

**THE SEA ALWAYS CHANGES:
CASE LAW AND LEGISLATIVE UPDATE**

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ALTERNATIVE DISPUTE RESOLUTION SEMINAR
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CHAPTER 1

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Alternative Dispute Resolution Experience arbitrator since the early nineties; participated in hearings lasting several days to several weeks; over the last five years has handled cases including:

served as panel chairman in multimillion dollar dispute involving 80+ parties growing out of the sale of series of interrelated limited partnership interests in high tech ventures which turned on issues of federal and state securities laws, breach of fiduciary duty, and complex accounting claims;

member of three person panel involving claims between former owners and management team under a leveraged buy-out and redemption agreement concerning issues of breach of contract, breach of fiduciary duty, officer and director liability and accounting claims;

sole arbitrator in case involving claims of breach of contract and FDA regulations in the manufacturing of oncology drugs by pharmaceutical firm;

panelist on three person panel to determine "fair value" of dissenting minority interest in bank holding company resulting from "squeeze out" and involving technical issues of appraisal methodology;

sole arbitrator in claims involving breach of contract, fiduciary duty, and accounting between physicians under limited partnership agreement;

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Presentations and Publications

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- January 2006 author, "Consumer Arbitration in Texas," and editor, "Dispute Resolution - Texas Style," 3rd ed., State Bar of Texas, Alternative Dispute Resolution Section;
- September 2005 speaker, "ADR Update and More", Texas Institute for CLE telephone conference;
- July 2005 author, "Arbitration in Banking and Financial Transactions," SAN ANTONIO BUSINESS JOURNAL;
- February 2005 author and speaker, "The Role of the CPA in Arbitration," San Antonio CPA Chapter;
- January 2005 author and speaker, "Use of Arbitration in Real Estate Disputes," San Antonio Bar, Real Estate Section;
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TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	CASE LAW DEVELOPMENTS	1
A.	A New Key Number	1
B.	Cases	1
1.	<u>Disclosure By Arbitrators</u>	1
a.	Positive Software Solutions: The Case Of The Year	1
b.	<i>Pullara</i> : Arbitrator Sued For Failure To Disclose	2
c.	<i>Perry Homes</i> : Enough Disclosure Is Enough	2
2.	<u>Federal Versus State Arbitration Law And Preemption</u>	3
3.	<u>Waiver Of Right To Seek Arbitration</u>	3
4.	<u>Binding The Nonsignatory To An Agreement To Arbitrate</u>	4
5.	<u>Appeal Of Orders Governing Arbitration</u>	4
6.	<u>Scope Of The Arbitrator's Power To Decide Issues</u>	5
a.	Buckeye Check Cashing: Enforcement Of The Contract Is An Issue For The Arbitrator	4
b.	<i>Palm Harbor Homes</i> : Most Issues Of Unconscionability Are For The Arbitrator	5
7.	<u>Review Of Arbitrator's Awards</u>	5
8.	<u>Arbitrator Immunity</u>	5
9.	<u>Foreign Arbitral Awards: Arbitration Goes Global</u>	6
III.	DEVELOPMENTS IN STATUTES AND RULES	6
A.	Statutory Nondevelopments	6
1.	<u>The Revised Uniform Arbitration Act</u>	6
2.	<u>The Arbitration Provisions Of The Residential Construction Commission Act</u>	6
B.	Legislative Agenda For The Coming Year	7
1.	<u>Interlocutory Appeals Under The Federal Arbitration Act</u>	7
2.	<u>Collaborative Dispute Resolution Process</u>	8
C.	Consumer Arbitration Fair Practice Guidelines	8
IV.	CONCLUSION	8
	APPENDIX A	
	APPENDIX B	

TABLE OF AUTHORITIES

Cases	Page
<i>Acosta v. Master Maintenance & Constr. Inc.</i> , 452 F.3d 373 (5th Cir. 2006)	6
<i>Blue Cross Blue Shield of Texas v. Juneau</i> , 114 S.W.3d 126 (Tex. App.—Austin 2003, no pet.)	6
<i>Buckeye Check Cashing, Inc. v. Cardegna</i> , 126 S. Ct. 1204 (2006)	5
<i>Cappadonna Elec. Mgmt. v. Cameron County</i> , 180 S.W.3d 264 (Tex. App.—Corpus Christi 2005, no pet.) (orig. proceeding)	4
<i>In re American Homestar of Lancaster, Inc.</i> , 50 S.W.3d 480, 483 (Tex. 2001) (orig. proceeding)	3
<i>In re D. Wilson Constr. Co.</i> , 2006 WL 1792021 (Tex. June 30, 2006) (per curiam) (orig. proceeding)	3, 7
<i>In re Halliburton Co.</i> , 80 S.W.3d 566 (Tex. 2002) (orig. proceeding)	5
<i>In re Heritage Bldg. Sys., Inc.</i> , 185 S.W.3d 539, (Tex. 2006) (per curiam) (orig. proceeding)	3
<i>In re Kellogg Brown & Root, Inc.</i> , 166 S.W.3d 732 (Tex. 2005) (orig. proceeding)	4
<i>In re Nitla S.A. de C.V.</i> , 92 S.W.3d 419, 422 (Tex. 2002) (per curiam) (orig. proceeding)	3
<i>In re Nexion Health Care at Humble, Inc.</i> , 173 S.W.3d 67 (Tex. 2005) (per curiam) (orig. proceeding)	3
<i>In re Palacios</i> , 2006 WL 1791683 (Tex. June 30, 2006) (per curiam) (orig. proceeding)	4
<i>In re Palm Harbor Homes, Inc.</i> , 195 S.W.3d 672 (Tex. 2006) (orig. proceeding)	5
<i>In re Phelps Dodge Magnet Wire Co.</i> , 2005 WL 2402677 (Tex. App.—El Paso Sept. 29, 2005, mandamus denied) (orig. proceeding)	7
<i>In re Vesta Ins. Group, Inc.</i> , 192 S.W.3d 759 (Tex. 2006) (per curiam) (orig. proceeding)	3, 4
<i>In re Weekley Homes, L.P.</i> , 180 S.W.3d 127 (Tex. 2005) (orig. proceeding)	4, 7
<i>Peebles v. Merrill Lynch, Pierce, Fenner & Smith Inc.</i> , 431 F.3d 1320 (11th Cir. 2005)	5
<i>Perry Homes v. Cull</i> , 173 S.W.3d 565 (Tex. App.—Fort Worth 2005, pet. filed)	2, 3
<i>Pheng Inv., Inc. v. Rodriguez</i> , 196 S.W.3d 322 (Tex. App.—Fort Worth 2006, no pet.)	5
<i>Positive Software Solutions, Inc. v. New Century Mortgage. Corp.</i> , 436 F.3d 495 (5 th Cir. 2006)	1, 2, 5
<i>Pullara v. American Arbitration Ass'n, Inc.</i> , 191 S.W.3d 903 (Tex. App.—Texarkana 2006, pet. filed)	2, 5, 6

