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ARBITRATION:
THE PRIVITAZATION OF THE THIRD BRANCH OF GOVERNMENT

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I. INTRODUCTION

This paper is a primer on the law relating to arbitration. As such, it has two basic sections: 1) arbitrability, that is, whether or not a party to a dispute can force the dispute into binding arbitration; and 2) enforceability, that is, how one can either reduce an arbitration award to judgment or seek to have an arbitral award vacated. It is not an exhaustive review of either topic, but instead seeks to simply expose Texas litigators to the variety of issues at play.

For those who wish to skip to the end, however, here is the answer: 1) if you can find an arbitration clause that arguably has anything to do with your dispute, the dispute can be forced into arbitration in Texas; and 2) once a party gets a final arbitral award, it is almost impossible to prevent its being reduced to a final, enforceable judgment. The paper will try to not opine as to whether this state of the law is a "good thing" or a "bad thing" but will instead leave that to the oral presentation.

Finally, the authors would note that the second substantive section of this paper, enforceability, is largely an update of a prior paper we did on this topic.

II. ARBITRABILITY

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. *See In re: Olga Palacious*, ___ S.W.3d ___ (Cause No. 05-0038), (Tex. 2006). 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"). 9 U.S.C. §§1-16; TEX. CIV. PRAC. & REM. CODE §§ 171.001-098. Texas also has an International Arbitration Act, which contains some interesting and potentially useful features absent from the TAA or FAA, but international arbitration is beyond the scope of this paper. The FAA also 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. 9 U.S.C. §4.

A. FAA or TAA: which 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 and state law. *In re: D. Wilson Construction Co.*, 196 S.W.3d 774, 779 (Tex. 2006). In order to 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." *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).

In other words, the FAA can be said to apply to many disputes, given the state of current Commerce Clause jurisprudence. In the *Nexion* case, 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. *Nexion*, 173 S.W.3d at 69.

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. *Wilson*, 196 S.W.3d at 779-780. This paper will discuss FAA pre-emption of the TAA in more detail below. 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. 9 U.S.C. §4.

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." *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). 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. *Id.* 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.'" *Id.*, at 516, *quoting Prudential Sec. Inc. v. Marshall*, 909 S.W.2d 896, 899 (Tex. 1995). 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. *In re: FirstMerit Bank, N.A.*, 52 S.W.3d 749, 756 (Tex. 2001).

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.

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

C. Does an agreement to arbitrate exist?

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. However, relatively recent expansive opinions from both 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.

1. The Employment Cases

Numerous recent opinions have discussed employers' imposition of arbitration agreements on their at-will employees. Perhaps the most famous is *Halliburton*. In that case, a thirty-year Brown & Root employee named James Myers got a notice that his employer had adopted a binding arbitration program for resolving employment disputes, and that by continuing to come to work after a short time had passed Myers would be deemed to have accepted the new program. *In re: Halliburton Co.*, 80 S.W.3d 566, 568 (Tex. 2002). Myers kept coming to work, but eventually he was demoted. *Id.* Myers claimed the demotion was age and race based discrimination, and he filed a lawsuit based on the Texas Commission on Human Rights Act. *Id.* Brown & Root asked the trial court to compel arbitration, the trial court denied the motion, the Court of Appeals denied the subsequent mandamus petition, and the Supreme Court stepped in. *Id.*

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 chage. *Id.* "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.'" *Id.*, *quoting Hathaway v. General Mills*, 711 S.W.2d 227, 229 (Tex. 1986).

In early 2006, the Supreme Court re-affirmed the *Halliburton* rule in *Dillard I*, but the Court added a potential wrinkle. 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. For that reason, and because the parties agreed to and signed the agreement, the agreement is binding on Martinez." *Dillard I*, 186 S.W.3d at 516. 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. *See also Davidson*, 128 S.W.3d at 228-29.

Several months later, the Court wrote another opinion on the same arbitration policy. *In re: Dillard Department Stores, Inc.*, 198 S.W.3d 778 (Tex. 2006) (hereinafter *Dillard II*). In *Dillard II*, the El Paso store had presented its arbitration policy to its employees at a meeting in August 2000. *Id.*, at 780. Later, an employee named Delia Garcia sued the company for retaliatory discharge, claiming that she was fired after applying for workers' compensation insurance benefits. *Id.* 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. *Id.*

Ms. Garcia herself 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. *Id.*, at 780-81. 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. *Id.*, at 781.

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. Dillard apparently put a new arbitration plan in place in 2002, more than a year after notifying Ms. Garcia of the first plan. *Id.*, at 782. 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. *Id.* 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 at-will employment arrangement. *Id.* 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.

On June 16, the Supreme Court ruled that "notice" under the *Halliburton* analysis does not actually require that the employee receive a copy of the arbitration agreement itself. *In re: Dallas Peterbilt, Ltd., L.L.P.*, 196 S.W.3d 161, 162-63 (Tex. 2006). 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." *Id.*, at 163. The employee in the case testified that he never received the plan itself, but he had signed the summary description. *Id.*, at 162.

2. Isn't the rule different in personal injury cases?

In Section II(A), above, we mention 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. 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.

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. *Nexion*, 173 S.W.3d at 69; *see also In re: AdvancePCS Health L.P.*, 172 S.W.3d 603, 606 (Tex. 2005); *In re: Weekley Homes*, 180 S.W.3d 127, 130 n.4 (Tex. 2005). 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.**

Medical negligence cases, of course, are a subset of personal injury cases. Chapter 74 of the Civil Practice & Remedies Code, which was recently enacted to replace the former Article 4590i, contains its own restriction on arbitration agreements. TEX. CIV. PRAC. & REM. CODE §74.451. Like the TAA, Chapter 74 requires that an arbitration agreement applicable to a medical negligence claim must be signed by both the party to be bound and his or her attorney. *Id.* However, unlike the TAA, Chapter 74 of the CPRC is likely not pre-empted by the FAA, under a doctrine lovingly referred to as McCarran-Ferguson Reverse Preemption.

The leading case on McCarran-Ferguson Reverse Preemption is a July 2005 case out of Houston. *In re: Kepka*, 178 S.W.3d 279 (Tex. App. – Houston [1st Dist.] 2005, orig. proceeding). In the interest of full disclosure, we report that a mandamus petition has been filed on this issue with the Texas Supreme Court, and that the Supreme Court has requested full briefing on the merits on the case (Supreme Court Cause No. 05-1043). As of the deadline for submitting this paper, no oral argument had yet been set, but it seems that we will get a pronouncement from that Court on McCarran-Ferguson Reverse Preemption sometime relatively soon. The Supreme Court was aksed to consider the issue on a motion for rehearing in the *Nexion* case, but it declined to do so. *Nexion*, 173 S.W.3d at 70.

At any rate, in *Kepka* the First Court of Appeals held that the McCarran-Ferguson Act ("MFA") reverse-preempts the FAA as it related to the former Article 4590i, such that the FAA did not preempt 4590i's attorney-signature requirement. *Kepka*, 178 S.W.3d at 292-93. In other words, according to *Kepka*, a medical negligence case could not be sent to arbitration unless the injured plaintiff's attorney signed the purported arbitration agreement. *Id.*

The MFA is a federal statute that states "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. §1012(b). The FAA does not specifically relate to the business of insurance, so it cannot preempt Texas law that regulates the business of insurance. According to the *Kepka* court, the former 4590i clearly was intended, in its entirety, to regulate the business of insurance, as its "findings and purposes" section indicates that it was enacted in response to the escalating costs of medical liability insurance. *Kepka*, 178 S.W.3d at 289. The current Chapter 74 does not include the same "findings and purposes" section, but given its political history one would think a review of the legislative history would indicate that the costs of medical liability insurance were offered as a justification for its enaction. Thus, we would think that *Kepka* would apply to current Chapter 74 as it did to 4590i (which is not to say the Supreme Court will not completely close the door on this issue when it gets to it).

Under McCarran-Ferguson Reverse Preemption, therefore, a medical negligence case ought not be arbitrable in the absence of both attorneys' signatures, even if the FAA applies to the case.

Finally, the Fifth Circuit has fairly recently explained the doctrine of McCarran-Ferguson Reverse Preemption as it applies to a provision in Mississippi's uninsured motorist insurance statute. *American Bankers Ins. Co. of Florida v. Inman*, 436 F.3d 490 (5th Cir. 2006). That Mississippi statute precludes UM carriers from putting arbitration requirements in UM policies, and according to the Fifth Circuit, the MFA reverse-preempts the FAA, such that the Mississippi statute applies notwithstanding the FAA. *Id.*, at 493-94. While attendees of the seminar will not likely encounter Mississippi uninsured motorist claims all that often, the Court's explanation of McCarran-Ferguson Reverse Preemption is helpful and a good starting point for analysis of this issue in the Circuit.

3. Direct-benefits estoppel, arbitration by agency, and other creative ways to impose arbitration on non-signatories

Texas courts have employed different and unusual theories in order to find than an agreement to arbitrate exists in the absence of a traditional written agreement. All of these theories stem from contract law, since, again, an agreement to arbitrate is simply a contract.

