

How to Bust or Follow Through With an Arbitration

Advanced Civil Trial Course,
State Bar of Texas, Fall 2008

Mark Trachtenberg
Anne M. Johnson

Haynes and Boone, LLP



Overview

- ◆ **Pre-arbitration litigation**
 - ◆ Procedures for enforcing arbitration clause
 - ◆ Strategies for defeating arbitration clause
- ◆ **Post-arbitration litigation**
 - ◆ Confirmation
 - ◆ Vacatur

Enforcing Arbitration Clauses- Overview

- ◆ **Impact of Governing Law**
- ◆ **Form of Action**
- ◆ **Venue**
- ◆ **Parties Subject to Arbitration**
- ◆ **Time for Seeking Enforcement of Clause/
Waiver**
- ◆ **Summary Judgment-Type Procedure**
- ◆ **Merits: Validity/Scope of Clause/Defenses**
- ◆ **Appellate Review**

Impact of Governing Law

- ◆ **FAA does not confer subject matter jurisdiction.**
- ◆ **For state court proceedings involving clause covered by FAA:**
 - ◆ State law controls procedure
 - ◆ FAA controls substance where state law provides contrary rule.

Form of Action

- ◆ **In state court (TAA or FAA)**
 - ◆ “Application” for Order Compelling Arbitration. *CPRC* § 171.021

- ◆ **In federal court (FAA)**
 - ◆ Stay of litigation. *9 U.S.C.* § 3
 - ◆ Motion to compel arbitration. *9 U.S.C.* § 4.

Venue

- ◆ **State court (CPRC § 171.024)**
 - ◆ Where litigation is already pending.
 - ◆ If no litigation pending, follow rules in CPRC § 171.096.
- ◆ **Federal Court**
 - ◆ Motions to Compel Arbitration should be filed in the district where arbitration is to take place.

Parties subject to arbitration

Six theories may bind non-signatories:

1. incorporation by reference
2. assumption
3. agency
4. alter ego
5. estoppel (equitable estoppel and direct benefits estoppel)
6. third-party beneficiary

Equitable Estoppel

- ◆ **Equitable estoppel allows a non-signatory to compel arbitration against a signatory when the signatory:**
 - ◆ must rely on the terms of a written agreement containing an arbitration clause in asserting its claims against a non-signatory. (5th Circuit and Texas state courts)
 - ◆ raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more signatories to the contract containing the arbitration clause. (5th Circuit only).
- ◆ **Second prong not available in Texas state courts.**
 - ◆ *In re Merrill Lynch Trust Co.*, 235 S.W.3d 185 (Tex. 2007).

Direct Benefits Estoppel

- ◆ **“A non-signatory plaintiff seeking the benefits of a contract is estopped from simultaneously attempting to avoid the contract’s burdens, such as the obligation to arbitrate disputes.”**
- ◆ **Applies when the non-signatory**
 - ◆ pursues a claim **“on the contract”** or
 - ◆ seeks and obtains substantial benefits from the contract.

Time for Filing/Waiver

- ◆ **Test for waiver:**
 - ◆ *Did the party seeking arbitration substantially invoke the judicial process?*
 - ◆ *Was the opposing party prejudiced?*
- ◆ **“Substantially invoke” decided under “totality of circumstances” test, looking at timing, discovery efforts, pleadings, motions, etc.**
- ◆ **Strong presumption against waiver.**
- ◆ **Decision for court, not arbitrator.**

Time for Filing/Waiver

- ◆ ***In re Fleetwood Homes of Texas, L.P.*, 2008 WL 2487094 (Tex. June 20, 2008).**
 - ◆ No waiver despite 8 month delay and limited discovery.
- ◆ ***In re Citigroup Global Markets, Inc.*, 2008 WL 2069835 (Tex. May 16, 2008).**
 - ◆ No waiver despite 7 month jurisdictional battle.
- ◆ ***Perry Homes v. Cull*, 2008 WL 1922978 (Tex. May 2, 2008).**
 - ◆ Waiver where party earlier opposed arbitration, conducted months of discovery, and requested arbitration 4 days before trial.

Step 1 – Party Seeking Arbitration Must Show:

- ◆ **Valid arbitration agreement**
 - ◆ contract meets the general requirements of contract law.
 - ◆ usually can be satisfied by attaching authenticated copy of agreement.
- ◆ **P's claims fall within scope of clause.**
 - ◆ Look to claims and language of clause (broad vs. narrow)

Step 2 – Burden Shifts to Party Resisting Arbitration to:

- ◆ **Raise fact issue as to existence of arbitration agreement, **or****
- ◆ **Raise fact issue on affirmative defense that goes to enforceability of clause (not entire contract); **or****
 - ◆ **e.g., waiver, duress, unconscionability, illusory, fraud**
- ◆ **Show that its claims fall outside the scope of the clause.**

Step 3 – Hearing to resolve any disputed fact issues:

- ◆ **Hearing must be held and issues must be decided “summarily.”**
- ◆ **If court compels arbitration, then it must stay any its proceedings pending the outcome of litigation.**
 - ◆ Abuse of discretion to allow merits discovery, for example.