TABLE OF AUTHORITIES (CONT'D)

Cases	Page
<i>Schmitz v. Zilveti</i> , 20 F.3d 1043 (9th Cir. 1994)	1
<i>Smile Inc. Asia Pte. Ltd. v. Britesmile Mgmt., Inc.</i> , 122 P.3d 654 (Utah Ct. App. 2005)	3
<i>Trico Marine Svcs., Inc. v. Stewart & Stevenson Tech. Svcs., Inc.</i> , 73 S.W.3d 545 (Tex. App.—Houston [1st Dist.] 2002, no pet.) (mandamus denied)	7
 Statutes	
9 U.S.C. §§ 201 et seq.	6
9 U.S.C. § 905	6
Tex. Civ. Prac. & Rem. Code Ann. ch. 151	6
Tex. Civ. Prac. & Rem. Code Ann. ch. 152	6
Tex. Civ. Prac. & Rem. Code Ann. § 51.016	7
Tex. Civ. Prac. & Rem. Code Ann. § 157.027	7
Tex. Civ. Prac. & Rem. Code Ann. § 171.098	7
Tex. Prop. Code Ann. § 436.001	7
 Other	
John Fleming, <i>The State of the Law of Arbitration (More or Less As It Exists on September 26, 2005)</i> (CLE 2005)	7
Lawrence R. Mills, <i>et al.</i> , VACATING ARBITRATION AWARDS, 11 No. 4 Dispute Resolution Mag. 23 (Summer, 2005)	5

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"Law must be stable, and yet it cannot stand still."— Roscoe Pound

I. INTRODUCTION

Not surprisingly, with the tectonic shift of disputes out of the courthouse into arbitration, the law of alternative dispute resolution has not stood still over the past year, with a number of significant changes and clarifications of which the practitioner should be aware. What follows is an overview of the significant changes to and clarifications of the law governing alternative dispute resolution in Texas from October 2005 to date. It should not be a surprise that the vast majority of cases concern binding arbitration in contrast to nonbinding mediation.

II. CASE LAW DEVELOPMENTS

A. A New Key Number

Although not a development in the case law governing ADR per se, it is worth noting that the explosion of interest in ADR in recent years has resulted in West Publishing Company creating a new key number for "Alternative Dispute Resolution." This new key number, 25T, brings together cases involving all aspects of alternative dispute resolution, and replaces references under other key numbers like Arbitration and Contracts. The subheadings include "In General," key numbers 100-109, "Arbitration," key numbers 110-439, "Mediation," key numbers 440-499, "Other Dispute Resolution Methods," key numbers 500-509 and "Foreign Dispute Resolution Proceedings," key numbers 510-515. This new key number topic should make it easier for the practitioner to find cases addressing specific ADR issues.

B. Cases

1. Disclosure By Arbitrators

One of the hot topic areas for the ADR practitioner involve questions of disclosure: what to disclose, to whom, and when. Several cases this year make clear that the old rule about voting in Chicago—vote early, vote often—also applies to disclosure issues in an ADR context.

a. Positive Software Solutions: The Case Of The Year

The most significant case on this issue decided in the last year is the Fifth Circuit's decision in *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 436 F.3d 495 (5th Cir. 2006). The decision, authored by Judge Reavley, establishes a very broad standard of arbitrator disclosure.

The facts of the case are straightforward, and involve a dispute over alleged copyright infringement. *Id.* at 496. The matter was sent to arbitration, and the parties chose a single arbitrator through the AAA. *Id.* at 497. Despite being asked on several occasions to disclose all circumstances "likely to affect impartiality or create an appearance of partiality," including "past or present relationships with . . . counsel, direct or indirect, whether . . . professional . . . or any other kind," the arbitrator indicated that he had nothing to disclose. *Id.* After the plaintiff lost, it investigated and discovered the arbitrator, personally, and his former firm, had been co-counsel with the defendant's counsel in what was described as "protracted patent litigation" about a decade before. *Id.* at 497-98. Because this fact was not disclosed, the plaintiff moved to vacate the award on the ground that it was the product of evident partiality. *Id.* at 497. The district court vacated the award on this ground, and the case was appealed to the Fifth Circuit. *Id.* at 498.

The opinion in *Positive Software Solutions* is significant, for a number of reasons. First, the court began by establishing that it would apply two standards of review of the district court's decision: factual matters would be reviewed to determine whether they were "clearly erroneous." This is consistent with Fifth Circuit precedent. More importantly, however, the application of the law to the facts would be reviewed de novo, not under the more lenient "clearly erroneous" standard. *Id.* at 498 & n.18. It then went on to give an overview of the law governing the determination of whether an arbitrator has or has not acted with "evident partiality" under the FAA, and decided the better precedent was that evident partiality existed when "undisclosed facts show a reasonable impression of partiality." *Id.* at 501 (citing and quoting *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994)). Based on this, the court held that, while every failure to disclose a connection between an arbitrator and someone involved in the arbitration will not support a finding of evident partiality, full disclosure of material matter is necessary to show impartiality: "[A]n arbitrator . . . displays evident partiality by the very failure to disclose facts that might create a reasonable impression of the arbitrator's partiality. This evident partiality is demonstrated from the nondisclosure, regardless of whether actual bias is established." *Id.* at 502 (emphasis added). Applying this definition to the facts, the court held the district court's conclusion that the arbitrator had a long-term professional relationship with one of the lawyers was factually correct, and because the existence of this relationship might convey the impression of partiality the legal effect of the nondisclosure required the award to be vacated. *Id.* at 503-04. The court then went on to reject the argument that the nondisclosure was waived because the objection was not raised until after the award was rendered, and to modify the district court's

order to remove instructions about how the case was to be handled when it was arbitrated again. *Id.* at 504-05.

For the practitioner, *Positive Software Solutions* contains several lessons. First, in cases involving challenges to the disclosure made by an arbitrator, the Fifth Circuit is willing to apply a relatively generous standard of review that does not give the arbitration award the special deference usually given, perhaps because if the arbitrator should not have sat then his award would never have been made. Second, *Positive Software Solutions* drives home what is a good rule for all ADR neutrals (whether they be arbitrators, mediators, private judges, or whatever) to follow: *when in doubt, disclose*. If the matter disclosed is trivial, it is unlikely to bother the parties; if it bothers the parties, it is probably not trivial, and disclosing all connection in advance means a failure to object until after the award will likely result in the objection being waived. Third, the Fifth Circuit has clearly defined the term "evident partiality," following the broader definition of the term, based in part on the decisions in other cases and in part on a relatively strict reading of the AAA's ethical rules. This definition clearly tells practitioners that if they err they should err on the side of over-disclosure. Finally, the court refused to undercut the burdens imposed by this rule by finding waiver in the absence of either proper disclosure or actual knowledge of the matter to be disclosed; although the court does not appear willing to allow a party to an arbitration to learn some fact that might indicate partiality to "lie behind the log," it will not allow a failure to disclose some material matter to result in the waiver of the issue.

