Arbitration-Related Litigation in Texas

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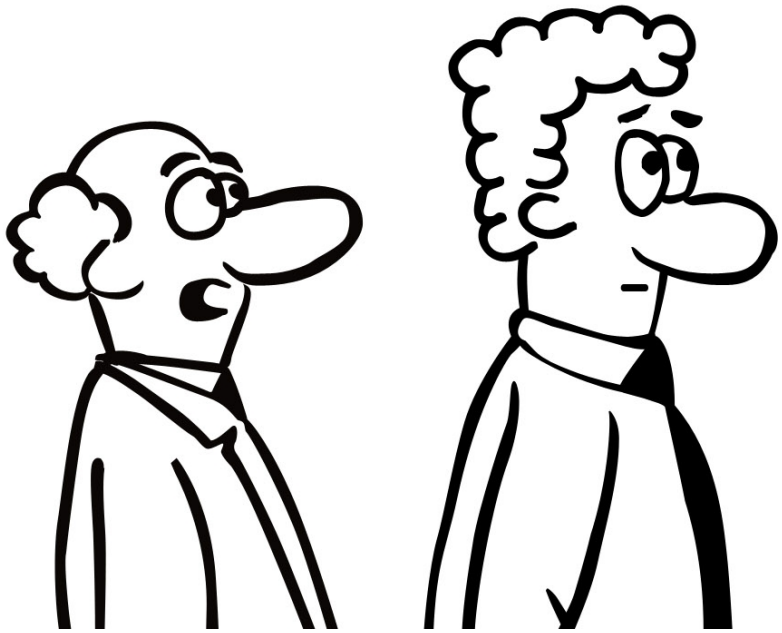
We're here to litigate the arbitration clause that was meant to avoid litigation.



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Overview

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

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Enforcing Arbitration Clauses- Overview

- Governing Law
- Who Decides Enforceability Questions?
- Parties Subject to Arbitration (Non-Signatories)
- Defenses to Enforcement
- Scope of Arbitration Clauses
- Arbitration-Related Litigation in Trial Courts (Summary Judgment-Type Procedure)
- Appellate Review
- Class Arbitration

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Governing Law

- FAA (9 U.S.C. § 1 et. seq)
  - applies to any contract “affecting commerce” as far as the Commerce Clause will reach
- TAA (CPRC Ch. 171)
  - applies broadly to most contracts with limited exceptions

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Governing Law – Choice of Law

- Can opt for FAA (even w/o showing impact on interstate commerce)
- To opt for TAA, must specifically exclude application of federal law.
  - Not enough to say governed by “Texas law” or “arbitration laws in your state”
  - Should reference TAA specifically.

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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.

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Governing Law – FAA Preemption

- FAA preempts only contrary state law, not consonant state law
- Example: FAA preempted TAA, b/c TAA would have rendered agreement that was < $50K and not signed by lawyers as unenforceable
  - *In re Olshan Foundation Repair LLC*, 328 S.W.3d 883 (Tex. 2010)

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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 when there is a challenge to the existence of a contract, but Fifth Circuit and Texas Supreme Courts say courts should resolve these disputes.

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Impact of Delegation Clause

- “Arbitrator, not court, should have exclusive authority to resolve any dispute relating to the interpretation, enforceability, or formation of the Agreement, including any claim that all or part of Agreement is void or voidable.”

- Incorporation of AAA Rules accomplishes the same result.

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Enforceability of Delegation Clause

- SCOTUS: Arbitrator resolves arbitrability dispute unless challenge is to the delegation clause itself.
  - *Rent-a-Center v.* Jackson, 561 U.S. 63 (2010).
- Fifth Circuit: Enforce delegation clause unless argument for arbitration is "wholly groundless."
  - *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488 (5th Cir. 2017) (cert. granted).
- SCOTX: Incorporation of AAA rules does not show clear intent to arbitrate arbitrability when dispute arises between signatory and non-signatory.
  - *Jody James Farms, JV v. Altman Group, Inc.*, 547 S.W.3d 624 (Tex. 2018).

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Non-signatories in arbitration

8 theories may bind or be invoked by non-signatories:

1. incorporation by reference
2. assumption
3. agency
4. alter ego
5. *estoppel*
6. third-party beneficiary
7. parties whose rights are derivative of signatory
8. non-signatories designated as parties in the arbitration agreement.

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Estoppel in Texas Courts

- Direct benefits estoppel – 
- Concerted misconduct estoppel – 
- Intertwined claims estoppel – 
  - Fifth Circuit, in *Erie* guess, said yes
  - Texas COAs split
  - SCOTX – declined to decide
    - *Jody James Farms, JV v. Altman Group, Inc.*, 547 S.W.3d 624 (Tex. 2018).

