# *The Arbitration Newsletter*

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*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]

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## ARBITRATION ISSUES AT TEXAS SUPREME COURT

### *Forest Oil Corp. v. El Rucio Land and Cattle Co., Inc.*, 446 S.W.3d 58 (Tex. App.—Houston [1st Dist.] 2014, pet. granted).[2]

A three member arbitration panel awarded $24.5 million in damages to James Argyle McAllen ("McAllen"), El Rucio Land and Cattle Company, Inc. ("El Rucio"), San Jacinto Land Partnership, Ltd., and McAllen Trust Partnership in a dispute with Forest Oil Corporation ("Forest Oil") (collectively, "the McAllens"). El Rucio moved to confirm the award, and Forest Oil moved to vacate. The trial court confirmed the award, except the bond requirement. Houston Court of Appeals (1st Dist.) confirmed the trial court's judgment. Forest Oil appealed to the Texas Supreme Court, which granted petition for review. Oral argument is scheduled for February 8, 2017.

Disputes between Forest Oil and El Rucio Land and Cattle Company date to the mid-1990s when McAllen filed suit against Forest Oil and alleged royalty underpayment and lease underproduction.[3] In 1999, the parties signed a Settlement Agreement releasing all claims against Forest Oil except "environmental liability, surface damages, personal injury, or wrongful death occurring at any time and relating to the McAllen Ranch Leases," which the parties agreed to arbitrate under the Texas General Arbitration Act.[4] The parties agreed to the following arbitration provision in the 1999 Settlement Agreement, in pertinent part:

> All disputes arising out of or relating to the McAllen Ranch leases, including, . . . disputes relating to this Agreement or disputes over the scope of this arbitration clause. . . . The resolution of any such dispute shall be initiated by the filing of a lawsuit in the District Court of Harris County, Texas, on such basis. The parties agree that the

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[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 Tave Parker Doty, a third-year law student at Texas A&M University School of Law, for her research and drafting assistance.

[2] *Pet. granted*, Cause No. 14-0979.

[3] Brief of Appellant, at *1, 2013 WL 5595802.

[4] Forest Oil Corp. v. El Rucio Land & Cattle Co., Inc., 446 S.W.3d 58, 65 (Tex. App.—Houston [1st Dist.] 2014, pet. granted).

> Court shall immediately refer the disputes that are the subject of the lawsuit to arbitration on the motion of any party, retaining jurisdiction over such controversy to the extent expressly provided herein . . . [5]

The parties incorporated a Surface Agreement into the Settlement Agreement, which required Forest Oil to provide ongoing care and remediation to the surface estate (collectively, "Surface Agreement").[6]

The McAllens filed suit against Forest Oil in 2005 alleging environmental damage and personal injury.[7] Relying on the arbitration provision in the 1999 Settlement Agreement, Forest Oil moved to compel arbitration.[8] The McAllens opposed, claiming McAllen was induced to sign the 1999 Surface Agreement under fraud.[9] The Texas Supreme Court held the arbitration clause in the Settlement Agreement was enforceable.[10] The Settlement Agreement required a panel of three neutral arbitrators.[11] Forest Oil selected Daryl Bristow, the McAllens selected Donato Ramos, and the trial court appointed Clayton Hoover.[12] The McAllens alleged negligence, gross negligence, trespass, nuisance, fraud, and breach of the Surface Agreement against Forest Oil and sought damages including actual damages for environmental contamination due to Forest Oil's operations on the ranch, exemplary damages, and attorney's fees for the breach of contract claim.[13] Mr. McAllen individually alleged civil assault against Forest Oil for his exposure to radioactive pipe donated by Forest Oil and sought damages for personal injury and mental anguish.[14]