However, this opinion as it stands will likely not be the Fifth Circuit's final word on the matter. The decision in *Positive Software Solutions* was issued on January 11, 2006, and, on May 5, 2006, the Fifth Circuit took the unusual step of voting to grant a motion for rehearing en banc. The case is currently set to be argued on September 27, 2006, with a decision to follow some time thereafter. Stay tuned.

b. *Pullara*: Arbitrator Sued For Failure To Disclose

Arbitrator disclosure was also an issue in a case out of Texarkana, *Pullara v. American Arbitration Ass'n, Inc.*, 191 S.W.3d 903 (Tex. App.—Texarkana 2006, pet. filed). *Pullara* involved an arbitration arising out of a construction contract to renovate an apartment, and the arbitrator awarded the contractor almost \$100,000 for his work. *Id.* at 905. Approximately a year later, the apartment owner discovered that the arbitrator had not only been a member of the Greater Houston Builders Association (a fact he had disclosed) but that he had for many years been the GBHA's general counsel (a fact he had not disclosed). *Id.* Since it was more than 90 days after the award had been rendered he could no longer

move to vacate the award, so the arbitrator sued both the AAA and the arbitrator, but lost on summary judgment. *Id.*

Although the central issue in *Pullara* was arbitrator immunity (discussed below), the plaintiff argued that giving arbitrators immunity in cases where they fail to disclose information that is indicative of evident partiality would immunize arbitrators from their failures to disclose, at least in cases where the failure to disclose is not discovered until after the deadline for vacating the award. *Id.* at 908-09. In rejecting this argument, the court held that although a failure to disclose can support the vacature of an arbitration award under the appropriate circumstances, decisions by the supreme court recognizing that arbitrators have an obligation to disclose "did not create a cause of action against arbitrators for failing to perform their duty to disclose." *Id.* at 909. This is good news for arbitrators, making clear that the duty to disclose does not give rise to an actionable tort, but rather merely provides a ground for doing the arbitration over. However, in an interesting footnote the court recognized such a rule can result in circumstances where an award, possibly tainted by undisclosed bias, could not be vacated because the failure to disclose was not discovered until after the deadline for seeking vacature had passed, but it claimed this was acceptable because it would force parties "to use their own diligence to discover . . . bias-revealing background information regarding their arbitrators." *Id.* at 909 n.6. Although the need for a rule that will give arbitration awards a significant degree of finality is certainly a good one, the court's suggestion can be read as a clear invitation to hunt out bias once an arbitration has been lost and to bring any colorable challenge to the arbitrator's neutrality before the deadline for vacating the award has passed. Such a suggestion is at odds with the idea that one of the primary reasons arbitration is a valuable tool is because it is less expensive than trials, and may end up doing more harm than good.

c. *Perry Homes*: Enough Disclosure Is Enough

Finally, there is authority showing the salutary effects of a broad degree of disclosure. In *Perry Homes v. Cull*, 173 S.W.3d 565 (Tex. App.—Fort Worth 2005, pet. filed), an arbitrator in a construction case disclosed to the parties his familiarity with construction arbitration, admitted that he knew many of the attorneys in the firm representing the defendant, and admitted that his practice meant he also knew many of the witnesses in the case (either personally or professionally). *Id.* at 571-72. The court found this degree of disclosure was sufficient to overcome the plaintiff's charge of evident partiality, even though he did not disclose that most (although not all) of his experience was as a member of the defense bar. *Id.* Evident partiality is never a result of too much

disclosure, only too little.

2. Federal Versus State Arbitration Law And Preemption

In many arbitration cases decided in the past decade, the Texas Supreme Court has looked to federal arbitration law to determine how Texas arbitration law should be interpreted. In a case decided late in 2005, the Texas Supreme Court continued this trend in a different way, applying federal preemption law to find that the FAA preempts the TAA. Specifically, the court held that because the TAA requires agreements to arbitrate personal injury cases to be signed by the counsel for a party while the FAA does not, the TAA "interferes with the enforceability" of an agreement subject to the FAA and, therefore, is preempted. *In re Nexion Health Care at Humble, Inc.*, 173 S.W.3d 67, 69 (Tex. 2005) (per curiam) (orig. proceeding). Although the TAA's requirements mean that the arbitration of disputes involving personal injuries and death are relatively uncommon, the decision in *Nexion Health Care* may result in the arbitration of more of these kinds of cases, at least those involving health care providers who conduct their operations on an interstate basis. (Think Medicare.)

In another case, the court held that it was improper for a Texas court to order the parties to mediate a claim subject to arbitration under the FAA, because the FAA preempted Texas state law and did not allow the courts to interfere with the referral to arbitration in any way. *In re Heritage Bldg. Sys., Inc.*, 185 S.W.3d 539, 541-42 (Tex. 2006) (per curiam) (orig. proceeding). Although this decision is probably correct and not very controversial, it is worth noting that it appears to assume the idea that mandamus is appropriate only when there has been an *abuse of discretion*, a narrow standard, that can only be corrected by mandamus appears to be a dead-letter in Texas. In *Heritage Bldg. Sys.*, the court held that mandamus was appropriate whenever a trial court reaches the relatively broader standard of an *arbitrary conclusion or erroneous application of law to the facts* of the case, making no mention of the requirement that there also be no other adequate remedy for the incorrect decision. *Id.* at 541.¹ It is hard to

accept that it is impossible to fashion a remedy for being improperly forced to arbitrate a claim (for example, such as an award of attorney's fees incurred in improperly mediating), especially in light of the arbitrator's power to decide almost any issue. See § II(B)(6), *infra*. The decision in *Heritage Bldg. Sys.* signals the explosion of arbitration-related mandamus proceedings will likely continue.

3. Waiver Of Right To Seek Arbitration

Several cases this year have reaffirmed the settled law of Texas, that the right to insist on arbitration is extremely difficult to waive by conduct, and that neither participation (even extensive participation) nor delay justifies a finding of waiver. *In re Vesta Ins. Group, Inc.*, 192 S.W.3d 759, 763 (Tex. 2006) (per curiam) (orig. proceeding). The rule remains that the right to seek arbitration is waived is found only if (1) the party seeking arbitration has "substantially invoked" the judicial process; and (2) his opponent has suffered some prejudice as a result. *Perry Homes*, 173 S.W.3d at 569-70. Cross-actions and requests for injunctions do not prove the existence of prejudice sufficient to justify a finding of waiver, *In re D. Wilson Constr. Co.*, 2006 WL 1792021, at *6 (Tex. June 30, 2006) (per curiam) (orig. proceeding), nor does two years of litigation. *Vesta Ins. Group*, 192 S.W.3d at 763-64. An example of the degree of participation in the process necessary to support a finding of waiver is found in a case from Utah: the court found waiver where the record showed the party seeking arbitration had, for at least two years prior to seeking arbitration: (1) twice moved to dismiss the suit; (2) counterclaimed; (3) opposed motions filed by its opponent; (4) engaged in extensive discovery, including deposing seven people; and (5) engaged in extensive pretrial scheduling. *Smile Inc. Asia Pte. Ltd. v. Britesmile Mgmt., Inc.*, 122 P.3d 654, 658-61 (Utah Ct. App. 2005). Suffice it to say the only action certain to result in a finding of the waiver of the right to seek arbitration is the actual trial of the case.