In 2001, the *FirstMerit* Court noted in passing that "a litigant who sues based on a contract subjects him or herself to the contract's terms." *FirstMerit*, 52 S.W.3d at 755. In other words, a beneficiary of, as in that case, a contract for the purchase of a mobile home cannot sue the seller under the purchase agreement's warranty without subjecting him or herself to the purchase agreement's arbitration clause. If the claim is breach of contract, the allegedly breached contract's arbitration clause will bind the claimant, even if that claimant was not a signatory to the contract (in *FirstMerit* the mobile home was purchased by a couple for their daughter, so the purchaser and the resident were different people). *Id.*, at 752.

On May 20, 2005, the Texas Supreme Court declined to extend the *FirstMerit* analysis to non-contractual claims, specifically to claims in *quantum meruit*. *In re: Kellogg Brown & Root*, 166 S.W.3d 732 (Tex. 2005). In that opinion, the Court noted that while a "direct-benefits estoppel" theory could be used to compel a non-signatory to arbitrate, "a non-signatory should be compelled to arbitrate a claim only if it seeks, through the claim, to derive a direct benefit from the contract containing the arbitration provision." *Id.*, at 741. In this case, the Court found that the non-signatory's *quantum meruit* claim specifically did not derive from the contract containing the arbitration clause, and direct-benefits estoppel did not allow the non-signatory to be hauled into arbitration. *Id.*

Five months later, however, the Texas Supreme Court seemingly changed its tune, using direct-benefits estoppel to compel a nonsignatory to arbitrate a personal injury claim. *Weekley Homes,* 180 S.W.3d at 127. In that case, an elderly widower named Vernon Forsting contracted with Weekley Homes to build a large home in which he could live with his daughter and her family. *Id.*, at 129. The daughter dealt directly with the builder, choosing floorplans and the like, but Mr. Forsting executed all the closing documents. *Id.* After closing, numerous problems arose with respect to the house, and both Forsting and his daughter eventally sued Weekley. *Id.* Forsting's claims were typical claims in this sort of case: negligence, breach of contract, statutory violations, and breach of warranty. *Id.* The daughter, however, sued only for personal injuries, asserting that the negligent repairs to the home caused her to develop asthma. *Id.*

Applying the FAA, the trial court compelled arbitration with respect to Forsting but not with respect to his daughter's personal injury claim. *Id.*, at 129-30. Weekley Homes filed a petition for mandamus, asserting that any claim asserted by a nonsignatory that arises out of a contract containing an arbitration clause is arbitrable, not just a breach of contract claim. *Id.*, at 132, In response, the Supreme Court applied direct-benefits estoppel to Texas arbitration cases to create an equitable theory a party can now use to attempt to compel a nonsignatory to a contract to arbitrate tort claims related to the contract. *Id.*, at 133-35.

According to the Court, the daughter here assumed certain benefits under the contract, including the right to insist on warranty repairs to the home and the right to negotiate with Weekley in attempts to settle the underlying case. *Id.*, at 133. That being the case, the Court would not allow her to avoid the contract's arbitration clause; "a nonparty cannot both have his contract and defeat it too." *Id.*, at 135.

> Like the equitable doctrine of promissory estoppel, we do not understand direct-benefits estoppel to create liability for noncontracting parties that does not otherwise exist. As Von Bargen and Weekley had no contract between them, estoppel alone cannot grant either a right to sue for breach. Nor do we understand the doctrine to apply when the benefits alleged are insubstantial or indirect. But once Von Bargen deliberately sought substantial and direct benefits from the contract, and Weekley agreed to comply, equity prevents her from avoiding the arbitration clause that was part of that agreement.

Id., at 134. The Supreme Court advises practitioners that direct-benefits estoppel applies when a beneficiary's conduct embraces the contract but not when it merely shakes hands with the contract, and notes that "the equitable nature of the doctrine may render firm standards inappropriate, requiring trial courts to exercise some discretion based on the facts of each case." *Id.*, at 134-35.

In March 2006, the Supreme Court used direct-benefits estoppel to allow non-signatories to a contract to compel arbitration in a tortious interference case. *In re: Vesta Ins. Group, Inc.*, 192 S.W.3d 759 (Tex. 2006). In that case, the plaintiff claimed that a contract to which he was a party was tortiously interfered with by, obviously, non-signatories to the contract. *Id.*, at 761. The plaintiff, an insurance agent named James Cashion, had a general insurance agency contract with a carrier called States General. *Id.* That contract contained an arbitration clause. *Id.* At some point, States General lowered Cashion's commissions, as allowed by the contract. *Id.* Shortly thereafter, States General was purchased by another insurance company, Vesta, and shortly thereafter Cashion was terminated as a agent. *Id.* Cashion sued Vesta, asserting that Vesta tortiously interfered with his contract with States General, presumably prior to its purchase of States General (the opinion does not explain the particulars of Cashion's claim). *Id.*

Vesta moved to compel arbitration based on the Cashion/States General contract's arbitration clause. *Id.* The Supreme Court ruled that direct-benefits estoppel applies to require arbitration of tortious interference claims: "we hold that tortious interference claims between a signatory to an arbitration agreement and agents or affiliates of the other signatory arise more from the contract than general law, and thus fall on the arbitration side of the scale." *Id.*, at 762. It is worth noting that the defendants in this case only became "agents or affiliates of the other signatory" pursuant to their purchase of States General; if the tortious interference occurred prior to the purchase (or perhaps pursuant to it, if Vesta's purchase was contingent on replacing States General agents like Cashion with Vesta's own agents), then the opinion's logic takes on a different context. Again, the Court compels arbitration because of the relationship between the interferer and the signatories to the contract; that relationship only existed, however, because of the facts giving rise to the tortious interference claim. In other words, it ought not be difficult to argue that *Vesta* can apply to any claim for tortious interference, given the nature of that cause of action.

Cashion raised that argument with the Court, and the Court's response to it demonstrates the potentially difficult circularity of its argument: "we agree with Cashion that he would not be required to arbitrate a tortious interference claim against a complete stranger to his contract and his arbitration clause. But he did not sue any strangers here; every defendant is a current or former owner, officer, agent, or affiliate of States General, with whom he agreed to arbitrate these disputes." *Id.*, at 763. The problem, of course, is that the facts surrounding the defendants' decision to become affiliated with States General are the facts that give rise to the tortious interference claim. The defendants were not "strangers" to the Cashion/States General contract **because they tortiously interfered with it**. If the act of tortiously interfering with a contract can supply the requisite nexus to compel arbitration under an estoppel theory, then any tortious interference claim is arbitrable, assuming the interfered-with

contract contains an arbitration clause. The Supreme Court eviscerates the distinction as it cites it.

As briefly summarized in the *Kellogg* opinion, other legal theories exist by which courts can find an agreement to arbitrate in the face of a failure of a party to sign an arbitration agreement, such as incorporation by reference, assumption, agency, alter ego and third-party beneficiary. *Kellogg*, 166 S.W.3d at 739. Most recently, the Fifth Circuit has considered and applied alter ego as a means of extending an agreement to arbitrate to a nonsignatory. *Bridas S.A.P.I.C. v. Government of Turkmenistan*, 447 F.3d 411 (5th Cir. 2006). While the opinion focuses on and explains the alter ego theory, a prior opinion in the case offers a detailed discussion of other theories by which a nonsignatory can be bound. *See Bridas S.A.P.I.C. v. Government of Turkmenistan*, 345 F.3d 347 (5th Cir. 2003). Taken together, the two *Bridas* opinions offer an excellent guide for the Fifth Circuit's take on non-signatory issues.

4. Consideration for agreement to arbitration

A court considers whether an agreement to arbitrate exists just as it considers whether any other contractual provision exists, which means the agreement to arbitrate must be supported by consideration. *In re: Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 676 (Tex. 2006). When an arbitration clause is part of an underlying contract between the parties, the rest of the agreement provides the consideration for the agreement to arbitrate. *AdvancePCS*, 172 S.W.3d at 607; *citing FirstMerit*, 52 S.W.3d at 757. With respect to stand-alone agreements to arbitrate, a mutuality of obligation to arbitrate forms the consideration. *Halliburton*, 80 S.W.3d at 569; *AdvancePCS*, 172 S.W.3d at 607. In other words, as the Court found in *Halliburton*, the at-will employee's continued employment after receiving notice of the arbitration policy constituted acceptance of the agreement, while the arbitration policy's mutuality was its consideration. *Halliburton*, 80 S.W.3d at 569. Both Halliburton and Mr. Myers were required to arbitrate their disputes, hence mutuality of obligation. Finally, as *Dillard II* demonstrates, it is almost impossible for an at-will employer to unilaterally modify such an agreement, since notice and continued employment are all that is required for a bilateral modification, and without notice there is no modification at all.

