The Arbitration Newsletter

(Published by Whitaker Chalk Swindle & Schwartz PLLC)
(John Allen Chalk, Sr., Editor)

April, 2015

****

The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]

****

NINE IS A CROWD!

AVIC International USA, Inc. v. Tang Energy Group, Ltd., No. 3:14-CV-2815-K, 2015 WL 477316 (N.D. Tex. Feb. 5, 2015)[2]

On February 5, 2015, a Northern District of Texas court granted a motion to dismiss a court challenge to the validity of a constituted nine-member arbitrator panel, based on the Court's finding that it lacked subject matter jurisdiction.[3] The Court reinforced that only in very limited circumstances does the Federal Arbitration Act allow a court to intervene in an arbitration process before an award has been issued.[4] Although the plaintiffs in the federal court lawsuit asserted that one of these circumstances—a "lapse" in selecting an arbitrator—was present, the Court disagreed by holding there was no lapse since all the parties each timely selected an arbitrator in accordance with the selection process outlined in the arbitration agreement. The Court ultimately held that since the only remaining issues raised by the plaintiffs in the federal lawsuit were essentially procedural, therefore for the arbitrators to answer, the Court had no subject matter jurisdiction and dismissed the federal court complaint.[5]

In 2008, the Plaintiffs, AVIC and Thompson ("Plaintiffs") and Defendants, Tang Energy Group, Ltd., Keith P. Young, Mitchell W. Carter, Jan Family Interests, Ltd., and The Nolan Group, Inc. ("Defendants") entered into a Limited Liability Company Agreement ("LLC Agreement") for Soaring Wind Energy, LLC.[6] The LLC Agreement included an arbitration provision requiring all disputes be resolved in binding arbitration as follows:

---

[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel. My thanks to Nicole Muñoz, third-year law student at Texas A&M University School of Law, for her research and drafting assistance.

[2] An appeal to the U.S. Fifth Circuit Court of Appeals was filed on March 12, 2015.

[3] *AVIC Int'l USA, Inc. v. Tang Energy Grp. Lt.*, No. 3:14-CV-2815-K, 2015 WL 477316 (N.D. Tex. Feb. 5, 2015).

[4] *Id.* at *3.

[5] *Id.* at *4.

[6] *Id.* at *1.

> (a) The Disputing Member desiring to initiate arbitration… shall provide the name of the Arbitrator appointed by the Disputing Member… (b) Within 15 days after receipt of such demand, *each* other Disputing Member receiving notice of the Dispute shall name an Arbitrator… the Arbitrators so selected shall… select an additional Arbitrator… In the event there are more than two Disputing Members, the Arbitrators selected by the Disputing Members shall cause the appointment of either one or two Arbitrators as necessary to constitute an odd number of total Arbitrators hearing the Dispute.[7]

In June 2014, the Defendants, in the subsequent federal court lawsuit, filed a demand for arbitration against the other LLC Members who, on August 5, 2014, filed the federal court lawsuit challenging the method by which the nine-member arbitrator panel was constituted.[8] After receiving notice of the June 2014 arbitration demand, each LLC member selected an arbitrator. This resulted in seven arbitrators selected to sit on the panel, two selected by the two plaintiffs and five selected by each of the five defendants.[9] The seven arbitrators then selected two additional arbitrators – creating a **nine** member arbitration panel in the AAA-administrated proceeding.[10]

The Plaintiffs filed the subsequent lawsuit, asking the Court to declare that the current arbitration panel deviated from the arbitrator selection process set forth in the arbitration provision of the LLC Agreement.[11] The Plaintiffs interpreted the arbitration agreement to mean each "side" of the dispute would collectively select an arbitrator, followed by those two arbitrators selecting a third arbitrator.[12] Additionally, the Plaintiffs asked the federal Court to reconstruct the arbitration panel because the current panel is "inherently unfair and not neutral," with five of the nine arbitrators having been selected by the Defendants.[13] In response to the lawsuit, the Defendants filed a motion to dismiss for lack of subject matter jurisdiction under the Federal Arbitration Act (FAA).[14]

