would render it illusory and thus non-binding on Ms. Garcia.[53] Dillard apparently put a new arbitration plan in place in 2002, more than a year after notifying Ms. Garcia of the first plan.[54] Since Ms. Garcia clearly did not receive notice of the changed plan, Ms. Garcia argued that Dillard obviously retained the right to modify the plan unilaterally, since it had in fact done so.[55] The Supreme Court was un-moved by this argument. In point of fact, says the court, since Dillard never gave Ms. Garcia notice of the changed plan, it had not as a legal matter effectively changed the plan, since notice is required to change an

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[35] *Id.* at 568.

[36] In re Halliburton Co., 80 S.W.3d 566, 568 (Tex. 2002).

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] *Halliburton*, 80 S.W.3d at 568.

[42] *Id.* at 568 (quoting *Hathaway v. General Mills*, 711 S.W.2d 227, 229 (Tex. 1986)).

[43] *See* Dillard I, 186 S.W.3d 514

[44] *Id*.

[45] *Dillard I*, 186 S.W.3d at 516.

[46] *See also Davidson*, 128 S.W.3d at 228-29 (discussing the clause: "[t]he Company reserves the right to unilaterally abolish or modify any personnel policy without prior notice.").

[47] *See* In re Dillard Department Stores, Inc., 198 S.W.3d 778 (Tex. 2006) (hereinafter *Dillard II*).

[48] *Id.* at 780.

[49] *Id.*

[50] *Id.*

[51] *Dilllard II*, 198 S.W.3d 778 at 781.

[52] *Id.* at 781.

[53] *See Dilllard II*, 198 S.W.3d 778.

[54] *Id.* at 781-82.

[55] *Id.* at 782.

at-will employment arrangement.[56] Therefore, Dillard did not unilaterally modify the plan, since an at-will employer cannot in fact modify the at-will arrangement without providing notice and an opportunity for the employee to reject the change by quitting.

In June 2006, the Texas Supreme Court ruled that "notice" under the *Halliburton* analysis does not actually require that the employee receive a copy of the arbitration agreement itself.[57] In that case, the employee had received a "Summary Plan Description of Agreement to Arbitrate Claims" that described the plan, which "constitutes effective notice because it unequivocally provided [employee] with knowledge of the arbitration agreement."[58] The employee testified that he never received the plan itself, but he had signed the summary description.[59]

D. Is the Dispute Within the Scope of the Arbitration Clause?

If an agreement to arbitrate has been established, a court must compel arbitration if the dispute falls within the scope of the arbitration clause. There is, as a general matter, less analysis on the scope question than the existence question, largely because the legal test courts in Texas employ, whether they be state courts or federal courts, is designed to be expansively inclusive, and most arbitration clauses are worded broadly enough to encompass more or less any claim that might be conceived of between parties to an arbitration agreement.

In evaluating whether a claim is within the scope of an arbitration clause, "a court should not deny arbitration 'unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue."[60] In *Dillard I*, the ex-employee sued Dillard for defamation; Dillard relied on language in its arbitration clause covering claims for "personal injuries arising from a termination, except those covered by workers' compensation."[61] According to the Supreme Court, since a reasonable interpretation of "personal injuries" includes injuries to reputation, the defamation claims are arbitrable.[62]

The former employee further argued that since her claim was based on defamatory comments, and not her actual termination, the claim did not "arise from a termination."[63] The court ruled that since the comments were made "near the time of her termination," "any damaged in this case could be viewed as intertwined with her employment and termination, and any ambiguity as to whether 'arising from' should mean intertwined, or occurring as a direct result from, is resolved in favor of arbitration."[64]

Within that context, the scope prong of arbitrability analysis ought not be a difficult hurdle for a party seeking to compel arbitration to overcome.

E. Personal Injury Cases

In Section II(A), above, we mentioned that the FAA and the TAA can co-exist peacefully, and that the FAA will only actually pre-empt the TAA when they differ. The most common example of this happens in personal injury cases. The Texas Arbitration Act requires that an agreement to arbitrate a personal injury case is only enforceable under the TAA if each party and each party's attorney signs it.[65] In other words, pre-injury arbitration agreements will not be valid in personal injury cases, since personal injury clients typically do not retain counsel before they get hurt. Therefore, in a Texas personal injury case, one can disprove the existence of a valid agreement to arbitrate if the injured plaintiff's lawyer did not sign the agreement.

The FAA, of course, has no such requirement. Thus, in a personal injury case governed by the FAA, the FAA's silence on this point preempts the TAA's attorney-signature requirement, and the default rules described above apply.[66] In other words, although it usually does not matter, for the most part, whether the FAA or the TAA applies, **in personal injury cases the FAA/TAA determination is critical and case determinative, at least on the arbitrability issue.**

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[56] *Id.*

[57] In re Dallas Peterbilt, Ltd., L.L.P., 196 S.W.3d 161, 162-63 (Tex. 2006).

[58] *Id.* at 163.

[59] *Id.* at 162.

[60] *Dillard I*, 186 S.W.3d at 516, citing *Prudential Sec. Inc. v. Marshall*, 909 S.W.2d 896, 899 (Tex. 1995), quoting *Neal v. Hardee's Food Sys., Inc.*, 918 F.2d 34, 37 (5th Cir. 1990); *see also Kellogg*, 166 S.W.3d at 737; *see also Wilson*, 196 S.W.3d at 782-83.

[61] *Id.*

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] TEX. CIV. PRAC. & REM. CODE §171.002(a)(3) and (c).

[66] *See Nexion*, 173 S.W.3d at 69; *see also* In re AdvancePCS Health L.P., 172 S.W.3d 603, 606 (Tex. 2005) (explaining that the FAA does not require that arbitration clauses be signed and the TAA's requirement did not apply to the case); In re Weekley Homes, 180 S.W.3d 127, 130 n.4 (Tex. 2005)(holding that the FAA preempts any state requirements that apply only to arbitration clauses.).

III. RECENT DEVELOPMENTS IN BINDING NONSIGNATORIES TO ARBITRATION

This section of the paper will, by necessity, consider the unusual cases, since the courts do not spend much time discussing the issue in the face of actual signed arbitration agreements between parties. Recent opinions from the U.S. Supreme Court, the Texas Supreme Court, and the Fifth Circuit, demonstrate that it is quite possible for an agreement to arbitrate to exist in the absence of an actual written agreement signed by both purportedly bound parties to the litigation.

A. U.S. Supreme Court

In March 2009, the U.S. Supreme Court held in *Arthur Anderson LLP v. Carlisle*, that a non-party to an arbitration agreement could appeal a trial court ruling that rejected the third party's motion to compel arbitration.[67] Justice Scalia delivered the majority opinion, joined by Justices Kennedy, Thomas, Ginsburg, Breyer, and Alito. Justice Souter filed a dissenting opinion, in which Chief Justice Roberts and Justice Stevens joined.[68]

In *Carlisle*, the accounting firm of Arthur Andersen LLP, together with Bricolage Capital, LLC, a financial advisor, and Curtis, a law firm, designed a tax strategy for Carlisle to limit its tax liability.[69] Only the agreements between Carlisle and Bricolage provided for arbitration of disputes.[70] As it turns out, the Internal Revenue Service (IRS) determined that the investment strategy was an illegal tax shelter and Carlisle brought suit in federal court against all three entities.[71] The suit alleged fraud, civil conspiracy, malpractice, breach of fiduciary duty, and negligence. Anderson and Curtis sought a stay invoking section 3 of the FAA demanded the dispute be referred to arbitration.[72] The district court denied the motion and the Court of Appeals for the Sixth Circuit dismissed for want of jurisdiction.[73]

The first issue the Court decided was whether appellate courts have jurisdiction under Section 16(a) of the FAA to review denials of stays of litigation requested by nonparties to the arbitration agreement. [74] The Court concluded that Section 16(a) with "clear and unambiguous terms" expressly authorizes interlocutory appeals of motions denying Section 3 stays.[75] Stressing that "[t]he jurisdictional statute here unambiguously makes the underlying merits irrelevant," the Court rejected that this interpretation will produce frivolous interlocutory appeals.[76]

Next, the Court explained that Section 2 of the FAA makes arbitration agreements "valid, irrevocable, and enforceable" requiring courts "to place [arbitration] agreements upon the same footing as other contracts."[77] Then, Section 3 allows enforcement of Section 2, by requiring the courts to stay litigation, "on application of one of the parties" if the issue is "referable to arbitration under an agreement in writing."[78] When interpreting the phrase "one of the parties," the Court clarified in footnote 4, that the word "parties" refers to parties to the litigation, and not to the parties to the contract.[79]

Then, the Court reasoned that Section 3 does not restrict the enforceability of Section 2. As a result, state law should be applied to determine which contracts are binding under Section 2 and enforceable under Section 3.[80] The Court added that because state law allows contracts to be enforced by or against nonparties through different theories (assumption, piercing the veil, alter ego, incorporation by reference, third-party beneficiaries, waiver and estoppel), then nonparties may invoke Section 3.[81]

In sum, in *Carlisle*, the U.S. Supreme Court ruled that appellate federal courts have jurisdiction to review the denial of a request for a Section 3 stay and that a litigant who was not a party to the arbitration agreement may invoke Section 3 if the relevant state contract law allows the nonparty to enforce the agreement. [82]

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[67] Arthur Andersen LLP v. Carlisle, 129 S.Ct. 1896, 1898 (2009).

[68] *Id*.

[69] *Id*. at 1899.

[70] *Id*.

[71] *Id*. Also named in the suit were two employees of Bricolage (Andrew Beer and Samyak Veera); Curtis, Mallet-Prevost, Colt & Mosle, LLP; William Bricker (the lawyer respondents worked with at the law firm); Prism Connectivity Ventures, LLC (the entity from whom the worthless warrants were purchased); Integrated Capital Associates, Inc. (a prior owner of the worthless warrants who had also been a client of the law firm); and Intercontinental Pacific Group, Inc. (a firm with the same principals as Integrated Capital Associates). *Id*.

[72] *Id*. at 1899-1900.

[73] *Id*. at 1900.

[74] *Id.*

[75] *Id.*

[76] *Id*. at 1901.

[77] *Id*.

[78] *Id*. at 1901-02.

[79] *Id*. at 1901.

[80] *Id*. at 1902.

[81] *Id*.

[82] *Id*. at 1898.

B. Texas Supreme Court

Texas courts have employed different and unusual theories in order to find that an agreement to arbitrate exists in the absence of a traditional written agreement: direct-benefits estoppel, incorporation by reference, assumption, agency, alter ego, and third-party beneficiary.[83] These theories stem from contract law, since, again, an agreement to arbitrate is simply a contract.