Finally, the June 9 *Palm Harbor Homes* opinion adds yet another wrinkle. In that case, Raymond and Crystal Ripple had purchased a defective manufactured home. *Palm Harbor Homes*, 195 S.W.3d at 675. Their contract with the retailer contained an arbitration clause; they never had a contract with the home's manufacturer. *Id.*, at 674-75. The Ripples sued both the retailer and the manufacturer, who both moved to compel arbitration. *Id.*, at 675. As described above, consideration with respect to the retailer was easy for the Court, since the agreement to arbitrate was part of the contract between the Ripples and the retailer. *Id.*, at 676-77. The manufacturer, however, was a third-party beneficiary to the contract and had no independent relationship with the Ripples. *Id.*, at 677. The actual arbitration agreement mentioned the manufacturer and

recited that it inured to the manufacturer's benefit, but it also gave the manufacturer the unilateral right to "opt-out" of any arbitration. *Id.*, at 675. The Ripples, therefore, argued that no consideration existed with respect to the manufacturer, and even if it did the agreement was illusory with respect to the manufacturer given its "opt-out" right. *Id.*, at 677.

The Supreme Court ruled that as a third-party beneficiary, the manufacturer's agreement to arbitrate was supported by the retailer's consideration; the lack of independent consideration between the Ripples and the manufacturer was "not relevant." *Id.* What's more, according to the Court, the default rule that a unilateral right to terminate an arbitration agreement renders it illusory simply does not apply in the third party beneficiary context. *Id.*

As an interesting comparison, readers might review an unreported Fifth Circuit opinion from around the same period which addresses a similar issue but which reaches the opposite result: *Goins v. Ryan's Family Steakhouse*, 181 Fed.Appx. 435 (5th Cir. 2006) (Cause No. 05-51549). In that case, the Fifth Circuit joined several other federal courts that had invalidated a "triangular" arbitration arrangement promulgated by an outfit called Employment Dispute Services, Inc. which was based on third-party beneficiary contracts, but pursuant to which one of the triangle's "legs" maintained the right to unilaterally abstain from arbitration, thus rendering the whole arrangement unenforceable, according to the Circuit.

5. What about statutory causes of action?

Arbitration agreements are enforceable even when they preclude the judicial assertion of statutory rights, unless the party resisting arbitration can prove a Congressional intent to exempt statutory rights from potential arbitral resolution. *Garrett v. Circuit City Stores, Inc.*, 449 F.3d 672, 674 (5th Cir. 2006). The *Garrett* opinion, while it applies directly only to claims under the Uniformed Services Employment and Reemployment Rights Act, offers a recent and clear summary of the law of arbitrability as it applies to statutory causes of action. Generally, "courts have regularly held that claims by employees arising under federal and state employment statutes are subject to the FAA and mandatory arbitration." *Id.*, at 675 n.1.

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 betwen 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.'" *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. 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." *Id.* According to the Supreme Court, since a reasonable interpretation of "personal injuries" includes injuries to reputation, the defamation claims are arbitrable. *Id.*

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." *Id.* 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." *Id.*

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. Does any affirmative ground exist with which to oppose arbitration?

"As a matter of federal law, arbitration agreements and clauses are to be enforced unless they are invalid under principles of state law that govern all contracts. Therefore, 'generally applicable contract defenses, such as fraud, duress, or unconscionability may be applied to invalidate arbitration agreements without contravening §2 [of the FAA]." *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 166 (5th Cir. 2004), *quoting Doctor's Assocs. v. Casarotto*, 517 U.S. 681, 687, 116 S.Ct. 1652 (1996). In other words, even if a party seeking to compel arbitration makes a showing as to arbitrability, a resisting party can assert affirmative defenses.

1. The defense must be specific to the arbitration clause, and not to the contract as a whole

While a party opposing arbitration can offer any affirmative defense normally available in contract cases, that party must take care to only assert defenses as they apply specifically to the arbitration clause, and not to the contract as a whole. A February U.S. Supreme Court case makes it clear that any challenge to the entire contract's enforceability must be decided by the arbitrator, and not by a trial court at

the motion to compel arbitration stage. *Buckeye Check Cashing v. Cardegna*, 126 S.Ct. 1204 (2006). That case involved a contract the Florida Supreme Court had found criminally usurious, but which involved an arbitration clause. *Id.*, at 1207. That had court found that enforcing an arbitration clause in a usurious contract "could breathe life into a contract that not only violates state law, but also is criminal in nature." *Id.* Maybe so, said the Supreme Court, but the determination is one for the arbitrator, since the affirmative defense of illegality in this case would have applied to the contract as a whole, and not specifically to the arbitration clause. *See also FirstMerit*, 52 S.W.3d at 756 ("We again note that these defenses must specifically relate to the Arbitration Addendum itself, not the contract as a whole, if they are to defeat arbitration. Defenses that pertain to the entire installment contract can be arbitrated.")

2. Unconscionability

The most common affirmative defense raised to arbitration clauses is unconscionability. "Under Texas law, unconscionability includes two aspects: (1) procedural unconscionability, which refers to the circumstances surrounding the adoption of the arbitration provision, and (2) substantive unconscionability, which refers to the arbitration provision itself." *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 301 (5th Cir. 2004), *citing Halliburton*, 80 S.W.3d at 571. Although there was at some time confusion on the issue, the *Halliburton* court clarified that courts, rather than arbitrators, may consider both procedural and substantive unconscionability challenges to arbitration. *Halliburton*, 80 S.W.3d at 572.

"[T]he basic test for unconsionability is whether, given the parties' general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract. The principle is one of preventing oppression and unfair surprise and not of disturbing allocation of risks because of superior bargaining power." *FirstMerit*, 52 S.W.3d at 757. "Unequal bargaining power does not establish grounds for defeating an agreement to arbitrate absent a well-supported claim that the clause resulted from the sort of fraud or overwhelming economic power that would provide grounds for revocation of any contract." *AdvancePCS*, 172 S.W.3d at 608.

The basic test, therefore, seems to require a showing of overwhelming economic power. It is difficult to provide any input as to what kind of showing would suffice, since I am unaware of any recent Texas cases where such a showing has been upheld (with the exception of the high cost of arbitration cases, which are described separately, below). However, it is easy to demonstrate the kind of factors that do not constitute unconscionability.

An arbitration clause that allows a lender to seek judicial remedies to protect its security interest but which requires the borrows to arbitrate all their claims is not

unconscionable; "most federal courts, however, have rejected similar challenges on the grounds that an arbitration clause does not require mutuality of obligation, so long as the underlying contract is supported by adequate consideration." *FirstMerit*, 52 S.W. 3d at 757-58.

In the employment context, "take it or leave it" arbitration policies, which require an at-will employee to either accept them or quit his or her job, with no opportunity for negotiation, are not unconscionable. *Halliburton*, 80 S.W.3d at 572.

"Take it or leave it" arbitration policies are also enforceable in the commerical, non-employment context, including those contained in contracts of adhesion. *AdvancePCS*, 172 S.W.3d at 608.

Contracts of adhesion between "unsophisticated" consumers and lendors, which inure to the benefit of third parties who may unilaterally "opt-out" of the obligation to arbitrate, are not unconscionable. *Palm Harbor Homes*, 195 S.W.3d at 678-79.

3. Costs as a basis for unconscionability

The U.S. Supreme Court has written that "the existence of large arbitration costs could preclude a litigant . . . from vindicating her federal statutory rights in the arbitral forum." *Green Tree Fin. Corp. – Alabama v. Randolph*, 531 U.S. 79, 90, 121 S.Ct. 513, 522 (2000). The Texas Supreme Court has acknowledged that substantial costs and fees associated with the arbitral forum can render an arbitration agreement unconscionable. *FirstMerit*, 52 S.W.3d at 756. In neither the *Green Tree* case nor the *FirstMerit* case, however, did the Court find that the party opposing arbitration had made an adequate evidentiary showing of what the costs of arbitration actually would be.

A Texas Court of Appeals in Houston, however, found an arbitration agreement to be unconscionable on the basis of a local attorney's testimony as to the proposed arbitration's cost. *In re: Luna*, 175 S.W.3d 315, 319-22 (Tex. App. - Houston [1st Dist.] 2004, orig. proceeding, app. for mandamus filed). In that case, the arbitration agreement in question actually contained a limit on the costs that provided some protection to the party resisting arbitration. *Id.*, at 319. In the *Luna* case, the party resisting arbitration put on evidence not only of what the costs would be, but also of his net worth, to demonstrate the unconscionable effect of the costs. The Texas Supreme Court, however, has already heard oral argument on the case, so it will rule on the *Luna* facts itself. Thus, in Texas, while the oppressive costs of arbitration may be a basis for avoiding arbitration, the window may be in the process of closing.