4. Binding The Nonsignatory To An Agreement To Arbitrate

Arbitration, as a creature of contract, originally was envisioned to resolve disputes between consenting parties to a contract. Taking it out of this context into the complex but real world of multi-party transactions—some parties who have consented to arbitration and some

¹Mandamus is an extraordinary writ, and entitlement to mandamus relief has traditionally required proof that the trial court abused its discretion and that the relator has no adequate remedy at law. See, e.g., *In re Nitla S.A. de C.V.*, 92 S.W.3d 419, 422 (Tex. 2002) (per curiam) (orig. proceeding). However, the Supreme Court has held that it is always an abuse of discretion to misapply the law, *In re American Homestar of Lancaster, Inc.*, 50 S.W.3d 480, 483 (Tex. 2001) (orig.

proceeding) (case involving failure to order arbitration), and so in any case where an error of law has arguably been made the availability of mandamus relief depends only on convincing the court that whatever legal remedy may exist is not adequate.

parties who have not but seek rights that flow from agreements containing such clauses—forces courts into a Procrustean bed. Hence, another "hot topic" in many cases is the question of whether and when a nonsignatory may nevertheless be bound by the agreement and made to arbitrate certain claims. Although, as set forth above, the FAA does not require a signature on an agreement to arbitrate to make it enforceable, the TAA does, and Texas courts have recognized a number of distinct occasions when a nonsignatory can be forced to arbitrate, even in the absence of his signature on the agreement itself. In a decision that lies just outside the scope of this article, the supreme court cited federal law for the proposition that there are a number of occasions when a nonsignatory may be bound by an agreement to arbitrate he did not sign: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) equitable estoppel, and (6) third-party beneficiary. *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005) (orig. proceeding).

More recently, the court has issued two decisions expanding on estoppel as a ground for binding nonsignatories to arbitration agreements. The first clearly holding that where the nonsignatory's claims arose under or sought some benefit from an agreement containing an arbitration clause, the nonsignatory was estopped from arguing that he could not be made to arbitrate under the theory of "direct benefits estoppel." *In re Weekley Homes, L.P.*, 180 S.W.3d 127, 131-34 (Tex. 2005) (orig. proceeding); *accord Cappadonna Elec. Mgmt. v. Cameron County*, 180 S.W.3d 264, 372-75 (Tex. App.—Corpus Christi 2005, no pet.) (orig. proceeding) (applying direct-benefits estoppel to claims brought by a government entity against subcontractor where claims arose out of construction contract between subcontractor and general contractor). *Weekley Homes* is interesting because it is a tort case, but, despite this, the court found the tort plaintiff could be forced to arbitrate because the injuries of which she complained were inflicted on her by a builder who was repairing a house that had been built for the plaintiff's parents, and the builder was (of course) only performing these repairs because of the contract. The court found that this was sufficient connection to the contract to support the conclusion that the injured plaintiff was seeking benefits under the contract and, therefore, could be forced to arbitrate. 180 S.W.3d at 132-33. In a second decision, the court went even further, holding that principles of estoppel compelled a nonsignatory to arbitrate claims of tortious interference with a contract because such claims "arise more from the contract than general law, and thus fall on the arbitration side of the scale." *Vesta Ins. Group*, 192 S.W.3d at 761-62. Suffice it to say that the current supreme court appears to be so strongly in favor

of arbitration that any defendant who has signed a contract with an arbitration provision will likely be able to invoke it as against a nonsignatory.

5. Appeal Of Orders Governing Arbitration

Although the intricacies of the appeal of orders granting arbitration will be discussed in greater detail below, the Texas Supreme Court issued a decision highlighting the need for greater clarity in the area, holding that (1) the only remedy for the *denial* of an order to arbitrate under the FAA is a petition for a writ of mandamus; (2) although prior authority allowed for mandamus from an order *ordering* arbitration under the FAA; (3) recent supreme court precedent changed this rule; and (4) although Texas courts are not governed by federal precedent on this point; and (5) even federal courts allow a mandamus in cases involving extraordinary circumstances; so (6) mandamus relief from an order sending a case to arbitration under the FAA, therefore, may not be available. *In re Palacios*, 2006 WL 1791683, at **1-2 (Tex. June 30, 2006) (per curiam) (orig. proceeding). **Clear?**²

6. Scope Of The Arbitrator's Power To Decide Issues

a. Buckeye Check Cashing: Enforcement Of The Contract Is An Issue For The Arbitrator

In its only decision to address an issue of arbitration law in the past year, the United States Supreme Court held that the question of whether a particular contract containing an arbitration provision is invalid is a question for the arbitrator. The question arose in a case in the Florida courts involving a class action suit against a lender for usury. *Buckeye Check Cashing, Inc. v. Cardegna*, 126 S. Ct. 1204, 1206 (2006). The plaintiff argued that because the contract was usurious it could not

²This apparently means mandamus will routinely issue to prevent a trial, i.e., arbitration *denied*, when the case should be arbitrated, because making a party go through a trial to appeal and have the verdict reversed and a case ordered to arbitration constitutes an irreparable injury for which mandamus relief is appropriate. Mandamus, however, will not routinely issue when a case that should be tried is ordered to arbitration, requiring it to be arbitrated before the party seeking a trial can have it reviewed, the award vacated, and the case sent to court. The supreme court believes the FAA shows this is exactly what Congress intended, *id.* at *3, but the fact that the scope of available mandamus relief is determined by the courts leaves some to question whether the existence of this inconsistent relief may be laid at the door of Congress, or whether the issue is as clear as the supreme court believes it to be.

be enforced, and because it could not be enforced he could not be made to go to arbitration. *Id.* at 1206. The Florida Supreme Court agreed, but the Supreme Court reversed, holding that the FAA created a substantive rule of federal law that was binding on state courts, and that this rule of law held whatever Florida state law may have to say about the issue the plaintiff's challenge to the contract was for the arbitrator and not for the court. *Id.* at 1208-10.

b. *Palm Harbor Homes*: Most Issues Of Unconscionability Are For The Arbitrator

The Texas Supreme Court reached a similar conclusion (albeit on different grounds), and reiterated fairly well-settled Texas law on who is responsible for deciding when a contract is so unconscionable that the provisions of the agreement (specifically including provisions governing arbitration) may be enforced. Issues of *substantive* unconscionability—the question of whether the arbitration provision is so unfair (ex. venue in Alaska) or one-sided that it should not be enforced at all—is a question for the court in the first instance; if the arbitration provision is substantively unconscionable, the court will not enforce it at all. *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672, 677-78 (Tex. 2006) (orig. proceeding). In contrast, issues of *procedural* unconscionability—the question of whether the circumstances surrounding the execution of the arbitration provision itself were fair, *id.* at 677-78, remain for the arbitrator. *In re Halliburton Co.*, 80 S.W.3d 566, 571-72 (Tex. 2002) (orig. proceeding). This holding prevents a party from avoiding an agreement to arbitrate merely by claiming that it is for some reason not fair to make him arbitrate under the circumstances, a necessary holding if arbitration is to remain an effective tool of dispute resolution.

