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IN THIS ISSUE

Pros and Cons of Arbitration 1
Bret Madole and Laura Hebert

Five Practical Things to Consider, If You Include an Arbitration Clause in Your Contract 1
Ken Carroll

Enforcing Your Arbitration Agreement: Where and How 2
Ken Carroll and Neil Burger

Can I Appeal a "Rogue" Arbitration Award?. 3
Lyndon Bittle

Supreme Court of Texas Clarifies Class Arbitration Issues. 5
Brent Rubin

Five Practical Things to Consider If You Include an Arbitration Clause in Your Contract

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If you've decided you want to arbitrate disputes relating to your contract or business arrangement, here are five practical things you ought to consider covering in your arbitration agreement, things that most people don't think about until it's too late:

1. Pick the right arbitration service. Many business arbitrations nowadays are conducted by the American Arbitration Association. But yours doesn't have to be. You can choose to use the AAA, and that brings with it a number of advantages, including established

continued on page 6

Pros and Cons of Arbitration

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Arbitration is a method for resolving legal disputes without going to court. Where parties are similarly situated, they may specify by agreement whether disputes will be arbitrated and, if so, how the arbitration will be conducted. At other times, one party may require that disputes will be arbitrated as a condition to doing business. Lawyers are frequently asked which is better: arbitration or litigation? The answer, of course, is "It depends." This edition of the *Capital* newsletter is devoted to arbitration, addressing some of the issues that most frequently arise and starting with a very brief summary of factors to be considered.

Cost

Perhaps the most the common reason for choosing arbitration is the belief that it will cost less than litigation. This may or may not be true. For a large employer that requires its employees to arbitrate disputes, mandatory arbitration likely would result in cost savings for the employer. But what about two parties to a commercial contract that requires arbitration? Attorneys' fees and the costs of discovery can be – but are not always – substantially lower in arbitration. What if the parties disagree on whether their dispute is subject to mandatory arbitration, as is often the case? The cost of litigating this initial question may eat up any savings that might otherwise have resulted from arbitration. Ultimately, if the parties can reach agreement on the questions of whether and how to arbitrate, arbitration can be less expensive than going to court. But absent such agreement, cost savings may not materialize.

For tips on keeping arbitration costs down and avoiding a dispute about whether to arbitrate, see the articles "Five Practical Things to Consider If You Include an Arbitration Clause in Your Contract" and "Enforcing Your Arbitration Agreement: Where and How."

Control

The general perception is that arbitration gives the parties greater control over the proceedings than they would have in court. Parties to arbitration may be able to select an arbitrator in whom both sides have confidence, whereas litigants do not get to select their judge. However, the arbitration parties are not always able to select the arbitrator or to mutually agree on an arbitrator. Sometimes the parties will not even be able to control how many arbitrators will hear their dispute, which can obviously affect the cost of arbitration. Moreover, once the arbitrator is selected, the arbitrator may have more discretion in fashioning the outcome than a judge has in a court case. Additionally, whereas trial results can usually be challenged on appeal, a party may not be able to appeal an unfavorable arbitration result. For more on this subject, see "Can I Appeal a 'Rogue' Arbitration Award?" in this issue.

continued on page 2

Privacy and Transparency

Weighing heavily in favor of arbitration for some is the privacy it affords to the parties involved. Unlike court records and trial proceedings, which are usually accessible by the public, arbitration is private, and the parties are typically under an obligation of confidentiality. For parties who put a premium on privacy, the confidential nature of arbitration can be enough to outweigh any advantages that a trial may have.

Formality

Arbitration proceedings can be relatively informal compared with a trial. The rules of evidence and procedure, which often make trials and trial preparation long and complicated, do not apply, and the setting is typically less formal. Arbitrations may proceed without, or with greatly reduced, formal discovery or depositions, which can lead to faster and less expensive resolution. The flip side of the informality is that the rules of evidence and procedure that apply to a trial have been worked out carefully over many years to try to ensure fairness to all parties. Without them, one or both sides may feel they did not get a fair hearing. An experienced and competent arbitrator can go a long way toward making the process fair to all parties.