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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)

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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, illegality
- Show that claims at issue fall outside the scope of the clause.

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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 proceedings pending the outcome of arbitration.
  - Abuse of discretion to allow merits discovery
  - Abuse of discretion to refuse to stay litigation against one D when litigation could moot arbitration of identical claims against D's corporate affiliate. *In re Merrill Lynch & Co.* (Tex. 2010).

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Waiver through Litigation – relevant factors

- whether the party asserting the right to arbitrate was plaintiff or defendant
- how long the party waited before seeking arbitration
- the reasons for any delay in seeking to arbitrate
- how much discovery and other pretrial activity the party seeking to arbitrate conducted before seeking arbitration
- whether the party seeking to arbitrate requested the court to dispose of claims on the merits
- whether the party seeking to arbitrate asserted affirmative claims for relief
- the amount of time and expense the parties have expended in litigation
- whether discovery conducted would be unavailable or useful in arbitration
    - *RSL Funding v. Pippins*, 499 S.W.3d 423 (Tex. 2016)

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Waiver through Litigation

- Payday lenders initiated criminal charges against their customers by systematically submitting worthless check affidavits to local district attorney's offices. Customers brought class actions against lenders.
- Did lenders waive the right to invoke arbitration clauses in customer contracts?
  - Yes, says the Fifth Circuit.
    - *Vine v. PLS Financial Sevices*, Fed. App'x 800 (5th Cir. 2017).
  - No, says the Texas Supreme Court.
    - *Henry v. Cash Biz, LP*, 2018 WL 1022838 (Tex. Feb. 23, 2018).

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Appellate review

	TAA State Ct	FAA State Ct	FAA Fed Ct
Order compelling arbitration or staying litigation	Appeal from Final Judgment*	Appeal from Final Judgment*	Appeal only if remainder of case dismissed or by permission
Order hostile to arbitration	Interlocutory Appeal	Interlocutory Appeal	Interlocutory Appeal

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Post-Arbitration Litigation - Overview

- Substantive Grounds for Vacatur
  - Statutory (FAA/TAA)
  - Non-statutory
    - Common law
    - Reurging arguments made in opposition to motion to compel
    - Contractual expansion of grounds for vacatur
- Procedural Issues

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FAA Grounds for Vacatur – 9 U.S.C. § 10(a)

- Award was procured by corruption, fraud, or undue means
- Evident partiality or corruption of the arbitrators
- Arbitrators guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear material evidence, or of any other prejudicial misbehavior
- Arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

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TAA Grounds for Vacatur – CPRC § 171.088(a)

- Award obtained by corruption, fraud, or other undue means
- Rights prejudiced by evident partiality of arbitrator, corruption in an arbitrator, or misconduct or willful misbehavior of an arbitrator
- Arbitrators exceed their powers, refused to postpone the hearing after a showing of sufficient cause, refused to hear material evidence, or conducted a hearing contrary to the TAA or in a manner that substantially prejudiced a party's rights

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Additional TAA Ground (not in FAA)

- "If there was no agreement to arbitrate, the parties were not compelled by the court to arbitrate, and the party opposing the arbitration did not participate in the hearing without raising the objection"

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Bottom line

- Limited to extremely narrow grounds, calling into question basic procedural fairness of proceeding
- Mistake of law is not enough
- Reviewing court may not substitute its judgment for that of the arbitrator merely because it would have reached a different result

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Tests for Evident Partiality

- Texas Supreme Court "*Tuco*" test: If arbitrator does not disclose facts that might, to an objective observer, create a reasonable impression of the arbitrator's partiality.

- Fifth Circuit test: If arbitrator's nondisclosure involves a significant compromising relationship.

- The Texas "Tuco" standard applies in state court, even under agreements governed by FAA

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Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC, 437 S.W.3d 518 (Tex. 2014)

- $125M arbitration award vacated under *Tuco* standard
- 9-0 opinion from Justice Guzman reversing the Dallas COA and reinstating the trial court's vacatur
- Key issue is whether losing party was on inquiry notice of facts giving rise to appearance of partiality through arbitrator's partial disclosure.

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Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC, 437 S.W.3d 518 (Tex. 2014)

- What arbitrator disclosed:
  - Nixon Peabody (representing one party to the arbitration) had recommended him as an arbitrator in three other arbitrations
  - He was a director of a litigation services company, but disclosures noted that “NP and Lexsite have done no business, and it is not clear that NP would have any business to give NP”
  - He attended a meeting at NP to solicit business for Lexsite

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Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC, 437 S.W.3d 518 (Tex. 2014)

- What arbitrator failed to disclose:
  - All of his contacts at the 700-lawyer firm were with the two lawyers that represented the party to the arbitration at issue
  - He owned stock in Lexsite
  - He served as the president of the Lexsite's US subsidiary, conducting significant marketing for the company
  - He had additional meetings or contacts with the two lawyers in question to solicit business from the firm
  - He allowed one of the two lawyers to edit his disclosures to minimize the contact.

