

March 13, 2015

The Texas Supreme Court Holds that the Federal Arbitration Act Preempts the Arbitration Requirements in the Texas Medical Liability Act

By [Michael L. Hood](#)

In an opinion that will certainly cause Texas hospitals, physicians, nursing home operators and other healthcare providers to consider whether they should insert standard arbitration clauses into their pre-treatment agreements, the Texas Supreme Court held last week that the Federal Arbitration Act (“**FAA**”) preempts the more stringent arbitration requirements set forth in the Texas Medical Liability Act (“**TMLA**”). *The Fredericksburg Care Co., L.P. v. Juanita Perez et al*, No. 13-0573, 2015 Tex.LEXIS 221, __ S.W.3d __ (Tex. March 6, 2015). Texas providers have hesitated in the past to include the TMLA arbitration clauses in their pre-treatment agreements. They feared that the TMLA’s stringent arbitration requirements would scare off patients. They also feared exposure to liability if they bungled any of its many requirements. The Texas Supreme Court now makes clear that in cases where the FAA preempts the TMLA’s arbitration requirements, courts will enforce standard arbitration clauses in their pre-treatment agreements.

Factual Background

The Fredericksburg Care Company, L.P. (“**Fredericksburg**”) operated a nursing home. Elisa Zapata was a patient. She signed a pre-admission agreement that included an arbitration clause stating:

Any legal dispute, controversy, demand or claim . . . that rises out of or relates to the Resident Admission Agreement or any service of health care provided by Facility to the Resident shall be resolved exclusively by binding arbitration. . . and not by lawsuit or resort to court process . . .

The arbitration clause did not comply with the more stringent requirements set forth in the TMLA. Texas enacted the TMLA in 2003 for the purpose of imposing comprehensive tort reform to further the goal of making healthcare more affordable in Texas. One part of the TMLA, section 74.451, applies to agreements to arbitrate healthcare liability claims. The arbitration clause must be in 10-point boldface type, must be signed by the patient’s attorney, and must clearly and conspicuously inform the patient that he/she is waiving legal rights. The arbitration clause must state:

UNDER TEXAS LAW, THIS AGREEMENT IS INVALID AND OF NO LEGAL EFFECT UNLESS IT IS ALSO SIGNED BY AN ATTORNEY OF YOUR OWN CHOOSING. THIS AGREEMENT CONTAINS A WAIVER OF IMPORTANT LEGAL RIGHTS, INCLUDING THE RIGHT TO A JURY. YOU SHOULD NOT SIGN THIS AGREEMENT WITHOUT FIRST CONSULTING WITH AN ATTORNEY.

Section 74.451 further states that a physician who fails to comply with the TMLA’s arbitration requirements violates the Texas Occupations Code, and that a healthcare provider, other than a physician, who fails to comply violates the Texas Deceptive Trade Practices-Consumer Protection Act.

Zapata died while a patient at Fredericksburg. Her beneficiaries sued Fredericksburg in state court for negligent care and wrongful death. Fredericksburg argued to the trial court that the FAA preempts section 74.451 and that under FAA, the court should enforce the arbitration agreement. The FAA establishes a national policy favoring arbitration when the parties contract for that mode of dispute resolution. Under the FAA, an agreement to arbitrate is valid if it meets the requirements of general contract law of the applicable state. The FAA preempts state law restrictions on arbitration that are inconsistent with the FAA.

Both the trial court and the court of appeals denied Fredericksburg's motion to compel arbitration, and Fredericksburg appealed to the Texas Supreme Court.

The Supreme Court Makes Four Preliminary Findings to Support that the FAA Preempts the TMLA's Arbitration Requirements

The Texas Supreme Court started its analysis by making four preliminary findings. First, the Court found that the FAA applied to the arbitration clause. The FAA applies to an arbitration clause in a contract evidencing a transaction involving interstate commerce. The Court found that that the pre-admission agreement affected interstate commerce; therefore, the FAA applied. The federal government paid Fredericksburg Medicare payments on behalf of the deceased patient Zapata which was sufficient to establish interstate commerce. Second, the Court found that the arbitration clause satisfied the FAA requirements. Under the FAA and Texas general contract law, an arbitration clause that is in writing, agreed to by the parties, and covers the claim at issue is enforceable, subject to state law contract defenses. Third, the Court found that the TMLA section 74.451 requires an arbitration clause to have additional elements that the FAA does not require, such as ten point boldface type, specific language warning the patient that he/she is waiving rights, and the patient's attorney's signature on the agreement. Fourth, the Court found that because section 74.451 directly conflicts with the FAA, FAA preemption applies. The Court concluded that it would enforce the arbitration clause unless the Zapata beneficiaries could show an exception to FAA preemption.

The Supreme Court Rejects the Argument that the McCarran-Ferguson Act is an Exception to FAA Preemption

The Zapata beneficiaries argued that there was an exception to FAA preemption, namely, the McCarran-Ferguson Act ("**MFA**"). The MFA is federal law making clear that state law governs the regulation and taxation of the business of insurance. The MFA states:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by a State *for the purposes of regulating the business of insurance*, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. . .
(emphasis added).

Under the MFA, state laws enacted for the purpose of regulating insurance prevail over general federal laws that do not specifically relate to the business of insurance.

The Zapata beneficiaries argued that section 74.451 was state law enacted for the purpose of regulating the business of insurance. They argued that as such, section 74.451 falls within MFA's protection and is an exception to FAA preemption. The issue for the Texas Supreme Court was whether the TMLA section 74.451 was state law regulating the business of insurance.