Separability Doctrine – Who Decides?

- ◆ **For Court:** Defenses that challenge the validity of the agreement to arbitrate only.
- ◆ **For Arbitrators:** Defenses that would void the contract as a whole.
- ◆ **Open Question:** U.S. Supreme Court reserved judgment on who decides the issue of whether any agreement between the alleged obligor and obligee was ever concluded.

Defenses to enforcement (in court)

- ◆ **Illusory** if clause is written in way that made it possible for one party to unilaterally modify or terminate the arbitration agreement.
 - ◆ ***Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir. 2008).**

Defenses to enforcement (in court)

- ◆ Clause is **substantively unconscionable** if, given parties' backgrounds and commercial needs, it is "so one-sided" under circumstances existing at time of execution.
- ◆ Clause is **procedurally unconscionable** if the circumstances surrounding the adoption of the clause were fundamentally unfair.

Other common defenses

- ◆ **Fraud**
- ◆ **Duress**
- ◆ **Waiver**
- ◆ **Lack of consideration**
- ◆ **Condition precedent**
- ◆ **Ambiguity**
- ◆ **Illegality**
- ◆ **Lack of Mental Capacity****

To Resist Pending or Threatened Arbitration:

- ◆ **In State Court (TAA or FAA):**
 - ◆ File Application to Stay Arbitration. CPRC § 171.023.
 - ◆ Shall be tried “promptly and summarily.”
 - ◆ If rejected, the court must order arbitration.
 - ◆ Same venue rules as in Application to Compel
- ◆ **In Federal Court (FAA):**
 - ◆ Seek declaratory/injunctive relief.

Pre-Arbitration Litigation Appellate Review

	TAA State Ct	FAA State Ct	FAA Fed Ct
Order compelling arbitration or stay of litigation	Mandamus	?	Appeal only if remainder of case dismissed
Order hostile to arbitration	Interlocutory Appeal	Mandamus	Appeal

Vacating Arbitration Awards FAQs

- ◆ **What are my chances of success?**
- ◆ **What are permissible grounds for vacatur?**
- ◆ **Can I get expanded appellate review?**
- ◆ **Where and what do I file to vacate an award?**
- ◆ **What are the best approaches when seeking to vacate an arbitration award?**

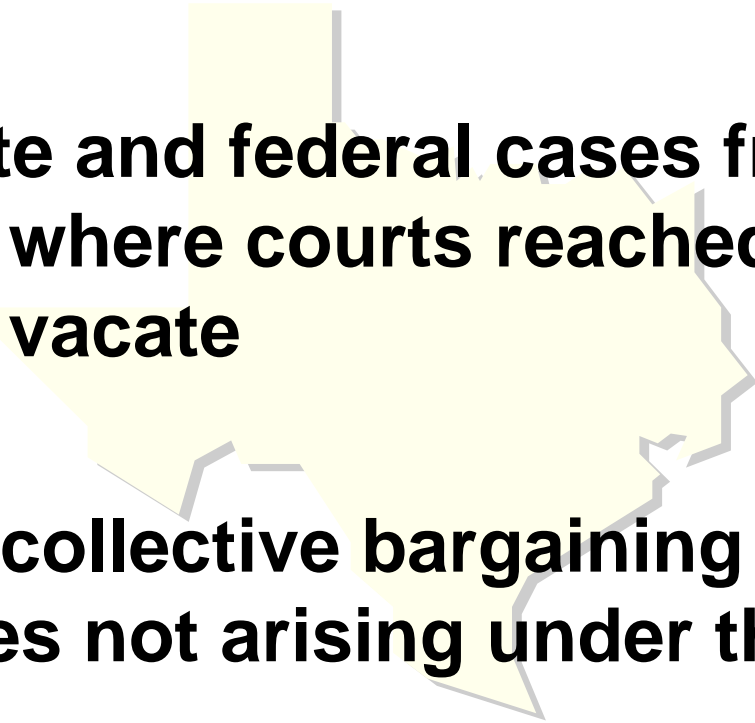
Post-Arbitration Litigation: Likelihood of Vacatur

National study

- ◆ 182 cases; 277 separate grounds asserted
- ◆ Vacatur succeeded 37 times
(20% of cases)
- ◆ 40 of asserted grounds were successful (14%
of total)
- ◆ State courts more likely to vacate than federal
courts (25.8% to 9.7%)

