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Arbitration Agreements, Expanded Judicial Review, and Preemption – Hall Street Associates and NAFTA Traders, Inc. – A National Debate with International Implications

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**ARBITRATION AGREEMENTS, EXPANDED JUDICIAL
REVIEW, AND PREEMPTION – *HALL STREET ASSOCIATES
AND NAFTA TRADERS, INC.* – A NATIONAL DEBATE WITH
INTERNATIONAL IMPLICATIONS⁺**

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I. INTRODUCTION

On May 13, 2011, the Texas Supreme Court, in construing the Texas Arbitration Act, rejected the U. S. Supreme Court’s analysis in *Hall Street Associates, L.L.C. v. Mattel, Inc.*¹ At issue was whether the parties may by agreement expand judicial review of an arbitration award beyond the specific grounds for vacatur or modification set forth in the Federal Arbitration Act. In *NAFTA Traders, Inc. v. Quinn*² the Texas Supreme Court held that the Texas Arbitration Act does not preclude the parties from supplementing judicial review by contract. A discussion on the reasoning of the Texas Court and others that have addressed this issue, together with implications, is vital to moving forward with contractual arbitration domestically and internationally.

The Federal Arbitration Act (“FAA”) of 1925³ prescribes the grounds for confirmation, vacatur, or modification of an arbitration award. The statutory grounds are set forth in §§ 9, 10 and 11 of the FAA.⁴ In *Hall Street Associates L.L.C. v. Mattel, Inc.*, the U. S. Supreme Court stated of these statutory grounds:

Sections 10 and 11, after all, address egregious departures from the parties’ agreed-upon arbitration: “corruption,” “fraud,” “evident partiality,” “misconduct,” “misbehavior,” “exceed[ing] . . . powers,” “evident material miscalculation,” “evident material

⁺ Received the "Best Article Award" for Volume XXIV of the *Southern Law Journal*.

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¹ 552 U.S. 576, 586 (2008).

² 339 S.W.3d 84 (Tex. 2011).

³ 9 U.S.C. §§ 1–16. All references to the FAA are to these provisions.

⁴ *Id.* §§ 9–11.

mistake,” “award[s] upon a matter not submitted;” the only ground with any softer focus is “imperfect[ions],” and a court may correct those only if they go to “[a] matter of form not affecting the merits.”⁵

In addition, a non-statutory ground for vacating an arbitral award was developed in the courts as the doctrine of “manifest disregard.” The doctrine arose in 1953 from language in *Wilko v. Swan*,⁶ where the Supreme Court stated, “the interpretations of the law by the arbitrators *in contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation.”⁷ Generally, under the “manifest disregard” doctrine a court manifestly disregards the law when an arbitrator knows of a clear legal principle and refuses to apply it.⁸ In addition to “manifest disregard of the law,” the Fifth Circuit Court of Appeals has recognized a non-statutory ground based on “public policy.”⁹

In *Hall Street* the U.S. Supreme Court ostensibly abolished all non-statutory grounds for judicial review, including “manifest disregard” and “public policy,” and held that, “[t]he FAA’s grounds for prompt vacatur and modification of awards are exclusive for parties seeking expedited review under the FAA.”¹⁰ In reaching this conclusion, the Court suggested that “‘manifest disregard’ can be read as merely referring to the § 10 grounds collectively, rather than adding to them . . . or as shorthand for the § 10 subsections authorizing vacatur when arbitrators were ‘guilty of misconduct’ or ‘exceeded their powers.’”¹¹

The Circuit courts were in conflict over the exclusiveness of the FAA provisions and the non-statutory doctrine of “manifest disregard” before *Hall*, and some still question whether “manifest disregard” survived the *Hall Street* decision.¹² More importantly, the ruling in *Hall Street* is of great significance to arbitration as an ADR process. Arbitration is a matter of contract between the parties, and parties typically provide for judicial review of the arbitral award in their agreement. The Supreme Court’s ruling in *Hall Street* precludes any such agreement, and now the statutory grounds for

⁵ *Hall Street*, 552 U.S. at 586.

⁶ 346 U.S. 427, 436-37 (1953).

⁷ *Id.* (italics added).

⁸ See Maureen A. Weston, *The Other Avenues of Hall Street and Prospects for Judicial Review of Arbitral Awards*, 14 LEWIS & CLARK L. REV. 929, 938-940 (2010); see generally Michael H. LeRoy, *Are Arbitrators Above The Law? The “Manifest Disregard of the Law Standard”*, 52 B.C. L. REV. 137 (2011).

⁹ See *Prestige Ford v. Ford Dealer Computer Services, Inc.*, 324 F.3d 391, 396 (5th Cir. 2003).

¹⁰ *Hall Street*, 552 U.S. at 576-78.

