THE (SURPRISINGLY COMPLEX) ART OF DRAFTING ARBITRATION CLAUSES

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The (Surprisingly Complex) Art of Drafting Arbitration Clauses

By
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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 person to resolve differences, whether factual or legal; 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 differences. Despite the increasing frequency with which parties contract to arbitrate their potential disputes, rather than litigate them, parties rarely give sufficient consideration to how that arbitration will work. 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. In arbitration, parties lose many of the procedural safeguards provided by the judicial process. *See, e.g. Glazer's Wholesale Distr. v. Heineken USA, Inc.*, 95 S.W.3d 286 (Tex. App.—Dallas 2001), *judg't vacated and remanded by agreement* (Tex. July 3, 2003). This paper will provide an overview of the law of arbitration and identify some considerations for attorneys who counsel clients about whether arbitration might be an appropriate dispute resolution vehicle for their relationship and how to shape their arbitration framework. It will also discuss special consideration 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 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 (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)In re McGregor, 126 S.W.3d 176,

181 (Tex. App.—Houston [1st. Dist.] 2003), rev'd in part, In re Kellogg, Brown & Root, Inc., 166 S.W.3d 732 (Tex. 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. *In re FirstMerit Bank*, 52 S.W.3d 749, 7654 (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). The other 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]).

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).

B. Enforceability of Arbitration Clauses. Procedural decisions regarding arbitration most frequently arise when one party is attempting either to avoid arbitration or avoid the result of an arbitration. In Texas state court proceedings, the TAA provides the sole statutory procedure for enforcing arbitration clauses, even if the FAA governs the parties' agreement. *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 266, 268-69 (Tex. 1992) (orig. proceeding). As a result, state law, rather than federal law, applies when analyzing procedural and substantive issues. *Id.*; *In re McGregor*, 126 S.W.3d at 181. By statute, there are two required showings: (1) an agreement to arbitrate; and (2) the opposing parties' refusal to arbitrate. TEX. CIV. PRAC. & REM. CODE ANN. § 171.021. Additionally, the movant must show that the claims to be arbitrated fall within the parties' agreement. *Menna v. Romero*, 48 S.W.3d 247, 250 (Tex. App.—San Antonio 2001, pet. dism'd) (TAA); *In re FirstMerit Bank*, 152 S.W.3d at 783 (FAA).

1. Existence of an agreement to arbitrate. Arbitration is, with some exceptions, a creature of contract. Procedural issues typically arise when one party either claims that it is not a party to an enforceable arbitration agreement, or the party claims that while it agreed to arbitrate some disputes, it did not agree to arbitrate this dispute. Consequently, both the state and federal acts first require a showing that the parties actually agreed to arbitrate a particular dispute.

a. State contract law principles determine whether the parties contracted to arbitrate their dispute, even under the federal act. *In re AdvancePCS Health, L.P.*, 172 S.W.3d 603, 606 (Tex. 2005) (orig. proceeding) (per curiam); *see also In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002) (orig. proceeding). Where the parties have an enforceable choice of law clause, the question of whether the arbitration agreement is enforceable is determined under the selected law. *Russ Berrie & Co. v. Gantt*, 998 S.W.2d 713 (Tex. App.—El Paso 1999, no pet.). The intention to have disputes resolved through arbitration must be expressed with certainty. *Tenet Healthcare Ltd. v. Cooper*, 960 S.W. 2d 386 (Tex. App.—Houston [14th Dist.] 1998, pet. dism'd w.o.j.). Despite the strong state and federal policies favoring arbitration, it remains a creature of contract, so that parties cannot be forced to arbitrate if they have not agreed to do so. Neither the FAA nor the TAA requires parties to sign their arbitration agreements; it is enough that the arbitration clause is written and the parties agreed to it. *In re AdvancePCS*, 172 S.W.3d at 606; 9. U.S.C. § 3; TEX. CIV. PRAC. & REM. CODE ANN. § 171.001(a).

(1) A series of letters may be enough. *Massey v. Galvan*, 822 S.W.2d 309, 315-16 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

(2) An oral agreement may be enough. *L.H. Lacy Co. v. City of Lubbock*, 559 S.W.3d at 348.

(3) An agreement contained in a separate, unsigned document that is incorporated by reference may be enough. *In re Bank One, N.A.*, 216 S.W.3d 825, 826-27 (Tex. 2007) (orig. proceeding) (per curiam); *In re D. Wilson Constr. Co.*, 196 S.W.3d at 781; *Teal Constr. Co./Hillside Villas Ltd. v. Darren Casey Interest, Inc.*, 46 S.W.3d 417, 420 (Tex. App.—Austin 2001, pet. denied).

b. If the party opposing arbitration denies the existence of an agreement, the court shall "summarily decide" that issue. TEX. CIV. PRAC. & REM. CODE ANN. § 171.021(b). Despite using the phrase "summarily decide," which suggests a motion for summary judgment, the court may hold an evidentiary hearing (unlike a true summary proceeding). In fact, the Supreme Court has instructed that if the party opposing arbitration presents evidence in response to the motion to compel, then the trial court must hold an evidentiary hearing. *Jack B. Anglin*, 842 S.W.2d at 269. "Summarily" thus describes the dispositive nature of the hearing and the time allowed for determination. *Trico Marine Servs., Inc. v. Stewart & Stevenson Tech. Servs.*, 73 S.W.3d 545 (Tex. App.—Houston [1st Dist.] 2002, orig. proceeding [mand. denied]). Although the Texas procedure allows for discovery where needed, TEX. CIV. PRAC. & REM. CODE ANN. § 171.086(a)(4), and that procedure extends to cases determined under the FAA, a court errs if it allows merits discovery before determining arbitrability. *In re Houston Pipe Line Co.*, 311 S.W.3d 449 (Tex. 2009).

2. Defenses to Enforcement – these are generally defenses specific to the arbitration provision, rather than to the contract as a whole.

a. Unconscionability. Claims that the agreement to arbitrate is barred by unconscionability must focus on the arbitration provision itself, rather than the entire contract. *In re FirstMerit Bank*, 52 S.W.3d at 756. A claim that the parties' agreement is unconscionable will be resolved by the arbitrator, not the court. These claims are generally difficult to assert, because a party is presumed to have read and understood the arbitration provision, and there is nothing inherently unconscionable about arbitration provisions.

(1) Procedural unconscionability: circumstances surrounding execution or adoption of the arbitration provision itself can be submitted to the court. *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 677 (Tex. 2006) (orig. proceeding).