Time

Many consider time as a critical advantage of arbitration, especially when compared with litigation, as arbitrators are often able to hear cases and render their decisions much more quickly than the courts. However, this may not necessarily be true. To cite an extreme example, in a partnership dispute where the partnership agreement required mandatory arbitration by a three-member arbitration panel, the panel did not render a decision for almost three years after the arbitration hearing. The parties might very well have saved themselves time and money if they had litigated.

As discussed here and as further shown in this issue of the *Capital* newsletter, the realities of arbitration can be very different from common perceptions and deciding whether to arbitrate can be a complicated decision. ■

Enforcing Your Arbitration Agreement: Where and How

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A dispute has arisen between you and one of your customers, employees, or someone else with whom you do business. Worse, your opponent has opened the hostilities by suing you in state or federal court. You believe there's an agreement that requires the dispute to be resolved in arbitration. But how do you enforce that agreement? And where, in what forum? Thinking about these issues and planning ahead in preparing and executing an arbitration agreement can help avoid uncertainty and costly delays in getting your dispute resolved as you intended.

Who decides "arbitrability"—that is, whether your dispute will be decided by the arbitrators or by a court?

When parties disagree about whether a matter must be arbitrated, there are two "gateway issues" that must be resolved at the outset: (1) whether there is an arbitration agreement, and if so, (2) whether the dispute at issue is covered by that agreement. But who decides those "gateway issues"? It's a tougher question than you might think.

Generally speaking, both "gateway issues" and any sub-issues are presumed to be questions for the court to decide before it will compel the parties to resolve their dispute in arbitration. But both federal and Texas state courts recognize that, because arbitration is favored and is a creature of contract, the parties can alter this normal procedure in their arbitration agreement. That is, they can agree to have the arbitrators, rather than the court, determine questions of "arbitrability."

Obviously, there's a bit of a chicken-and-egg problem: How can arbitrators be authorized to determine arbitrability if there's a question about whether there should be any arbitration (or arbitrators) in the first place? Most jurisdictions, state and federal, have resolved this logical conundrum by (1) having the court determine the threshold question about whether there is any arbitration agreement at all, but then (2) allowing the arbitrators to decide all other issues of arbitrability ***if*** there is "clear and unmistakable evidence" that the parties intended to delegate those issues to the arbitrators. Whether there exists such "clear and unmistakable evidence" is itself an issue for the court.

So, how do you make sure your arbitration agreement expresses "clear and unmistakable" intent to delegate questions of arbitrability to the arbitrators and not the court? Probably the most common method, recognized by Texas and federal courts, is to explicitly incorporate by reference into the parties' arbitration agreement the AAA Commercial Rules. That's because Commercial Rule 7 provides that an arbitrator "shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim." Even that approach, however, has its limits. For example, a party may be held to have waived its right to arbitrate if that party has "substantially invoke[d] the judicial process to the detriment or prejudice of the other party" before seeking to compel arbitration. The U.S. Fifth Circuit Court of Appeals very recently held, in I*nternational Energy Ventures Management v. United Energy Group* (2021), that a court and not the arbitrator should decide whether such a "litigation-conduct waiver" has occurred, even where the

AAA rules were incorporated into the parties' agreement. In addition, care must be taken not to make any delegation language subject to "carve-outs" or exceptions—circumstances that have led to lengthy and expensive court battles over who decides issues of arbitrability. Decide for yourself whether to delegate those threshold issues to the arbitrators or leave them with the court. But be clear about your choice. Avoid uncertainty, because that can lead to costly preliminary litigation, rather than quick referral of the dispute to arbitration for resolution on the merits.

Prepare to prove the parties and claims are subject to arbitration.

Once you've established an arbitration agreement exists, you still need to prove that (1) the parties and (2) the claims are subject to that agreement, whether that question is raised before a trial court or the arbitrators. These two inquiries seem simple, but can run into practical real-world problems.