The Fifth Circuit, however, has beaten the Texas Supreme Court to the punch, with an August 23 opinion that rejected cost-unconscionability. *Overstreet v. Contigroup Companies, Inc.*, 462 F.3d 409 (5th Cir. 2006). In that case, a Mississippi

chicken farmer named Gertrude Overstreet sued a chicken provider for fraudulent inducement, and the chicken provider filed a motion to compel arbitration. *Id.*, at 411. Ms. Overstreet asserted the high cost of arbitration as a grounds for unconscionability:

> the district court found that the arbitration clause was unconscionable because arbitration pursuant to that clause would cost Appellee between $27,500 and $29,000. The court reasoned that the cost made the clause unconscionable because Appellee is now extremely poor. As evidence of Appellee's current financial status, the court considered the following facts in the record: Appellee and her husband (1) receive less than $1,000 per month in social security benefits, (2) own no land, (3) have no cash savings, (4) receive food stamps, and (5) rely on Medicaid to pay for their required medical prescriptions.

Id., at 412. Despite this record, the Fifth Circuit reversed the trial court's unconscionability finding, based on Georgia unconscionability law which requires that the analysis take into account the party's position at the time the contract was executed. *Id.* Since Ms. Overstreet did not prove up her 2001-era destitution, she did not establish her unconscionability defense.

4. Waiver

Finally, it is possible to argue that a party seeking arbitration has waived its right to arbitrate if that party has "substantially invoked the judicial process to his opponent's detriment." *Vesta*, 192 S.W.3d at 763; *Wilson*, 196 S.W.3d at 783. Like all other impediments to arbitration, however, courts are loath to find waiver; in a recent case, the Texas Supreme Court found that a party had not waived its right to arbitration despite two years of litigation, extensive discovery, and attorneys' fees in excess of $200,000. *Vesta*, 192 S.W.3d at 763.

III. CONFIRMING, VACATING OR MODIFYING ARBITRAL 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.

On the last day of 2002, Texas Supreme Court Justice Nathan Hecht articulated his view of a court's proper role in reviewing an arbitrator's award:

> "Subjecting arbitration awards to judicial review adds expense and delay, thereby diminishing the benefits of arbitration as an efficient, economical system for resolving disputes. Accordingly, we have long held that 'an award of arbitrators upon matters submitted to them is given the same effect as a judgment of a court of last resort. All reasonable presumptions are indulged in favor of the award, and none against it.'"

CVN Group, Inc. v. Delgado, 95 S.W.3d 234, 238 (Tex. 2002), quoting *City of San Antonio v. McKenzie Constr. Co.*, 136 Tex. 315, 150 S.W.2d 989, 996 (Tex. 1941). Justice Hecht's view is in line with that of many commentators and most court opinions that opine as to the advisability of allowing courts to review arbitral decisions, and the case law bears out this inherent prejudice against judicial review of arbitral decisions. In other words, if you are tasked with trying to avoid an arbitral award, you face an uphill battle.

A. Vacating or Modifying Arbitral Awards Governed by the Texas General Arbitration Act

1. The Grounds for Vacating or Modifying an Award

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 wilful misbehavior of an arbitrator;
(3) the arbitrators:
  (A) exceeded their powers;
  (B) refused to postpone the hearing after a showing of sufficient cause for the postponement;
  (C) refused to hear evidence material to the controversy; or

(D) conducted the hearing, contrary to Section 171.043, 171.044, 171.045, 171.046 or 171.047, in a manner that substantially prejudiced the rights of a party; or

(4) there was no agreement to arbitrate, the issue was not adversely determined in a proceeding under Subchapter B, and the party did not participate in the arbitration hearing without raising the objection.

TEX. CIV. PRAC. & REM. CODE §171.088(a).

Additionally, in residential construction cases, a court shall vacate an arbitral award upon a party's showing of manifest disregard of Texas law. TEX. PROP. CODE §438.001. Significantly, "manifest disregard of Texas law" is not a ground for vacatur in cases other than residential construction cases under TAA analysis. *Action Box*, 130 S.W.3d at 252.

Also, in certain extreme 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." *CVN Group*, 95 S.W.3d at 239.

The TAA also requires a court to modify an arbitral award in certain circumstances:

On application, the court shall modify or correct an award if:

(1) the award contains:
  (A) an evident miscalculation of numbers; or
  (B) an evident mistake in the description of a person, thing, or property referred to in the award;

(2) the arbitrators have made an award with respect to a matter not submitted to them and the award may be corrected without affecting the merits of the decision made with respect to the issues that were submitted; or

(3) the form of the award is imperfect in a manner not affecting the merits of the controversy.

TEX. CIV. PRAC. & REM. CODE §171.091(a).

2. Corruption, Fraud and Undue Means

Upon proper application by a party, a court must vacate an arbitral award obtained by corruption, fraud, or other undue means. TEX. CIV. PRAC. & REM. CODE §171.088(a)(1). A recent court of appeals opinion from El Paso provides an example.

Tri-Star Petroleum v. Tipperary involved an appeal of a trial court's decision to vacate an arbitral award due to undue means and to refuse to order that a new arbitration take place. *Tri-Star Petroleum Co. v. Tipperary Corp.*, 107 S.W.3d 607, 614 (Tex. App. - El Paso 2003, pet. denied). The arbitration clause at issue was itself the product of a prior settlement agreement, and it required the parties to hire a neutral accounting firm to make certain calculations and factual determinations, which would be enforced as a binding arbitral award under the TAA. *Id.*, at 610-11.

The Tri-Star trial court refused to confirm the arbitral award based on its finding that Ernst & Young, the accounting firm hired, acted not as a neutral but as retained accountants on behalf of one of the parties. *Id.*, at 612. Ernst & Young, according to the trial court, refused to conduct a hearing, refused to communicate with the party that did not hire them, and otherwise consciously excluded one of the parties due to its own professional obligations to the party which hired it as its accountants. *Id.* While Ernst & Young's conduct may have been appropriate as a retained professional advisor to a client, it certainly did not allow for an open, impartial and efficient dispute resolution procedure.

In affirming the trial court's decision, under Section 171.088(a)(1), to vacate Ernst & Young's award, the Court of Appeals also specifically found that, post vacatur, a court is not required to order a new arbitration. *Id.*, at 614-16. Starting the arbitration process over after the prolonged disastrous first arbitration would have defeated the policy of arbitration as an efficient and inexpensive dispute resolution mechanism. *Id.* Instead, the Court of Appeals found that Tri-Star Petroleum materially breached the arbitration clause of the settlement agreement, and therefore that the arbitration clause was revoked under Section 171.001(b) of the TAA. *Id.*, at 613-16. In so doing, the Court of Appeals explicitly found that the TAA's revocation analysis is not limited to formation defenses, such as lack of consideration, mistake and duress; arbitration agreements are not, according to the Court, more enforceable than other types of contracts. *Id.* Material breach of an arbitration agreement therefore, which presumably will take place whenever a party obtains an arbitral award through undue means, can revoke the arbitration agreement itself. Establishing undue means, therefore, can serve to not only vacate an award but also to eliminate arbitration altogether.

Rogers v. Maida, while not a vacatur case, is still helpful with respect to establishing corruption, fraud or undue means, as it provides an example of a Court of Appeals affirming a trial court's refusal to compel arbitration due to duress. *Rogers v. Maida*, 126 S.W.3d 643 (Tex. App. - Beaumont 2004, orig. proceeding). *Rogers* is an employment case, whereby an employee of RLS Legal Solutions refused to sign an arbitration agreement, and her employer refused to pay her for services already rendered until she capitulated. *Id.*, at 645. Litigation eventually ensued, the employer moved to compel arbitration, and the trial court found that the arbitration agreement was a product of duress, since the employer did not have the legal right to refuse to pay

its employee wages already earned. *Id.* This would be a classic case of a defect in the formation of an arbitration clause.

Rogers is also obviously distinguishable from the classic case of a contract of adhesion, whereby an employer refuses to continue to employ an employee unless the employee agrees to an arbitration clause. This latter situation is absolutely kosher in Texas, as described above.

3. Evident Partiality, Willful Misconduct, Corruption

Upon proper application by a party, a court must vacate an award if the rights of a party to the arbitration were prejudiced by the evident partiality of a neutral arbitrator, by corruption in an arbitrator, or by misconduct or wilful misbehavior of an arbitrator. TEX. CIV. PRAC. & REM. CODE §171.088(a)(2).

The Texas Supreme Court issued its first opinion explaining the evident partiality standard within the context of the TAA in 1997. *Burlington Northern Railroad Co. v. TUCO, Inc.*, 960 S.W.2d 629, 633 (Tex. 1997). The *TUCO* court explains, however, that it bases its opinion on federal jurisprudence interpreting an identical provision in the Federal Arbitration Act. *Id.* The *TUCO* rule is as follows: "a neutral arbitrator selected by the parties or their representatives exhibits evident partiality under this provision if the arbitrator does not disclose facts which might, to an objective observer, create a reasonable impression of the arbitrator's partiality." *Id.*, at 630. The *TUCO* rule, therefore, only applies with respect to neutral arbitrators and in a situation where the parties or their representatives select the challenged arbitrator. The rule therefore applies to many, but not all, arbitrators.