(2) Substantive unconscionability: fairness of the arbitration provision. Courts disagree here. As an example of unconscionability, the court in Iberia Credit Bureau, applying Louisiana law, held that a contract was unconscionable where it required a customer, but not the cellular service provider, to agree to arbitration. *Iberia Credit Bureau v. Cingular Wireless, L.L.C.*, 379 F.3rd 159 (5th Cir. 2004). *In AT&T Mobility LLC v. Concepcion*, , the Supreme Court held that the FAA preempted a California common law rule that classifies most collective arbitration waivers as "unconscionable." 131 S. Ct. 1740 (2011).

(3) Severance: an illegal or unconscionable provision of a contract may generally be severed so long as it does not constitute the essential purpose of the agreement. *In re Poly–America, L.P.*, 262 S.W.3d 337 (Tex. 2008) (orig. proceeding). As a result, if a portion of an arbitration provision should be severed because of unconscionability or its wrongful effect on statutory rights or remedies, the court should sever this objectionable portion in order to further the arbitration agreement's purpose. *Venture Cotton Co-op. v. Freeman,* 435 S.W.3d 222, 230 (Tex. 2014).

b. Waiver – issue for the court. *In re Bruce Terminix Co.*, 988 S.W.2d 702 (Tex. 1998) (orig. proceeding).; *see also Perry Homes v. Cull*, 258 S.W.3d 580, 586-87 (Tex. 2008) (FAA).

(1) Two prong-test: (1) did the party seeking arbitration substantially invoke the judicial process?; and (2) did the opposing party prove that it suffered prejudice as a result? *Prudential Securities Inc. v. Marshall*, 909 S.W. 2d 896, 898 (Tex. 1995); *Perry Homes*, 258 S.W.3d at 595 (confirming prejudice requirement).

(2) Just like a strong presumption favors arbitration, a strong presumption exists against waiver. It must be intentional, and the party pursuing waiver bears a "heavy burden of proof," while all doubts are resolved in favor of arbitration. *In re Sun Comm's*, 86 S.W.3d 313 (Tex. App.—Austin 2002, no pet.). In fact,

the Supreme Court found waiver for the first time in Perry Homes, after rejecting it in eight prior cases. *Perry Homes*, 258 S.W.3d at 590.

(3) A party cannot commit waiver by failing to initiate a claim against itself. *In re MONY Sec. Corp.*, 83 S.W.3d 279, 284 (Tex. App.-Corpus Christi 2002, orig. proceeding); *In re Bruce Terminix Co.*, 988 S.W.2d 702.

c. Fraud. Fraud claims that invalidate the entire contract are subject to arbitration, while claims of fraudulent inducement of the arbitration agreement may be reserved for the court. *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 56 (Tex. 2008).

d. Lack of consideration/lack of mutuality. *Iberia Credit Bureau, Inc.*, 379 F.2d at 159. Where standalone arbitration agreements are avoidable by one party, a lack of mutuality may make the agreement illusory and the clause unenforceable. *In re AdvancePCS*, 172 S.W.3d at 607. While "take it or leave it" contracts may be adhesion contracts, their arbitration provisions are not necessarily unenforceable as unconscionable. *Id.* at 608.

(1) The FAA can override state statutory schemes and common law. Further, states cannot apply their contract law principles differently to arbitration clauses than they do to other contracts. *Cf. AT&T Mobility LLC v. Concepcion*, 131 S. Ct. at 1746.

(2) For federal statutes, the party opposing arbitration bears the burden of showing a clear congressional intent to override the FAA's mandate in favor of arbitration. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987).

e. Duress. *In Rogers v. Maida*, , the Plaintiff alleged that her employer held her paycheck until she agreed to the arbitration provisions in her employment agreement. *Rogers v. Maida*, 126 S.W.3d 643, 644 (Tex. App.—Beaumont 2004, no pet.)The Court held that this was "some evidence the agreement was produced by duress." *Id.* at 645.

C. Scope of the arbitration clause. This relates to a third element that parties must overcome when proving the existence of an "agreement to arbitrate." Not only must the party seeking arbitration prove that the parties agreed to arbitrate, but also must demonstrate that the parties' dispute falls within the scope of the agreement. *In re Oakwood Mobile Homes*, 987 S.W.2d 571, 573 (Tex. 1999) (orig. proceeding) (per curiam) abrogated on other grounds by I*n re Halliburton Co.*, 80 S.W.3d 566, 572 (Tex. 2002) (orig. proceeding). The Court decides this question as a matter of law. *Id.* at 574, although parties may be able to contract to reserve "scope" determinations for the arbitrator. *Forest Oil Corp.*, 268 S.W.3d at 61

1. Presumptions

a. Broad arbitration clause: a broadly-drafted clause is one that purports to cover all claims, disputes, and other matters relating to the contract or its breach. *American Realty Trust, Inc. v. JPN Real Estate-McKinney L.P.*, 74 S.W.3d 527 (Tex. App.—Dallas 2003, pet. denied). That broad clause creates a rebuttable presumption that the dispute in question falls within the clause and subject to arbitration.

b. Under both FAA and TAA, doubts as to whether a claim falls within the provision are resolved in favor of arbitration. Courts must apply these presumptions to avoid intruding on the merits of the case. *Prudential Securities Inc.,* 909 S.W. 2d at 899.

c. Application. The court considers the terms of the agreement and the factual allegations in the petition. The court does not base its determination upon the legal theories advanced in the petition. *Meyer v. WMCO-GP, L.L.C.*, 126 S.W.3d 313, 316 (Tex. App.—Beaumont 2004), judgment rev'd on other grounds, 211 S.W.3d 302 (Tex. 2006). The court denies a motion to compel only where it can be said with "positive assurance" that an arbitration clause is not susceptible to an interpretation that would cover the dispute at issue. *Prudential Securities Inc.,* 909 S.W. 2d at 899.

2. Related claims

a. Related claims are generally arbitrable if the facts in the petition "have a significant relationship to" the issue that is the subject of the arbitration agreement. *In re Medallion, Ltd.*, 70 S.W. 3d 284 (Tex. App.—San Antonio 2002) (*orig. proceeding*). Again, the court must be able to say with "positive assurance" that a dispute is not covered before denying arbitration. *Prudential Securities Inc.,* 909 S.W. 2d at 899.

b. Where a contract contains a broad arbitration clause, related tort claims arising out of the contract will be arbitrable as well. Thus, if a tort claim is so interwoven with the contract that it could not stand alone, it will be subject to arbitration. *Valero Energy Corp. v. Teco Pipeline*, 2 S.W. 3d 576, 590 (Tex. App.—Houston [14th Dist.] 1999, no pet.). If, however, the facts alleged stand alone, or are completely independent of the contract, and could be maintained without reference to the contract, the claim is not subject to arbitration.

c. Examples of covered claims

(1) Fraudulent inducement: *Prima Paint Corp. v. Flood and Conklin Mfg. Co.*, 388 U.S. 395, 398 (1967).

(2) Anti-trust: *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Co.*, 473 U.S. 614 (1985).