1. Wrongful Death Cases: *Labatt* and *Jindal*

In *Labatt*, the Texas Supreme Court resolved the issue of whether nonsignatories to an arbitration agreement should be compelled to arbitrate claims when the decedent's claims would have to be arbitrated.[84] Plaintiffs in this case are family members who brought a wrongful death action against the employer Labatt Food Service, L.P.[85] Labbatt filed a motion to compel arbitration, pursuant to the arbitration agreement signed by the decedent.[86] The trail court denied Labbatt's motion and Labbatt appealed.[87]

The Texas Supreme Court stated that "is well established that statutory wrongful death beneficiaries' claims place them [the family members] in the exact 'legal shoes' of the decedent, and they are subject to the same defenses to which the decedent's claims would have been subject.[88] The court reasoned that if the employee had not died from his injuries, his claims would have been arbitrated.[89] Accordingly, the court held that the beneficiaries are required to arbitrate their wrongful death claim.[90]

Similarly, in *Jindal*, the Texas Supreme Court held that an arbitration agreement between a decedent and his employer required the nonsignatories beneficiaries to arbitrate their claims against the employer.[91]

2. Agents and Affiliates: *Merrill Lynch* and *Kaplan*

In *Merrill Lynch*, the Texas Supreme Court refused to adopt concerted-misconduct equitable estoppel as a means by which non-signatories to an agreement to arbitrate can nonetheless compel arbitration.[92] The facts of the case are follows. Juan Alaniz, having settled a personal injury lawsuit, opened several accounts with Merrill Lynch to manage his settlement proceeds.[93] All his contracts with Merrill Lynch contained arbitration clauses.[94] Part of his investment plan, however, required that he also enter into contracts with Merrill Lynch Trust Company (MLT) and Merrill Lynch Life Insurance Company (MLLI), so that he could create a life insurance trust.[95] Mr. Alaniz' contracts with MLT and MLLI did not contain arbitration clauses.[96] The broker who handled all of these accounts was a fellow named Henry Medina. [97] In April 2003, Alaniz sued Medina, MLT and MLLI, but not Merrill Lynch.[98] All defendants moved to compel arbitration, based on the Merrill Lynch contracts which contained arbitration clauses.[99] Both, the trial court and the Thirteen Court of Appeals denied the motions to compel arbitration.[100]

The Texas Supreme Court reversed those decisions so far as the Alaniz claims against Mr. Medina were concerned.[101] The majority opinion holds that the Plaintiffs cannot sue an agent of the company with whom it had the agreement to arbitrate and thus avoid the agreement to arbitrate.[102] This holding is certainly consistent with prior Texas case law. The court reasoned that in substance the claims were against Merrill Lynch, so arbitration was the appropriate forum.

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[83] *See* In re Kellogg Brown & Root, 166 S.W.3d 732, 739 (mentioning the legal theories used by Texas courts to find an agreement to arbitrate).

[84] In re Labatt Food Service, L.P., 279 S.W.3d 640 (Tex. 2009).

[85] *Id*. at 642.

[86] *Id*.

[87] *Id*.

[88] *Id*. at 644.

[89] *Id*. at 649.

[90] *Id*.

[91] In re Jindal Saw Ltd., __ S.W.3d __ (Tex. 2009); 2009 LEXIS 33.

[92] In re Merrill Lynch Trust Co. FSB, 235 S.W.3d 185 (Tex. 2007).

[93] *Id* at 188.

[94] *Id*. Each account agreement contained the following clause: "I agree that all controversies which may arise between us, including but not limited to those involving any transaction or the construction, performance, or breach of this or any other agreement between us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration." *Id.*

[95] *Id*.

[96] *Id*.

[97] *Id*.

[98] *Id*.

[99] *Id*.

[100] *Id*.

[101] *Id*. at 190.

[102] *Id*.

However, the majority refused to compel arbitration with respect to the Alaniz claims against MLT and MLLI.[103] MLT and MLLI entered into separate contractual relationships with Alaniz.[104] They had an opportunity to negotiate for an arbitration clause, and they chose not to. Compelling arbitration against them, therefore, would allow them to re-write their agreements with Alaniz after the fact. In other words, in Texas, if you're a non-signatory hoping to compel arbitration based on someone else's contract with the Plaintiff, you're much better off if you don't have a contract of your own with the Plaintiff that lacks an arbitration clause.

Next, MLT and MLII urge the Court to find an agreement to arbitrate pursuant to a theory called concerted-misconduct equitable estoppel (or "CMEE").[105] Like direct benefits estoppel, CMEE is an estoppel theory some courts have adopted to require non-signatories to arbitration agreements to arbitrate claims. Since the Texas Supreme Court has enthusiastically applied direct benefits estoppel to compel arbitration, MLT and MLII apparently decided to have a go at CMEE.

After discussing other jurisdictions' approach to CMEE, the Texas Supreme Court decides not to adopt it here:

> Similarly, while Texas law has long recognized that nonparties may be bound to a contract under traditional contract rules like agency or alter ego, there has never been such a rule for concerted misconduct. Conspiracy is a tort, not a rule of contract law. And while conspirators consent to accomplish an unlawful act, that does not mean they impliedly consent to each other's arbitration agreements. As other contracts do not become binding on nonparties due to concerted misconduct, allowing arbitration contracts to become binding on that basis would make them easier to enforce than other contracts, contrary to the Arbitration Act's purpose.[106]

Merrill Lynch required the plaintiffs to arbitrate against the employee and to proceed with litigation against the affiliated entities. What, then, happens next? The court has compelled arbitration of claims against one Defendant, but not the other two. Well, the rule in Texas is that the arbitration gets to go first. The court stays the litigation between Alaniz and the Merrill Lynch companies until the arbitration against Medina is complete. The court stated that "the case illustrates one of many circumstances in which litigation must be abated to ensure that an issue two parties have agreed to arbitrate is not decided instead in collateral litigation."[107]

In *Kaplan*, the Texas Supreme Court cited *Merrill Lynch* and held that a fraudulent inducement claim must be arbitrated if the contract which was allegedly fraudulently induced contained an arbitration clause, even if the party seeking to compel arbitration is not a signatory to that contract.[108] *Kaplan* involves fraudulent inducement claims by a group of student electricians against a vocational college.[109] The students alleged that the college induced them to enroll by making false promises that they would be eligible for journeyman or master electrician licenses upon graduation.[110]

The college, with whom the students had entered into the arbitration agreements, was wholly owned by Kaplan Higher Education Corporation.[111] When the students sued the college, the college moved to compel arbitration, and the students dropped their claims against the college; choosing instead to proceed against Kaplan.[112] Kaplan was not a signatory to the enrollment agreement with the arbitration clause, and neither the trial court nor the Thirteen Court of Appeals would compel arbitration.[113]

The Texas Supreme Court directed the trial court to compel arbitration and added that "when an agreement between two parties clearly provides for the substance of a dispute to be arbitrated, one cannot avoid it by simply pleading that a nonsignatory agent or affiliate was pulling the strings."[114]

3. Securities Firm as Beneficiary of Employee's Agreement: *In re Next Financial*

In NEXT Financial, the Texas Supreme Court held that a third party beneficiary of an arbitration agreement was entitled to enforce the arbitration

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[103] *Id*. at 191.

[104] *Id*.

[105] *Id*.

[106] *Id*. at 194.

[107] *Id*. at 196.

[108] In re Kaplan Higher Educ. Corp., 235 S.W.3d 206, 210 (Tex. 2007).

[109] *Id*. at 208.

[110] *Id*.

[111] *Id*.

[112] *Id*.

[113] *Id*.

[114] *Id*. at 210.

provision.[115] Michael Clements was an employee of NEXT Financial Group, Inc. a securities firm since September, 2006.[116] Surprisingly, the parties did not have a written employment contract.[117] However, as a condition of employment, Clements was required to register with the National Association of Securities Dealers (NASD) by executing a Uniform Application for Securities Industry Registration or Transfer form (U-4).[118] The U-4 form contains an agreement to "arbitrate any dispute, claim or controversy that may arise between me and my firm . . . that is required to be arbitrated under the rules, constitutions, or bylaws of [the NASD] . . . as may be amended from time to time . . . ."[119] In August, 2007, NEXT Financial fired Clemens claiming that he failed to perform some duties required by his job.[120] Clemens sued NEXT Financial claiming he was fired for refusing to conceal a trader's fraudulent transactions.[121] NEXT Financial moved to compel arbitration, based on the arbitration clause in the U-4.[122] The trial court denied the motion and the court of appeals denied mandamus relief.[123]

The Texas Supreme Court held that Clements claims fell within the scope of his arbitration agreement with NASD and was not subject to an exception limited to statutory employment discrimination.

4. Automobile Dealership Transfer : *Meyer*

Similarly, in *Meyer*, the Texas Supreme Court emphasized that non-signatories to arbitration agreements can still be required to arbitrate certain disputes.[124] In *Meyer*, the court analyzed circumstances in which a non-signatory can actually compel arbitration pursuant to a contract to which the non-signatory was, of course, not a party. The majority opinion, written by Justice Hecht, continues the trend of judicial empowerment of arbitration contracts.

In this case, a jilted potential purchaser of a Ford dealership sued Ford, the dealership, and the eventual successful purchaser when Ford exercised a right of first refusal and caused the purchase and sale agreement (PSA) between first purchaser and the dealership to be terminated.[125] The PSA was a contract between the dealership and the first purchaser; Ford and the eventual purchaser were not parties.[126]

The first purchaser sued based on a theory that Ford's right of first refusal was not valid and did not allow Ford to terminate the PSA or allow the dealership to get out of the PSA.[127] The first purchaser also sued the eventual purchaser for interfering with the PSA.[128] The PSA, which, again was between only the dealership and the first purchase, included an arbitration clause.[129] However, in what could be described as the "flip side" of the normal fact pattern, Ford and the eventual purchaser, who were never parties to the PSA, moved to compel arbitration, based on the PSA's arbitration clause.[130] The trial court and the Court of Appeals refused to compel arbitration, but the Texas Supreme Court saw the issue differently.[131] According to Justice Hecht, since the plaintiff-first purchaser's claims against Ford and the eventual purchaser were completely intertwined with its claims against the dealership, and since a arbitration agreement did exist between it and the dealership, equitable estoppel requires that all the claims be arbitrated.[132]

In her dissent, Justice O'Neill argues that this claim for tortious interference with a contract could not be so intertwined with a claim for breach of that contract to support equitable estoppel, especially since the arbitration clause itself was not a traditional sweepingly broad clause.[133]

The opinion in *Meyer* discusses in detail the doctrine of equitable estoppel as it applies to the enforcement of arbitration agreements, and it continues a powerful trend in Texas jurisprudence making arbitration clauses extremely difficult to avoid.

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[115] In re NEXT Financial Group, Inc., 271 S.W.3d 263 (Tex. 2008).

[116] *Id*. at 265.

[117] *Id*.

[118] *Id*.

[119] *Id*.

[120] *Id*.

[121] *Id*. The court cited Sabine Pilot, 687 S.W.2d at 734-35 (holding that an at-will employee can recover damages from an employer who terminated his employment solely for refusing to perform an illegal act). *Id.*

[122] *Id*. at 266.

[123] *Id*.

[124] Meyer v. WMCO-GP, L.L.C. 211 S.W.3d 302 (Tex. 2008).

[125] *Id*. at 304.

[126] *Id*.

[127] *Id*.

[128] *Id*.

[129] *Id*.

[130] *Id*.

[131] *Id*. at 305.

[132] *Id*. at 307.

[133] *Id*. at 308-09.