First, what happens if the employee, customer, or other party simply denies that they signed the agreement? Did anyone in your office actually see the person sign it? Was the signature electronic? Where's the original? You can set up fairly simple processes to avoid this proof conundrum and help ensure your arbitration agreement will be enforced.

If you're having parties physically sign the arbitration agreement, be sure to establish an HR protocol that ensures that every person signs at the beginning of the relationship, and then have an employee staffed with the job of collecting each original agreement. These agreements can then either be stored alphabetically in one place or be housed with each person's employment or account file. Knowing where these agreements are stored is essential to efficiently locating each agreement during tight litigation deadlines, should the need arise. If possible, the same person should be in charge of collecting signatures and storing the executed agreements. This allows that person to sign an affidavit "proving up" the agreement—swearing to the court or arbitrators that the arbitration agreement was signed by the employee and filed in the company's ordinary course of business. If you have multiple offices, consider having one central location where all the signed agreements are kept. And, just to be safe, scan all the paper documents for electronic storage in case the hard copy goes missing, can't be found, or is destroyed.

Electronic signatures present their own unique issues. Relying on the Texas Uniform Electronic Transactions Act, the Supreme Court of Texas in *Aerotek, Inc. v. Boyd* (2021) recently bolstered parties' ability to rely on e-signatures and digital agreements, even when one party denies having electronically "signed" such an agreement. (A discussion of *Aerotek*, with a link to the decision itself, is available at *https://dallasappellateblog.com*). Still, how do you prove that the opposing party (and not someone else) actually consented to having their signature electronically placed on the arbitration agreement? As in *Aerotek*, you need to be able to track how the electronic agreement was sent, how it was accessed by the signer, when it was electronically signed, and then where on the computer server it is stored. One way to prevent someone from later denying they electronically executed the agreement is to forward the fully executed agreement by email back to the person after they've signed it. If they don't object at that time, it will be harder for them to deny the electronic signature in the future.

Remember, courts will not necessarily rely on affidavits from an HR employee explaining the customary practices that the business takes when onboarding an employee or vendor. Just because it's the *usual* practice to have someone sign an arbitration agreement on their first day doesn't necessarily prove this particular person signed the agreement, especially if that person denies that they did. You need to set up a provable system that allows you to establish that each employee signed the arbitration agreement, whether by hand or electronically.

Last, the claims asserted in the dispute must fall within the scope of the arbitration provision. Here, the drafter of the agreement can be its best proponent. Both Texas law and federal law strongly favor arbitration and presume that an agreement to arbitrate exists. Therefore, broad language that encompasses all possible disputes between the parties will likely prevail, even if the particular dispute was not foreseen at the time the arbitration agreement was signed. Once the claims asserted touch on the parties' agreement—such as "all claims arising between the parties"—the trial court lacks discretion to refuse to compel arbitration. And if the court doesn't compel, you can seek immediate appellate relief, a remedy the party opposing arbitration does not have if the case is sent to the arbitrators by the court. ■

Can I Appeal a "Rogue" Arbitration Award?

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You agreed to arbitration, and thought the hearing went well. Sometime later, you receive the arbitrators' decision and ask, "What were they thinking? This can't be right. They're wrong on the law and the facts. Can I appeal?" To determine whether, and on what grounds, you can appeal an unfavorable arbitration award, the first step is to review the agreement that approved arbitration as a means of settling disputes. That agreement may control whether the scope of an appeal is governed by the Federal

continued on page 4

continued from page 3 - Can I Appeal a "Rogue" Arbitration Award?

Arbitration Act (FAA), the Texas Arbitration Act (TAA), or an appellate panel of the organization that administered the arbitration, such as the American Arbitration Association (AAA). And that decision can affect the odds of a successful appeal.