(3) Tortious interference and intentional infliction of emotional distress: *American Employers Ins. Co. v. Aiken*, 942 S.W.2d 156 (Tex. App.—Fort Worth 1997, no writ).

(4) Defamation and DTPA: *Prudential Securities, Inc. v. Marshall*, 909 S.W.2d 896 (Tex. 1995).

(5) Breach of fiduciary duty and conversion: *In re Sun Communications, Inc.*, 86 S.W.3d 313 (Tex. App.—Austin 2002, orig. proceeding).

(6) Personal injury/wrongful death. *In re LaBatt Food Serv., L.P.*, 279 S.W. 3d 640 (Tex. 2009) (agreement contained within employee benefits plan); *In re Jindal Saw Ltd.*, 289 S.W.3d 827 (Tex. 2009).

(7) Wrongful discharge (Sabine Pilot). *In re NEXT Financial Group*, 271 S.W.3d 263, 270 (Tex. 2008) (orig. proceeding) (per curiam).

d. Related Parties. Depending upon the claims and how the arbitration agreement is written, affiliates and subsidiaries of a bound party may also be subject to an arbitration agreement. *In re Macy's Texas, Inc.*, 291 S.W.3d 418 (Tex. 2009) (orig. proceeding) (per curiam).

3. Related parties. Under a theory of equitable estoppel, non-signatories may be bound where they assert claims that rely upon a written agreement that includes an arbitration clause. *WMCO-GP, L.L.C.*, 211 S.W.3d at 319. Non-signatories may also be bound by arbitration agreements when the non-signatory raises allegations of interdependent and concerted action involving another signatory and a non-signatory, or where the non-signatory is a third-party beneficiary of the contract. *Brown v. Anderson*, 102 S.W.3d 245, 249 (Tex. App.—Beaumont 2003, pet. denied); *Nationwide of Bryan Ins. v. Dryer,* 969 S.W.2d 518 (Tex. App.—Austin 1998, no pet.). Moreover, in some instances non-signatories may invoke the benefits of arbitration agreements. *In re Kaplan Higher Ed. Corp.*, 235 S.W.3d 206, 209 (Tex. 2007) (orig. proceeding) (per curiam). The same is true of employees. *In re H&R Block Fin. Advisors*, 235 S.W.3d 177, 179 (Tex. 2007) (per curiam).

D. Deciding Preliminary Issues

1. Arbitrability is generally a question for the court. This determination is typically limited to the questions of (1) whether there is an agreement to arbitrate, and (2) whether the dispute falls within that agreement. Alternatively, questions affecting the contract as a whole are generally reserved for the arbitrator. The most problematic nexus is when a party contends that some contract defense also vitiates the agreement to arbitrate. Courts generally reserve those issues for the arbitrator. The court's concern is whether it can apply state law general contract principles to determine that the parties agreed to arbitrate. This is true under the FAA as well as under the TAA because despite courts determining FAA arbitrability under federal law, courts still apply state contract law to determine whether the parties agreed to arbitrate. In re

First Texas Homes, Inc., 120 S.W.3d 868, 870 (Tex. 2003) (orig. proceeding) (per curiam), see also Iberia Credit Bureau, Inc. v. Cingular Wireless LLC, 159 F.3d at 159 (applying federal law to determine whether court or arbitrator decided unconscionability defense).

2. Although procedural issues are reserved for the arbitrator, courts are split as to how to handle conditions precedent and similar defenses (mediation, demand/notice, opportunity to cure). Some arbitration clauses include notice requirements, or require the parties to mediate their dispute before they arbitrate. Where one party contends that the other failed to comply with the conditions, and thus is not entitled to arbitrate, courts are split as to whether the court or the arbitrator has the obligation to resolve that procedural question. *Valero Energy Corp. v. Teco Pipeline*, 2 S.W.3d 576, 583 (Tex. App.—Houston [14th Dist.] 1999, no pet.). Some appellate courts have determined that the trial court may determine satisfaction of the condition. *D. Wilson Constr. Co. v. Cris Equip. Co.*, 988 S.W.2d 388, 295 (Tex. App.—Corpus Christi 1999, pet. granted, jgmt rev'd w.r.m.); *City of Alamo v. Garcia*, 878 S.W.2d 664, 666 (Tex. App.—Corpus Christi 1994, no writ) (notice requirements); *Weekly Homes, Inc. v. Jennings*, 936 S.W.2d 16, 19 (Tex. App.—San Antonio 1996, pet. denied) (pre-arbitration mediation requirement). Alternatively, some courts have held that the question of whether failure to comply with contractual conditions precedent is reserved for the arbitrator. *City of Lubbock v. Hancock*, 940 S.W.2d 123, 127 (Tex. App.—Amarillo 1996, orig. proceeding); *Kline v. O'Quinn*, 874 S.W.2d 776, 782 (Tex. App.—Houston [14th Dist.] 1994, writ denied); *Valero*, 2 S.W.3d at 583-84; *American Realty Trust, Inc. v. JDN Real Estate-McKinney, L.P.*, 74 S.W.3d 527 (Tex. App.—Dallas 2002, pet. denied); *In re Gardner Zemke Co.*, 978 S.W.2d 624, 627 (Tex. App.—El Paso 1998, orig. proceeding).

3. Other problematic procedural defenses.

    a. Failure of condition precedent in forming the contract, as opposed to a condition precedent to the arbitration provision. *In re Kenwood Communications Corp.*, 2003 WL 1191409 (Tex. App.—San Antonio, Mar. 12, 2003, orig. proceeding [mand. denied]). In *Kenwood*, the party resisting arbitration claimed that there had been a failure of condition precedent in forming the contract. The Court considered this a "gateway" issue for the court's consideration, because it went to contract formation, rather than a condition precedent to arbitration.

    b. Effect of assignment and standing. *Hisaw & Assocs. General Contractor, Inc. v. Cornerstone Concrete Sys.*, 115 S.W.3d 16 (Tex. App.—Forth Worth 2003, pet. denied). In *Hisaw,* the court faced a post-award confirmation argument that the arbitrator exceeded his authority because the claimant had assigned the claim to a third party. The court concluded that the broad form arbitration clause conferred authority to determine the issue on the arbitrator. The question of whether a plaintiff had assigned a cause of action would present a standing question in court. This gateway jurisdictional issue thus became a mere procedural question in arbitration.

E. Appellate review

1. State law. Interlocutory appeal is available for orders that either deny an application to compel arbitration or grant an application to stay arbitration: TEX. CIV. PRAC. & REM. CODE ANN. § 171.098(a); *Rogers v. Maida*, 126 S.W.3d at 644. In short, a party is entitled to an interlocutory appeal of a decision that is contrary to the strong presumption in favor of arbitration.