C. Fifth Circuit

Recently, the Fifth Circuit held in *Graves* that nonsignatories plaintiffs were bound by the arbitration agreement between decedent and his employer.[134] Plaintiffs in *Graves* are the surviving relatives of an employee of defendant JV Industrial Companies, who died in a work-related accident at a BP facility in Texas.[135] The plaintiffs sued under the Texas wrongful death statute and the Texas survival statute.[136] Defendants moved to compel arbitration pursuant to the arbitration clause in decedent's employment contract.[137] The district court granted the motion with respect to the survival claims, because it found those claims to be "wholly derivative of the decedent's rights."[138] On the other hand, the court refused to compel arbitration of the wrongful death claims, as it found them to be "personal to the plaintiffs."[139] Defendants appealed.[140]

The issue before the Fifth Circuit was whether nonsignatories suing a decedent's employer under the Texas wrongful death statute are bound by an arbitration agreement between the employer and the decedent.[141] The court first considered whether state or federal law choice of law applied, by setting out the two-prong analysis presented by a motion to compel arbitration:

1. Validity: whether there is a valid agreement to arbitrate.[142] Here, the court answered that it applies state law principles that govern contract formation to resolve this question.[143]

2. Scope: whether the dispute is within the scope of the arbitration agreement.[144] The court pointed out that this question is resolved by applying the federal substantive law of arbitrability.[145]

Next, the court noted that the present issue falls somewhere between validity and scope and added that case law is inconsistent as to the choice of law.[146] However, the Fifth Circuit reasoned that it was not required to decide the applicable choice of law because under both, federal and state law, the outcome was the same.[147]

Under Texas law, citing *Labatt*, the court determined that nonsignatories are bound by the agreement because they "stand in the decedent's legal shoes."[148] Similarly, applying federal law, the court stated that the "direct benefits" version of estoppel applies.[149] Accordingly, "a nonsignatory cannot sue under an agreement while at the same time avoiding its arbitration clause."[150] Then, the court found that the statutory wrongful death action was, at least in part, premised on the decedent's employment agreement.[151] The Fifth Circuit reversed, holding that the plaintiffs were bound by the arbitration agreement made by the decedent.[152]

IV. DISCOVERY IN ARBITRATION

A. Discovery Between Arbitration Parties

In 1991, the United States Supreme Court decided that age discrimination claims under the ADEA could be subject to binding arbitration; in other words, nothing about the nature of the claims themselves (i.e. that they involved allegations of depravations of statutory rights) meant that employees could not waive the right to pursue those claims in courts by way of arbitration agreements.[153] The underlying plaintiffs in that case had argued, unsuccessfully, that one reason ADEA claims ought not be arbitrable was the limited availability of discovery in arbitral proceedings.[154] As the argument went, since discovery is limited in arbitration proceedings, plaintiffs in those proceedings do not have the same tools at their disposal that they would have in court, and therefore the claims ought not

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[134] Graves v. BP America, Inc., 568 F.3d 221, 223 (5th Cir. 2009).

[135] *Id*. at 222.

[136] *Id*.

[137] *Id*.

[138] *Id*.

[139] *Id*.

[140] *Id*.

[141] *Id*.

[142] *Id*. at 222.

[143] *Id*.

[144] *Id*.

[145] *Id*.

[146] *Id*. at 222-23.

[147] *Id*. at 223.

[148] *Id*.

[149] *Id*.

[150] *Id*.

[151] *Id*. at 223-24.

[152] *Id*. at 224.

[153] Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S.Ct. 1647 (1991). *See also* 14 Penn Plaza LLC v. Pyett, 129 S.Ct. 1456 (2009) (collective bargaining agreement that "clearly and unmistakably" required union members to arbitrate ADEA claims was enforceable as a matter of federal law).

[154] *Id.*, at 31, 1654-55.

be arbitrable at all, since arbitration by its nature would deprive claimants of their full ability to pursue the claims.[155]

The Supreme Court rejected this argument, and the basis for the rejection, although fairly terse, is an important framework within which to discuss discovery in arbitration. First, the Court notes that discovery in some fashion was in fact available in the *Gilmer* case under the arbitral rules that would apply (the New York Stock Exchange and NASD rules, in this case).[156] This is the case with virtually every mainstream and major provider of arbitration administration (like the AAA – more on this later).

Second, the Court reflected that even though the parties could, in all fairness, expect some limitations on their ability to conduct discovery in the arbitration process, those limitations are a trade-off the parties made in exchange for "the simplicity, informality, and expedition of arbitration."[157] In other words, some discovery is to be expected in arbitration, if not even required, but some limitations on discovery are part of the policy rationale for favoring arbitration in the first place.

The Fifth Circuit, somewhat more recently, followed *Gilmer* in its rejection of an argument against arbitration made on the basis of arbitration's assumed limitations on the discovery process.[158]

All of this means that arbitration participants typically go into the process assuming that discovery is either not really permitted or ought to be rather dramatically limited, that is, ought not be as broad or deep as it would be in the court setting. In reality, however, parties to arbitration ought to seek discovery as they feel reasonable and appropriate, and they have remedies at their disposal in the event that discovery is resisted.

1. Is Discovery Permitted in the First Place?

There is nothing in either the Federal Arbitration Act (FAA), the Texas General Arbitration Act (TAA) or the Texas International Arbitration Act (TIAA) that precludes discovery in the arbitration process; indeed, as discussed in the Section 2 below, those statutes provide a basis for parties in arbitration proceedings to seek court intervention to enforce arbitral orders compelling discovery. However, Section 3 presupposes that an arbitral order compelling discovery exists. Whether or not an arbitrator will issue such an order is another question, and frankly a more important question.

It is quite well-settled that arbitration is a creature of contract between parties, and that contract, the arbitration clause, can also set out the administrative rules that will govern the arbitration. Most familiar would be rules promulgated by the American Arbitration Association. Other organizations exist, however, that provide arbitration administration services, and it is also permissible for parties to craft their own procedural rules. Almost all of these rules, however, allow for the potential for discovery, at the arbitrator's discretion.

a) American Arbitration Association

The American Arbitration Association (AAA) promulgates several different sets of rules. This paper will set out their discovery rules in the major rule-sets. The AAA's Rules for Commercial Arbitrations are commonly used. That set of rules includes the following:

> **R-21. Exchange of Information**
>
> (a) At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct
>
> i) the production of documents and other information, and
>
> ii) the identification of any witnesses to be called.
>
> (b) At least five business days prior to the hearing, the parties shall exchange copies of all exhibits they intend to submit at the hearing.
>
> (c) The arbitrator is authorized to resolve any disputes concerning the exchange of information.[159]

The Rule is silent on the availability of depositions. We take the position that there is nothing that

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[155] *Id.*

[156] *Id.*

[157] *Id.*, at 31, 1655, *quoting Misubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628, 105 S.Ct. 3346 (1985). This begs several questions beyond the scope of this paper, but worth mentioning, such as: Can employment dispute plaintiffs in Texas really be said to bargain for the arbitration process? Is arbitration actually simple, informal and expeditious? I will leave it for your own experience and biases to answer these questions, but U.S. arbitration policy rests on an assumption that the answers are "yes."

[158] Carter, et al. v. Countrywide Home Loans, Inc., 362 F.3d 294, 298-99 (5th Cir. 2004).

[159] *AAA Commercial Arbitration Rules and Mediation Procedures, (*Amended and Effective June 1, 2009) *available at http://www.adr.org/sp.asp?id=22440*

precludes depositions, but again their availability will be up to the arbitrator. However, Rule 22 states that in a preliminary hearing, an arbitrator may establish "the extent of and schedule for the production of relevant documents and other information."[160] Some arbitrators interpret the "other information" language to include the power to order depositions.

The AAA Rules for Commercial Arbitrations that apply to complex cases (defined by AAA as cases where the claim is in excess of $500,000.00 exclusive of interest and attorneys' fees) specifically mention the possibility of depositions but also leave their availability up to the arbitrator:

> **L-4. Management of Proceedings**
>
> (a) Arbitrator(s) shall take such steps as they may deem necessary or desirable to avoid delay and to achieve a just, speedy and cost-effective resolution of Large, Complex Commercial Cases.
>
> (b) Parties shall cooperate in the exchange of documents, exhibits and information within such party's control if the arbitrator(s) consider such production to be consistent with the goal of achieving a just, speedy and cost-effective resolution of a Large, Complex Commercial Case.
>
> (c) The parties may conduct such discovery as may be agreed to by all the parties provided, however, that the arbitrator(s) may place such limitations on the conduct of such discovery as the arbitrator(s) shall deem appropriate. If the parties cannot agree on production of documents and other information, the arbitrator(s), consistent with the expedited nature of arbitration, may establish the extent of the discovery.
>
> (d) At the discretion of the arbitrator(s), upon good cause shown and consistent with the expedited nature of arbitration, the arbitrator(s) may order depositions of, or the propounding of interrogatories to, such persons who may possess information determined by the arbitrator(s) to be necessary to determination of the matter.
>
> (e) The parties shall exchange copies of all exhibits they intend to submit at the hearing 10 business days prior to the hearing unless the arbitrator(s) determine otherwise.
>
> (f) The exchange of information pursuant to this rule, as agreed by the parties and/or directed by the arbitrator(s), shall be included within the Scheduling and Procedure Order.
>
> (g) The arbitrator is authorized to resolve any disputes concerning the exchange of information.
>
> (h) Generally hearings will be scheduled on consecutive days or in blocks of consecutive days in order to maximize efficiency and minimize costs.[161]

Again, AAA writes into its rules the idea that arbitration has as a goal "just, speedy and cost-effective resolution of . . . Large, Complex Commercial Case[s]," and it codifies the notion that things like depositions are contrary to the achievement of the goal. That being the case, we certainly acknowledge that seeking such discovery could be met with some resistance, but it really does depend on the arbitrator. None of these rules precludes discovery; they simply tacitly discourage it. Presumably, in a Large, Complex Commercial Case experienced counsel and their client representatives will see the benefit of some pre-trial discovery. In our experience, it has not been difficult to obtain discovery in arbitration, but admittedly the rules do not allow it as a matter of right.

b) NAF

The National Arbitration Forum (NAF) has a discovery rule that is a bit more detailed than the AAA's rule. It basically specifically allows the arbitrator to order written discovery or depositions, and it allows the arbitrator to "draw an unfavorable, adverse inference or presumption from the failure of a Party to provide discovery."[162] The Rule itself is lengthy, so we will not re-print it here.[163] It simply provides a bit more structure for a discovery dispute, stating that parties are of course to attempt to conduct discovery informally first, but then setting out a

[160] *See Id.*

[161] *Id.*

[162] *NAF Code of Procedures, Rule 29.*

[163] NAF rules can be found on its website: http://www.arb-forum.com/.

briefing schedule for taking discovery disputes to the Arbitrator.

c) NASD (FINRA)

In July 2007, the National Association of Securities Dealers (NASD) and the arbitration functions of the New York Stock Exchange (NYSE) consolidated to form the Financial Industry Regulatory Authority (FINRA). FINRA is now the entity that conducts securities arbitration pursuant to what we used to refer to as the NASD Code of Arbitration Procedure. FINRA continues to enforce NASD arbitration rules, and two rule-sets exist: one for customer disputes (that is, a dispute between a customer and licensed securities professional, like a broker), and one for industry disputes (that is, disputes between licensed securities professionals or firms).

In FINRA arbitration of customer disputes, some discovery, particularly document exchange, is permitted and expected.[164] However, the NASD Code also specifically and strongly discourages depositions:

> Depositions are strongly discouraged in arbitration. Upon motion of a party, the panel may permit depositions, but only under very limited circumstances, including:
>
> - To preserve the testimony of ill or dying witnesses;
> - To accommodate essential witnesses who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to participate in the hearing;
> - To expedite large or complex cases; and
> - If the panel determines that extraordinary circumstances exist.[165]

In other words, an NASD arbitrator has the discretion under the Code to permit depositions, but the Code on its face seeks to limit that discretion.