Any discussion of arbitration appeals begins with the FAA, which governs most commercial contracts affecting interstate commerce. Under the FAA, as interpreted by the United States Supreme Court, arbitration awards are presumed to be final and enforceable, except in rare circumstances. Specifically, a court may vacate an award:

(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 Supreme Court has held these are the only grounds for vacating an arbitration award, and they cannot be supplemented by agreement of the parties, thus rendering appeals of most arbitration awards toothless. For example, in *Hall Street Associates, LLC v. Mattel, Inc.* (2008), the parties agreed that a district court "shall vacate, modify, or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous." The Supreme Court held this provision unenforceable because it purported to expand the scope of review beyond the statutory grounds. The Fifth Circuit subsequently interpreted *Hall* as barring "manifest disregard of the law," a long-recognized common law ground for reversing arbitrations, as a basis for review under the FAA. And the Fifth Circuit has defined "evident partiality" to mean an arbitrator's failure to disclose a "significant compromising relationship."

For matters governed by the TAA, the potential grounds for appeal are only slightly more liberal. In *Nafta Traders, Inc. v. Quinn* (2011), the Texas Supreme Court held that *Hall* did not control the meaning of virtually identical language in the TAA. Specifically, the Court held "the TAA permits parties to agree to expanded judicial review of arbitration awards." Moreover, the Court held the FAA did not prevent state courts from enforcing the parties' agreement to expand judicial review of an award governed by the TAA. In addition, Texas applies a somewhat broader definition of "evident partiality" than the Fifth Circuit. And the Texas Supreme Court has not resolved whether common-law grounds for challenging arbitration awards are preempted by the TAA.

Given these differences, how do you know whether your agreement is governed by the federal or state rules? Unless an agreement explicitly provides otherwise or a statutory exception applies, the FAA governs arbitration provisions in any "contract evidencing a transaction involving commerce," which has been interpreted quite broadly. And where the FAA applies, it overrides conflicting provisions of state law, including the TAA. Contracting parties may, however, choose to have their agreement governed by state law, provided they use language leaving no doubt as to their intention. It is not enough to provide that the agreement is "governed by Texas law." The Texas Supreme Court and the Fifth Circuit have held the FAA does not apply where a contract explicitly requires that disputes be resolved "in accordance with the Texas General Arbitration Act."

As noted, choosing to have an agreement governed by the TAA might result in a somewhat expanded scope of review. Are other options available if the parties want to ensure greater review of arbitration awards for legal or factual errors? In recent years, in response to concerns by many parties of the lack of effective relief for serious errors by arbitrators, several major organizations, including the AAA, JAMS, and CPR (the International Institute for Conflict Prevention & Resolution), have developed internal procedures for review by a panel of senior arbitrators. Because the appeal is internal to the organization and does not affect judicial review, it can be available in agreements governed by the FAA or TAA. This review is available, however, only if the original arbitration agreement includes provisions invoking the internal appeals process. According to the AAA, its "rules permit review of errors of law that are material and prejudicial, and determinations of fact that are clearly erroneous." And it touts that its appellate process "can be completed in about three months, while giving both sides adequate time to submit appellate briefs." An appeal is treated as a new proceeding, requiring additional fees.

Here's the rub: How do you know when negotiating an agreement requiring arbitration of disputes whether you or your adversary will be the one searching for grounds to appeal an arbitration award? Protecting against "rogue" awards could make arbitration more attractive. But making appeals more available or effective could undermine one of the primary purposes of arbitration—an efficient means of resolving disputes. There is no simple answer to this question, but these issues should be considered whenever an arbitration agreement is contemplated. Be careful what you ask for. ■

The Supreme Court of Texas Clarifies Class Arbitration Issues

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The Federal and Texas Rules of Civil Procedure both contain detailed rules addressing whether and how a lawsuit may proceed as a class action. When an arbitration agreement applies to a dispute, and one party seeks to proceed as a class action, additional questions must be answered: First, who decides whether the arbitration can proceed on a class basis—the court or the arbitrator? Second, can the arbitration proceed on a class basis, in light of the parties' arbitration agreement? The Supreme Court of Texas substantially clarified these two issues recently in *Robinson v. Home Owners Management Enterprises, Inc.*, 590 S.W.3d 518 (Tex. 2019). The upshot of *Robinson*, and U.S. Supreme Court decisions on the same issue, is that it will be quite difficult for consumers subject to an arbitration agreement to arbitrate on a class basis.