The seventeen day arbitration hearing resulted in a majority award in favor of the McAllens.[15] Daryl Bristow, selected by Forest Oil, dissented in a written opinion.[16] The majority awarded $15,000,000 to the McAllens in actual damages, $500,000 to Mr. McAllen in actual damages, $500,000 to the McAllens in exemplary damages, $5,017,374 in attorney's fees, required Forest Oil to post a $10,000,000 bond, and required Forest Oil to perform environmental remediation work on the McAllen Ranch.[17] Bristow's dissent criticized the majority for not specifying a basis for the damages award and for interfering with the Texas Railroad Commission's ("RRC") jurisdiction.[18] In 2007, Mr. McAllen requested the RRC investigate Forest Oil.[19] As a result, the RRC placed Forest Oil in its Operator Cleanup Program.[20] Bristow reasoned that the arbitration panel should have delayed the arbitration until the RRC made its final determination on the property.[21] Bristow's dissent

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[5] Defendant's Motion to Compel Arbitration and Stay this Litigation, at 3, 2005 WL 6122669.
[6] Forest Oil Corp. v. McAllen, 268 S.W.3d 52, 54 (Tex. 2008).
[7] Forest Oil Corp. v. El Rucio Land & Cattle Co., Inc., 446 S.W.3d 58, 64–65 (Tex. App.—Houston [1st Dist.] 2014, pet. granted).
[8] *Id.* at 65.
[9] *Id.*
[10] *Id.*; Forest Oil Corp. v. McAllen, 268 S.W.3d at 62.
[11] Forest Oil Corp. v. El Rucio Land & Cattle Co., Inc., 446 S.W.3d at 65–66.
[12] *Id.* at 66.
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.* at 66–67.
[18] *Id.* at 67.
[19] *Id.*
[20] *Id.*
[21] *Id.*

also claimed the evidence offered during arbitration did not support the majority's damages award and the majority interpreted the Surface Agreement to include obligations the agreement did not require.[22]

The McAllens moved to confirm the award in the trial court.[23] Forest Oil moved to vacate the award based on many reasons from Bristow's dissent.[24] The trial court confirmed the final arbitration award, except the $10,000,000 bond requirement, and awarded the McAllens $6,781,802 in attorney's fees.[25] Forest Oil claimed the trial court erred because the RRC has exclusive or primary jurisdiction over the dispute, Arbitrator Ramos, selected by the McAllens, exhibited evident partiality, the arbitrators exceeded their authority, the actual damages award resulted from gross mistake or a manifest disregard for the law, and the exemplary damages award violated contractual limits of the arbitrators' authority.[26]

The Houston First Court of Appeals viewed RRC's primary jurisdiction as prudential, exclusive jurisdiction as jurisdictional, and determined the RRC did not have primary or exclusive jurisdiction over this dispute.[27] The court reasoned that if the RRC had exclusive jurisdiction, as Forest Oil claimed, then the Arbitration Panel would have lacked subject-matter jurisdiction to give an award, and the trial court would have lacked jurisdiction to confirm or vacate the award against Forest Oil.[28] The court of appeals determined the statutes Forest Oil cited did not "clearly or plainly indicate that the Legislature intended the Railroad Commission's regulatory scheme to abrogate or to supplant a landowners' right to obtain common-law relief for injuries caused to his property by environmental contamination."[29] "Simply because the Railroad Commission might have jurisdiction to determine some facts related to a controversy does not oust a court, or in this case, the arbitrators, of jurisdiction to make the underlying factual determinations."[30]

In its second issue to the Houston First Court of Appeals, Forest Oil claimed the arbitration award violated public policy that the RRC be solely responsible for issues arising from oil and gas production.[31] However, the Texas Supreme Court previously held that "an arbitration award cannot be set aside on public policy grounds except in an extraordinary case in which the award clearly violates carefully articulated, fundamental policy.[32]

Forest Oil also claimed the arbitration award should be vacated under the Texas General Arbitration Act ("TAA") and common law.[33] The Houston First Court of Appeals did not agree.[34]

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[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.* at 68.
[27] *Id.*
[28] *Id.*
[29] *Id.* at 71.
[30] *Id.* at 73.
[31] *Id.* at 74.
[32] *Id.* (quoting CVN Grp., Inc. v. Delgado, 95 S.W.3d 234, 239 (Tex. 2002)).
[33] *Id.* at 75.
[34] *Id.* at 76.