The FINRA/NASD Code of Arbitration Procedure for Industry Disputes is largely the same as the Code for Customer Disputes, with one significant exception. In Customer Arbitration, certain documents are presumed discoverable and must be automatically produced in every case.[166] No corresponding Rule exists in the NASD Code of Arbitration Procedure for Industry Disputes.

d) Non-Administered Arbitration

The AAA and the NAF are corporations that administer arbitrations. That is, they not only promulgate rules and sample arbitration clauses (which in turn require the use of their rules and services), but they also administer the arbitration, acting as a go-between between counsel for the parties and the arbitrator(s). Parties "file" pleadings by faxing or emailing them to AAA, and AAA in turn provides them to the arbitrator. The procedure is cumbersome and, in our experience, rife with opportunity for administrative error. The procedure is also quite expensive.

The International Institute for Conflict Prevention and Resolution (CPR)[167] also promulgates rules and sample clauses, but it advocates non-administered or ad-hoc arbitration, wherein the parties decide how the case will be arbitrated and the arbitrator self-administrates. The only administration CPR is willing to perform is to help parties select an arbitrator or arbitrators if they are unable to do so.

CPR Promulgates a set of Rules for Non-Administered Arbitration, and its rule on discovery is predictably deferential to the arbitrator's discretion:

> **Rule 11: Discovery**
>
> The Tribunal may require and facilitate such discovery as it shall determine is appropriate in the circumstances, taking into account the needs of the parties and the desirability of making discovery expeditious and costeffective. The Tribunal may issue orders to protect the confidentiality of proprietary information, trade secrets and other sensitive information disclosed in discovery.[168]

e) ICC

The International Chamber of Commerce (ICC) maintains a Court of Arbitration which administers international arbitration and is commonly used in that context. ICC promulgates its own set of Rules as well. These Rules do not address the issue of discovery. The Rules do, however, allow the Arbitrator to revert to the procedural rules of the national law that applies to the arbitration in question in the event an issue is raised that the Rules do not address:

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[164] *FINRA (NASD) Code of Arbitration Procedures for Customer Disputes*, Rules 12505, 12506 and 12507.

[165] *Id.*, at Rule 12510.

[166] *Id.*, at Rule 12506.

[167] http://www.cpradr.org

[168] *CPR Rules for Non-Administered Arbitration*, Rule 11.

Article 15
Rules Governing the Proceedings

1. The proceedings before the Arbitral Tribunal shall be governed by these Rules and, where these Rules are silent, by any rules which the parties or, failing them, the Arbitral Tribunal may settle on, whether or not reference is thereby made to the rules of procedure of a national law to be applied to the arbitration.

2. In all cases, the Arbitral Tribunal shall act fairly and impartially and ensure that each party has a reasonable opportunity to present its case.[169]

In other words, if the arbitrator(s) in an international case administered by the ICC decide to apply U.S. law, then in the absence of a contrary agreement between the parties one could argue that the federal rules of civil procedure ought to apply, which in turn would provide for relatively robust discovery, given the general anti-discovery prejudice that is part of the arbitration process.

2. What if the Arbitrator Will Not Permit Discovery?

Arbitral discretion, of course, is the key. In Section 3, we explain how one can take an order compelling discovery issued by an arbitrator and ask a court to enforce it with all the enforcement mechanisms available to the court. There is not, however, a corresponding mechanism to request immediate relief from an arbitrator's decision to deny a motion to compel. Indeed, while the Texas Arbitration Act, as set out below, empowers courts to enforce arbitral orders and empowers arbitrators to order discovery, it does not allow courts to order discovery in arbitrations in the absence of an arbitral order for the same relief.[170] Parties have to ask the arbitrator for the discovery first, and if the arbitrator says no then the buck almost always will stop there.

As a last resort, both the TAA and the FAA allow parties, after an arbitration award has been issued, to ask a court to vacate the award on the basis that the arbitrator refused to hear evidence material to the controversy. [171] A party not permitted to conduct basic discovery could argue that he or she had not been allowed to put forth material evidence, but it is always difficult to demonstrate the materiality of evidence a party has not been allowed to discover, and the cases on vacatur of arbitral awards require courts to interpret these statutory provisions with a strong eye towards enforcement of arbitral awards.[172]

3. What Can I Do with an Arbitral Order Compelling Discovery?

a) The Legal Basis for Court Enforcement of Arbitral Orders Compelling Discovery

In Texas, a party to an arbitration is authorized by the TAA to apply for a court order "to require compliance by an adverse party or any witness with an order made under this chapter by the arbitrators during the arbitration."[173] The TAA also provides arbitrators with the authority to order depositions and to issue subpoenas to require either the attendance of witnesses or the production of documents or other evidence.[174]

In other words, once a party asks for and receives an arbitral order compelling discovery, the Texas Arbitration Act provides that party with a basis by which the party can ask for court enforcement of the order.

The FAA is less specific than the TAA in terms of what it explicitly authorizes arbitrators to do, but Section 7, which authorizes arbitrators to order the attendance of witnesses and the production of documents, has for the most part also been interpreted to allow arbitrators to order discovery.[175]

If a case arises, however, where a party tries to take the position that the FAA does not specifically authorize arbitral depositions, so long as the arbitration is pending in Texas one could argue that the TAA authorizes the depositions, because the FAA does not always or necessarily preempt the TAA.

As a threshold matter, a party seeking to compel arbitral discovery should consider whether or not the FAA or the TAA applies to his, her or its case. The first place to look, as in any arbitration question, is the arbitration clause itself. Parties are free to specify which statute should apply in an arbitration clause. However, if the arbitration clause is silent as to which statute applies, the clause can be said to potentially invoke both federal and state law.[176] In order to

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[169] *ICC Rules of Arbitration*, Article 15.

[170] *See also* Transwestern Pipeline Co. v. Blackburn, 831 S.W.2d 72, 78 (Tex. App. – Amarillo 1992, orig. proceeding).

[171] *See* TEX. CIV. PRAC. & REM. CODE §171.088(a)(3)(C); 9 U.S.C. §10(a)(3).

[172] This subject is discussed at length in our longer paper on the standards of review that apply to arbitral awards, which is available for free on our website.

[173] TEX. CIV. PRAC. & REM. CODE §171.086(b)(2).

[174] TEX. CIV. PRAC. & REM. CODE §§171.050 and 171.051.

[175] 9 U.S.C. §7; *see e.g.*, Recognition Equip., Inc. v. NCR Corp., 532 F.Supp. 271, 273-74 (N. Dist. TX 1981).

[176] In re D. Wilson Construction Co., 196 S.W.3d 774, 779 (Tex. 2006).

determine if the FAA can apply in a state-court proceeding, Texas courts look to the relationship between the parties, and extend the FAA "to any contract affecting commerce, as far as the Commerce Clause of the United States Constitution will reach." [177]

In other words, the FAA can be said to apply to many disputes, given the state of current Commerce Clause jurisprudence. In *Nexion*, for example, the Texas Supreme Court found the FAA to apply to a Texas medical malpractice case brought by a Texan against Texans in a Texas state court for torts committed in Texas because Medicare had paid for some of the plaintiff's medical expenses.[178]

However, the simple fact that the FAA can be said to apply to a dispute does not deprive a Texas Court of TAA jurisprudence. The TAA and the FAA can simultaneously apply to a dispute, and the FAA only preempts the TAA in cases where the TAA is inconsistent with the FAA.[179] In other words, most Texas litigants will be able to choose which statute they wish to apply, whether or not the federal courts have jurisdiction over the claim, since the FAA is designed to be enforceable and enforced in state courts. Indeed, the FAA itself does not confer federal question jurisdiction; in order to be brought in federal court, a petition under the FAA to compel arbitration must have some independent basis for federal court jurisdiction.[180]

All of this means that since the FAA does not specifically preclude discovery, including depositions (and, indeed, most courts have found that Section 7 specifically allows for discovery), the fairly general Section 7 should not preempt the more specific but not inconsistent TAA. There is no case on this, of course, of which we are aware, but the argument should be in line with the current case law in these areas.

Finally, in the world of international arbitration, the Texas International Arbitration Act ("TIAA" – Chapter 172 of the Civil Practice and Remedies Code), like the TAA, allows arbitrators to issue interim awards and allows parties to ask district courts to enforce those awards.[181] Additionally, the TIAA specifically adopts Section 171.051 of the TAA which in turn specifically empowers the arbitrator to issue subpoenas for documents or witnesses.[182] Interestingly, the TIAA does not adopt Section 171.050 of the TAA, which specifically empowers arbitrators to order depositions. However, other portions of the TIAA give arbitrators broad swath to fashion procedural rules for arbitrations within the confines of the arbitration agreement itself.[183] That being the case, if a party to an international arbitration which is taking place in Texas obtains an arbital order compelling a deposition, that party ought to be able to seek an order from a Texas court enforcing the arbitral order under the TIAA.

b) What You Might Do if the Arbitrator Orders Discovery that you Strongly Oppose

There is very little one can do if an arbitrator orders discovery against the strong wishes of a party. If the discovery sought is clearly inconsistent with the rules governing that particular arbitration, the party may later argue that the arbitrator exceeded his or her authority when ordering the discovery, which in turn is a basis for opposing entry of the arbitral award as a judgment under either the TAA or the FAA.[184] Again, though, any party seeking to prevent the entry of an arbitral award as a judgment faces a remarkably steep burden, as arbitral awards are for the most part un-appealable in Texas.

The various statutory mechanisms set out above to seek Court intervention for enforcement of arbitral awards do, by their nature, take time, so a party theoretically could at least seek to delay complying with the arbitral order compelling discovery, but at some point that party needs to consider the wisdom of such a tactic. The same arbitrator who issued the order will be the arbitrator who will be deciding the case, and that arbitrator is given spectacular flexibility in weighing the evidence and making his or her decision by the applicable statutory and case law. The final decision will be, for the most part, impossible to appeal. Irritating or agitating the arbitrator, even if the arbitrator is wrong, is not advisable. In litigation in Texas, as a last resort, a party can seek mandamus help in the face of an overly onerous discovery order; no such remedy exists in the arbitral setting. So, while it may be more difficult for a party to an arbitration to get an order compelling discovery, once the order is obtained that party may well be in a stronger position than the party would be at the courthouse.

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[177] In re Nexion Health at Humble, Inc., 173 S.W.3d 67, 69 (Tex. 2005), quoting In re: L&L Kempwood Assocs., L.P., 9 S.W.3d 125, 127 (Tex. 1999); citing Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 56-57, 123 S.Ct. 2037, 156 L.Ed.2d 46 (2003).

[178] *Nexion*, 173 S.W.3d at 69.

[179] *Wilson*, 196 S.W.3d at 779-780.

[180] 9 U.S.C. §4.

[181] TEX. CIV. PRAC. & REM. CODE §§172.083 and 172.175.

[182] TEX. CIV. PRAC. & REM. CODE §172.105.

[183] TEX. CIV. PRAC. & REM. CODE §172.103.

[184] TEX. CIV. PRAC. & REM. CODE §171.088(a)(3); 9 U.S.C. §10(a)(4).