The Robinsons initially sued their home warranty company—HOME—on an individual basis for failing to promptly and properly correct construction defects. Over the Robinsons' opposition, the trial court sent the parties to arbitration because their agreement with HOME required "unresolved warranty issues" to be arbitrated. Shortly before the arbitration final hearing (the arbitration equivalent to a trial), the Robinsons sought to add class-action claims, alleging HOME routinely demanded overbroad releases as a precondition to fulfilling its warranty obligations. HOME objected to the arbitrator that class claims were not arbitrable. The arbitrator denied HOME's objections, but bifurcated the class claims from the Robinsons' individual claims.

In the trial court, HOME again raised the question of whether the Robinsons could proceed with their class claims in arbitration. The court first decided the court, not the arbitrator, should determine class arbitrability, because the parties had not clearly provided that the arbitrator should decide the issue in their arbitration agreement. The court then determined that the arbitration agreement did not permit class arbitration.

The trial court's decision on "who decides" class arbitrability ran counter to the Texas Supreme Court's 2004 decision in *In re Wood*, 140 S.W.3d 367 (Tex. 2004). In *Wood*, the Court determined that when an agreement submits all disputes to the arbitrator, the arbitrator, not the court, has the power to address class certification issues.

In *Robinson*, the Texas Supreme Court reconsidered Wood's determination of who decides class arbitrability. *Wood* had read *Green Tree Financial Co. v. Bazzle*, a 2003 U.S. Supreme Court case, to require this issue to be submitted to the arbitrator. (U.S. Supreme Court cases were controlling here because the Federal Arbitration Act applied to this arbitration agreement.) But in later cases, the U.S. Supreme Court clarified that *Bazzle* left the question open. Most courts to consider the issue after this clarification determined that unless the arbitration agreement contains "clear and unmistakable" language delegating the issue to the arbitrator, the question of class arbitrability goes to the court.

The Court in *Robinson* overruled *Wood* and held that class arbitrability is a question for the court *unless* it had been delegated to the arbitrator by agreement. Because the agreement between the Robinsons and HOME made no mention of delegating arbitrability issues to the arbitrator, the trial court correctly determined that it had to decide whether the arbitration could proceed on a class basis.

The Texas Supreme Court then turned to whether the trial court properly decided that arbitration could not proceed on a class basis. The U.S. Supreme Court has determined that an arbitration cannot proceed on a class basis unless the parties' contract demonstrates that they agreed to do so. An agreement that is silent or ambiguous on class arbitration does not allow a court to compel arbitration on a class basis. This is because the significant differences between individual and class arbitration cast doubt on an agreement to arbitrate on a class basis. Therefore, for a court to order class arbitration, an agreement must expressly reference class arbitration. In *Robinson*, the agreement was silent on class arbitration, so the Texas Supreme Court concluded the parties had not agreed to arbitrate on a class basis.

Finding no help under their agreement, the Robinsons argued HOME's conduct demonstrated its consent to class arbitration. The Robinsons focused on HOME's decision to first object to class arbitration in the arbitration, only to re-raise the objections in the trial court after the arbitrator ruled against it. The Supreme Court disagreed, explaining that HOME consistently objected to both arbitration on a class basis and the arbitrator's power to determine the issue. The Court emphasized that the Robinsons tried to add their class claims at the "eleventh hour," so objecting to the arbitrator first was reasonable. A different result might obtain if it were feasible to present objections to class arbitration to the court in the first instance but a party failed to do so. ■

continued from page 1 - Five Practical Things to Consider

rules and procedures and a wide selection of experienced potential arbitrators. But there are other organizations that do arbitrations, such as JAMS, formerly known as the Judicial Arbitration & Mediation Services. Or you and your counter-party may be able to agree up front on a private individual arbitrator. Consider the costs and the advantages and disadvantages of each approach in drafting your arbitration agreement.