2. Mandamus review is likely unavailable for orders under the TAA. Several Texas courts have found that mandamus review is unavailable, holding the appeal of an interlocutory order outlined in The Texas Civil Practices and Remedies Code Section 51.016 to be an adequate remedy by appeal. *In re Santander Consumer USA, Inc.,* 445 S.W.3d 216, 226 (Tex. App.-Houston [1st Dist.] 2013, orig. proceeding); *In re H.D. Vest, Inc.,* 334 S.W.3d 333, 334 (Tex.App.-El Paso 2010, orig. proceeding) (denying petition for writ of mandamus because section 51.016 afforded relator appellate review of order denying motion to compel arbitration under FAA); *In re Green Tree Servicing, LLC,* No. 04–12–00277–CV, 2012 WL 1744264 at *1 (Tex. App.-San Antonio May 16, 2012, orig. proceeding) (mem. op., per curiam) (same); *Bashaw v. Republic State Mortg. Co.,* 01-14-00427-CV, 2014 WL 4374121, at *1 (Tex. App.—Houston [1st Dist.] Sept. 4, 2014, no pet.) ("Whether under the Texas Arbitration Act or the Federal Arbitration Act, there is no interlocutory appeal from an order granting a motion to compel arbitration").

3. Federal law

   a. An appeal may be taken if the Court refuses to stay a suit and order the parties to arbitration. 9 U.S.C. § 16(a)(1)(A).

   b. An appeal may be taken if the Court denies an application under 9 U.S.C. § 206 to compel arbitration. 9 U.S.C. § 16(a)(1)(C).

4. Dual proceedings? For years, there was a significant disconnect between the TAA and the FAA, because where a trial court denied an application for arbitration, the party had to pursue both an interlocutory appeal (for TAA) and a mandamus (for FAA). That problem has been corrected. TEX. CIV. PRAC. & REM. CODE ANN. § 51.016 (appeal for FAA proceeding); *Id.* § 171.098 (TAA proceedings).

F. Post hearing procedure. Arbitration awards have the same effect as judgments of a court of last resort, and a court reviewing an award may not substitute its judgment for the arbitrators "merely because the court would have reached a different decision." *Crossmark v. Hazar*, 124 S.W.3d 422, 429 (Tex. App.—Dallas 2004, pet. denied). To reduce cost, post-hearing review should be "expeditious." *Id.*

1. Confirming an award. In the state courts, both FAA and TAA confirmation is governed by TAA procedure. *Jack B. Anglin*, 842 S.W.2d at 268-69. On application, the court must confirm an award unless grounds are offered for vacating, modifying, or correcting the award. TEX. CIV. PRAC. & REM. CODE ANN. § 171.087. A mistake

of law or fact by the arbitrator will not jeopardize an award. *Crossmark*, 124 S.W. 3d at 429. Once the Court confirms an award, the confirming party can take advantage of all enforcement proceedings available for other judgments.

2. Modifying an award

   a. State law: (TEX. CIV. PRAC. & REM. CODE ANN.) § 171.091(a). The grounds are for:

      (1) Evident miscalculation of numbers

      (2) Evident mistake in the description of a person, thing, or property

      (3) May be modified or corrected in a manner that does not affect the merits if the arbitrators made an award with respect to a matter not submitted to them (TEX. CIV. PRAC. & REM. CODE ANN. § 191.091(2), or the form of award is imperfect. TEX. CIV. PRAC. & REM. CODE ANN. § 191.091(3).

      (4) Must be made within 90 days after the day the applicant receives a copy of the award. TEX. CIV. PRAC. & REM. CODE ANN. § 171.091(b)

   b. Federal law –

      (1) Similar to TAA. 9 U.S.C. § 11.

      (2) The court may substitute its judgment for the arbitrator's if the award would violate public policy.

3. Grounds for vacating an award

   a. State law

      (1) TAA – focuses on the integrity of the process, not the propriety of the result.

         (a) It is insufficient to allege that the relief granted was not available in court. TEX. CIV. PRAC. & REM. CODE ANN. § 171.090.

         (b) Courts must indulge in every reasonable presumption to preserve an award.

         (c) The statutory grounds for vacating an award under the TAA are stated in: TEX. CIV. PRAC. & REM. CODE ANN. § 171.088:

            (A) The award was obtained by corruption, fraud, or other undue means

            (B) The rights of a party were prejudiced by the arbitrator's evident partiality, corruption, or misconduct or willful behavior. *See, e.g. Tenaska Energy, Inc. v. Ponderosa Pine Energy, LLC, 4*37 S.W.3d 518, 524–25 (Tex. 2014). (involving evident partiality claim arising

from arbitrator's failure to disclose the full extent of his business relationship with party's attorneys).

(C) The arbitrator exceeded his powers, refused to postpone a 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 the rights of a party.

(D) 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 an objection.

(d) Where the court vacates an award because the arbitrators exceeded their authority, that issue should be resolved in the court; otherwise, the parties go back to arbitration.

(e) Applications to vacate must be made within 90 days after delivery of a copy of the award, or 90 days after the party should have known about the corruption, fraud, or other undue means. TEX. CIV. PRAC. & REM. CODE ANN. § 171.088(b).

(2) Common law. Arbitrations under the TAA may also be set aside on common law grounds. The grounds include:

(a) Awards violating a "carefully articulated" fundamental public policy. *CVN Group, Inc. v. Delgado*, 95 S.W.3d 234, 239 (Tex. 2002).

(b) Fraud, misconduct, or gross mistake in the decision that implies bad faith and failure to exercise honest judgment. *J.J. Gregory Gourmet Servs. v. Antone's Import Co.*, 927 S.W.2d 31, 35 (Tex. App.—Houston [1st Dist.] 1995, no writ).

b. Federal law

(1) Similar grounds as under TAA (9 U.S.C. § 10)

(a) Award procured by corruption, fraud, or undue means

(b) Evident partiality or corruption in the arbitrators

(c) Arbitrators guilty of misconduct in refusing to postpone the hearing upon sufficient cause shown, refusing to hear material evidence, or any other misbehavior that prejudiced a parties' rights

(d) Arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made

(2) Common law

(a) Can vacate if the award violates public policy or the law.

(b) Manifest disregard for the law by the arbitrators that results in significant injustice to the losing party. *See Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*, 130 S. Ct 1758, 1768, n.3 (declining to decide whether "manifest disregard" survived *Hall Street Associates* as a basis for non-statutory ground for judicial review of arbitration awards; *see also Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008). There is a split among the federal circuits as to whether manifest disregard is a basis for vacatur. The Second, Fourth, Sixth and Ninth Circuits continue to recognize the doctrine. The Fifth Circuit, in *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349 (5th Cir. 2009), held that manifest disregard of the law does not constitute an independent, nonstatutory ground for vacating awards under FAA.