Our Texas - Specific Study

- ◆ **All TX state and federal cases from 1/1/03 to 3/31/07 where courts reached merits of motion to vacate**
- ◆ **Excluded collective bargaining cases and other cases not arising under the TAA or FAA**



Our Texas - Specific Study

- ◆ **38 total cases (state and federal); 59 grounds for vacatur asserted.**
- ◆ **5 vacaturs granted – 13.1% of total cases and 8.5% of total grounds asserted.**
- ◆ **Large disparity between state court and federal vacatur rates (22.7% to 0%).**

Grounds for Vacatur - FAA 9 USC § 10(a)

- ◆ Award was procured by corruption, fraud, or undue means

[Nat'l: 1/13 (7.6%); TX: 0/0]

- ◆ Evident partiality or corruption

[Nat'l: 4/33 (12.1%); TX: 0/3]

Grounds for Vacatur - FAA 9 USC § 10(a) (con't)

- ◆ Arbitrators guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown [Nat'l: 2/12 (16.7%)], or in refusing to hear material evidence, or of any other prejudicial misbehavior [Nat'l: 7/42 (17%)]. [TX: 0/2]
- ◆ Arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made [Nat'l 21/101 (20.8%); TX: 0/7]

Hall Street Assocs., LLC v. Mattel, Inc., 128 S.Ct. 1396 (2008).

- ◆ K'I Clause at issue: “The Court shall vacate, modify or correct any award (i) where the arbitrator’s findings of fact are not supported by substantial evidence, or (ii) where the arbitrator’s conclusions of law are erroneous.”
- ◆ Dist. Ct. vacated arbitration award; 9th Cir. reversed.
- ◆ U.S. Sup. Ct. granted cert. to determine whether parties may contractually expand appellate review

Hall Street: **Freedom of Contract v. Statutory Construction**

Freedom of Contract

- ◆ If judges can add grounds to vacate, so can contracting parties.
- ◆ Arbitration is a creature of contract and should be entirely governed by the parties' agreement.

Strict Statutory Construction

- ◆ FAA grounds “constitute the exclusive grounds for expedited vacatur and modification of arbitration awards pursuant to the provisions of the FAA.”
- ◆ “[T]he statutory text gives us no business to expand the statutory grounds.”

Unresolved Issues after *Hall Street*

Is this the end of judicially-created, non-statutory grounds of vacatur?

- ◆ manifest disregard of the law
- ◆ against public policy
- ◆ arbitrary and capricious
- ◆ completely irrational

Unresolved Issues after *Hall Street*

How does a party “opt out” of the FAA for vacatur purposes?

- ◆ When do parties have the FAA “in mind?”
- ◆ *Hall Street* is on remand. Stay tuned!

Contractually Modified Appellate Review

Only Remaining Options after *Hall Street*:

- ◆ Agree to private arbitral appeal panel
 - ◆ More certainty – still protected under *Hall Street*
 - ◆ More flexibility – can fashion own “**appellate rules**”
 - ◆ More efficiency – can fashion expedited **timeline**
- ◆ Choose forum for confirmation/vacatur

Important Considerations in Vacatur Actions

- ◆ **Venue**
- ◆ **Deadlines for filing**
- ◆ **Onerous Standard of Review**
- ◆ **Error preserved? / State of the “record”?**
- ◆ **Reasoned decision?**
- ◆ **Possibility of sanctions**

Is there any hope for vacating arbitration awards?

Approach #1: Fairness of Process NOT Merits of Award

- ◆ If arbitrator does not disclose facts that might, to an objective observer, create a reasonable impression of the arbitrator's partiality

Burlington Northern Railroad Co. v. Tuco (Tex. 1997)

- ◆ If arbitrator's nondisclosure involves a significant compromising relationship

Positive Software v. New Century Mortgage (5th Cir. 2007, en banc)

Approach #2: Frame Challenges as Arbitrator “Exceeding Powers”

- ◆ Fifth Circuit’s Essence Test: Where the arbitrator acts contrary to express contractual provisions, the award does not draw its essence from the contract
- ◆ Arbitrator exceeds his powers by refusing to strictly apply the law. See *Edstrom Industries, Inc. v. Companion Life Ins. Co.*, 516 F.3d 546, 553 (7th Cir. 2008).

Approach #3: Parties did not have “the FAA in mind at the outset” under *Hall Street*.

- ◆ *Hall Street* is an invitation to search for other sources of authority for enforcing a contract.
- ◆ State Common Law
- ◆ Federal Rule of Civil Procedure 16 – Court’s inherent power to manage litigation.

Thank You!