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Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC, 437 S.W.3d 518 (Tex. 2014)

- Held that "[t]aken together, this undisclosed information might cause a reasonable person" to view the arbitrator as being partial towards the NP lawyers to gain their favor for securing business for Lexsite
- Rejected Ponderosa's argument for an intent-based, subjective test
- Rejected "inquiry notice" argument adopted by the Dallas COA. A party may waive an evident partiality challenge only by proceeding to arbitrate based on information it knows, not information it is unaware of.

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Karlseng v. Cooke, 346 S.W.3d 85 (Tex. App.—Dallas 2011, no pet.)

- Vacated a $22 million award where the arbitrator, a former judge, had a decades-long social relationship with one of the attorneys, received valuable gifts and meals from the attorney, and yet the two presented themselves as “complete strangers” at the arbitration hearing

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Other Arbitrator Nondisclosures Warranting Vacatur

- Business relationship with a party
- Acceptance of substantial referral from the law firm of non-neutral co-arbitrator
- Prior adverse relationship with a party's expert witness
- Attorney-client relationship with a trade association to which a party belonged

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Other Arbitrator Nondisclosures Warranting Vacatur

- Another attorney in arbitrator's law firm represented a parent company of one of the parties
- Party representative had appeared before arbitrator in a prior arbitration
- Involvement in a prior arbitration that concerned the same issues of contract interpretation and damages calculations

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Not Enough, at Least in Fifth Circuit

- More than 7 years earlier, arbitrator served as co-counsel with one of the party's attorneys in a prior unrelated litigation

- An award cannot be vacated based on a ***trivial or insubstantial*** prior relationship between the arbitrator and parties to the proceeding
  - *Positive Software Solutions v. New Century Mortgage Corp.,*476 F.3d 278 (5th Cir. 2007) (en banc).

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Arbitrators “Exceed Their Powers”

- Arbitrators “exceed their powers” when they decide matters that are not properly before them or their award is not rationally inferable from the parties agreement.

- Look to scope of arbitration agreement (broad or narrow?), factual allegations, submission agreement and pleadings to determine what parties agreed to arbitrate.

- Does not include misinterpretations of contract or misapplication of law.

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Arbitrator Exceeded His Powers Where He:

- Ordered parties to allocate costs and fees among the parties in direct contravention of the agreement, which required that costs and fees be borne by non-prevailing party
- Assessed all his fees against the client in an attorney-client dispute, when the engagement agreement expressly provided that the cost of arbitration would be split 50%-50%
- Ordered a remedy outside the specific remedies contemplated in the arbitration agreement

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Arbitrator Exceeded His Powers Where:

- Arbitrators chosen in a manner inconsistent with the parties' agreement.
- Arbitrator resolved dispute between signatory and non-signatory that should have been adjudicated by trial court.
- Parties agreed to arbitrate only issues in an exhibit to arbitration agreement and arbitrator decided a question outside the agreement
- Agreement stated firm would be dissolved and award did not dissolve firm

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Common Law Vacatur Grounds?

- Not for agreements subject to the TAA.
  - *Hoskins v. Hoskins*, 497 S.W.3d 490 (Tex. 2016).
- Not for agreements subject to the FAA, at least in the Fifth Circuit.
  - *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349 (5th Cir. 2009).
- Still available for agreements not governed by the TAA, such as collective bargaining agreements.
  - *Jefferson County v. Jefferson County Constables Ass'n*, 546 S.W.3d 661 (Tex. 2018).

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Re-urge Arguments Made in Resisting Motion to Compel

- **State Court:** If motion to compel granted and case stayed, party resisting arbitration can raise arbitrability challenges on appeal after final judgment entered.
- **Federal Court:** Depends if case is stayed or dismissed following grant of motion to compel. If stayed, raise arbitrability challenges in appeal from final judgment. If dismissed, take immediate appeal.

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Vacaturs based on expanded review clauses

1. If the parties opted into TAA, and
2. If the parties expand grounds for vacatur by contract,
   - "Arbitrator shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error."
3. Then, you can challenge award under "exceed their powers" statutory ground.

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Procedural considerations for filing vacatur

- Deadlines for filing
- Forum
- Final decision?
- Error preserved?
- State of the “record”?
- Reasoned decision?
- Possibility of sanctions

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Thank You!

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