B. Discovery from Third Parties

1. FAA and Arbitrators' Authority to Compel Non-Party Discovery: The Circuit Courts

The question of when one party to the arbitration may acquire the necessary evidence from a third party (a non-party to the arbitration) has become a common theme in arbitration. Over the past decade, courts have begun to establish limitations on arbitral powers within the context of discovery on third parties.[185]

Section 7 of the FAA states that the arbitrators: "may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case." [186] The summons issued by arbitrators "shall be served in the same manner as subpoenas to appear and testify before the court" and shall be enforced "upon petition [to] the United States district court for the district in which such arbitrators, or a majority of them, are sitting" whereby the district court "may compel the attendance of" or "punish said person or persons for contempt in the same manner provided by law . . . in the courts of the United States."[187]

The FAA is unclear as to the scope of the discovery it authorizes. While Section 7 has been interpreted by most courts to empower arbitrators to subpoena non-parties to produce documents at an arbitration **hearing**,[188] some courts have disagreed as to whether Section 7 grants an arbitrator authority to compel a non-party to attend a **prehearing** deposition.[189] Currently, a circuit split exists with regard to the arbitrators' authority to compel discovery from non-parties under the FAA.

In Am. *Fed'n of Television and Radio Artists, AFL-CIO v. WJBK-TV*,[190] citing analogous cases interpreting Section 7 of the FAA, the Sixth Circuit Court of Appeals held that under Section 301 of the Labor Management Relations Act of 1947 an arbitrator has the power to compel a non-party to produce material records either before or during an arbitration hearing.

In 1999, the Fourth Circuit Court of Appeals held in *COMSAT Corp. v. National Science Foundation*[191] that an arbitrator may not compel a third party to comply with an arbitral subpoena for prehearing discovery **unless** there is a there is a "special need" for the documents. The court did not define "special need" except to say that "at a minimum, a party must demonstrate that the information it seeks is otherwise unavailable." The court reasoned that the "hallmark of arbitration - and a necessary precursor to its efficient operation - is a limited discovery process." The court made no distinctions between depositions and document production.

On the other hand, in 2000, the Eight Circuit Court of Appeals held in *Arbitration Between Security Life Insurance Company of America and Duncanson & Holt, Inc.*,[192] that an arbitrator impliedly has the power under section 7 of the FAA to compel pre-hearing discovery from non-parties because the FAA authorizes arbitrators to subpoena non-parties to bring documents to the arbitration in conjunction with their testimony.

Perhaps the narrowest interpretation of Section 7 comes from the Third Circuit Court of Appeals. In 2004, in *Hay Group, Inc. v. E.B.S. Acquisition Corp.*,[193] 2004, the Third Circuit stated that pursuant

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[185] For an article providing a detailed review of arbitration discovery and non-parties, *see* Rau, Alan Scott Rau, *Evidence and Discovery in American Arbitration: The Problem of 'Third Parties'. American Review of International Arbitration*, Fall 2009; U of Texas Law, Public Law Research Paper No. 146, *available at* http://ssrn.com/abstract=1397617.

[186] 9 U.S.C. § 7.

[187] *Id.*

[188] *See e.g.*, In re Sec. Life Ins. Co. of Am., 228 F. 3d 865, 870 (8th Cir. 2000) (acknowledging "an arbitration panel's power [under the FAA] to subpoena relevant documents for production at a hearing"); Festus & Helen Stacy Found. v. Merrill Lynch, Pierce Fenner & Smith Inc., 432 F. Supp. 2d 1375, 1379 (N.D. Ga. 2006) (holding that the district court has jurisdiction to order non-party private equity firm to comply with subpoenas issued under the Federal Arbitration Act); Amgen Inc. v. Kidney Ctr. of Del. County, Ltd., 879 F. Supp. 878, 883 (N.D. Ill. 1995) (a district court in the Northern District of Illinois held that an arbitrator's subpoena duces tecum, issued to a third person not party to the arbitration proceeding and located outside the district in which the arbitrator sat or beyond 100 miles of the site of the arbitration, was valid and enforceable); Meadows Indem. Co. v. Nutmeg Ins. Co., 157 F.R.D. 42, 45 (M.D. Tenn. 1994) (stating that "[T]he power of the panel to compel production of documents from third-parties for the purposes of a hearing implicitly authorizes the lesser power to compel such documents for arbitration purposes prior to a hearing.").

[189] *See* Rau, Alan Scott Rau, *Evidence and Discovery in American Arbitration: The Problem of 'Third Parties'. American Review of International Arbitration*, Fall 2009; U of Texas Law, Public Law Research Paper No. 146, *available at* http://ssrn.com/abstract=1397617.

[190] In Am. Fed'n of Television and Radio Artists, AFL-CIO v. WJBK-TV, 164 F.3d 1004 (6th Cir. 1999).

[191] Comsat Corp. v. Nat'l Sci. Found., 190 F.3d 269, 275 (4th Cir. 1999).

[192] Arbitration Between Security Life Insurance Company of America and Duncanson & Holt, Inc., 228 F.3d 865 (8th Cir. 2000).

[193] Hay Group, Inc. v. E.B.S. Acquisition Corp., 360 F. 3d 404 (3rd Cir. 2004)

to the "unambiguous" language of section 7 of the FAA, an arbitrator's subpoena power is limited to "situations in which the non-party has been called to appear in the physical presence of the arbitrator and to hand over the documents at that time."[194] The court held that an arbitrator lacks authority to compel **prehearing** discovery from nonparties, whether it be deposition testimony or document production.

In 2008, the Second Circuit Court of Appeals joined the Third Circuit and held that Section 7 does not authorize an arbitrator to compel pre-hearing document discovery from non-parties to the arbitration. In *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*,[195] the court, citing Section 7, explained that arbitrators may "order 'any person' to produce documents so long as that person is called as a witness at a hearing." The court also noted that a non- party could be subpoenaed to produce documents at a preliminary hearing on non-merits issues before one or more arbitrators.

2. International Arbitration and the Meaning of 'Tribunal' Under Section 1782

Under 28 U.S.C. Section 1782 (Assistance to Foreign and International Tribunals and to Litigants Before such Tribunals), a federal court has authority to compel discovery for many types of proceedings conducted outside the United States:

> The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal \investigations conducted before formal accusation. [196]

The statute does not define the term "foreign or international tribunal." In 1999, the Second[197] and Fifth[198] Circuits held that "foreign or international tribunals" **do not include** private arbitration panels. In 2004, the U.S. Supreme Court interpreted the language of Section 1782 in *Intel Corp. v. Advances Microdevices, Inc.*[199] The Court, however, did not reach the question of arbitral tribunals.[200]

In 2009, the Fifth Circuit, in the unpublished opinion *El Paso Corporation v. La Comision Ejecutiva*, reaffirmed *Republic of Kazakhstan* and held that Section 1782 does not apply for a discovery motion for use in a private international arbitration.[201] La Comision Ejecutiva Hidroelectrica Del Rio Lempa (CEL) is a state-owned utility company in El Salvador and Nejapa Power Company (NPC) is a utility company related to El Paso Corporation (El Paso), an energy corporation based in Houston, Texas.[202] CEL and NPC are arbitrating a contract dispute in Geneva, Switzerland, under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), El Salvadoran substantive law, and Swiss procedural law.[203] CEL sued to obtain discovery (production of documents and depositions) from El Paso, (a non- party to the arbitration) to use it in its international private arbitration proceeding with NPC, pursuant to 28 U.S.C. Section 1782 (Assistance to Foreign and International Tribunals and to Litigants Before such Tribunals).[204]

The Texas District Court denied CEL's request for discovery and held that Section 1782 did not apply to discovery for use in a *private* international arbitration.[205] The court also held that, even if it did have the authority under Section 1782, "it would not [grant the application], out of respect for the efficient administration of the Swiss arbitration."[206] The court granted the Rule 60(b) motion for relief from a judgment or order, vacated its ex parte order, and quashed the outstanding discovery requests.[207] CEL appealed.).[208]

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[194] *Id.* at 407.

[195] Life Receivables Trust v. Syndicate 102 at Lloyd's of London, 549 F3d 210 (2d Cic. 2008).

[196] 28 U.S.C. § 1782(a) (2000).

[197] Nat'l Broad. Co. v. Bear Stearns & Co., 165 F3d 184 (2d Cir. 1999).

[198] Kazakhstan v. Biedermann Int'l, 168 F.3d 880 (5th Cir. 1999).

[199] Intel Corp. v. Advanced Micro Devices, Inc, 542 U.S. 241(2004).

[200] *See* Jessica Weekley, Comment: Discovering Discretion: Applying Intel to § 1782 Requests for Discovery in Arbitration, Case W. Res. 535 (2009); Walter B. Stahr, Discovery Under 28 U.S.C. § 1782 for Foreign and International Proceedings, 30 VA. J. INT'L. L. 597, 615-19 (1990).

[201] El Paso Corporation v. La Comision Ejecutiva, No. 08-20771, 2009 U.S. App. LEXIS 17596 (5th Cir. 2009).

[202] *Id.* at *2.

[203] *Id.*

[204] *Id.*

[205] *Id.* at *4.

[206] *Id.*

[207] *Id.*

[208] *Id.*

The Fifth Circuit first considered El Paso's argument that CEL's appeal was moot.[209] Because the evidentiary hearing for the arbitration has concluded and the panel has closed the evidence, El Paso argues that "there is no longer a live case or controversy."[210] The court noted that under UNCITRAL arbitration rules, an arbitral tribunal may reopen the hearings at any time before the award is made.[211] So, if CEL discovered new evidence with a Section 1782 application, the court reasoned, that evidence could still be considered if the tribunal reopen the evidentiary hearing.[212] The court concluded that a live controversy still exists and proceeded to address the merits of the appeal.[213]

Next, the Fifth Circuit reviewed the granting of the Rule 60(b) motion.[214] The court stated that "[s]uch a motion can be granted for a number of reasons, including mistake, inadvertence, surprise, or excusable neglect" and "any other reason that justifies relief.[215] The law of this circuit permits a trial judge, in his discretion, to reopen a judgment on the basis of an error of law."[216] The court noted that in *Republic of Kazakhstan*, the court held that "a 'tribunal' within the meaning of Section 1782 did not include a private international arbitral tribunal, and thus Section 1782 did not apply to discovery sought for use in such a tribunal."[217] CEL argued that *Republic of Kazakhstan* is no longer controlling in light of the Supreme Court's decision in *Intel Corp. v. Advanced Micro Devices.*[218] However, the Fifth Circuit was not persuaded by CEL's argument.[219] The court concluded that the issue of whether a private international arbitration tribunal qualifies as a "tribunal" under § 1782 was not before the U.S. Supreme Court in *Intel.*[220]

In addition, the court, citing *Republic of Kazakhstan,* explained that "empowering parties in international arbitrations to seek ancillary discovery through federal courts could destroy arbitration's principal advantage as a speedy, economical, and effective means of dispute resolution if the parties succumb to fighting over burdensome discovery requests far from the place of arbitration."[221] Accordingly, the court denied El Paso's motion to dismiss the appeal as moot and affirmed the district court's grant of the Rule 60(b) motion.[222]

C. Discovery and Motions to Compel Arbitration: *In re Houston Pipe Line*

The Supreme Court of Texas held recently that a court abused its discretion by permitting discovery instead of deciding a motion to compel arbitration.[223] *Houston Pipe Line* involves a gas purchase agreement between Houston Pipe Line Company, L.P. and O'Connor & Hewitt, Ltd.[224] The agreement was based on the Houston Ship Channel Price Index (the "Index") and contained the following arbitration clause:

> Except for matters within the jurisdiction of the Railroad Commission of Texas, any and all claims, demands, causes of action, disputes, controversies, and other matters in question arising out of or relating to this Agreement, any of its provisions, or the relationship between the Parties created by this Agreement . . . shall be resolved by binding arbitration pursuant to the Federal Arbitration Act. . . .If a Party refuses to . . . arbitrate, the other Party may seek to compel arbitration in either federal or state court. . . .The final hearing shall be conducted within 60 days of the selection of the third arbitrator. . . [and] shall not exceed 10 business days.[225]

A few years later, O'Connor sued Houston Pipe Line claiming manipulation of the Index, which, according to O'Connor, caused the company to receive lower payments for the gas purchased under the contract.[226] Houston Pipe Line moved to compel arbitration.[227] O'Connor challenged the motion arguing that "it would be impossible to identify all potential defendants and to complete damages calculations within the sixty days

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[209] *Id*. at *4-*5.