The Court examined both the TMLA in its entirety and section 74.451 specifically, to determine whether the Texas Legislature enacted them for the purpose of regulating the business of insurance. The Court found that the TMLA was enacted for the purpose of imposing tort reform and placing limitations on healthcare liability claims so that medical malpractice insurers would lower rates for healthcare providers thereby making

healthcare more affordable in Texas. The Court concluded that the indirect effect of cost savings trickling down to patient policyholders and their insurers was only a “tenuous impact” on the business of insurance. The Court wrote, “In fact, the only possible thread tying [the TMLA] to insurance contracts is the aspiration of lower rates, which . . . is not enough to qualify for the MFA’s protection . . .” The Court then examined section 74.451. It found that section 74.451 was enacted to address arbitration of healthcare liability claims between patient and healthcare provider. The Court wrote, “Much like the rest of [the TMLA], section 74.451 has little to do with the relationship between the insurance company and its policyholders.” The Court noted that the Zapata beneficiaries failed to show that section 74.451 is aimed at protecting or regulating the performance of a contract for insurance, either between a healthcare provider and its malpractice insurer, or between the patient and his/her insurer.

The Court held that neither the TMLA nor section 74.451 is for the purpose of regulating the business of insurance; therefore, the MFA does not except them from FAA preemption. The Court remanded the case to the trial court. The trial court is supposed to stay or dismiss the state court lawsuit and order Fredericksburg and the Zapata beneficiaries to arbitrate their dispute.

The Texas Supreme Court Changes the Landscape for Healthcare Liability Arbitration

The Texas Supreme Court’s ruling is an important development for Texas healthcare providers, such as hospitals, physicians and nursing home operators who favor arbitration to resolve healthcare liability claims. Many healthcare providers want to take advantage of arbitration because they believe it controls litigation costs, reduces negative publicity, avoids the risk of a runaway jury award and discourages lawsuits. Before the Court’s recent decision, providers did not want to insert section 74.451 arbitration clauses into their pre-treatment agreements. They were concerned about scaring off patients. Patients get spooked when presented with bold, conspicuous language stating they are waiving important legal rights, or that they need to consult with an attorney who must also sign the agreement. Providers were also concerned that if they bungled the arbitration clause, they could be exposed to liability under the Texas Occupations Act or the Texas Deceptive Trade Practices Act. Many healthcare providers who would have preferred arbitration stayed away from arbitration clauses.

Now the Texas Supreme Court has given healthcare providers some comfort about using standard arbitration clauses, but there are still issues the provider should consider:

- (1) Providers should consider whether their pre-treatment agreements affect interstate commerce which is what invokes the FAA in the first place. The provider needs to be aware that if the pre-treatment agreement does not affect interstate commerce, the FAA does not apply and, as a result, the FAA would not preempt state law arbitration requirements. In the *Fredericksburg* case, the provider established interstate commerce by showing that it received Medicare payments on behalf of the patient.
- (2) Providers should consider whether the arbitration clause satisfies the less stringent FAA requirements, such as the arbitration clause must be in writing, agreed to by the parties, and cover the claim at issue.
- (3) Providers should consider that arbitration clauses, even if they meet the FAA requirements, are still subject to state law defenses. One can imagine a scenario of a patient being treated during an emergency or trauma, and the issue arises whether the patient signed the pre-treatment agreement under duress. Or a scenario where an elderly or very sick patient claims he/she signed the agreement while incapacitated.

- (4) Providers should consider the type of arbitration procedure best suited for disputes expected to arise. Arbitration clauses should spell out the procedure, such as whether the parties will use an arbitration service and its rules, how many arbitrators there will be, how the arbitrators will be selected, and who pays the arbitration costs. If the arbitration clause does not provide guidance on the procedure, the provider and patient might have to go to the courthouse for judicial help administering the arbitration.
- (5) Providers should consider whether arbitration is, in fact, the superior method for resolving disputes. Some providers complain that arbitration is not the panacea it claims to be. There is concern that asking the patient to agree to arbitration is a put off to the patient. Arbitration can be expensive. An arbitrator bills by the hour, and the costs increase if there is more than one arbitrator. The rules of discovery and evidence are relaxed in an arbitration, which means that the arbitrator might hear and be swayed by positions that are not grounded in fact. Arbitrators are generally reluctant to grant summary judgment. There is a limited right to challenge or appeal an arbitrator's award. Errors in an arbitrator's findings of fact or law are generally not grounds to set aside an arbitration award. Some providers believe that with the other TMLA protections in place, such as limits on a patient's recovery for damages, jury trials are preferred over arbitration.

For Texas healthcare providers who desire to arbitrate healthcare liability claims, the Texas Supreme Court's ruling in *The Fredericksburg Care Co., L.P. v. Juanita Perez et al*, is a new development for providers and will cause them to consider whether to include standard arbitration clauses in their pre-treatment agreements.

For additional information, please contact:

Michael L. Hood

214.651.5673

michael.hood@haynesboone.com

Stacy L. Brainin

214.651.5584

stacy.brainin@haynesboone.com

Jeremy D. Kernodle

214.651.5159

jeremy.kernodle@haynesboone.com

Sean McKenna

214.651.5249

sean.mckenna@haynesboone.com

Kenya S. Woodruff

214.651.5446

kenya.woodruff@haynesboone.com