7. Review Of Arbitrator's Awards

For arbitrators, the good news is that the cases decided in the past year make clear that the scope of review of an award (at least in the absence of bribery or other affirmative fraud) is still very, very narrow, with reviewing courts still making all reasonable presumptions that may be made in favor of the award. With the possible exception of a review for evident partiality (discussed in the *Positive Software Solutions* decision), the only "substantive" grounds for vacating an arbitration award remain "gross mistake" and "manifest disregard for the law."

As the Fort Worth Court of Appeals clearly states, these standards of review impose an extraordinarily high bar: A gross mistake exists only if the award is so arbitrary or capricious that the only conclusion is the arbitrator has acted in bad faith or has failed to use his honest best judgment, while manifest disregard for the

law remains more than just a misunderstanding of the law, but a circumstance where the arbitrator affirmatively knows what the law is and knows that it applies, but nevertheless chooses not to apply it. *Pheng Inv., Inc. v. Rodriguez*, 196 S.W.3d 322, 330-32 (Tex. App.—Fort Worth 2006, no pet.). As a case from outside of Texas shows, misinterpretation, misapplication, or misunderstanding of the law or error in determining its weight is not manifest disregard for the law. *Peebles v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 431 F.3d 1320, 1326-27 (11th Cir. 2005). Arbitrators would have to know the law and expressly disregard it. *Id.* at 1326. Accordingly, the vacation of an arbitration award for misapplication of the law or other, similar errors is, and should remain, very rare.³

8. Arbitrator Immunity

The primary issue in *Pullara* was not about disclosure, but rather about arbitrator immunity. The claims of the aggrieved apartment owner were based on breach of contract, fraud, negligence, and violations of the DTPA, and the arbitrator claimed he was immune from such claims. *Pullara*, 191 S.W.3d at 905 n.4. The appellate court agreed, primarily because it found that an arbitrator was essentially acting as a judge, and immunity for arbitrators is necessary for the same reason it is necessary for judges: to ensure that the decisionmaker can make an unbiased determination based on the merits of the claims without having to worry about his own personal liability. *Id.* at 906. In reaching this conclusion, the *Pullara* court relied on the earlier decision in *Blue Cross Blue Shield of Texas v. Juneau*, 114 S.W.3d 126 (Tex. App.—Austin 2003, no pet.), finding it correctly held that the immunity afforded arbitrators meant courts are without jurisdiction to determine claims against them. 191 S.W.3d at 906-07.⁴ Additionally, the court recognized that the requirement that Texas arbitration laws should be interpreted uniformly with the laws of other states meant it should consider how other states have addressed the issue, and

³ For a study showing just how rare, see Lawrence R. Mills, *et al.*, VACATING ARBITRATION AWARDS, 11 No. 4 Dispute Resolution Mag. 23 (Summer, 2005) (study of proceedings to vacate arbitration awards in state and federal court).

⁴*Pullara* was an appeal from a summary judgment, not a plea to the jurisdiction. Although *Pullara* does not address the issue, if arbitrator immunity deprives the court of jurisdiction over claims against arbitrators it should have dismissed the case rather than affirming the summary judgment, although as a practical matter this is usually a distinction without a difference.

it found that "virtually all of the various states," and various federal courts recognize the concept of arbitral immunity, *id.* at 907, and it declined the apartment owner's invitation to allow him to sue the arbitrator.

9. Foreign Arbitral Awards: Arbitration Goes Global

Although most practitioners are familiar with the Federal Arbitration Act, fewer are familiar with the Convention on Recognition and Enforcement of Foreign Arbitral Awards, 9 U.S.C. §§ 201 et seq. This law gives federal courts both original and removal jurisdiction over cases that "relate to" the enforcement of arbitration awards entered in other countries, 9 U.S.C. § 905, and a recent decision by the Fifth Circuit shows that this grant of jurisdiction will be applied very broadly. *Acosta v. Master Maintenance & Constr. Inc.*, 452 F.3d 373, 377-79 (5th Cir. 2006) (a matter "relates to" a foreign arbitration award when a foreign arbitration matter could have any effect on a case or claim or has some connection or relation to the case). Given the frequency with which arbitration is used in other nations and in international business, it is likely that more and more arbitration cases will be brought in or removed to federal court.

III. DEVELOPMENTS IN STATUTES AND RULES

A. Statutory Nondevelopments

Like Sherlock Holmes's dog that did not bark in the night, the interesting things about the statutes governing ADR in Texas in the past year is not what the Legislature did, but rather what it did not do. Perhaps because it was distracted by the need to address issues relating to school funding, the Legislature has not changed the statutes governing ADR in Texas since the technical amendments to Chapters 151 and 152 of the Civil Practice and Remedies Code that took effect on September 1, 2005. Although this degree of stability is usually welcome by practitioners (at least in the absence of an important issue that has not been addressed), there are at least two major issues the Legislature may address in the near future that can affect the practice of ADR law.

1. The Revised Uniform Arbitration Act

The first is consideration of the Revised Uniform Arbitration Act (RUAA). The RUAA was adopted by the National Conference of Commissioners on Uniform State Laws in 2000, and was intended to update the original Uniform Arbitration Act that was first promulgated in 1955. Although the Alternative Dispute Resolution Section endorses the RUAA it elected not to make its passage an issue in 2005, at least in part because of the "Christmas tree" effect, i.e., concern that

the need to preserve its uniformity would be overcome by the desire to add any number of nonuniform "gimmies" and that it would be lost in the shuffle of other business. Similar concerns have led the Section to elect not to make the passage of the RUAA a priority in 2007 either, perhaps based on the hope that if enough other states adopt the RUAA in essentially the same form it will be more difficult for Texas legislators to attach nonuniform amendments to it when it is offered at a later date.