4. Attorneys' fees: The TAA allows the recovery of costs associated with an application to confirm, correct, or modify an award. TEX. CIV. PRAC. & REM. CODE ANN. § 171.092(b). This does not include attorneys' fees, even if the underlying contract calls for the recovery of attorneys' fees. To the contrary, a trial court's award of additional fees constitutes reversible error unless the underlying arbitration calls for additional fees related solely to award confirmation. *Crossmark*, 124 S.W.2d at 436.

II. Drafting considerations

A. What are your goals?

1. Manage the process. Parties often prefer arbitration because it removes some of the vagaries of court-administered dispute resolution. But except in limited circumstances, parties do not know that they will have a dispute. As a result, they rarely devise an arbitration mechanism that is truly tailored to their needs. They can also tailor the available remedies.

2. Reduce cost. This presumes that the parties have developed a system that truly reduces the workload. Of course, they now have to pay one or more neutrals.

3. Avoid juries. This justification may evaporate in Texas with tort reform, depending upon how the pendulum swings.

4. Hire a fact finder with industry experience. In many industries, the parties would prefer to deal with industry experts.

5. Quicker determinations. Parties can almost invariably contract for a quicker resolution than is available in court.

6. Finality. Because arbitration generally is not appealable, when the award is rendered, the case is over.

7. Confidentiality. Arbitration does not have the same issue of sealing public records that are inherent in litigation, other than those related to proceedings to enforce arbitration clauses and enter awards.

B. Parties

1. Who to bind or exclude? Do you want an agreement that binds successors and assigns?

2. Unintended (or intended) third parties?

   a. Parents, subsidiaries, and successors may enforce, or be subject to, arbitration clauses where the claims arise out of the same operative facts and are inherently inseparable from the claims against the affiliate or predecessor.

   b. Third party beneficiaries to a contract may be bound, particularly where they make a claim tied to the contract. *In re Rangel*, 45 S.W. 3d 783 (Tex. App.—Waco 2001, no pet.).

3. Theories (*see In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005).

   a. Incorporation by reference. This can include non-signatories who assert claims that rely upon documents that include arbitration clauses. *In re McGregor*, 126 S.W.3d at 182. A prime example, present in *McGregor*, is a subcontractor.

   b. Assumption. *Mohamed v. Auto Nation USA Corp.*, 89 S.W. 3d 830 (Tex. App.—Houston [1st Dist.] 2002, no pet.) (combined appeal & orig. proceeding).

   c. Agency. *McMillan v. Computer Translation Systems and Support, Inc.*, 66 S.W.3d 477, 482 (Tex. App.—Dallas 2001, orig. proceeding).

   d. Veil-piercing/alter ego: *In re Kellogg Brown,* 166 S.W.3d 732.

   e. Equitable estoppel: the claims against signatories and non-signatories are intertwined. *Grigson v. Creative Artist Agency, L.L.C.*, 210 F.3d 524, 527 (5th Cir. 2000); *In re Koch Indus.*, 49 S.W.3d 439, 447 (Tex. App.—San Antonio 2001, orig. proceeding [mand. denied]).

   f. Third-party beneficiary: *MCI Telecommunications Corp. v. Texas Utilities Elec. Co.*, 995 S.W.2d 647, 652 (Tex. 1999)

C. Forum

1. Choice of law agreements

   a. Phrases such as "the law of the place where the project is located" and "the law of the State of Texas" do not preclude application of the FAA. *See, e.g., In re L&L Kempwood Assocs.*, 9 S.W. 3d 125, 127 (Tex. 1999) (orig. proceeding) (per

curiam); *In re Valle Redondo*, 47 S.W. 3d 655, 660-62 (Tex. App.—Corpus Christi 2001, orig. proceeding).

b. It remains an open question whether an agreement to arbitrate under the FAA may establish the applicability of the federal act without a showing that the transaction affects or involves interstate commerce. *See In re Kellogg Brown & Root*, 80 S.W.3d 611 (Tex. App.—Houston [1st Dist.] 2002, orig. proceeding). Generally parties cannot confer jurisdiction by agreement; for that reason, even where parties contract for FAA jurisdiction, the reviewing court must first determine whether the transaction involves interstate commerce. *See, e.g., J.M. Davidson, Inc. v. Webster*, 49 S.W.3d 507, 515 (Tex. App.—Corpus Christi 2001) (Castillo, J., dissenting); *Russ Berrie & Co. v. Gantt*, 998 S.W.2d 713, 715 (Tex. App.—El Paso 1999, no. pet.); *In re Green Tree Servicing LLC*, 275 S.W.3d 592, 600 (Tex. App.—Texarkana 2008, no pet.).

c. Can you disavow the FAA or TAA? With federal pre-emption, some argue that parties cannot disavow the FAA and its strong preference for arbitration. It is probably easier to avoid application of the TAA.

d. Choice of law – "Qualified Transactions"

(1) Choice of law for "qualified transactions" requires consideration in the transaction of at least $1 million. TEX. BUS. & COM. CODE ANN. § 271.001.

(2) These written agreements by the parties to a "Qualified Transaction" are enforceable:

(a) The selection of the law of a particular jurisdiction to govern an issue in the transaction, if the jurisdiction bears a reasonable relationship to the transaction. TEX. BUS. & COM. CODE ANN. § 271.005(a)(2).

(b) The selection of the law of a particular jurisdiction to govern interpretation of a contract in the transaction, regardless of whether the jurisdiction bears a reasonable relationship to the transaction. TEX. BUS. & COM. CODE ANN. § 271.005(a)(1).

(3) "Reasonable relation" TEX. BUS. & COM. CODE ANN. § 271.004.

(1)(A) Residence

(1)(B) Place of business

(1)(C) Subject matter of transaction

(1)(D) Performance

(1)(E) Negotiation and execution

(1)(F) Subject matter of transaction is related to the governing documents or internal affairs of an entity formed under the laws of that jurisdiction

(2)(A-C) Transaction in which all of the following are true: (A) all or part of the subject matter of the transaction is a loan or other extension of credit in which a party lends, advances, borrows, or receives, or is obligated to lend or advance or entitled to borrow or receive, money or credit with an aggregate value of at least $25,000,000, (B) there are at least three financial institutions or other lenders or providers of credit party to the transaction, (C) that particular jurisdiction is part of the United States, and (D) a party to the transaction has more than one place of business and has an office in that particular jurisdiction

2. Establishing venue.

   a. You may need to fix the place for enforcement as same as the place for performance. That is, if the arbitration is to occur in a particular county, there needs to be some other performance in that county.

   b. Use arbitration clauses to fix jurisdiction or venue. Contractual choice of forum provisions, standing alone, have been held unenforceable under Texas law. This is true regardless of whether the clause limits the available venue choices or designates an improper forum. Restrictions on choice of venue clauses may allow a court to refuse to enforce a forum selection clause, even if the contract selects the governing law of a state other than Texas. This will not, however, restrict parties' ability to employ a forum selection clause to agree to the jurisdiction and venue of another state.