Forest Oil argued the arbitration award should be vacated because of evident partiality of Arbitrator Donato Ramos, the arbitrator chosen by the McAllens.[35] Forest Oil contended that Arbitrator Ramos was not a neutral arbitrator because Ramos did not disclose that he had been considered as a mediator in a dispute involving the McAllen's Santillana Ranch and Chevron USA, Inc. ("Chevron").[36] However, the court of appeals noted that the trial court was the fact finder in the proceeding for vacatur and was in the best position to "resolve the conflicts in the evidence and to judge the witnesses' credibility."[37] "Given the record, the evidence supported an implied finding by the trial court that Ramos was unaware of what had occurred in the Santillana litigation with respect to the parties' consideration of him for the position of mediator."[38] The trial court denied Forest Oil's claim of evident partiality.[39]

Forest Oil also argued the arbitration award should be vacated because the arbitration panel exceeded its powers and "rewrote the Surface Agreement by injecting certain terms while removing or ignoring other terms."[40] An arbitrator derives his authority to resolve disputes from the parties' agreement to submit their claims to arbitration.[41] Misinterpretation of a contract or misapplication of the law does not mean an arbitrator exceeded his authority.[42] "An arbitrator exceeds his authority when he disregards the contract and dispenses his own idea of justice."[43] The appropriate question is whether the arbitrator had the authority to decide the issue, not whether the arbitrator decided the issue correctly.[44] When analyzing whether or not an arbitrator exceeded his authority, "federal courts have held that an arbitrator's award is 'legitimate only so long as it draws its essence' from the parties' agreement."[45] Here, Forest Oil acknowledged the arbitration panel had authority to interpret the Surface Agreement, but it complains that the arbitration panel expanded Forest Oil's obligations under the Surface Agreement.[46] An arbitrator's remedy lies beyond his jurisdiction "only if there is no rational way to explain the remedy handed down by the arbitrator as a logical means of furthering the aims of the contract."[47] The court of appeals determined the arbitration panel's declaration could "be read to derive from the wording and purpose of the Surface Agreement" and upheld the arbitration panel's award.[48]

Forest Oil also complained the arbitration panel made a gross mistake of law in its damages calculation.[49] The Texas common law standard used to vacate arbitration awards is gross mistake, or

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[35] *Id.*
[36] *Id.* at 77–78.
[37] *Id.* (citing City of Keller v. Wilson, 168 S.W.3d 802, 819–20 (Tex. 2005)).
[38] *Id.* at 81.
[39] *Id.*
[40] *Id.*
[41] *Id.* (citing Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84, 90 (Tex. 2011)).
[42] *Id.* (citing Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc., 294 S.W.3d 818, 830 (Tex. App.—Dallas 2009, no pet.)).
[43] *Id.* (citing Forged Components, Inc. v. Guzman, 409 S.W.3d 91, 104 (Tex. App.—Houston [1st Dist.] 2013, no pet.)).
[44] *Id.* (citing D.R. Horton-Texas, Ltd. v. Bernhard, 423 S.W.3d 532, 534 (Tex. App.—Houston [14th Dist.] 2014, pet. denied)).
[45] *Id.* at 81–82 (quoting Nationsbuilders, Ins. Servs., Inc. v. Houston Int'l Ins. Grp. Ltd., No. 05-12-01103-CV, 2013 WL 3423755, at *4 (Tex. App.—Dallas July 3, 2013) (mem. op.)).
[46] *Id.* at 81.
[47] *Id.* at 82 (citing *Nationsbuilders* 2013 WL 3423755 at *4).
[48] *Id.* at 84.
[49] *Id.*

an arbitrator's mistake that "implies bad faith or failure to exercise honest judgment."[50] Gross mistake results in an arbitrary or capricious decision, but "honest judgment made after due consideration given to conflicting claims, however erroneous, is not arbitrary or capricious."[51] The court of appeals disagreed that the McAllen's expert report was erroneous because it contained 266 pages detailing his damages model and methodology, and the expert was subjected to extensive cross-examination during arbitration.[52] The expert's damages report was partially based on the possibility of unknown contamination.[53] If the expert's report contained evidence not admissible at trial, and the arbitration panel misapplied substantive law to the evidence, then a mistake of fact or law may have occurred.[54] This mistake, however, does not rise to the level of a gross mistake warranting vacatur of the arbitration award.[55]