In the *TUCO* case, each party selected a friendly arbitrator, and the friendly arbitrators selected the third, neutral arbitrator, whose partiality was challenged. *Id.*, at 630-31. After the panel made its decision, the friendly arbitrator for *TUCO* overheard the neutral arbitrator thank the friendly arbitrator for Burlington Northern for referring him a large piece of litigation work. *Id.* TUCO filed a suit, pursuant to Section 171.088(a)(2)'s predecessor, asking the court to vacate the award due to evident partiality.

The Texas Supreme Court, realizing that it was making new Texas law, provides a thorough history of the evident partiality standard as it applies to the FAA, which I will not recap in this paper, but which I do recommend to any party challenging an arbitral award, under either the TAA or the FAA, on the ground of evident partiality. The Court rules that, since arbitration is a creature of contract between parties, and since parties have an incentive to choose the most qualified and experienced arbitrators who would naturally be the most likely to have conflicts, it is critical that the arbitrators disclose potential conflicts as fully as is reasonable. *Id.*, at 635. This early and complete disclosure allows the parties, and not subsequent courts,

to evaluate potential bias and decide whether or not to proceed. *Id.* The Court emphasizes that the evident partiality does not stem from the potential conflict, but from the fact of nondisclosure itself, "regardless of whether the undisclosed information necessarily establishes partiality or bias." *Id.*, at 636. Under *TUCO*, arbitrators are not required to disclose trivial relationships or connections, but they are required to disclose, for example, a familial or close social relationship, and "the conscientious arbitrator should err in favor of disclosure." *Id.*, at 637. Finally, in a footnote, the *TUCO* court notes that "a party who learns of a conflict before the arbitrator issues his or her decision must promptly object to avoid waiving the complaint." *Id.*, n.9.

In 2002, the Texas Supreme Court revisited the issue and added complexity to the analysis. *Mariner Fin. Group, Inc. v. Bossley*, 79 S.W.3d 30 (Tex. 2002). After restating the *TUCO* rule, the Court affirmed the court of appeals' decision to reverse a summary judgment confirming an award that had been challenged on evident partiality grounds. *Id.* In Mariner, about two months after an arbitral award had been issued, the Bossleys' expert witness realized that she had earlier testified against one of the arbitrators in a malpractice proceeding. *Mariner*, at 31-32. The Bossleys filed a proceeding to vacate the award, and Mariner, the prevailing party at arbitration, moved for summary judgment on the grounds that no legal basis existed to vacate the award. *Id.*, at 32.

Procedurally, Mariner's decision to move for summary judgment on this issue proved determinative. Ordinarily, the party challenging an award under 171.088(a) has the burden of proving evident partiality; in this case, however, since Mariner filed a "traditional" motion for summary judgment, to prevail Mariner had to establish, as a matter of law, that no issue of material fact existed with respect to the arbitrator's evident partiality. *Id.*; see also Tex. R. Civ. P. 166a(c). Under *TUCO*, the arbitrator had an affirmative obligation to disclose his previous relationship with the Bossleys' expert if he knew of it. *Id.* The summary judgment evidence, however, was "silent about whether [the arbitrator] remembered [the expert] or even knew of her." *Id.*, at 33. That being the case, the trial court should not have granted the motion for summary judgment.

In its analysis, the *Mariner* court emphasizes the fact-intensive inquiry that must take place with respect to evident partiality analysis. *Id.*, at 34. While some cases involve "common knowledge" of a potentially conflicting relationship which does not require additional formal disclosure, others absolutely require disclosure since only the arbitrator would know of the potential conflict. *Id.* While the Mariner court seems to suggest that its set of facts is somewhere in the middle, it cannot even make that assertion based on the record before it. What is clear, though, is that the duty to disclose is the arbitrator's, so the arbitrator's state of mind is the critical factual inquiry. While a party with knowledge of a conflict must object immediately lest it waive a potential challenge, a party is not required to conduct independent research to discover potential conflicts. *Id.*, at 34-35. "[T]he whole purpose of an arbitrator's

duty to disclose is to avoid this very type of speculative presumption and let the parties to the arbitration make the call." *Id.*, at 35.

Finally, the Austin Court of Appeals recently applied the *TUCO* rule, reversed a trial court's decision to vacate an arbitral award on the basis of evident bias, and rendered judgment enforcing the arbitral award. *Kendall Builders, Inc. v. Chesson*, 149 S.W.3d 796 (Tex. App. - Austin 2004, pet. denied). Kendall involved an arbitration award issued against a homeowner in favor of a remodeling contractor. *Id.*, at 800. The homeowner was an employee of Vignette Corporation who had moved to Austin due to work obligations and had bought a house there in need of repair. *Id.*, at 801. During a break in the arbitration, the arbitrator complained to the homeowner about the price of Vignette stock. *Id.*

After the arbitrator issued an award in the contractor's favor, the homeowner mentioned the exchange about Vignette stock to his attorney, who promptly deposed the arbitrator and filed an application to vacate the award based on evident partiality. *Id.* The trial court vacated, but Court of Appeals reversed, finding that the homeowner waived his right to complain about any alleged anti-Vignette bias when he did not object during the arbitration. *Id.*, at 804-805. The logical basis for disclosure is to allow the parties themselves to decide whether to complain about potential conflicts, says the Court, so parties can and often will "waive an otherwise valid objection to the partiality of the arbitrator despite knowledge of facts giving rise to such an objection." *Id.*, at 804. Again, parties in specialized cases will often hire expert arbitrators in the are who will therefore be will-known to the parties.

The Kendall court's analysis is in line with *TUCO*, and based on the factual record as presented in the opinion it is difficult, as an arbitrator and as an attorney who represents clients in arbitration, to believe that the price of Vignette stock had anything to do with the arbitrator's decision. However, it seems worth considering the burden the Court places on parties to arbitrations left alone in rooms with arbitrators. In order to preserve his complaint, the party here, during a pending arbitration, would have been required to make an objection to an off-hand remark in what is supposed to be a less-formal proceeding. On the other hand, had the remark evidenced serious and relevant bias, perhaps immediate objection would seem a more reasonable expectation (The actual complained-of comment was the question of whether Vignette stock was "ever going to go up." *Kendall Builders*, 149 S.W.3d at 801.).

4. 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. TEX. CIV. PRAC. & REM. CODE §171.088(a)(2).

Determining whether or not an arbitrator has exceed 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." *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). 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." *Id*. 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. *Id*. 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." *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). 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. Id. In other words, the clause need not specifically give the arbitrator authority to act; it must simply not specifically prevent the arbitrator from acting. 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.).

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. *Barsness v. Scott*, 126 S.W.3d 232, 241-42 (Tex. App. - San Antonio 2003, pet. denied). 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. *Id*. In other words, 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 exceed 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. *Hoggett v. Zimmerman, Axelrad, Meyer, Stern & Wise, P.C.*, 63 S.W.3d 807, 811 (Tex. App. - Houston [14th Dist.] 2001, no pet.). 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. *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).

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, and this paper will touch on this idea later.

5. No Agreement to Arbitrate

Finally, the TAA allows a party to seek vacation of an arbitral award on the grounds that no agreement to arbitrate exists, the issue was not adversely determined under Subchapter B, and the party did not participate in the arbitration hearing without raising objection. TEX. CIV. PRAC. & REM. CODE §171.088(a)(4). Subchapter B is the subchapter of the TAA which controls disputes over whether or not a dispute is arbitrable that arise at the beginning of an arbitral proceeding. So, for 171.088(a)(4) to apply, a party would object to arbitration, the objection would be overruled at the outset, the party would participate in the arbitration under objection, and the party would move to vacate the award within ninety days of the award.

While this scenario is plausible, most disputes (and there are lots) as to a dispute's arbitrability occur at the outset. A court's refusal to compel arbitration under the TAA is an immediately appealable interlocutory order. TEX. CIV. PRAC. & REM. Code §171.098. Therefore, numerous reported opinions exist concerning trial courts' refusals to compel arbitration. The arbitrability analysis, however, is similar to the vacatur analysis, in that the strongest argument one can make at either point in the process must be based in the language of the arbitration clause itself.

6. Public Policy as a Grounds for Vacating an Arbitral Award Under Texas Law

As has been noted above, Texas law allows a court to vacate a Texas arbitration award (i.e. one that does not fall under the auspices of the Federal Arbitration Act) if the award contravenes public policy. *CVN Group, Inc. v. Delgado*, 95 S.W.3d at 237-38. However, the Texas Supreme Court makes such a remedy quite difficult to obtain: "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." *Id.*, at 239. The example the Court uses comes from a 1936 case in which the Court refused to confirm an award which enforced a gambling debt. *Id.*, at 237. So, under *CVN Group* at least, it is clear than a party ought to be able to vacate an arbitration award which supports an illegal activity.