      (1) Because the place of performance is a proper venue, the parties to a contract may contractually direct the place of performance, and thus create a proper venue, but only if the place of performance for venue purposes is the place of performance for obligations under the contract in general.

      (2) "Major Transactions." In 1999, the legislature allowed parties to certain non-consumer transactions, in which consideration was at least $1 million, to select their venue. Thus, parties may contractually select venue. TEX. CIV. PRAC. & REM. CODE ANN. § 15.020(b). Courts cannot enforce permissive or mandatory venues under Chapter 15 that contravene the agreement. *Id.* § 15.020(c).

      (3) Defenses

         (a) Unconscionability

         (b) The provision is voidable under TEX. BUS. & COM. CODE ANN. § 272.001 (construction contracts).

         (c) Venue is established other than under Chapter 15.

D. Arbitration - specific

1. If there is a pending proceeding, an application related to arbitration should be made in that court. TEX. CIV. PRAC. & REM. CODE ANN. § 171.024(a). If there is no pending litigation, an application may be made in any court, TEX. CIV. PRAC. & REM. CODE ANN. § 171.024(b), subject to section 171.096. That section requires filing:

2. In the county in which an adverse party resides or has a place of business

3. In any county, if the adverse party has no place of business or residence in Texas.

4. If the arbitration agreement calls for a hearing in a particular county, then the initial application must be filed in that county.

5. If a hearing has already been held before arbitrators, then the application must be filed in the county where that hearing took place.

E. Number of arbitrators

1. Panel or single? While you save money with a single arbitrator, you also are subject to the vagaries of one person. You might achieve the same result with a jury waiver. *In re Prudential Ins. Co.*, 148 S.W.3d 124 (Tex. 2004) (orig. proceeding).

2. Panel of neutrals? Some agreements allow each party to designate one arbitrator and those two "party arbitrators" will select a neutral. The primary advantage to each side here is that they each have an advocate to directly lobby the "neutral" arbitrator during the award-drafting process. Frequently, the panel chair will request the parties to end *ex parte* communications with their party arbitrator when the neutral is selected but parties may wish to address this contingency. Some arbitral organizations, such as the AAA, require that all arbitrators to a panel are neutrals, unless the parties expressly agree otherwise in their agreement to arbitrate.

3. Identify your arbitrators, or pool of arbitrators, in advance.

4. Selection process. Do you want a "strike" process or a negotiated process?

F. Administrator

1. AAA/ICDR – American Arbitration Association/International Centre for Dispute Resolution

2. CPR (International Institute for Conflict Prevention & Resolution)

3. JAMS

4. ICC (International Chamber of Commerce)

5. LCIA (London Court of International Arbitration)

G. Process. Parties can control how their arbitration progresses.

1. Waiver. Parties often worry about whether they have waived their right to demand arbitration. This most commonly arises when a plaintiff files a lawsuit, and the defendants participate in the litigation before demanding arbitration. Parties may, in their arbitration agreement, define acts that will or will not constitute waiver.

2. Other ADR requirements, such as the requirement that the parties engage in mediation prior to instituting arbitration.

3. Notice requirements / conditions precedent

4. Will you require/bar security for future judgments? TEX. CIV. PRAC. & REM. CODE ANN. § 171.086(d); *In re Noteboom*, 111 S.W.3d 794 (Tex. App.—Fort Worth 2003, orig. proceeding). A court may require a respondent to post security before it will order the parties to arbitration, which acts much like a supersedeas bond.

H. Discovery. For many cases, discovery is the most expensive phase of the litigation. As a result, discovery is the area in arbitration where parties can exercise the greatest cost savings. Parties can limit or define:

1. The number of depositions, length of depositions, types of depositions (individuals, third parties, and corporate representatives), and total time for depositions.

2. Documents to be exchanged and timing for exchange. In some instances, parties must provide documents upon making a demand for arbitration and responding to that demand.

3. Federal-type disclosures (parties, persons with knowledge, documents, damages).

4. Other forms of written discovery, such as interrogatories and requests for admissions.

5. The use of experts, including the time for designation and number of experts.

I. Timing. This is an area where parties do truly notice a difference between arbitration and litigation. In litigation, there are general discovery periods, and some docket control orders set the time for trial and pleading cutoffs. In arbitration, parties have complete control in the planning stages, although they may, as a result of poor planning, forfeit that control. Unfortunately, when parties draft their agreements, they don't know how long they will need. They can, however, set an amount of time, running from a selected date (such as the date the respondent receives notice of the claim) to:

a. Respond to the claimant's demand.

b. Engage in (and presumably complete) discovery.

c. Select a neutral or panel. There are two common types of panels – those selected from a list, and those where each party "names a neutral." If you select the latter,

be careful. The claimant, who knows that a dispute is brewing, has a distinct advantage because it can take longer to select a panelist than can the respondent, who may have only ten or fifteen days to receive notice of a dispute, investigate it, and select an arbitrator.

d. File motions and have them heard.

e. Hold hearings.

J. Evidence. As a practical matter, trying to restrict or define the type of evidence admitted at arbitration is often futile. One of the few errors for which an arbitrator can be reversed is a failure to hear relevant evidence. TEX. CIV. PRAC. & REM. CODE ANN. § 171.088(c). To foreclose this appellate remedy, most arbitrators will admit all evidence offered, so that any objection receives the response "I'll admit it and give it the weight it's due." So, parties may wish to establish the types of evidence admissible for certain narrow disputes (post-closing disputes, for example, may rely solely upon financial statements), but otherwise, trying to define the types of admissible evidence is generally a wasted exercise.

K. Remedies

1. Punitive damages. Many arbitration agreements allow the panel to award actual damages, but not punitive damages. These types of agreements are most common in a party's form contract when it is most frequently the respondent/defendant, such as in the consumer context.

2. Injunctions. Parties may elect to bar arbitrators from granting injunctive relief.

3. Trebling – for example, will arbitrators be allowed to grant quasi-punitive damages available under DTPA or antitrust statutes?

4. Quality of evidence. If punitive or treble damages are available, can they be awarded on a preponderance of the evidence, or must the panel award them based upon some higher quality of evidence, such as the "clear and convincing" standard currently required to award punitive damages in Texas? TEX. CIV. PRAC. & REM. CODE ANN. § 41.003. The parties can also consider whether the panel must unanimously award punitive damages.