[210] *Id*.

[211] *Id*. at *5-*6.

[212] *Id*.

[213] *Id*. at *6

[214] *Id*.

[215] *Id*.

[216] *Id*.

[217] *Id*. at *7 citing Republic of Kazakhstan v. Biedermann International, 168 F.3d 880 (5th Cir. 1999).

[218] *Id.* citing Intel Corp. v. Advanced Micro Devices, Inc, 542 U.S. 241, 258 (2004).

[219] *Id*. at *8-*9.

[220] *Id*.

[221] *Id*.

[222] *Id*. at *9.

[223] In re Houston Pipe Line Co., No. 08-0800, 2009 Tex. LEXIS 468 (Texas 2009).

[224] *Id*. at *1.

[225] *Id*. at *3.

[226] *Id*. at *1-*2.

[227] *Id*. at *2.

allotted for discovery as set out in the arbitration provision."[228] Instead of ruling on the motion, the trial court ordered discovery to determine: (1) if additional defendants could invoke the arbitration clause, (2) whether the claims fell within the scope of the arbitration clause, and (3) if the discovered time limits on the agreement where jurisdictional.[229] Houston Pipe Line appealed and the Court of Appeals refused to issue writ.[230]

The Texas Supreme Court decided whether the trial court abused its discretion by permitting discovery on damage calculations and other potential defendants, instead of ruling on the motion to compel arbitration.[231] Citing *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), the court stated that "[w]hen a party disputes the scope of the arbitration provision or raises a defense to the provision, the trial court, not the arbitrator must decide the issues."[232] Pre-arbitration discovery is authorized under the Texas Arbitration Act, the court noted, when a court lacks sufficient information on the scope of the arbitration provision, and therefore, cannot make a decision on the motion to compel arbitration.[233] However, the court concluded that this is not the case because determinations of liability must be answered by the arbitrator.[234] The court pointed out that a party cannot avoid arbitration by merely alleging that there may be other potential defendants.[235] Accordingly, the court directed the trial court to vacate the discovery order and rule on the motion to compel arbitration.[236]

D. New York State Bar Guidelines on Arbitration Discovery

The Dispute Resolution Section of the New York State Bar Association recently issued a report on Arbitration Discovery in Domestic Commercial Cases"[237] The objective of the report was to issue some guidelines of use to counsel and arbitrators to best handle the unpredictability issue of discovery proceedings in arbitration.[238] The report provides ten precepts to help enable arbitrators to control the discovery process: (1) Good Judgment of the Arbitrator, (2) Early Attention to Discovery by the Arbitrator, (3) Party Preferences, (4) E-discovery, (5) Legal Considerations, (6) Arbitrator Tools (7) Artfully Drafted Arbitration Clauses, (8) Depositions, (9) Discovery Disputes, and (10) Discovery & Other Procedural Aspects of Arbitration.[239] In addition, the report includes an exhibit with advice on relevant factors for arbitrators to determine the appropriate scope of arbitration discovery.[240]

V. MOTIONS TO CONFIRM, VACATE OR MODIFY ARBITRATION AWARDS

The criteria a court relies on to confirm, vacate or modify an arbitrator's award differ depending on the character of the arbitration itself: if the arbitration is between Texans and does not involve interstate commerce, the court looks to the Texas General Arbitration Act for its guidance; if the arbitration brushes up against the Commerce Clause, then the Federal Arbitration Act is the starting point; and if the arbitration is "international," which does not necessarily require that at least one party be foreign, then the reviewing court should break out its copy of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (commonly referred to as the "New York Convention" after the city in which it was enacted). Each of these starting points invokes a slightly different set of rules and interpreting case law and, potentially, standard of review. This paper will not discuss confirming, vacating, modifying or enforcing international arbitral awards, though that is a fascinating topic worthy of examination. In this section, we will focus on recent developments and vacatur cases related to evidence.

A. Arbitral Awards Governed by the Federal Arbitration Act

Arbitration provides a final and binding decision that is very difficult to successfully appeal in court. The Federal Arbitration Act (FAA). Sections 10 and 11 provide the bases for vacatur and modification of arbitration awards. Under the Under Section 10, the grounds to vacate an arbitration award are:

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[228] *Id*. at *2-*3.

[229] *Id*.

[230] *Id*. at *3.

[231] *Id*. at *4.

[232] *Id*. at *4-*5.

[233] *Id*. at *5.

[234] *Id*. at *6.

[235] *Id*.

[236] *Id*.

[237] New York State Bar Association Dispute Resolution Section Arbitration Committee, *Report on Arbitration Discovery in Domestic Commercial Cases* (2009), available at http://www.nysba.org/Content/NavigationMenu42/April2009HouseofDelegatesMeetingAgendaItems/DiscoveryPrecepsReport.pdf.

[238] *Id.*

[239] *Id.*

[240] *Id.*

(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.[241]

The FAA also provides for modification of an erroneous award:

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration --

(a) Where there was an evident 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 materially 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.

The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.[242]

The general standard of review a court in the Fifth Circuit employs when considering a motion to vacate an award under the FAA is well-established and severe: "[w]e review de novo an order vacating an arbitration award. Our review of the award itself, however, is exceedingly deferential. We can permit vacatur of an arbitration award only on very narrow grounds."[243] While courts describe the standard of review under the FAA as de novo, the review of the award itself (as theoretically opposed to the decision to vacate the award, but the two seem to always conflate) requires a much restricted version of de novo review, and "normal" do novo review of an award is in fact grounds for reversal of a vacatur.[244]

1. Arbitrator Misconduct, Refusal to Postpone Hearing or Hear Material Evidence

The Fifth Circuit provided clear precedent on the kind of arbitrator misconduct which will support vacatur under FAA Section 10(3) when it affirmed a district court vacatur of an award on the ground that "the arbitrator misled Exxon into believing that evidence was admitted, and then refused to consider that evidence."[245]

In *Gulf Coast*, Exxon attempted to discharge a union worker for just cause when a substance found in her vehicle tested positive for marijuana, which would have violated Exxon's policy with respect to controlled substance misuse.[246] At the arbitration, Exxon's attorney began to prove up the "DLR test" which had identified the substance found as marijuana, but the arbitrator stopped him.[247] The arbitrator specifically ruled that the test had been admitted into evidence and that arbitral time did not need to be spent establishing it as a business record. [248] The court cites references to the arbitration record, which includes both a transcript of the proceedings and a stipulation between the parties as to the DLR tests's accuracy and reliability.[249] In the end, however, the arbitrator ruled against Exxon on the basis that Exxon had not proven that the substance found was in fact marijuana, since the DLR test was inadmissible hearsay.[250] "[t]he arbitrator then spent five pages of his decision in a diatribe on the unreliability of hearsay."[251] Relying on Section

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[241] 9 U.S.C. § 10(a).

[242] 9 U.S.C. §11.

[243] *Brabham*, 376 F.3d at 380 (citations omitted); *see also* Prescott v. Northlake Christian School, 369 F.3d 491 (5th Cir. 2004) ("the district court's review of an arbitration award, under the [FAA], is 'extraordinarily narrow'").

[244] *See* Kergosien v. Ocean Energy, Inc., 390 F.3d 346, 357 (5th Cir. 2004).

[245] Gulf Coast Indus. Workers Union v. Exxon Co., *USA*, 70 F.3d 847, 848 (5th Cir. 1995).

[246] *Id.* at 848-49.

[247] *Id*. at 849.

[248] *Id*.

[249] *Id*.

[250] *Id*.

[251] *Id*.

10(a)(3) of the FAA, the Fifth Circuit found that the arbitrator in this case misled Exxon's attorney into not adequately proving up the DLR test, and therefore triggered vacatur under the FAA.[252]

Of course, *Gulf Coast* must be considered within a larger context of great deference to arbitral awards. The general rule is that arbitrators are given significant leeway on evidentiary issues: "arbitrators are not bound to hear all of the evidence tendered by the parties; however, they must give each of the parties to the dispute an adequate opportunity to present its evidence and arguments."[253] In other words, it would seem that an arbitrator must pro-actively lure a party into evidentiary hot water for 10(a)(3) to apply. Given many arbitrators' willingness to simply admit all evidence, 10(a)(3) may, as a practical matter, be a rather rare ground for vacatur (one wonders if the Gulf Coast result would have differed had the arbitrator admitted the DLR test result into evidence but, perhaps even without cogent explanation, ruled against Exxon anyway - such a result would have been much more difficult for Exxon to overcome it would seem).

2. Nonstatutory Grounds for Vacating Arbitration Awards after *Hall Street v. Mattel*

In addition to the grounds for vacating awards provided by the FAA, courts had developed the doctrine of "manifest disregard" of the law as a common-law ground to vacate awards.[254] Generally, an arbitral panel is said to have manifestly disregarded the law if, knowing the existence of a clear legal principle, refuse to apply it. However, in 2008, in *Hall Street Associates, LLC v. Mattel, Inc.*, the U.S. Supreme Court concluded that the statutory grounds for vacating arbitration awards are exclusive when a party seeks judicial review under the FAA.[255] The Court indicated that "manifest disregard" of the law was not a basis for reviewing such awards.

Over the past year, the circuit courts have differed over whether the "manifest disregard" doctrine survives the Supreme Court's holding in *Hall Street*. The First Circuit, in *Ramos-Santiago v. United Parcel Serv.*,[256] concluded that *Hall Street* abolished "manifest disregard" as a ground for vacating or modifying an award under the FAA. Similarly, in *Citigroup Global Mkts v. Bacon*,[257] the Fifth Circuit strongly rejected "manifest disregard" as an independent, nonstatutory ground for setting aside an award. It stated that "the term itself, as a term of legal art, is no longer useful in actions to vacate arbitration awards."[258] But because the court in *Citigroup* remanded the case to the district court to determine whether vacatur is available under any of the FAA statutory grounds, it is possible that the distinct court could reconceptualize "manifest disregard" of the law within the "excess of powers" ground.[259]

However, other circuit courts have reached a different conclusion. The Second Circuit held that "manifest disregard" survives *Hall Street* in *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.*[260] The court explained that "manifest disregard" was shorthand for a statutory ground, merely that the arbitrators "exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the

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[252] *Id*. at 850.

[253] Prestige Ford, 324 F.3d at 395.

[254] In addition to "manifest disregard of the law, the Fifth Circuit had adopted the "public policy" as a non-statutory ground for vacatur. *See* Prestige Ford v. Ford Dealer Computer Services, Inc., 324 F.3d 391, 396 (5th Cir. 2003) (stating that the Fifth Circuit also "does recognize some circumstances in which a court may refuse to enforce an arbitration award that is contrary to public policy.").