The *Action Box* Court is careful to note that arbitral errors of contract interpretation, even if clear, "do not begin to approach such a fundamental policy contravention." *Action Box,* 130 S.W.3d at 253. Similarly, the *Crossmark* Court makes it clear that the public policy ground for vacatur cannot be used to complain of arbitral errors in applying the law: "any alleged errors by the arbitrators in applying the substantive law are not subject to review in the courts." *Crossmark*, 124 S.W.3d at 435. "Because Crossmark's arguments at most raise issues as to the application of law, as opposed to presenting fundamental public policy arguments, the trial court could not have set aside the arbitrators' award." *Id.* In other words, just as it is within an arbitrator's power to be wrong so long as he or she is wrong on an issue properly before him or her, it is also no violation of the public policy of the State of Texas to make mistakes of contract construction or in the application of the law to the facts.

7. Modifying an Arbitral Award Due to Evident Miscalculations

Upon proper application by a party, a court must modify or correct an award if the award contains an evident miscalculation of numbers or an evident mistake in the description of a person, thing, or property referred to in the award. TEX. CIV. PRAC. & REM. CODE §171.091(a)(1).

In a 1994 opinion, the Houston Court of Appeals considered a challenge to an arbitral award that the challenging party claimed made errors of arithmetic on the arbitrators' part in assessing liquidated damages. *City of Baytown v. C.L. Winter, Inc.*, 886 S.W.2d 515, 519 (Tex. App. - Houston [1st Dist.] 1994, no writ). However, the *Baytown* court refused to modify the award in the absence of a transcription of the arbitration proceeding: "we do not know what evidence the arbiters considered in making their award, and the award on its face does not reflect a miscalculation." *Id.*, at 520. In other words, if you are arbitrating a case involving a lot of arithmetic, you may well want to have the proceedings recorded.

The *Crossmark* court refuses to modify an award on the basis of a claimed miscalculation when the party to the arbitration requesting the modification also requested, during the arbitration, that the arbitrators employ his methodology with respect to calculation. *Crossmark*, 124 S.W.3d at 436. Based on these facts, the Court found the arbitral math to be a concerted decision to not adopt a party's proposed calculation, as opposed to an error. *Id.* The miscalculation ground for modification of an award, therefore, clearly seems to apply only to legitimate errors in arithmetic, and not to arbitral decisions as to the proper measure of damages, even if those decisions may seem unusual or unfair (in *Crossmark*, for example, the arbitrators refused to

discount an accelerated liquidated damages payment to present value of the funds, awarding instead in one lump sum all payments that were to be paid out over ten years originally - this may not in fact have been unusual or unfair, but even if it were it would not be grounds for modifying an award).

8. Practice Note on Standard of Review

More than one of the above-cited vacatur cases involves a party, after the final arbitral award, filing an action to vacate or confirm an award, and then moving for summary judgment, asking the court to vacate or confirm or specifically not to vacate. This is not necessary, and it in fact is not a great way to achieve either vacatur or confirmation of an award. The *Crossmark* Court explains the rule:

> The [Texas General Arbitration] Act provides that an application under the Act is heard in the same manner and on the same notice as a motion in a civil case. . . . Thus, applications to confirm or vacate an arbitration award should be decided as other motions in civil cases; on notice and an evidentiary hearing if necessary. Summary judgment motions are not required for the trial court to confirm, modify or vacate an arbitration award. However, if a party chooses to follow summary judgment procedure rather than the simple motion procedure authorized by the Act, it assumes the traditional burdens and requirements of summary judgment practice.

Crossmark, 124 S.W.3d at 430. While this may not normally be a dispositive difference, given that the remarkable judicial deference given to arbitral decisions makes the standard of review skewed in favor of the award in any case, it can be.

As discussed above, the *Mariner* Court was bound by summary judgment standard, as opposed to TAA standards, which shifted the burden of proof and proved to be dispositive. *Mariner*, 79 S.W.3d at 32.

B. Vacating or Modifying Arbitral Awards Governed by the Federal Arbitration Act

1. The Grounds for Vacating or Modifying an Award

The Federal Arbitration Act ("FAA") sets forth several independent grounds under which a court may vacate an arbitral award:

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

(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.

9 U.S.C. §10(a).

The Fifth Circuit has accepted manifest disregard of the law as an additional, non-statutory basis by which a court may vacate an arbitral award. *Brabham v. A.G. Edwards & Sons, Inc.*, 376 F.3d 377, 381 (5th Cir. 2004) (discussing the history of the Circuit's jurisprudence on this issue). 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." *Prestige Ford v. Ford Dealer Computer Services, Inc.*, 324 F.3d 391, 396 (5th Cir. 2003). Both manifest disregard and public policy grounds for vacatur are, like most grounds for vacatur under either Texas or Federal law, construed quite narrowly.

The Fifth Circuit does not, however, accept arbitrariness and capriciousness as a nonstatutory ground for vacatur in FAA cases, though some federal circuits do.[1] *Brabham*, 376 F.3d at 382-85. "In the interest of establishing clear and deferential standards of review, however, we must avoid hashing the existing grounds for vacatur into analytical bits, only to see those bits take on a life of their own and inexorably overwhelm the deference accorded arbitration awards." *Id.*, at 385-86 (paraphrasing, by the Court's own admission, Goethe).

Finally, like the TAA, the FAA provides for modification of an erroneous award:

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[1]A caveat exists: arbitration awards arising from the terms of a collective bargaining agreement may be vacated if arbitrary and (or?) capricious in the Fifth Circuit. *Brabham*, 376 F.3d at 382. The arbitrary and capricious ground stems from Section 301 of the Labor-Management Relations Act, 29 U.S.C. §185, a statutory ground independent of the FAA, and thus not from Fifth Circuit common law, and so it does not apply to cases decided under the FAA. *Id.*

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.

9 U.S.C. §11.

The general standard of review a court in the Fifth Circuit employs when considering a motion to vacate an award under either the FAA or one of the non-statutory grounds is well-established and severe: "We 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." *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'"). 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. *Kergosien v. Ocean Energy, Inc.*, 390 F.3d 346, 357 (5th Cir. 2004).

2. Award Procured by Corruption, Fraud or Undue Means

Upon proper application by a party, a court may vacate an arbitral award procured by corruption, fraud, or other undue means. 9 U.S.C. §10(a)(1). The Fifth Circuit has interpreted this ground for vacatur "as requiring a nexus between the alleged fraud and the basis for the panel's decision." *Forsythe Int'l, S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1022 (5th Cir. 1990). In other words, a party seeking vacatur must allege more than just fraud during the arbitration process; the allegation must link the alleged fraud to the arbitral award complained of. "The requisite nexus

may exist where fraud prevents the panel from considering a significant issue to which it does not otherwise enjoy access." *Id.*

In the Forsythe case, the arbitral panel clearly considered a party's allegations of fraud when making its award. *Id.*, at 1022-23. According to the Fifth Circuit, "the panel effectively ruled that the asserted fraud was immaterial." *Id.* The Court reversed the trial court's vacatur of the arbitral award on the grounds of fraud or undue means. *Id.* at 1023. In other words, when fraud upon the panel is discovered and explored before the rendition of the final award, it will be quite difficult for a party to obtain a vacatur on those grounds.

Interestingly, the Court also notes that the arbitral panel seemed a bit irritated that the parties spent so much time dwelling on the alleged fraud, which seemingly entailed deposition shenanigans (a former employee of a party was represented to be a current employee so the party could exert more control over his deposition). *Id.*, at n.7 ("the neutral arbitrator, however, expressed impatience with protracted diversion from the merits"). As the Court states, "submission of disputes to arbitration always risks an accumulation of procedural and evidentiary shortcuts that would properly frustrate counsel in a formal trial. . . . whatever indignation a reviewing court may experience in examining the record, it must resist the temptation to condemn imperfect proceedings without a sound statutory basis for doing so." *Id.*, at 1022.

A later district court opinion from the Southern District of Texas which the Fifth Circuit later adopted examined fraud and undue influence as grounds for vacating an arbitral award and offered a bit more explanation:

> Under the FAA a party who alleges that an arbitration award was procured through fraud or undue means must demonstrate that the improper behavior was (1) not discoverable by due diligence before or during the arbitration hearing, (2) materially related to an issue in arbitration, and (3) established by clear and convincing evidence. Although "fraud" and "undue means" are not defined in section 10(a) of the FAA, courts interpret the terms together. Fraud requires a showing of bad faith during the arbitration proceedings, such as bribery, undisclosed bias of an arbitrator, or willfully destroying or withholding evidence. Similarly, undue means connoted behavior that is 'immoral if not illegal' or otherwise in bad faith. Section 10(a)(1) also requires a nexus between the alleged fraud or undue means and the basis for the arbitrator's decision.

In the matter of the Arbitration Between Trans Chemical Ltd. and China Nat'l Machinery Import & Export Corp., 978 F.Supp.266 (S.D. Texas 1997), *aff'd* 161 F.3d 314 (5th Cir. 1998) (citations omitted).

