The Arbitration Newsletter

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(John Allen Chalk, Sr., Editor)

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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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Conn Appliances, Inc. v. Puente[2]

When an appliance repairman injured his thumb on the job, he filed suit alleging that his employer, Conn Appliances, Inc. ("Conn"), failed to provide him with the proper tools.[3] Conn, a non-subscriber, moved to compel arbitration, and both Conn and the employee joined a motion to abate the claims and arbitrate.[4] The arbitrator awarded the employee $60,000, finding Conn negligent in failing to provide the correct tools, but also taking into account the employee's failure to act reasonably.[5] In an unusual role reversal, the employee filed a motion to vacate the award, while Conn filed a motion to confirm.[6] The employee argued that the arbitrator manifestly disregarded the law by improperly considering contributory negligence.[7] The arbitrator made extensive findings of fact and law in his award, all of which were scrutinized by the trial court.[8]

In support of his motion, the employee cited a provision in the arbitration agreement allowing vacatur "on the grounds specified in the Federal Arbitration Act or when the arbitrator's award reflects a *manifest disregard for the law*."[9] The trial court agreed with the employee, but also went one step further by declaring the arbitration agreement void due to fraudulent inducement by Conn.[10] The trial court found that the arbitrator's application of contributory negligence was a manifest disregard of

[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 Jared Hendrix, a third-year law student at Texas A&M University School of Law, for his research and drafting assistance.

[2] Conn Appliances, Inc. v. Puente, No. 09-18-00326-CV, 2020 Tex. App. LEXIS 6410 (Tex. App.—Beaumont Aug. 13, 2020, no pet. h.) (mem. op.).

[3] *Id.* at *1.

[4] *Id.* at *2-3.

[5] *Id.* at *4.

[6] *Id.* at *5.

[7] *Id.* at *4-5.

[8] *Id.*

[9] *Id.* at *5 (emphasis added).

[10] *Id.* at *6.

the law and that Conn materially breached the contract by having never intended to abide by the vacatur provision in the arbitration agreement.[11]

Conn argued on appeal that the Federal Arbitration Act ("FAA") does not permit vacatur based on manifest disregard and that there was no evidence of a breach of contract or fraudulent inducement.[12] The employee maintained his positions on appeal and argued the same manifest disregard and fraudulent inducement grounds for vacatur.[13]

The Beaumont appeals court noted that under the FAA arbitration awards are presumed valid and must be confirmed unless specific *statutory* grounds exist for vacatur.[14] The court refused to consider additional non-statutory grounds for vacatur, even for an arbitrator's mistake of law or fact.[15] Review of an award under the FAA "is extraordinarily narrow"[16] and "focuses on the integrity of the process, not the propriety of the result."[17] Stopping just shy of declaring manifest disregard dead, the appeals court held that "'manifest disregard of the law' as a non-statutory ground is no longer a proper basis for setting aside an arbitration award under the FAA."[18]

The employee argued that manifest disregard of the law remained a viable option for vacatur as part of the "judicial gloss" that courts may consider under section 10(a)(4).[19] The court declined to rule on the argument, however, because the employee failed to meet his burden in proving the arbitrator manifestly disregarded the law.[20] The court explained that "to the extent that manifest disregard survived *Hall Street*, it requires far more than mere error in the law or failure of the arbitrator to properly apply or consider the law."[21] Additionally, in Texas, even if manifest disregard is shown, deference should be given to the arbitrator's decision unless the award results in significant injustice.[22]

Lastly, the appeals court addressed the employee's fraud argument, holding that under section 10(1)(a) of the FAA, fraud does not encompass the parties' behaviors in creating the arbitration agreement. Instead, fraud must have a nexus to the arbitrator's award.[23] That Conn never intended to abide by the arbitration provision is immaterial to a fraud determination under 9 U.S.C § 10(a)(1).[24] There must instead be a showing of the arbitrator's "bad faith *during* the arbitration proceedings."[25]

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[11] *Id.* at *5-6.
[12] *Id.* at *6.
[13] *Id.* at *10.
[14] *Id.* at *7 (citing 9 U.S.C. § 10(a)).
[15] *Id.* at *8-9.
[16] *Id.* at *8 (quoting Hughes Training, Inc. v. Cook, 148 F. Supp. 2d 737, 742 (N.D. Tex. 2000), *aff'd*, 254 F.3d 588 (5th Cir. 2001)).
[17] *Id.* at *9 (citing Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc., 294 S.W.3d 818, 826 (Tex. App.—Dallas 2009, no pet.).
[18] *Id.* at *14 (citing Citigroup Glob. Mkts., Inc. v. Bacon, 562 F.3d 349, 358 (5th Cir. 2009), and numerous Texas courts of appeals).
[19] *Id.* at *14-15.
[20] *Id.* at *15.
[21] *Id.* Manifest disregard requires proof that the arbitrator knew of a governing principle, yet chose not to apply or consider it. *See id.* at *15 (citing Brabham v. A.G. Edwards & Sons, Inc., 376 F.3d 377, 381-82 (5th Cir. 1999)).
[22] *Id.* at *15-16 (citing Williams v. Cigna Fin. Advisors, Inc., 197 F.3d 752, 762 (5th Cir. 1999)).
[23] *Id.* at *17.
[24] *Id.*
[25] *Id.* at *17 (emphasis added).

OBSERVATIONS

1. The *de novo* standard of review under the FAA was again applied in this case resulting in the reversal and remand of a state trial court's order granting a motion to vacate, denying a motion to confirm, and ruling that the employer's "Dispute Resolution Plan" was void.

2. The limited vacatur grounds under 9 U.S.C. §10(a) are again cited and applied.

3. The famous "judicial gloss" footnote in *Stolt-Nielsen*[26] clings to faint life but remains subject to the high standards of proof required for the common-law doctrine of "manifest disregard" to exist even as a gloss on 9 U.S.C. §10(a).

4. The continued use of a 2006 draft of the arbitration clause[27] long after the 2008 *Hall Street* opinion created one of the implied issues in this case – can parties contract around 9 U.S.C. §10(a)?

5. Although the Beaumont court recognized "that manifest disregard of the law is not an independent basis for setting aside an arbitration award under the FAA,"[28] the court refused to decide if "the statutory grounds for vacatur [can] be supplemented by [parties'] agreement."[29]

6. *Puente* also reminds practitioners that failure to object timely "to the arbitrator, or to the arbitration procedure" can waive later objections, including an argument for "exemption" under 9 U.S.C. §1.[30]

7. The vacatur ground of "fraud" in 9 U.S.C. §10(a)(1) requires "clear and convincing evidence," "a nexus between the award and the alleged fraud," and "bad faith during the arbitration proceedings" (e.g., "bribery, undisclosed bias of an arbitrator, or willfully destroying or withholding evidence"), which the employee failed to establish.[31]

[26] Stolt-Nielsen S. A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 672 n.3 (2010).
[27] *Puente* at *2 ("The award may be vacated or modified on the grounds specified in the Federal Arbitration Act *or when the arbitrator's award reflects a manifest disregard for the law*.") (emphasis added); *see also id.* at *10 n.1.
[28] *Id.* at *14.
[29] *Id.* at *15 ("…because Puente failed to meet his burden to demonstrate that the arbitrator manifestly disregarded controlling law.").
[30] *Id.* at *11-12.
[31] *Id*. at *16-17.