Forest Oil also challenged the arbitration panel's $500,000 personal injury award to Mr. McAllen and $500,000 in exemplary damages.[56] The Houston First Court of Appeals determined Forest Oil did not show these awards should be overturned.[57] In Mr. McAllen's personal injury award, the panel did not act in bad faith or fail to exercise honest judgment.[58] Relating to exemplary damages, the arbitration agreement's language allowed the arbitration panel to award punitive damages under Texas's substantive law.[59]

In sum, the Houston First Court of Appeals confirmed the trial court's decision to uphold the arbitration award of $15,000,000 in actual damages, $500,000 in personal injury to Mr. McAllen, $500,000 in exemplary damages, and attorney's fees. The Houston First Court of Appeals also determined the Railroad Commission did not have exclusive or primary jurisdiction over the dispute, Forest Oil failed to show evident partiality of Arbitrator Ramos, and the arbitration panel did not exceed its authority in rendering its award. Forest Oil appealed the Houston First Court of Appeals decision to the Texas Supreme Court.

## OBSERVATIONS

1. The separate written dissent by one of the arbitrators provided a roadmap for vacatur.

2. The party-appointed arbitrators, one of whom was the dissenting arbitrator, were neutrals in the arbitration, and therefore subject to the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes.

3. The Settlement Agreement was the product of experienced oil and gas parties.

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[50] *Id.* (citing Callahan & Assocs. v. Orangefield Indep. Sch. Dist., 92 S.W.3d 841, 844 (Tex. 2002); Ouzenne v. Haynes, No. 01-10-00112-CV, 2012 WL 1249420, at *2 (Tex. App.—Houston [1st Dist.] Apr. 12, 2012, pet. denied) (mem.op.)).
[51] *Id.* (citing Universal Computer Sys., Inc. v. Dealer Solutions, L.L.C., 183 S.W.3d 741, 752 (Tex. App.—Houston [1st Dist.] 2005, pet. denied)).
[52] *Id.* at 85.
[53] *Id.*
[54] *Id.*
[55] *Id.*
[56] *Id.* at 85–86.
[57] *Id.* at 86.
[58] *Id.*
[59] *Id.* at 87.

4. The arbitration clause in the Settlement Agreement requiring an initial filing in the district court and that the district court immediately compel arbitration sounds like an advisory opinion.

5. This case continues to engender discussion about the common law grounds for vacatur of awards that is confusing in light of *Hoskins v. Hoskins*.[60]

6. "Exceeding powers" is the most often cited and used vacatur ground offered in 9 U.S.C. §10(a).[61]

7. There are numerous Texas cases that limit what constitutes exceeding the arbitrator's powers.[62]

[60] Hoskins v. Hoskins, 497 S.W.3d 490 (Tex. 2016).

[61] Lawrence R. Mills & Thomas J. Brewer, *Exceeded Powers: Exploring Recent Trends in Cases Challenging Tribunal Authority*, 31 ALTS. TO THE HIGH COST OF LITIG. 121 (2013); Thomas J. Brewer & Karen Fitzgerald, AAA Red Flags & Risk Areas for Arbitrators: A Review of Recent Cases Challenging Arbitrator Authority (2016).

[62] *See* Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84 (Tex. 2011); Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc., 294 S.W.3d 818 (Tex. App.—Dallas 2009, no pet.); Forged Components, Inc. v. Guzman, 409 S.W.3d 91 (Tex. App.—Houston [1st Dist.] 2013, no pet.); D.R. Horton-Texas, Ltd. v. Bernhard, 423 S.W.3d 532 (Tex. App.—Houston [14th Dist.] 2014, pet. filed); Nationsbuilders, Ins. Servs., Inc. v. Houston Int'l Ins. Grp. Ltd., No. 05-12-01103-CV, 2013 WL 3423755, (Tex. App.—Dallas July 3, 2013) (mem. op.).