3. Evident Partiality or Corruption in the Arbitrators

In its *TUCO* decision, the Texas Supreme Court creates TAA evident partiality jurisprudence, but the Court states from the outset that it is basing its holding on cases interpreting the FAA's identical provision. *TUCO*, 960 S.W.2d at 632. *TUCO*, therefore, while not controlling, is certainly helpful with respect to federal evident partiality analysis, particularly since vacatur cases employing FAA analysis are often heard in state courts rather than federal courts. The *TUCO* Court's holding is based on what it characterizes as "the seminal evident partiality case," the 1968 U.S. Supreme Court opinion in *Commonwealth Coatings*.

Commonwealth Coatings establishes the simple rule that it is the nondisclosure of a potential bias, rather than evidence of actual bias itself, which triggers a potential vacatur under the FAA. *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 147-48, 89 S.Ct. 337, 338-39 (1968). "We can perceive of no way in which the effectiveness of the arbitration process will be hampered by the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias." *Id.*, at 149, 339. Justice White's concurrence explains a bit more the policy rationale for the *Commonwealth Coatings* rule: "it is often because [arbitrators] are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function." *Id.*, at 150, 340 (J. White, concurring). Since arbitrators, unlike judges, function as part of the world in which they make decisions and are chosen because of their prominence in that world, potential conflicts may abound. The solution to this is frankness, so that the parties can decide from the outset whether or not they wish to proceed.

As a slight aside, the Supreme Court's analytical basis for its decision is germane to the overall thrust of this paper: "we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free reign to decide the law as well as the facts and are not subject to appellate review." *Id.*, at 149, 339 There you have it.

A three-justice dissent in *Commonwealth Coatings* argues that vacatur for an arbitrator's undisclosed conflict is too harsh a result when all parties seem to agree that no actual bias or impartiality in the challenged arbitrator's ruling existed. *Id.*, at 152-55, 341-42. As the *TUCO* court explains, some federal circuits have declined to follow *Commonwealth Coatings* or have diluted its mandate. *TUCO*. 960 S.W.2d at 633-34 ("Although Justices White and Marshall joined fully in Justice Black's opinion for the Court, some lower federal courts have purported to see a conflict between the two writings. By treating Justice Black's opinion as a mere plurality, they have felt free to reject the suggestion that 'evident partiality' is met by an 'appearance of bias,' and to apply a much narrower standard.")

In 1987, the Fifth Circuit, in dicta, suggested that it would adopt the Second Circuit's narrower standard of evident partiality analysis: "evident partiality means more than a mere appearance of bias." *Bernstein Seawell & Kove v. Bosarge*, 813 F.2d 726, 732 (5th Cir. 1987) (quoting *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 173 (2d Cir. 1984)). In early 2006, it fully adopted the *Commonwealth Coatings* rule, and in so doing offered a detailed discussion of the history of the current split amongst the circuits with respect to that opinion. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 436 F.3d 495, 502-504 (5th Cir. 2006). As the Court states:

> Having analyzed the case law, we address what standard to apply in this case. This is a nondisclosure case in which the parties chose the arbitrator. Striking the balance of the competing goals of expertise and impartiality in the selection process, maintaining faithfulness to the Court's opinion in *Commonwealth Coatings*, and agreeing with the policy arguments set out in *Schmitz*, we hold that an arbitrator selected by the parties displayes evident partiality by the very failure to disclose facts that might create a reasonable impression of the arbitrator's partiality. The evident partiality is demonstrated from the nondisclosure, regardless of whether actual bias is established.

Id., at 502. **However**, on May 5, the Circuit ordered the case re-heard *en banc*. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 449 F.3d 616 (5th Cir. 2006). Thus, we are in the midst of a seminal moment in the development of Fifth Circuit evident partiality law. In the meantime, frankly, we are unsure as to whether the Fifth Circuit opinion in *Positive Software* applies or whether parties should revert to the pre-May status quo pending the *en banc* rehearing.

Before the Fifth Circuit issued its *Positive Software* opinion, the district court in the Northern District had used the case to adopt the broader rule also adopted by the Texas Supreme Court in *TUCO*. *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp.2d 862, 878-887 (N.D. Texas 2004). That Court held "that in nondisclosure cases, an arbitration award must be vacated where there is a reasonable impression of partiality." *Id.*, at 885. The Court refused to apply the Second Circuit cases adopting a heightened standard, explaining that their rule in large part developed from partiality cases in which the potential conflicts were in fact disclosed. *Id.*, at 883. This distinction seems to be critical: the analytical foundation for evident partiality rulings is the idea that parties ought to be able to choose whether or not to object to a potential conflict. Obviously the standard should be stricter in cases in which the potential conflict was disclosed, and the *Positive Software* District Court maintained a clear distinction.

In nondisclosure cases, therefore, the Northern District clearly rejects the stricter evident partiality analysis which takes place in the Second Circuit and some other federal circuits. Finally, the rule in the Southern District of Texas is perhaps less

clear, as a recent opinion (dealing with facts which would suggest a partially disclosed conflict as opposed to a fully undisclosed conflict) seems to employ something of a mixture of evident partiality tests. *Lummus Global Amazonas, S.A. v. Aguaytia Energy Del Peru, S.R. Ltda.*, 256 F.Supp.2d 594, 622-29 (S.D. Texas 2002).

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

Conveniently, the Fifth Circuit provided clear precedent on the kind of arbitrator misconduct which will support vacatur 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." *Gulf Coast Indus. Workers Union v. Exxon Co., USA*, 70 F.3d 847, 848 (5th Cir. 1995).

In the *Gulf Coast* case, 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. *Id.*, at 848-49. 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. *Id.* at 849. 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. *Id.* 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. *Id.*

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. *Id.* "The arbitrator then spent five pages of his decision in a diatribe on the unreliability of hearsay." *Id.* Relying on Section 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. *Id.*, at 850.

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." *Prestige Ford*, 324 F.3d at 395. 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).

5. The Arbitrator Exceeded His or Her Powers

The Fifth Circuit has also recently explained in some detail the analysis that must take place when a party asks a court to vacate an arbitral award on the basis that the award exceeds the arbitrator's powers. *Kergosien v. Ocean Energy, Inc.*, 390 F.3d 346, 354-55 (5th Cir. 2004). The *Kergosien* case explains that an arbitrator's jurisdiction is defined by both the contract containing the arbitration clause and the parties' submissions, but that a failure to provide a reviewing court with a full record of an arbitration proceeding makes it exceedingly difficult for a court to find in favor of vacatur. *Id.*

> [I]n deciding whether the arbitrator exceeded his jurisdiction, 'any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration.' . . . arbitration should not be denied 'unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.' We held that the decision as to whether or not an issue is arbitrable is for the arbitrator to decide 'if the subject matter of the dispute is arguably arbitrable,' and that courts have no business overruling an arbitrator 'because their interpretation of the contract is different from his.'

Id., at 355 (citations omitted, emphasis in original). This quoted passage leaves little room for doubt as to the limits of any argument that an arbitrator exceeded his or her power in issuing an arbitral award.

An earlier U.S. Supreme Court case explained the operation of this basic rule, when that Court found that, in a case within the parameters of the FAA (more on this below), an arbitration clause combined with the arbitration rules of the National Association of Securities Dealers allowed an arbitrator to award punitive damages in the case, even though 1) New York law specifically prohibited arbitral awards of punitive damages; and 2) the arbitration clause specified that New York substantive law applied to any disputes under the contract. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S.52, 115 S.Ct. 1212 (1995). The FAA, the Court found, trumped New York law prohibiting arbitral punitive damages award, so if the arbitration clause allowed them, the FAA required their enforcement. *Id.*, at 58, 1216. The arbitration clause was silent on the issue, but silence in these cases is significant only to the extent it means that the clause did not specifically prohibit punitive damages. *Id.*, at 59, 1217. see also *Action Indus., Inc. v. United States Fidelity & Guaranty Co.*, 358 F.3d 337, 343 (5th Cir. 2004); *Bridas S.A.P.I.C. v. Government of Turkmenistan*, 345 F.3d 347, 365-66 (5th Cir. 2003).

A recent Fifth Circuit decision held that, even in the face of an arbitrator's obvious abandonment of an arbitration clause's scriptures, a court cannot award vacatur of the eventual award when a party does not formally and properly object to the arbitrator's deviation from the clause. *Brook v. Peak Int'l, Ltd.*, 294 F.3d 668 (5th Cir. 2002). The *Brook* case involved an arbitration administered by the American Arbitration Association ("AAA") pursuant to the AAA's rules and procedures. *Id.* at 670. According to the Court, "parties to an arbitration agreement may determine by contract the method for appointment of arbitrators," and an arbitrator exceeds his or her powers when he or she does not adhere to this contractually determined methodology. *Id.*, at 672. Within this context, the Court writes, "To state that the AAA failed to follow the simple selection procedure outlined in Brook's Employment Agreement is insufficient: the AAA flouted the prescribed procedures and ignored complaints from both sides about the irregular selection process. . . . Because arbitration is a creature of contract, the AAA's departure from the contractual selection process fundamentally contradicts its role in voluntary dispute resolution." *Id.*, at 673.