However, even though the RUAA is not yet the law of Texas, practitioners may notice that some of its provisions may come in through the back door, with courts being persuaded by the reasoning of other courts that are interpreting the RUAA, and issuing opinions with holdings based on the provisions of the RUAA rather than current law. Additionally, parties from out of state may contractually agree to apply the RUAA. The text of the RUAA may be found on the National Conference of Commissioners on Uniform State Laws' website, www.nccusl.org under the "Final Acts & Legislation" tab.

2. The Arbitration Provisions Of The Residential Construction Commission Act

In addition to not adopting the RUAA, the Legislature also did not correct the poorly written and often contradictory provisions of the Texas Residential Construction Commission Act (TRCCA) relating to the arbitration of complaints. In 2003 the legislature significantly changed how homeowners bring claims against builders for shoddy construction by enacting the TRCCA. Among its provisions are certain rules governing the arbitration of disputes between builders and purchasers, found in Chapter 436 of the Property Code.

As pointed out by John Fleming in his article from last year, *The State of the Law of Arbitration (More or Less As It Exists on September 26, 2005)*, E5-E7 (CLE 2005), the definition of "arbitration" found in § 436.001(1) of the Property Code defines it with reference to § 157.027 of the Civil Practice and Remedies Code, which refers only to *nonbinding* arbitration. Therefore, a plain reading of the TRCCA shows that its arbitration provisions do not apply to the binding arbitration clauses found in most construction contracts and therefore means that an important part of the regime of remedies established by the TRCCA does not apply to the typical arbitration case. The legislature did not address this apparent oversight in 2005, and the ADR practitioner can only hope that it will do so when it next meets in 2007.

B. Legislative Agenda For The Coming Year

In 2007, the Alternative Dispute Resolution Section intends to support two bills, one of which is intended to

eliminate a pointless procedural "gotcha" from ADR practice, while the other (primarily sponsored by the Collaborative Dispute Resolution Section) is intended to expand the use of collaborative dispute resolution to resolve disputes.

1. Interlocutory Appeals Under The Federal Arbitration Act

The "gotcha" the Section wants to eliminate deals with the remedy for an erroneous refusal by a trial court to order a matter to arbitration. Some of the effects of this "gotcha" were mentioned in the discussion of recent case law, and the Section hopes to introduce legislation that will clarify the question of appeals of orders denying arbitration once and for all.

Because of constitutional notions of concurrent jurisdiction, state courts may, of course, hear cases involving the FAA as well as the Texas Arbitration Act. As a practical matter, litigants are often uncertain which act applies. In cases governed by the Texas act, a party that is aggrieved by the trial court's *denial* of a request to send a pending case to arbitration may *appeal* this denial. Tex. Civ. Prac. & Rem. Code Ann. § 171.098(a)(1). However, there is no equivalent provision allowing an interlocutory appeal of an order denying an arbitration request in a matter governed by the Federal Arbitration Act, and the remedy for the denial of such a request is a petition for a writ of mandamus. *Weekley Homes*, 180 S.W.3d at 130. In cases where a party seeks relief under both Texas and federal law (usually because it is not clear which law will apply), this can result in one of two things happening: (1) the practitioner is forced to file both an interlocutory appeal and a petition for a writ of mandamus (which then may or may not be consolidated into a single proceeding by the appellate court), *see, e.g., In re Phelps Dodge Magnet Wire Co.*, 2005 WL 2402677, at *1 (Tex. App.—El Paso Sept. 29, 2005, mandamus denied) (orig. proceeding) (not yet released for publication); or (2) the practitioner guesses which law will apply and either has the appeal dismissed for lack of jurisdiction or the petition for a writ of mandamus denied because he guesses wrong.⁵

⁵Requiring such "split proceedings" also results in awkward petition histories. *See, e.g., Trico Marine Svcs., Inc. v. Stewart & Stevenson Tech. Svcs., Inc.*, 73 S.W.3d 545 (Tex. App.—Houston [1st Dist.] 2002, no pet.) (mandamus denied). In a concurring opinion in *D. Wilson Construction Company*, Justice Brister suggested the court discontinue this practice, and allow a party to file a single proceeding, and allow the appellate courts to "treat it as they think proper," i.e., as either an interlocutory appeal or a mandamus. *D. Wilson Constr.*

In an attempt to alleviate this pointless distinction between state and federal law, the Section will propose that the Legislature enact as § 51.016 of the Civil Practice and Remedies Code, which will read:

In a matter subject to the Federal Arbitration Act (Title 9, United States Code) a person may appeal an order, including an interlocutory order, from a district court, county court at law, or county court to an appellate court in this state to the extent that appeal is permitted in 9 USC § 16.

In essence, the proposed legislation will adopt the federal rules regarding when an appeal of an order regarding arbitration under the FAA is permitted, and will place these rules on par with the rules permitting such appeals under Texas law.⁶

2. Collaborative Dispute Resolution Process

In April, the Alternative Dispute Resolution Section was approached by the Collaborative Dispute Resolution Section regarding a bill it wishes to introduce next session. The intent of this law is to codify a provision regarding the use of collaborative law techniques that are already provided for by the Family Code as another ADR tool in other kinds of civil cases.

Collaborative law is a relatively new area of practice that is gaining strength in the field of family law. Broadly, its purpose is to create a voluntary procedure by which the parties are encouraged to settle their differences in a nonconfrontational and nonadversarial manner. Proponents of collaborative law claim that it is most useful in cases where the parties to a dispute will have some kind of an ongoing relationship even after the dispute has been resolved, such as divorced parents who will continue to have to raise their children until they are grown.

The State Bar Legislative Committee voted not to support the proposal, but to remain "neutral." There were two reasons: first, opposition from the trial/defense bars and second, the Committee felt the proposal was premature, given that virtually no cases outside family law have used the process.

A copy of the bill (which would be inserted into the Civil Practice and Remedies Code as Chapter 161) and a copy of the letter sent to the Section regarding the intent

at * 7 (Brister, J. concurring). The majority rejected this suggestion, holding that it was a matter for the Legislature to decide. *Id.* at * 3 n. 4.

⁶Cases discussing when such an appeal is and is not permitted will be discussed in § III(B)(5), *infra*.

of the bill are attached in the Appendix.

C. Consumer Arbitration Fair Practice Guidelines

Arbitration has been traditionally used in sophisticated business-to-business disputes. With its growth to address consumer complaints numerous complaints have been raised about its fairness and even movements to curtail its use in this arena. The Alternative Dispute Resolution Section, consistent with its professional and ethical responsibilities to the public, promulgated a set of guidelines governing the arbitration of consumer disputes. Although these guidelines do not have the force of law, they represent the Section's endorsement of the best practices that should be used in consumer arbitrations to ensure the process is a fair one and that it leaves both sides feeling they have received a "fair shake" from the arbitrator.