[255] Hall Street Associates, LLC v. Mattel, Inc., 128 S.Ct. 1396 (2008).

[256] Ramos-Santiago v. United Parcel Serv., 524 F.3d 120 (1st Cir. 2008).

[257] Citigroup Global Mkts v. Bacon, 562 F.3d 349 (5th Cir. 2009); *See also* Victoria VanBuren, *Hall Street Meets S. Maestri Place: What Standards of review will the Fifth Circuit Apply to Arbitration Awards Under FAA Section 10(a)(4) after Citigroup?* May 4, 2009, *available at* http://loreelawfirm.com/blog/guest-post-hall-street-meets-s-maestri-place-what-standards-of-review-will-the-fifth-circuit-apply-to-arbitration-awards-under-faa-section-10a4-after-citigroup (last visited Sept. 3, 2009).

[258] *Citigroup* at *24.

[259] *See* Victoria VanBuren, *Hall Street Meets S. Maestri Place: What Standards of review will the Fifth Circuit Apply to Arbitration Awards Under FAA Section 10(a)(4) after Citigroup?* May 4, 2009, *available at* http://loreelawfirm.com/blog/guest-post-hall-street-meets-s-maestri-place-what-standards-of-review-will-the-fifth-circuit-apply-to-arbitration-awards-under-faa-section-10a4-after-citigroup (last visited Sept. 3, 2009).

[260] Stolt-Nielsen SA v. AnimalFeeds Int'l Corp., 548 F.3d 85 (2d Cir. 2008). *See also* Philip J. Loree Jr., *Hall Street Meets Pearl Street: Stolt Nielsen and the Federal Arbitration Act's New Section 10(a)(4)*, May 29, 2009, *available at* http://loreelawfirm.com/blog/hall-street-meets-pearl-street-stolt-nielsen-and-the-federal-arbitration-act%E2%80%99s-new-section-10a4 (last visited Sept. 3, 2009). On June 15, 2009, the U.S. Supreme Court has granted certiorary to *Stolt-Nielsen* on the issue of class arbitration. *See* Victoria VanBuren, *U.S. Supreme Court Grants Cert to Stolt-Nielsen: Class Action Arbitration Case*, June 16, 2009, *available at* http://www.karlbayer.com/blog/?p=2576 (last visited Aug. 27, 2009).

subject matter submitted was not made"[261] The court stressed that arbitration is a creature of contract law and that the parties did not agree to an arbitration carried out in "manifest disregard" of the law. Likewise, the Ninth Circuit concluded in *Comedy Club Inc. v. Improv. West Assocs.*[262] that *Hall Street* did not abolish "manifest disregard" because its case law considers it as a shorthand for statutory ground in § 10(a)(4). Also, the Sixth Circuit, in *Coffee Beanery, Ltd. v. WW, L.L.C.*,[263] interpreted *Hall Street* to limit only the contractual expansions of the grounds for review.

B. Arbitral Awards Governed by the Texas General Arbitration Act

The Texas General Arbitration Act ("TAA") sets forth several independent grounds under which a court must vacate an arbitral award:

> On application of a party, the 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 willful 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.[264]

The enumerated list of grounds for vacatur is nearly identical to that contained in Section 10 of the FAA. Also, in certain rare cases, a court may vacate an arbitral award that violates public policy, though the Texas Supreme Court has been careful to note that "an arbitration award cannot be set aside on public policy grounds except in an extraordinary case in which the award clearly violates carefully articulated, fundamental policy."[265]

The TAA authorizes a court to modify or correct errors in an award when:

> (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.[266]

1. Did the Arbitrator Exceed His or Her Power, Refuse to Postpone a Hearing, or Refuse to Hear Material Evidence?

Upon proper application by a party, a court must vacate an award if the arbitrator exceeded his or her powers, refused to postpone the hearing after a showing of sufficient cause for the postponement, or refused to hear evidence material to the controversy.[267]

[261] 9 U.S.C. § 10 (a)(4).

[262] Comedy Club Inc. v. Improv. West Assocs., 553 F.3d 1277 (9th Cir. 2009).

[263] Coffee Beanery, Ltd. v. WW, L.L.C., 300 Fed. Appx. 415 (6th Cir. 2008).

[264] TEX. CIV. PRAC. & REM. CODE §171.088.

[265] *CVN Group*, 95 S.W.3d at 239.

[266] Tex. Civ. Prac. & Rem. Code §171.091.

[267] TEX. CIV. PRAC. & REM. CODE §171.088(a)(3).

Determining whether or not an arbitrator has exceeded his or her power requires at the outset an examination of the arbitration clause itself: "the authority of an arbitrator derives from the arbitration agreement and is limited to a decision of the matters submitted therein."[268] This means establishing that the arbitrator made rulings specifically outside the scope of the arbitration clause; it is not enough that the arbitrator decided matters within his or her purview wrongly or haphazardly. In the *Action Box* case, for example, the party seeking vacatur alleged that the "arbitrator exceeded his powers by misinterpreting the operative agreement and erroneously admitting parol evidence to construe it even though it was unambiguous."[269] The Court found that even if those allegations were proven, they would not amount to the arbitrator's exceeding his or her power, and so they cannot support vacatur.[270] Put another way, it is well within an arbitrator's power to decide an issue incorrectly.

What's more, when courts read arbitration clauses to determine whether an arbitrator's ruling was within the scope of his or her power, they read them broadly: "every presumption will be indulged to uphold the arbitrators' decision, and none is indulged against it."[271] The *J.J. Gregory* Court held that, in a case with a broad form arbitration clause (like the standard clauses promulgated by all the major arbitration providing organizations), an arbitrator has authority to decide any issue that the clause does not specifically take out of his scope.[272] In other words, the clause need not specifically give the arbitrator authority to act; it must simply not specifically prevent the arbitrator from acting.[273]

The San Antonio Court of Appeals, however, reversed a trial court's judgment confirming an arbitral award to the extent the trial court confirmed an improperly modified award.[274] The Court ruled that since arbitral awards are treated "very deferentially" under Texas law, an arbitrator exceeds his or her powers by modifying his or her award absent a finding that statutory grounds for modification exist under the TAA.[275] Once the arbitrator made his or her final decision, the merits of the arbitration were no longer before him or her, except as allowed by the narrow guidelines of Section 171.054(a) of the TAA. The trial court, therefore, was required to vacate the modification as it exceeded the arbitrator's power.

At least one Texas Court of Appeals has analyzed a party's claim that an arbitrator's failure to postpone an arbitration required vacatur.[276] In that case, the court applied analysis similar to that a court would use in the context of a trial court's refusal to grant a continuance in determining that the failure to postpone in the face of sufficient notice did not warrant vacatur.[277]

The end result of Texas law interpreting the TAA in this area is that, in most cases and in the "default" cases where a party uses a form or standard arbitration clause, there is no opportunity for meaningful appeal of an arbitral decision on the basis that the arbitrator was obviously wrong on the facts, the evidence, or the law. Indeed, since the Supreme Court's opinion in *CVS Group v. Delgado*, courts treat any attempt to appeal an arbitration as an affront to jurisprudential efficiency. However, since arbitration is a creature of contract, it is possible for parties to build some sort of appeal, either in limited or full common-law form, into the clause.

C. AAA Evidence Rules

The AAA's Rules for Commercial Arbitrations includes the following rules regarding evidence:

> **R-31. Evidence**
>
> (a) The parties may offer such evidence as is relevant and material to the dispute and shall produce such evidence as the arbitrator may deem necessary to an understanding and determination of the dispute. Conformity to legal rules of evidence shall not be necessary. All evidence shall be taken in the presence of all of the arbitrators and all of the parties, except where any of the parties

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[268] Action Box Co., Inc. v. Panel Prints, Inc., 130 S.W.3d 249, 252 (Tex. App. - Houston [14th Dist.] 2004, no pet.) (citing Gulf Oil Co. v. Guidry, 160 Tex. 139, 327 S.W.2d 406, 408 (Tex. 1959).

[269] *Id*.

[270] *Id*.

[271] J.J. Gregory Gourmet Services, Inc. v. Antone's Import Co., 927 S.W.2d 31, 36 (Tex. App. - Houston [1st Dist] 1995, no writ).

[272] *Id*.

[273] *See also* Hisaw & Assocs. Gen. Contractors, Inc. v. Cornerstone Concrete Sys., Inc., 115 S.W.3d 16, 20 (Tex. App. - Fort Worth 2003, no pet.).

[274] Barsness v. Scott, 126 S.W.3d 232, 241-42 (Tex. App. - San Antonio 2003, pet. denied).

[275] *Id.*

[276] Hoggett v. Zimmerman, Axelrad, Meyer, Stern & Wise, P.C., 63 S.W.3d 807, 811 (Tex. App. - Houston [14th Dist.] 2001, no pet.).

[277] *Id. See also* Crossmark, Inc. v. Hazar, 124 S.W.3d 422, 432 (Tex. App. - Dallas 2004, pet. denied) (court refused, with no analysis, to require vacatur when party did not ask for postponement until six days before arbitral hearing).

is absent, in default or has waived the right to be present.

(b) The arbitrator shall determine the admissibility, relevance, and materiality of the evidence offered and may exclude evidence deemed by the arbitrator to be cumulative or irrelevant.

(c) The arbitrator shall take into account applicable principles of legal privilege, such as those involving the confidentiality of communications between a lawyer and client.

(d) An arbitrator or other person authorized by law to subpoena witnesses or documents may do so upon the request of any party or independently.[278]

R-32. Evidence by Affidavit and Post-hearing Filing of Documents or Other Evidence

(a) The arbitrator may receive and consider the evidence of witnesses by declaration or affidavit, but shall give it only such weight as the arbitrator deems it entitled to after consideration of any objection made to its admission.

(b) If the parties agree or the arbitrator directs that documents or other evidence be submitted to the arbitrator after the hearing, the documents or other evidence shall be filed with the AAA for transmission to the arbitrator. All parties shall be afforded an opportunity to examine and respond to such documents or other evidence.[279]

VI. MISCELLANEOUS EMPLOYMENT ARBITRATION CASES

Empirical evidence suggests that the use of arbitration clauses in employment contracts has increased in recent years.[280] Yet another comprehensive study of 240 post-award arbitration disputes between employees and employers from 1975 to 2006 found that individuals prevailed in 38.3% of awards and won a split award in 9.6% of the cases in the sample. The median value of an employee award was $250,000. Also, the legal issues arbitrated were: breach of contract (39.2%), title VII discrimination (17.1%), unjust dismissal (13.8%), state discrimination (10.4%), ADEA discrimination (5.8%), emotional distress (5.0%), negligence /miscellaneous torts (5.0%), defamation (4.6%), ADA discrimination (4.2%), and tortious interference (4.2%).[281] This section will discuss recent noteworthy cases within the context of employment arbitration agreements.

