Planning for Arbitration of Disputes under Texas Law

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> *"[S]hort of authorizing trial by battle or ordeal or, more doubtfully, by a panel of three monkeys, parties can stipulate to whatever procedures they want to govern the arbitration of their disputes; parties are as free to specify idiosyncratic terms of arbitration as any other terms in their contract."* Varavati v. Josephtal, Lyon & Ross, Inc., *28 F.3d 704, 709 (7th Cir. 1994)*

Parties often view arbitration as a concept distinct from litigation. For commercial disputes, however, arbitration and litigation have several similarities. Each is a form of dispute resolution; each employs a neutral to resolve differences, whether factual or legal; and, each depends upon rules that are (generally) developed before the dispute arises. And when all is said and done, at least one party is going to be unhappy with the result because, like litigation, arbitration is a zero-sum game: at the end of the day someone loses.

But there are important differences. As the quote above illustrates, arbitration provides the parties with flexibility to choose how the arbitration will be conducted. Unfortunately, parties seldom give sufficient consideration to how arbitration will work; instead, they rely on "cookie cutter" form arbitration provisions that may not be right for their situation. Consequently, their image of arbitration as a non-litigation panacea that will save time and money in the event of future disputes is often shattered when they realize that they put too little thought into how to shape resolution of those future disputes. That lack of planning often causes arbitration to cost more than, and take longer than, the default litigation would have required.

This paper provides an overview of the law of arbitration and identifies some considerations for deciding whether arbitration might be an appropriate dispute resolution vehicle for a particular situation and how to shape an arbitration framework if it is. The paper will also discuss special considerations for the drafter of an arbitration clause when the parties' transaction is international.

I. **Overview**. Before parties can decide whether arbitration is right for them, they have to understand the general principles behind arbitration.

A. Governing law. One of the questions for drafting an arbitration provision is what law will govern the arbitration agreement. There are two sources of governing statutory law for arbitrations: state and federal.

1. State – Texas Arbitration Act ("TAA"). TEX. CIV. PRAC. & REM. CODE ANN. ch. 171.

2. Federal – Federal Arbitration Act ("FAA"). 9 U.S.C. The FAA governs suits pending in state court when the dispute concerns a "contract evidencing a transaction

involving commerce." *Perry v. Thomas*, 482 U.S. 483, 489 (1987). In some instances, the FAA will pre-empt application of state arbitration statutes, but only if the state law conflicts with the FAA's purpose of "enforcing the parties' contractual obligation to arbitrate." *In re MacGregor (FIN) Oy*, 126 S.W.3d 176, 181 (Tex. App.—Houston [1st Dist.] 2003), *mandamus conditionally granted sub nom. In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005) and *opinion vacated in part*, 174 S.W.3d 419 (Tex. App.—Houston [1st Dist.] 2005); *see also Volt Info Sciences, Inc. v. Bd. of Trustees*, 489 U.S. 468, 477-78 (1989).

a. Scope. The FAA reaches all contracts "relating to" interstate commerce. *Fredericksburg Care Co., L.P. v. Perez*, 461 S.W.3d 513, 517 (Tex. 2015), reh'g denied (June 26, 2015); *In re FirstMerit Bank*, 52 S.W.3d 749, 754 (Tex. 2001) (orig. proceeding). A strong federal policy favors arbitration of disputes and enforcement of arbitration clauses. As a result, the FAA is applied to the fullest reach of the commerce clause. *Allied-Bruce Terminix Co. v. Dobson*, 513 U.S. 265, 277 (1995); *In re McGregor*, 126 S.W.3d at 182.

b. Application. The FAA preempts contrary state law that renders unenforceable an otherwise enforceable arbitration agreement. *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 779-80 (Tex. 2006) (orig. proceeding). State legislatures may not create defenses that specifically target arbitration agreements, even if they reach other, non-arbitration settings. *Kindred Nursing Center LP v. Clark*, 581 U.S. ____ (2017). Another significant difference between the TAA and FAA is the scope of appellate review between the two statutes. Ultimately, if the arbitration clause is enforceable under the FAA, "an analysis of enforceability under the [TAA] is unnecessary." *In re McGregor*, 126 S.W.3d at 181; *see also In re Anaheim Angels Baseball Club, Inc.*, 993 S.W.2d 875, 877 n. 1 (Tex. App.—El Paso 1999, orig. proceeding [mand. denied]).

c. Convention Act. International arbitration falls under Chapter 2 of the FAA, known as the "Convention Act." That act governs an agreement or arbitral award arising out of a commercial relationship, unless the relationship does not have a reasonable relation with one or more foreign states and is entirely between citizens of the United States and does not involve property, performance or enforcement abroad. 9 U.S.C. § 202. With the Convention Act, the United States confirms enforcement of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 ("New York Convention"), 9 U.S.C. § 201, and creates original, federal question jurisdiction over the disputes. 9 U.S.C. § 203. The Convention Act also creates removal jurisdiction. 9 U.S.C. § 205.

3. Parties may also need to consider common law, which co-exists with the state and federal statutory schemes. *See, e.g., L.H. Lacy Co. v. City of Lubbock*, 559 S.W.2d 348, 350 (Tex. 1977); *see also Monday v. Cox*, 881 S.W.2d 381, 385 (Tex. App.—San Antonio 1994, writ denied). In 2015, the Supreme Court of Texas set aside common law grounds for vacatur in cases governed by the TAA and suggested that those grounds are exclusive. *Hoskins v. Hoskins*, 497 S.W.3d 490, 494 (Tex. 2016). But the Court failed to address prior holdings, such as *CVN Group, Inc. v. Delgado*,

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