The Court, therefore, clearly finds that the arbitration award was issued in manner completely outside the scope of the parties' agreement to arbitrate, since the AAA wholly botched the arbitrator selection process. However, even in this blatant case, it does not matter. Even though the parties complained during the selection process, failing to object in formal writing or at the commencement of the arbitration hearing constituted waiver of their potential complaint. *Id.*, at 673-74. The Fifth Circuit, therefore, reversed the district court's decision to vacate the award. *Id.*

At this point it is worth mentioning again a recent Texas Supreme Court case on arbitration, *AdvancePCS*. That case, although it would fall under the scope of the FAA, did not involve a motion to vacate an award under the FAA and does not discuss FAA grounds for vacatur, but the clause itself at issue raises an interesting point. The clause used in *AdvancePCS* reads, in part:

> Any and all controversies in connection with or arising out of this Agreement will be exclusively settled by arbitration before a single arbitrator in accordance with the Rules of the American Arbitration Association. **The arbitrator must follow the rule of law**, and may only award remedies provided in this Agreement.

AdvancePCS, 172 S.W.3d at 605-606 (emphasis added). The Texas Supreme Court has now ordered the parties to arbitrate this dispute. The clause here would clearly allow a post-award vacatur under the FAA (Section 10(a)(4)) in the event that the arbitrator does not "follow the rule of law," since the contract which provides this arbitrator's power contains the limitation. While it is unclear exactly what this means, the unusual requirement that an arbitrator follow the rule of law may well, at least in this specific case, reign in the arbitrator's discretion under the default rule, which is exceedingly

broad and may well encompass decisionmaking that cannot be claimed to be within the confines of the rule of law (see Section II(B)(6), below).

6. Manifest Disregard

As has been noted above, in the Fifth Circuit an arbitrator's manifest disregard for the law warrants vacating an arbitral award. *Brabham*, 376 F.3d at 381. The Court's first opinion on a case involving the government of Turkmenistan provides the most thorough recent discussion of that standard for vacating an award. *Bridas*, 345 F.3d at 363-65.

> Manifest disregard clearly means more than error or misunderstanding with respect to the law. The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing principle but decides to ignore or pay no attention to it. . . . The governing law alleged to have been ignored by the arbitrators must be well defined, explicit, and clearly applicable.

Id., at 363 (*quoting Prestige Ford*, 324 F.3d at 395).

In the Fifth Circuit, courts apply a two-step inquiry into whether or not manifest disregard exists. First, if it is not manifest to the reviewing court that the arbitrators acted contrary to existing law, the award should be upheld. *Id.* Second, even if it is manifest that the arbitrator acted contrary to applicable law, the award should still be upheld unless "it would result in significant injustice, taking into account all the circumstances of the case, including the powers of arbitrators to judge norms appropriate to the relations between the parties." *Id.* Both analytical steps, of course, are to be undertaken under the specter of the "extraordinarily narrow" standard of review that applies to claims for vacatur under the FAA. *Id.*

In a recent Fifth Circuit case, the Court over-ruled a vacatur which had been based on manifest disregard when it found that "the district court improperly substituted its judgment for that of the arbitrator." *Kergosien*, 390 F.3d at 357. The Court explains that the breadth of an arbitrator's discretion with respect to the facts and the law allows an arbitrator to make rulings that are "erroneous," that reflect "serious error," and that involve "improvident, even silly factfinding." *Id.*, at 358 (quoting *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509, 121 S.Ct. 1724 (2001)).

7. Standard for Modifying an Award

As allowed by the TAA, the FAA allows a court to modify an arbitral award under certain circumstances, notably in the even of an "evident material miscalculation." 9 U.S.C. §11. The Fifth Circuit has recently explained this basis for modification: "an 'evident material miscalculation' occurs 'where the record before the arbitrator demonstrates an unambiguous and undisputed mistake of fact and the record demonstrates strong reliance on that mistake by the arbitrator in making his award.'" *Prestige Ford*, 324 F.3d at 396 (citations omitted).

C. Self-Help: making up your own standard of review

None of this has to matter. It is perfectly allowable for parties, who draft arbitration clauses in the first place, to change the standard of review described above in the interest of allowing for a meaningful appeal, or for any other interest I suppose.

A 1995 Fifth Circuit case involved an arbitration clause which provided that "the arbitration decision shall be final and binding on both parties, except that errors of law shall be subject to appeal." *Gateway Tech., Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 996 (5th Cir. 1995). According to the Court, "such a contractual modification is acceptable because, as the Supreme Court has emphasized, arbitration is a creature of contract." *Id.* The clause at issue in Gateway had the legal affect of changing the standard of review with respect to the arbitral award itself, such that it "allow[ed] for de novo review of issues of law embodied in the arbitral award." *Id.*, at 997.

The trial court in *Gateway* refused to conduct the bargained-for de novo review, but the Fifth Circuit did, apparently enjoying the opportunity, for once, to make fun of arbitrators. Specifically, the Court objected to the arbitrator's decision to award punitive damages:

> In an extremely confusing passage, the arbitrator found that punitive damages were justified 'in part for an additional reason not assigned by Claimant, but found by the Arbitrator: that Respondent's attempt to terminate Claimant for default was part of a deceptive scheme in wanton disregard of Respondent's obligations to Claimant.' Beyond this lone, opaque statement, the arbitration award is silent about its rationale for imposing punitive damages against MCI.

Id., at 998. The Court, conducting de novo review, vacates the arbitral award to the extent it awarded punitive damages. *Id.*, at 1001.

The Fifth Circuit examines a similar clause several years later but reaches a slightly different result. *Harris v. Parker College of Chiropractic*, 286 F.3d 790 (5th Cir. 2002). The *Harris* case reiterates that parties are free to change the standard of review and impose meaningful appeals of arbitral awards. *Id.*, at 793. The Court goes

on to find, however, that the phrase "questions of law" is ambiguous, since it "could reasonably be interpreted to encompass solely 'pure' questions of law, or it could be read broadly, to encompass mixed questions of law and fact." *Id.*, at 793-94. The Court interprets the clause against the party who drafted it and adopts the narrower interpretation. *Id.*, at 794.

More recently, the Fifth Circuit revisited both of these cases. *Prescott*, 369 F.3d 491. *Prescott* was an employment case, involving a principal of a private school's claims under Title VII. *Id.*, at 493.

> When the school's relationship with Prescott deteriorated, however, Prescott filed suit. The district court ordered ADR. Mediation occurred, then arbitration; NCS appealed a highly adverse and somewhat dubious award back to the court; NCS appealed to this court; and we are forced to remand for further proceedings. So much for saving money and relationships through alternative dispute resolution. Perfect justice is not always found in this world.

Id. The Prescott arbitration clause required that any dispute be resolved in conformity with the biblical injunctions of 1 Corinthians 6:1-8, Matthew 5:23, 24 and Matthew 18:15-20[2]. *Id.* It also, via a properly executed hand-written addendum, provided that "No party waives appeal rights, if any, by signing this Agreement." *Id.*, 494.

The *Prescott* Court eventually remanded the case to the trial court for an evidentiary hearing to determine what exactly the hand-written appeal provision means. *Id.*, at 498. The Court makes it clear, however, that even this unusual and uncertain addition to the arbitration clause must mean something, so the trial court was wrong to ignore it. *Id.*

IV. CONCLUSION

In Texas, whether the TAA or the FAA applies, it is remarkably difficult to avoid arbitration if an arbitration clause exists anywhere near a dispute, and it's even harder to get a court to vacate an arbitral award; they are, for the most part, unappealable. Given the prevalence of mandatory arbitration in a seemingly unlimited variety of cases, this may well cause practitioners concern. To the extent that we as a judicial system embrace arbitration, we reject the concept of any meaningful review of a determinative decision. It is not alarmist to fear for the future of, among other things, continuing publicly available legal precedent on which we can rely in advising clients.

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[2] As an aside, the arbitrator found that the school violated Matthew, Chapter 18, which in turn superseded the contract language and provided Prescott a remedy not normally permitted under Louisiana law.

This is not, of course, irrevocable. Arbitration clauses can perfectly easily provide for some sort of appellate review (although as a practical matter consumer arbitration involves clauses, such as those in the credit card context, typically offered on a "take it or leave it" basis). Businesses can choose other dispute resolution mechanisms which, while potentially more efficient than a jury trial, still invoke the protections of a court system, such as bench trials.

None of this helps the lawyer who is given a dispute once it's already started, where the arbitration clause has already been agreed to. That lawyer has few options. If he or she fears that an appeal may eventually be desirable, he or she certainly needs to provide a record of the arbitration, but even that decision is a risk: the prevailing party in arbitration is almost certainly guaranteed victory in the event no record exists. Arbitral decisions are inherently more difficult to predict, since arbitrators do not really have to follow the law (put a less cynical way, there is no way to avoid an arbitrator's erroneous legal analysis). Finally, for the party or parties unhappy with an arbitral decision, the best advice may simply be to live with it and cut your client's losses with respect to attorneys' fees unless clear grounds for vacatur somehow exist. Good luck.