5. Fees. The parties must determine whether the arbitrators can award attorneys' fees. Parties are generally free to contract for attorneys' fees as they see fit. *Intercontinental Group P'ship v. KB Home Lone Star L.P.*, 295 S.W.3d 650, 653 (Tex. 2009). For example, a contract that fails to provide reciprocal rights to attorney's fees is not unconscionable *per se*, though a review of all factors surrounding the agreement could support a finding of unconscionability. *Venture Cotton Co-op. v. Freeman,* 435 S.W.3d 222, 233 (Tex. 2014). As a general matter, if the agreement is silent, the arbitrators will defer to general principles governing

attorneys' fees, including those in Texas Civil Practice & Remedies Code Section 38.001.

Parties must also consider whether a court can award attorneys' fees for successfully compelling arbitration or entering an arbitration award to secure judgment. If the arbitration agreement is silent on these issues, the arbitrators and courts generally cannot award these fees to a prevailing party.

L. What type of Award? Parties should consider when drafting their arbitration clauses whether they would prefer the simple or reasoned award. Generally, the simple award simply states that the claimant will recover a stated sum and reads much like a final judgment. In contrast, the reasoned award reads like findings of fact and conclusions of law and details the facts determined by the arbitrator, as well as the conclusions drawn from those facts.

When considering between the two, most parties who find themselves as plaintiff/claimant prefer the simple award, while defending/responding parties prefer the reasoned award. In general, parties perceive that they will have an easier time proving error if the arbitrator or panel of arbitrators states the facts determined and the conclusions drawn from those facts. This may not prove true, however, where errors of law or fact are not reviewable on appeal.

The type of award can be defined by including the clause "the panel shall issue a simple award" or "the panel shall issue a reasoned award, stating its findings and conclusions."

M. Appellate remedies.

While one attractive feature of arbitration is its finality, with limited review, parties are increasingly contracting for appellate review. In some instances, this review is limited to particular issues, or simply expands the court's statutory review. In other instances, parties provide for a complete appeal, to a new arbitration appellate panel.

Federal courts had been split on the question of whether parties can contractually provide for appellate review. Some courts, including the Fifth Circuit, have held that arbitration is a creature of contract, so that parties may freely contract to expand appellate review. *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 996 (5th Cir. 1995). In contrast, courts such as the Ninth Circuit have held that appellate jurisdiction over a private arbitration is created only by statute, so that the parties cannot contract to expand that statutory authority. *Kyocera Corp. v. Prudential-Bache Trade Svcs*, 341 F.3d 987 (9th Cir. 2003). The U.S. Supreme Court resolved this question in *Hall Assocs.*, holding that the parties may not contract to expand the scope of review by the Courts under the FAA. The Texas Supreme Court has reached the opposite conclusion and held that parties may contract to expand the scope of appellate review by the courts. *Nafta Traders v. Quinn*, 339 S.W.3d 84 (Tex 2011).

Parties should consider whether they want the potential extra expense of an appellate remedy, and they should assume that if the remedy is available, it will be used. Then,

they must consider whether they wish to simply expand courts' statutory scope of review, or so they wish to create their own separate appellate arbitration agreement.

N. Alternative: forum selection coupled with jury waiver.

1. Advantages.

   a. Preserves appeal.

   b. Reduces cost.

   c. Fixes venue.

   d. Minimizes pre-dispute litigation.

   e. Preserves ancillary relief.

2. Significant and recent cases to review.

   a. *Morgan v. Bronze Queen Mgt. Co.*, LLC, 14-13-00535-CV, 2014 WL 783782, at *7 (Tex. App.-Houston [14th Dist.] Feb. 27, 2014, no pet.) (enforcing jury waiver, finding that "[c]ontractual jury waivers are permitted under both state and federal law.")

   b. *In re Guggenheim Corp. Funding, LLC*, 380 S.W.3d 879, 884 (Tex. App.—Houston [14th Dist.] 2012, original proceeding [mand. dism'd]) (enforcing jury waiver).

   c. *In re: Int'l Profit Assocs.*, 286 S.W.3d 921 (Tex. 2009) (orig. proceeding) (per curiam) (enforcing forum selection clause). Forum selections clauses will be enforced unless the provision is unreasonable or unjust, the clause is invalid because of fraud or overreaching, enforcement with contravene a strong public policy of the forum where suit is brought, or the selected forum would be "seriously inconvenient" for trial. 286 S.W.3d at 923; *see also In re Int'l Profit Assocs., Inc.*, 274 S.W.3d 672, 675 (Tex. 2009).

   d. *In re Fisher,* 433 S.W.3d 523 (Tex. 2014) (orig. proceeding) (corrected op. on reh'g) (holding that a trial court abused its discretion by failing to enforce a forum selection clause).

   e. *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 130-33 (Tex. 2004) (orig. proceeding) (per curiam)(enforcing jury waiver);

   f. *In re Bank of Am., N.A.*, 278 S.W.3d 342 (Tex. 2009) (orig. proceeding) (*In re Prudential* did not create a presumption against jury waivers).

g. *In re Lyon Fin. Servs., Inc.*, 257 S.W.3d 228, 231 (Tex. 2008) (orig. proceeding) (per curiam) (mandamus relief is available for trial court's failure to enforce forum selection clause).

O. Special Considerations When Drafting an International Arbitration Clause.

The Convention on the Recognition and Enforcement of Foreign Arbitral Award, commonly referred to as the "New York Convention," provides for the recognition and enforcement of arbitral awards in countries that are signatories to the New York Convention. Over 140 countries are signatories, making the New York Convention one of the most successful international treaties. There is no similar treaty for the recognition of judgments. Consequently, arbitration is the most effective means, and some would say only means, of resolving international disputes.

Whether an arbitration agreement is international is determined by the criteria set forth in 9 U.S.C.A § 202. Section 202 states:

> An arbitration agreement or arbitral award arising out of a legal relationship, whether contractual or not, which is considered as commercial, including a transaction, contract, or agreement described in Section 2 of this title, falls under the Convention. An agreement or award arising out of such a relationship which is entirely between citizens of the United States shall be deemed not to fall under the Convention unless that relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states. For the purpose of this section a corporation is a citizen of the United States if it is incorporated or has its principal place of business in the United States.

If the arbitration agreement is international, drafting of the clause presents certain additional considerations. The following discusses some of those considerations:

1. Institutional Arbitration

The threshold determination is whether the arbitration is to be *ad hoc* or institutional (often referred to as administered). An administered arbitration has certain advantages. The institution provides assistance in running the arbitral proceedings and can assist with such matters as organizing hearings, handling communications and arbitrator payments. Other services include appointing an arbitrator if a party defaults and deciding a challenge against an arbitrator. All of these services are done for a fee.

2. Drafting the international arbitration clause for an administered arbitration

a. Use of Model Clause

When institutional arbitration is selected, the starting point for drafting the clause is the institution's model clause. The following are examples of model clauses from two of the more prominent international arbitration institutions.