In order to publicize these guidelines to consumers, the Section printed a pamphlet called "Consumer Arbitration in Texas." The pamphlets were distributed to each of the seventeen dispute resolution centers in Texas, to most county, district, and appellate judges in the State, and to the Legislature.

The pamphlet begins by explaining how a consumer could be drawn into the arbitration process, and contains a description of the arbitration process in a question-and-answer format, aimed at the unsophisticated consumer. Finally, the pamphlet lists fifteen guidelines arbitrators and the parties should

follow when conducting a consumer arbitration.

Most of the guidelines will be familiar to ADR practitioners, and include things like the arbitration agreement should be reciprocal and not one-sided, the arbitrator should be neutral and independent, the arbitration should be conducted close to the consumer's residence and the fees charged for the arbitration should be reasonable. However, some of the guidelines differ from the rules governing most arbitrations; for example, the guidelines specifically provide that predispute agreements to arbitrate should not require the award to be confidential, because "there may be good reason to allow a synopsis of each award to be subject to public review or reporting." Consumer Arbitration Fair Practice Guideline 15.

A copy of the Consumer Arbitration Fair Practice Guidelines is attached to this paper as Exhibit A, and is available at no charge. Contact Tammy Sweet, State Bar of Texas, (800) 204-2222, ext. 1419.

IV. CONCLUSION

In the past year the law governing ADR has been stable, at least in the sense that there has been no sea change on any issue that would substantially expand or restrict the availability of alternative methods of dispute resolution other than trials. With the acceptance of alternative dispute resolution as a cornerstone of jurisprudence, however, the law has not stood still, with some issues finally being decided, others being clarified, and new issues being raised.

APPENDIX A

TEXAS STATE BAR ADR SECTION BEST PRACTICES FOR CONSUMER ARBITRATION

Background: The use of arbitration agreements in contracts between a consumer and a business has expanded substantially in the last decade. Complaints about the arbitration process made by consumers resulted in the Texas Legislature conducting two interim studies on the subject. The House Civil Practices committee held hearings on the subject and issued a report in 2002, and the Senate Jurisprudence Committee held hearings and issued a report in 2004. The reports of the Interim Charges may be found online at Texas Legislature Online. The ADR Section of the State Bar monitored these hearings, and members of the Section have testified before the Committees.

In response to the concerns expressed by consumers, the ADR Section launched several initiatives. The Section convened several roundtables and invited business and consumer users of arbitration to share their concerns and perceptions with the Section. The Section devoted portions of the 2004 annual CLE to better equipping lawyers to advocate in the arbitration forum. In addition, the Arbitration Task Force was charged with developing a set of best practices for consumer arbitration. The best practices are intended to serve two purposes. First, the best practices are intended to serve as a guide to attorneys who draft arbitration clauses for use in a business transaction for the consumer. These best practices set forth what the Section believes to be adequate due process safeguards for consumers. Second, the Section is aware that Texas Courts have in the past looked to the Sections' Mediator Ethical Guidelines for guidance on ADR issues before the tribunal. The Section hopes that Texas Courts will likewise find these best practices a useful reference in determining issues of procedural or substantive unconscionability of an arbitration agreement in a contract of adhesion between a consumer and a business.

In developing these *Best Practices*, the Section has looked to the consumer protocols established by the American Arbitration Association and by JAMS. The Section believes that protocols providing similar procedural standards are appropriate for arbitrations which may not be conducted under the auspices of those organizations.

The Section believes that arbitration is an appropriate dispute resolution for consumer transactions. When conducted with adequate procedural safeguards, arbitration offers consumers an expeditious and fair resolution of their disputes. The absence of any one of the following factors, by itself, should not be determinative of whether the agreement/proceeding is or is not unconscionable.

BEST PRACTICES

Scope: The best practices described herein apply to pre-dispute agreements to arbitrate that are contained in contracts between a business and a consumer. A consumer is a person who enters into a transaction primarily for personal, household, of family purposes.

1. Arbitration is a selection of a dispute resolution forum. An agreement to arbitrate is not the waiver of substantive legal rights, but merely a change in the forum. Therefore, an arbitration agreement must provide a fair process with appropriate safeguards for due process.
2. The agreement to arbitrate should be mutual and reciprocal. If a consumer is required to arbitrate the consumer's claims, then the business must equally be bound to arbitrate its claims against the consumer. The business should not be given an "opt-out" right unless the same is granted to the consumer.

3. The arbitration clause must be conspicuous and sufficiently clear to notify the consumer of the terms and conditions relating to the arbitration. Ideally, the notice should specifically state that both parties are waiving any right to a jury trial.
4. Arbitrators must be neutral and independent. Arbitrators should be required to adhere to the Arbitrator Ethics Guidelines adopted by the American Bar Association and the Alternative Dispute Resolution Section of the State Bar of Texas. This includes the requirement that arbitrators should be required to disclose all former and current associations and relationships with the parties and attorneys in a case that are likely to affect partiality or relationships that would cause a reasonable person to conclude the arbitrator was partial to one party to the arbitration.
5. Arbitration service providers must be independent. When an arbitration agreement names an arbitration service provider in which the business is a member, the agreement should also provide the option for the consumer to choose another non-affiliated and independent service provider to administer the arbitration. Full disclosure of the relationship should be made when a party is affiliated with or a member of the arbitration service provider.
6. All parties to an arbitration agreement should be provided an equal opportunity to participate in the selection of the arbitrator.
7. Consumers forum access fees which include arbitration filing fees, administrative fees, and arbitrator expenses must be reasonable. One of the factors to consider in the determination of what is a reasonable charge, is the amount of filing fees and court fees which a party would be expected to pay to initiate litigation of the claim.
8. The arbitration agreement should not require a consumer who does not prevail in an arbitration to pay the attorney fees or arbitration expenses of the business unless such payment is expressly provided in an applicable state or federal statute.
9. Consumers and businesses should be provided adequate disclosures and, if necessary, discovery in order to allow each party reasonable opportunity to fully present its claims or defenses. The amount and scope of discovery should be subject to the direction of the arbitrator and should be consistent with the equal goals of providing each party an adequate opportunity to develop its claim or defense and to avoid the excessive costs incurred in civil litigation.
10. A consumer is entitled to an in person hearing, and is entitled to be represented.
11. The arbitration venue should be in reasonable proximity of a consumer's residence.
12. The arbitrator must be given the power to award any damages or other relief that the consumer would be entitled to recover under applicable federal or state law.
13. The award of the arbitrator should include a brief written statement of the basis of the award.
14. The arbitration agreement should provide that when the size of the claim is small, either party may elect to bring the claim in small claims court.
15. A pre-dispute agreement to arbitrate should not require the arbitration award itself to be confidential, as there may be good reason to allow a synopsis of each award to be subject to public review or reporting. Normally, the proceeding is private. Subsequent to the occurrence of a dispute, the parties may mutually

enter into an agreement providing that the arbitration proceeding, arbitration award, or both will be confidential.