2. Specify the number of arbitrators. Under the AAA Commercial Rules, if the arbitration agreement doesn't specify whether the dispute is to be heard by a single arbitrator or by a panel, "the dispute shall be heard and determined by one arbitrator, *unless the AAA, in its discretion*, directs that three arbitrators be appointed." To state the obvious, three arbitrators will cost a lot more than a single arbitrator. Having three arbitrators also introduces more challenges in scheduling and in arbitrator selection. You may prefer having a panel of three decide your case, rather than entrusting all decisions to a single arbitrator. But, especially where there is a limited amount in controversy, the parties should make that decision, rather than leaving it to "the AAA, in its discretion."

3. Specify where and how the arbitration will be held. If your company is headquartered in Dallas, but you have customers or business relationships with persons and entities across the country, you probably want to specify that the arbitration will be held in Dallas, in accordance with Texas law. As may seem obvious, not only will that reduce your arbitration costs, it may also help ensure more consistent results. Further, knowing they will have to travel to Texas to arbitrate may dissuade some of your opponents from pursuing the process. So, you should specify that in your agreement, rather than leaving the "locale" of the arbitration to the AAA or the arbitrator. But the nation's recent experience during the COVID-19 pandemic has added a wrinkle. The value of specifying a Dallas "locale" for your arbitration—to say nothing of the quality of the parties' presentations, including witness testimony—may be diminished if the arbitration is conducted "virtually," by Zoom or some other remote-communication platform. So, consider adding a requirement that at least the final hearing in the arbitration will be conducted in person in the specified locale, and not remotely through some electronic platform, unless all parties agree otherwise when it comes time for that hearing.

4. Be specific about attorneys' fees. Under the "American rule" followed in most court cases in the United States, each side in a lawsuit pays its own attorneys' fees, unless (i) there is a statute that provides for an award of fees, usually to the prevailing party, or (ii) the contract between the parties does so. The AAA Commercial Rules, however, arguably introduce a twist. Rule 47(a) says the "arbitrator may grant any remedy that the arbitrator deems just and equitable," and Rule 47(d) specifically allows for "an award of attorneys' fees if all parties have requested such an award." At least on their face, these provisions don't adhere to the American Rule requiring a statutory or contractual basis for a fees award. You should carefully consider how you want fees to be handled by an arbitrator, including perhaps specifying in your agreement that the parties agree fees may not be awarded by the arbitrator under AAA Rule 47 other than as authorized by statute.

5. Don't go international if you don't need to. The AAA's international arm is the ICDR—the International Centre for Dispute Resolution. It offers capabilities suited to international arbitrations, such as multilingual staff. But its administrative costs are higher than standard AAA costs. Cases will be shifted to the ICDR if the parties are from different countries, if much of the contract is performed outside the United States, or for several other reasons. Often, however, even when the technical bases for involving the ICDR are triggered, the parties do not need the ICDR's additional resources—for example, when one party is a U.S. company and the other is incorporated in Canada or Mexico but operates largely from a U.S. facility, and all dealings between the parties have been and will be in English. Consider specifying in your arbitration agreement that any arbitration will be administered by the AAA or JAMS, and not the ICDR, to try to avoid unnecessary fees. In the same vein, you might consider including an agreement that all arbitration fees and expenses will be split equally between the parties, at least pending the final award. Otherwise, you may find yourself saddled with a fee schedule (for example, the AAA employment dispute schedule) that provides for fees and expenses to be paid largely or entirely by the business. ■

WHAT LEGAL ISSUES ARE IMPORTANT TO YOU?

We want to know what's on your mind. Let us know what legal topics you would like to read about in the next issue of the *Capital Newsletter*. Please send an email to Laura Hebert (*lhebert@ccsb.com*).