International Centre for Dispute Resolution (ICDR)

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be determined by arbitration administered by the International Centre for Dispute resolution in accordance with its International Arbitration Rules. The parties should consider adding:
>
> The number of arbitrators shall be (one or three);
>
> The place of the arbitration shall be [city, (province or state), country]
>
> The language(s) of the arbitration shall be ____.'

International Chamber of Commerce (ICC)

> All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.
>
> In each of these examples, the parties by selecting the arbitral institution, have also selected its rules. CAVEAT: Do not select one institution for the arbitration and another institution's rules. In all likelihood, the arbitration clause will be unenforceable.

b. Selecting the Tribunal

When selecting a certain institution to administer the arbitration, a party should be thoroughly familiar with the institution's rules, especially the rules relating to the manner in which arbitrators are to be appointed and to be paid. For example, under the ICC Rules, it is the ICC and not the parties that appoints the chair of the tribunal unless the parties have agreed otherwise. Similarly, if the parties have not agreed upon the number of arbitrators, the ICC will appoint a sole arbitrator "save where it appears . . . that the dispute is such to warrant the appointment of three arbitrators."

c. Selecting the Seat of Arbitration

The ICDR Model Clause suggests that the parties select the place or "seat" of the arbitration. This is a wise suggestion. While the convenience of the parties is one consideration in selecting the seat, it should not be the primary one because most institutional rules provide that hearings can be held anywhere.

Far more than simply a convenient venue, the place of arbitration is the juridical home of the arbitration and has overriding legal consequences. Much thought, therefore, should be given to its selection. While the place or seat of arbitration does not determine the law governing the contract and the merits, it does determine the law (arbitration law or *lex arbitri*) that governs certain procedural aspects of the arbitration not addressed in the institution's rules. For example, the *lex arbitri* will determine the extent of judicial oversight of the arbitral process. In addition, the courts at the seat can be called upon to provide assistance to the arbitration by appointing or replacing arbitrators, by ordering provisional and conservatory measures, or by assisting with the taking of evidence. Conversely, the courts at the seat may also interfere with the conduct of the arbitration by ordering a stay of the arbitral proceedings. Furthermore, it is the courts of the seat that hear challenges against the award at the end of the arbitration. An award set aside at the place of arbitration may not be enforceable elsewhere.

In addition, consideration should be given to whether the seat is located in a country that is a signatory to the New York Convention. By seating an arbitration in a country that is a signatory to the New York Convention, the parties help insure that any award will ultimately be enforceable.

d. Selecting the language

The parties should also select the language of the arbitration. In the international arena, it is possible that documents may be in more than one language and witnesses will testify in uncommon languages. If a language is not selected, the arbitration tribunal typically will make the decision for the parties. While the ICDR Model Clause suggests that it is possible that more than one language be the "official" language of the arbitration, as a practical matter, a single language is preferable.

3. *Ad Hoc* Arbitration

In an *ad hoc* (or non-administered) arbitration, the burden of running the arbitral proceedings falls entirely on the parties and, once they have been appointed, the arbitrators. Because it is not administered, drafting the clause can be particularly challenging.

4. Drafting the *ad hoc* international arbitration clause

For an *ad hoc* arbitration in which the parties have designated a set of rules, the institution's model clause should be used as basis for drafting the arbitration clause. CAVEAT: Some institutions have taken the position that selection of its model clause in an *ad hoc* arbitration is a selection of the institution to administer the arbitration.

a. The UNCITRAL Arbitration Rules

The UNCITRAL Arbitration Rules were designed to be used in *ad hoc* arbitrations and address many of the issues that will arise in an arbitration, including arbitrator replacement. The UNCITRAL model clause provides:

> Any dispute, controversy or claim arising out of or relating to the contract. or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with UNCITRAL Arbitration Rules as at present in force.
>
> Note – The parties may wish to consider adding:
>
> (a) the appointing authority shall be . . . (name of institution or person);
>
> (b) The number of arbitrators shall be . . . (one or three);
>
> (c) the place of arbitration shall be . . . (town or country)'
>
> (d) The language(s) to be used in the arbitral proceeding shall be …

b. Suggested Clause When No Rules are Selected.

In those instances in which the parties have agreed to an *ad hoc* arbitration without designating a set of rules, the IBA Guidelines for Drafting International Arbitration Clauses suggest the following clause:

> All disputes arising out of or in connection with this agreement, including any question regarding its existence, validity or termination, shall be finally resolved by arbitration.
>
> The place of arbitration shall be [city, country]. The language of the arbitration shall be [...].
>
> The arbitration shall be commenced by a request for arbitration by the claimant, delivered to the respondent. The request for arbitration shall set out the nature of the claim(s) and the relief requested.
>
> The arbitral tribunal shall consist of three arbitrators, one selected by the claimant in the request for arbitration, the second selected by the respondent within [30] days of receipt of the request for arbitration, and the third, who shall act as presiding arbitrator, selected by the two parties within [30] days of the selection of the second arbitrator. If

any arbitrators are not selected within these time periods, [the designated appointing authority] shall, upon the request of any party, make the selection(s).

If a vacancy arises, the vacancy shall be filled by the method by which that arbitrator was originally appointed, provided, however, that, if a vacancy arises during or after the hearing on the merits, the remaining two arbitrators may proceed with the arbitration and render an award.

The arbitrators shall be independent and impartial. Any challenge of an arbitrator shall be decided by [the designated appointing authority].

The procedure to be followed during the arbitration shall be agreed by the parties or, failing such agreement, determined by the arbitral tribunal after consultation with the parties.

The arbitral tribunal shall have the power to rule on its own jurisdiction, including any objections with respect to the existence, validity or effectiveness of the arbitration agreement. The arbitral tribunal may make such ruling in a preliminary decision on jurisdiction or in an award on the merits, as it considers appropriate in the circumstances.

Default by any party shall not prevent the arbitral tribunal from proceeding to render an award.

The arbitral tribunal may make its decisions by a majority. In the event that no majority is possible, the presiding arbitrator may make the decision(s) as if acting as a sole arbitrator.

If the arbitrator appointed by a party fails or refuses to participate, the two other arbitrators may proceed with the arbitration and render an award if they determine that the failure or refusal to participate was unjustified.

Any award of the arbitral tribunal shall be final and binding on the parties. The parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made. Enforcement of any award may be sought in any court of competent jurisdiction.

Given the complexities that arise when drafting any arbitration clause, especially an international one, great care and thought

should be directed to drafting the clause. Too many "midnight" clauses result in litigation—the very dispute resolution mechanism the parties hoped to avoid.

As is readily apparent, if the UNCITRAL Model Rules are not selected, the drafter of the arbitration clause is saddled with crafting an entire arbitration procedure.