APPENDIX B

April 12, 2006

A proposed collaborative law procedures bill is attached. The bill will amend the Tex. Civ. Prac. & Rem. Code by adding a new Chapter 161. This paper will summarize the possible uses of collaborative law procedures for resolving civil disputes, and explain the need for statutory directives regarding the use of collaborative law procedures.

1. The ADR Act, Chapter 154 of the Tex. Civ. Prac. & Rem Code, states that it is the policy of this state to encourage the peaceable resolution of disputes and the early settlement of pending litigation through voluntary settlement procedures. Rule 1 of the Texas Rules of Civil Procedure sets forth the objective of the Rules, i.e., to obtain a just, fair, equitable and impartial adjudication of the rights of litigants, and to attain this objective with great expedition and dispatch and at least expense both to the litigants and to the state.
2. Collaborative Law Procedures have been in the Texas Family Code since 2001 (Sections 6.603 and 153.0072). Texas was the first state to enact a collaborative law procedures bill, and the collaborative process is being widely used in family law throughout the state. The bill is virtually identical to the collaborative law procedures provision in the Texas Family Code.
3. The collaborative dispute resolution process is **voluntary and it cannot be court ordered**. It is initiated by the written agreement of the parties and their attorneys. During the process, if a suit is pending the parties may request a stay of court proceedings. The proposed bill sets out the requirements which must be included in the written agreement of the parties seeking a stay of court proceedings.
4. A Collaborative Law Procedures provision in the Tex. Civ. Prac. & Rem. Code would require that collaborative law procedures be applied uniformly throughout the state in non-family cases, as it is today in family cases. Judge Charles Stokes in the 68th Civil District Court in Dallas recently established Rules and a Collaborative Law Order (Copy attached), which are patterned after the provision in the Family Code. Statutory directives will assure uniformity as judges throughout the state establish collaborative law rules and orders.
5. The collaborative process can be efficiently used for resolving disputes in many areas of law. For example to name a few: probate and trust law, real estate and construction, business and commercial, professional malpractice, health and elder law, employment and labor, property & casualty and life insurance, and intellectual property.
6. The collaborative process is extremely important for disputes where it would be beneficial for parties to have an ongoing relationship. Examples are healthcare providers, families in probate matters, business and professional partners, builders and developers, wholesalers and retailers, vendors and purchasers, employers and employees, church congregations, and landlords and tenants, to name a few.
7. No state funding is required. The process is voluntary and the only involvement with a state government entity would be a request of the parties that a court stay a pending case. Not only is no funding required, the collaborative process will reduce court dockets and save the courts money since the collaborative process does not rely on court intervention.
8. The process is proving to be very efficient in settling family law cases. Collaborative family lawyers are finding that their collaborative case settle months sooner than non-collaborative cases, and the parties are spending significantly less money on attorney's fees, experts and discovery, and are able to maintain relationships within the family.

9. Concerns have been raised that eventually the law may be changed, so that courts could order the parties to participate in the collaborative process. This cannot and will not happen for one simple reason. The parties and their attorneys must voluntarily sign a participation agreement which is a contract. The agreement requires parties to proceed honestly and in good faith. Courts cannot order parties to negotiate in good faith. In the early days of mediation, the Supreme Court of Texas made that clear in the *Decker* case. The only possible way that the process can work is to be and to remain voluntary.

We earnestly solicit your support for enactment of this Collaborative Law Procedures bill.

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By: _____

Senate Bill No. _____

A BILL TO BE ENTITLED

AN ACT

relating to the resolution of certain disputes by collaborative law procedures.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Civil Practice and Remedies Code, is amended by adding a new Chapter 161, Collaborative Law, to read as follows:

CHAPTER 161
COLLABORATIVE LAW

Sec. 161.001. POLICY. It is the policy of this state to encourage the peaceable resolution of disputes and the early settlement of pending litigation through voluntary settlement procedures.

Sec. 161.002. COLLABORATIVE LAW PROCEDURES.

(a) On a written agreement, parties and their attorneys may undertake to resolve a dispute using collaborative law procedures.

(b) Collaborative law is a voluntary procedure in which the parties and their attorneys agree in writing to use their best efforts and make a good faith attempt to resolve their dispute on an agreed basis without resorting to judicial intervention except to have the court approve the settlement agreement, make the legal pronouncements, and sign the orders required by law to effectuate the agreement of the parties as the court determines appropriate. The parties' attorneys may not serve as litigation counsel except to request the court to approve the settlement agreement.

(c) A collaborative law agreement must include:

(1) provisions for full and candid exchange of information between the parties and their attorneys as necessary to make a proper evaluation of the case;

(2) provisions for suspending court intervention in the dispute while the parties are using collaborative law procedures;

(3) provisions for hiring experts, as jointly agreed, to be used in the procedure; and

(4) provisions for withdrawal of counsel involved in the collaborative law procedure if the collaborative law procedure does not result in settlement of the dispute.

(d) The collaborative law agreement may contain other provisions as agreed to by the parties consistent with a good faith effort to collaboratively settle the matter.

(e) Notwithstanding Rule 11, Texas Rules of Civil Procedure, or another rule or law, a party is entitled to judgment on a collaborative law settlement agreement if the agreement:

(1) provides in a prominently displayed statement that is boldfaced, capitalized, or underlined, that the agreement is not subject to revocation; and

(2) is signed by each party to the agreement and the attorney of each party.

(f) Subject to Subsection (h), a court that is notified 30 days before trial that the parties are using collaborative law procedures to attempt to settle a dispute may not, until a party notifies the court that the collaborative law procedures did not result in a settlement:

critical provision
★

- (1) set a hearing or trial in the case;
- (2) impose discovery deadlines;
- (3) require compliance with scheduling orders; or
- (4) dismiss the case.

(g) The parties shall notify the court if the collaborative law procedures result in a settlement. If a settlement has not been reached, the parties shall file:

- (1) a status report with the court not later than the 180th day after the date of the written agreement to use the procedures; and
- (2) a status report on or before the first anniversary of the date of the written agreement to use the procedures, accompanied by a motion for continuance that the court shall grant if the status report indicates the desire of the parties to continue to use collaborative law procedures.

(h) If the collaborative law procedures do not result in a settlement on or before the second anniversary of the date suit was filed, the court may set the suit for trial on the regular docket.

Section 161.003. CONFIDENTIALITY OF COLLABORATIVE LAW PROCEDURES.

The provisions for confidentiality of alternative dispute resolution procedures as provided in Chapter 154 apply equally to collaborative law procedures under Chapter 161 and Sections 6.603 and 153.0072, Family Code.

SECTION 2. This Act applies only to an action commenced:

- (1) on or after the effective date of this Act; or (2) before the effective date of this Act if the trial in the action has not begun before the effective date of this Act.

SECTION 3. This Act takes effect September 1, 2007.