A. The 4.1 Billion Arbitration Award: *Chester v. iFreedom*

An arbitration case that made the national headlines this year is *Chester v. iFreedom Communications Inc*.[282] In that case, a Los Angeles Court confirmed on May 28, 2009 a $4.1 billion arbitration award against iFreedom, an Internet communications company accused of firing its chief operating officer in a dispute over commissions he said he was owed.[283] Arbitrator William F. McDonald wrote in his decision that the award is "appropriate to punish and make an example of defendants."[284] Here is the breakdown of the award: compensatory damages $975,425,558; interest on compensatory damages $1,420,011; labor code section 203 penalties $53,653; labor code section 226 penalties $3,050; punitive damages $2,926,276,674; attorneys' fees $633,450; attorney's costs $1,054; sanctions previously awarded $1,210.00; JAMS fees paid by plaintiff $5,532; and post-June 30, 2008 daily interest $267,239.

B. Monetary and Non-Monetary Relief: *Sands v. Menard*

Generally, arbitrators have broad powers to issue remedies in their arbitral awards. The Commercial Arbitration Rules of the American Arbitration

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[278] *AAA Commercial Arbitration Rules and Mediation Procedures, (*Amended and Effective June 1, 2009) *available at http://www.adr.org/sp.asp?id=22440*

[279] *AAA Commercial Arbitration Rules and Mediation Procedures, (*Amended and Effective June 1, 2009) *available at http://www.adr.org/sp.asp?id=22440*

[280] Whereas a total of 50.5% of the contracts in our sample include an arbitration provision, this masks an upward trend in the use of arbitration over time from a low of 35.9% of contracts in 1997 to 60.4% of contracts in 2005. Randall Thomas et al., When Do CEOs Bargain for Arbitration?: A Theoretical and Empirical Analysis 21 (Vanderbilt Law of Econ., Working Paper No. 08-23, 2008), available at http://www.ssrn.com/abstract=1247843.

[281] Michael H. LeRoy and Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOTIATION L. REV. 167 (2008).

[282] Walter Olson, *Former Employee Wins $4.1 billion*, OVERLAWYERED, June 12, 2009, *available at* http://overlawyered.com/2009/06/former-employee-wins-41-billion/.

[283] *Id.*

[284] *Id.*

Association provide that an "arbitrator may grant any remedy or relief which the Arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract."[285] One recent case is *Sands v. Menard, Inc*. decided in April, 2009 by the Court of Appeals for the State of Wisconsin.[286] Dawn Sands is a former general counsel for Menard whose employment was terminated following a dispute over compensation.[287] Pursuant to a mandatory arbitration agreement, Sands submitted her claims to an arbitration panel.[288]

The panel found that Menard violated the Equal Pay Act by paying Sands less than a male employee and also found that Menard retaliated against her for complaining of discrimination.[289] According to Sands attorney, the panel awarded Sands with attorney fees and $1.6 million plus attorney fees, which included $900,000 in punitive damages.[290] In addition, the panel ordered Menard to reinstate Sands to her position with a salary of $175,000 per year plus a bonus (she previously earned $70,000 per year).[291] Menard refused to reinstate Sands and filed a motion to vacate the award's reinstatement order on the basis that the arbitrators manifestly disregarded the law allowing clients to choose their own attorneys. [292] The circuit court refused to vacate the award and the appellate court affirmed.[293]

In *Sands*, the court ordered reinstatement of Dawn Sands employment, as per the arbitration award even thought it conflicted with the Rules of Professional Conduct for Attorneys. Given the broad powers of arbitrators to issue remedies in their arbitral awards and the final and binding nature of such awards, parties who wish to place certain limits on an arbitrator's remedial power should expressly set forth those limitations in the arbitration agreement.

C. Arbitration of Torts by an Employee: ***Jones v. Halliburton***

Jones v. Halliburton Co. is a recent case with tragic facts that made the national headlines, including a story by the National Public Radio (NPR).[294] In this case, the Fifth Circuit held that claims for (1) assault and battery; (2) intentional infliction of emotional distress; (3) negligent hiring, retention and supervision of employees involved in a sexual assault; and (4) false imprisonment are not related to the plaintiff's employment contract and refused to compel arbitration.[295]

In *Jones v. Halliburton Co*., in 2004, at the age of 19, Jamie Leigh Jones began working as an administrative assistant for Halliburton Company/Kellogg Brown & Root (Halliburton/KBR) in Houston, Texas.[296] On July 21 2005, Jones signed an employment contract with a subsidiary of Halliburton/KBR to work in Baghdad, Iraq that included the following clause:

> You . . . agree that you will be bound by and accept as a condition of your employment the terms of the Halliburton Dispute Resolution Program which are herein incorporated by reference. You understand that the Dispute Resolution Program requires, as its last step, that any and all claims that you might have against Employer **related to your employment**, including your termination, and any and all **personal injury claim[s] arising in the workplace**, you have against other parent or affiliate of Employer, must be submitted to binding arbitration instead of to the court system. (Emphasis added.)[297]

The incorporated Dispute Resolution Program, provides:

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[285] American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures, Rule 43 (Amended and Effective June 1, 2009) *available at* http://www.adr.org/sp.asp?id=22440#R43. For a discussion of arbitral remedial powers and the parameters of "excess of powers" *see* Jessica T. Martin, *Advanced Micro Devices v. Intel Corp. and Judicial Review of Commercial Arbitration Awards: When Does a Remedy "Exceed" Arbitral Powers?* 46 HASTINGS L.J. 1907 (1995).

[286] Sands v. Menard, Inc., 2009 Wisc. App. LEXIS 262.

[287] *Id*. at *1

[288] *Id*.

[289] *Id*.

[290] *See* Martha Neil, *Company Won't Reinstate In-house Lawyer; How Much Will that Add to $1.6M Award?*, ABA JOURNAL, April 15, 2009, *available at* http://www.abajournal.com/news/co._wont_reinstate_in-house_lawyer_how_much_will_that_add_to_1.6m_award/

[291] Sands v. Menard, Inc., 2009 Wisc. App. LEXIS 262.

[292] *Id*.

[293] *Id*.

[294] Jones v. Halliburton, No. 08-20380, 2009 U.S. App. LEXIS 20543 (5th Cir. Tex. Sept. 15, 2009); *See* Wade Goodwyn, *Rape Case Highlights Arbitration Debate*, National Public Radio, Sept. 23, 2009, available at http://www.npr.org/templates/story/story.php?storyId=105153315.

[295] *Jones v. Halliburton*, at *36.

[296] *Id*. at *2-*3.

[297] *Id*. at *3.

> "Dispute" means all legal and equitable claims, demands, and controversies, of whatever nature or kind, whether in contract, tort, under statute or regulation, or some other law, between persons bound by the Plan or by an agreement to resolve Disputes under the Plan . . . including, but not limited to, any matters with respect to . . . any **personal injury allegedly incurred in or about a Company workplace**. (Emphasis added.)[298]

Jones arrived in Baghdad on July 25 2005.[299] Halliburton/KBR provided Jones with housing in a barracks (where the ratio of men to women was 20 to one) as a term of her employment contract.[300] On July 27, 2005 Jones complained of sexual harassment by co-workers and requested to be moved to a different housing location.[301] Jones alleges that no action was taken, and instead, her managers told her to "go to the spa."[302]

Jones alleges that on July 28 2005, she was drugged, beaten, and gang-raped in her barracks bedroom by several Halliburton/KBR employees after a social function.[303] Jones reported the incident promptly. After her rape-kit was administered, Jones alleges that she was placed under armed guard in a container and not permitted to leave or call her family.[304] She further alleges that Halliburton/KBR human resources interrogated her for several hours and gave her two options: to stay and "get over it", or to return to the U.S. without "guarantee" of a job.[305] In the end, Jone's father was able to get the help of a Congressman to secure his daughter's return to the United States.[306] As a result of the alleged incident, Jones received several serious injuries, which would later require reconstructive surgery.[307] Upon arrival to the U.S., Jones filed a complaint with the Equal Employment Opportunity Commission.[308] The agency conducted an investigation and concluded that: Jones "had been sexually assaulted by one or more employees; physical trauma was apparent; and that Halliburton/KBR's investigation had been inadequate."[309]

In February 2006, Jones filed a request for arbitration against Halliburton/KBR.[310] While the arbitration was pending, Jones obtained new counsel and filed this lawsuit claiming negligence, negligent undertaking, sexual harassment and hostile environment under Title VII, retaliation, false imprisonment, breach of contract, fraud in the inducement to enter the employment contract, fraud in the inducement to enter the arbitration agreement, assault and battery, and intentional infliction of emotional distress.[311]

In November, 2007, Halliburton/KBR moved to compel arbitration pursuant to the employment contract.[312] On May 9, 2008, the district court refused to compel arbitration of Jones' claims for: (1) assault and battery; (2) intentional infliction of emotional distress arising out of an alleged assault; (3) negligent hiring, retention and supervision of employees involved in the assault; and (4) false imprisonment.[313] The district court concluded that those claims feel outside of the scope of the arbitration provision because they were **not related to Jone's employment** and were beyond the outer limits of even a broad arbitration provision.[314] The court, however, stayed litigation of those claims until the parties complete arbitration of the rest of the claims found arbitrable by the court.[315] In June 2008, Halliburton/KBR appealed.[316]

The Fifth Circuit stated that the issue before the court was whether the alleged rape fell within the scope of the arbitration agreement.[317] First, the court rejected Jones' argument that the public policy of the Texas Arbitration Act (TAA) governed the scope of the arbitration provision.[318] Under the TAA, agreements to arbitrate personal injury claims must be

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[298] *Id*.

[299] *Id*. at *4.

[300] *Id*. at *4-*5.

[301] *Id*. at *5.

[302] *Id*.

[303] *Id*. at *6.

[304] *Id*.

[305] *Id*.

[306] *Id*.

[307] *Id*. at *5-*6.

[308] *Id*. at *6-*7.

[309] *Id*. at *7

[310] *Id*.

[311] *Id*. at *8-*9.

[312] *Id*.

[313] *Id*.

[314] *Id*. at *9.

[315] *Id*. at *9-*10.

[316] *Id*. at *11.

[317] *Id*. at *13.

[318] *Id*..

signed by each party's lawyer.[319] The court concluded that to the extent that the TAA affects the enforceability of the agreement, the Federal Arbitration Act preempts.[320] Next, the court reviewed the case law split about similar arbitration clauses and claims premised on sexual assault.[321] The court explained that a liberal construction of "scope of employment" for purposes of workers' compensation was not necessarily the same standard to be applied when construing a similar arbitration provision.[322]

Finally, the Fifth Circuit agreed with the district court and concluded although the arbitration provision extended to personal-injury claims "arising in the workplace," the court "d[id] not believe [Jones'] bedroom should be considered the workplace, even though her housing was provided by her employer"[323] The court, however, noted that its analysis was fact-specific.[324]

VII. CONCLUSION

None of the discussion in this paper will matter nearly as much as what the arbitrator thinks. Choosing the arbitrator is still overwhelmingly the most important decision a lawyer representing a client in arbitration will be asked to make.

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[319] *Id.* The Texas Arbitration Act requires that an agreement to arbitrate a personal injury case is only enforceable under the TAA if each party and each party's attorney signs it. *See* TEX. CIV. PRAC. & REM. CODE §171.002(a)(3) and (c). In other words, pre-injury arbitration agreements will not be valid in personal injury cases, since personal injury clients typically do not retain counsel before they get hurt. Therefore, in a Texas personal injury case, one can disprove the existence of a valid agreement to arbitrate if the injured plaintiff's lawyer did not sign the agreement.

[320] *Id*. at *14-*15.

[321] *Id*. at *15-*27.

[322] *Id*. at *28-30.

[323] *Id*. at *10-*11.

[324] *Id*. at *30.