The central question in the subsequent litigation was whether the Court had subject matter jurisdiction to intervene in the arbitration process—by reconstructing or invaliding the panel—before the nine-member panel had issued an award.[15] To answer this, the Court turned to 9 U.S.C. § 5 that allows a court, in limited circumstances, to intervene in the arbitral process by selecting an arbitrator.[16] The Court acknowledged that the FAA allows a court to select an arbitrator in only three situations: "(1) if the arbitration agreement does not provide a method for selecting arbitrators; (2) if the arbitration agreement provides a method for selecting arbitrators

---

[7] *Id.* at *1.
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.* at *2.
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.* at *2-3; *See* 9 U.S.C. §5 (2015).

but any party to the agreement has failed to follow that method; or (3) if there is 'a *lapse* in the naming of an arbitrator or arbitrators.'"[17] The Fifth Circuit has interpreted "lapse" under the FAA to include a "mechanical breakdown in the arbitrator selection process."[18]

The Plaintiffs argued that the Court had jurisdiction to intervene and reconstruct the arbitration panel under §5, asserting there had been a "lapse" in the arbitration process, since an impasse had been reached by Plaintiffs' refusal to arbitrate before the nine-member panel.[19] The Court disagreed that an impasse equates to a "lapse" under the FAA. First, the Court found that none of the facts in the present case qualify for "lapse" under §5 terms since each party promptly named an arbitrator in accordance with the arbitration provision in the LLC Agreement.[20] Second, the Court held that "neither the specific language of the FAA or Fifth Circuit caselaw [*sic*] defines 'lapse' to include a party's refusal to participate in arbitration… Therefore, the Court has no jurisdiction on that basis."[21]

The Plaintiffs alternatively plead that the Court had jurisdiction by asserting their constitutional right to have disputes resolved by an impartial decionmaker was violated by a deck stacked against them – since five out of nine arbitrators were Defendant-appointed.[22] Again, the Court rejected jurisdiction over this issue particularly because it raised a challenge to the process and procedure used to select arbitrators, and courts have repeatedly held that procedural questions are reserved for the arbitrator to answer.[23] In addition, the Court added that courts have no other authority under the FAA to entertain the Plaintiffs' challenges because a court has no jurisdiction to remove an arbitrator, or intervene in any other context, prior to an arbitration award being issued.[24]

OBSERVATIONS

1. When drafting an arbitration clause, it is important to carefully consider the intentions and expectations the signatories have in the arbitrator selection process, as well as to be precise when using the term "sides" versus "parties" to specify who can appoint an arbitrator.

2. Arbitration clause drafters should specify the arbitration rules that will govern the arbitration process since arbitral institutions, such as the AAA, have procedures and rules for removing an arbitrator from a panel, while courts generally do not have jurisdiction to do the same.

---

[17] *AVIC Int'l*, 2015 WL 477316 at *3.
[18] *Id.* (citing *BP Exploration Libya Ltd. v. ExxonMobil Libya Ltd.*, 689 F.3d 481, 491 (5th Cir.2012)). The Court opined that although "Congress provided for judicial intervention when an impasse in the arbitrator selection process has occurred, the FAA makes clear that the parties must adhere to their contractual arbitrator selection procedure if one exists." *Id.* at *3 (citing *Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co.*, 304 F.3d 476, 491 (5th Cir. 2002).
[19] *Id.* at *3.
[20] *Id.* at *4.
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.* at *4-5 (citing *Gulf Guar. Life Ins. Co. v. Conn. Gen. Life Ins. Co.*, 304 F.3d 476, 489-90 (5th Cir. 2002)).

3. The Fifth Circuit has been clear that even where an arbitrator's bias is an issue, "the FAA does not provide for [a court's] removal of an arbitrator from service prior to an award."[25]

4. Although § 5 of the FAA affords courts limited subject matter jurisdiction to intervene in the arbitrator selection process prior to an award being issued, courts and parties must follow the arbitrator selection procedure described in the parties' arbitration agreement if one exists.

5. It is important not to construe the limited circumstances stated in 9 U.S.C. §5 more broadly than the language permits. As the Court in this lawsuit explains, a party's refusal to participate in arbitration does not qualify as a "lapse" under the FAA.

[25] *Id.* at 489-90; *see Adam Techs. Int'l S.A. de C.V. v. Sutherland Global Servs., Inc.*, 729 F.3d 443, 452 (5th Cir. 2013).