¹¹ *Id.*

¹² *Id.* at 583-85. See generally *infra* notes 60-66 and accompanying text.

vacating or modifying an arbitration award under the FAA “are exclusive and cannot be supplemented by contract.”¹³ The Court went on to say, however, that:

In holding that §§10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well. The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable. But here we speak only to the scope of the expeditious judicial review under §§9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement of arbitration awards.¹⁴

The larger issue then after *Hall Street* is whether and to what extent the parties to an arbitration agreement can provide for judicial review either beyond or narrower than the specific criteria in the FAA under the common law or a state arbitration act. Furthermore, to what extent must all courts follow *Hall Street* in light of the preemption doctrine? In Texas, these issues have been answered in *Nafta Traders, Inc. v. Quinn*.¹⁵ In that case, the Texas Supreme Court held that under the Texas General Arbitration Act (“TAA”) parties can indeed contract for expanded judicial review of arbitration awards and that such a conclusion is not preempted by the FAA or the U.S. Supreme Court’s ruling in *Hall Street*.¹⁶ This ruling appears to create a conflict in the law of judicial review of arbitration awards, and the rulings in *Nafta Traders* and other cases leave significant uncertainty for parties to arbitration agreements. Part II of this Article discusses and analyzes the rationale and ruling of the United States Supreme Court in *Hall Street*. Part III discusses the aftermath of the *Hall Street* decision, particularly unanswered questions that remain after that ruling was issued. Part IV discusses the rationale and ruling of the Texas Supreme Court in *Nafta Traders* as it resolved the Texas-specific issues remaining after *Hall Street*. Part V discusses the issue of preemption, and whether the result reached in *Nafta Traders*, as well as other state courts, should be preempted by the ruling in *Hall Street*. Finally, Part V discusses and analyzes the practical implications of these differing rulings, and how knowledgeable counsel can deal with this conflict of law when drafting arbitration agreements.

¹³ *Id.* at 577-78, 585-88. (emphasis added.)

¹⁴ *Id.* at 590-91.

¹⁵ 339 S.W.3d 84 (Tex. 2011).

¹⁶ *Id.* at 97.

II. THE FAA AND *HALL STREET ASSOCIATES, L.L.C. v. MATTEL, INC.*

The *Hall Street* litigation arose from a lease dispute between Hall Street Associates, L.L.C. (hereinafter “Hall Street”), which had leased property to Mattel, Inc. (hereinafter “Mattel”) for use as a manufacturing facility.¹⁷ The lease between the parties provided that Mattel would indemnify Hall Street for any costs incurred as a result of Mattel, or any predecessor tenants, failing to comply with environmental laws while operating manufacturing facilities on the property.¹⁸ A test was conducted in 1998 on the property’s well water, and high levels of trichloroethylene (TCE) were detected.¹⁹ The presence of TCE was believed to be the result of manufacturing discharge by tenants prior to Mattel, during the period between 1951 and 1980.²⁰ An onsite property examination by the Oregon Department of Environmental Quality (hereinafter DEQ), identified pollutants in the well water on the property.²¹ As a result, Mattel ceased using well water and agreed to a consent order with the DEQ to commence cleanup of the site.²² In 2001, Mattel notified Hall Street of its intent to terminate the lease.²³ In response, Hall Street filed suit challenging Mattel’s notice to terminate the lease, particularly claiming Mattel was obligated to indemnify Hall Street for cleanup costs incident to the removal of TCE and other pollutants from the property.²⁴ Trial was held in the U.S. District Court for the District Court of Oregon, and the trial court ruled in favor of Mattel on the termination issue; however, by agreement the parties agreed to submit the indemnification issue to arbitration.²⁵ The parties prepared an arbitration agreement and the trial court approved the agreement.²⁶ Specifically, the following provision was set forth in the arbitration agreement:

The United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) where the arbitrator’s

¹⁷ *Hall Street*, 552 U.S. at 579.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous.²⁷

At the conclusion of arbitration, Mattel received a favorable ruling, with a finding that it had no obligation to indemnify Hall Street.²⁸ The arbitrator reasoned the lease directed Mattel to comply with all applicable federal, state and local environmental laws, but did not specifically require Mattel to comply with the testing requirements of the Oregon Drinking Water Quality Act.²⁹

Hall Street then filed a motion to vacate, modify and/or correct the arbitrator's decision in District Court, urging it was legal error not to consider the Oregon Drinking Water Quality Act as an environmental law requiring Mattel's compliance under the terms of the subject lease.³⁰ The District Court agreed with Hall Street, vacated the arbitrator's decision and remanded the matter to the arbitrator for further proceedings.³¹ On remand, the arbitrator ruled in favor of Hall Street, concluding that the Oregon Drinking Water Quality Act did constitute an environmental law under the lease.³² Thereafter, both parties sought to modify portions of the arbitrator's decision in District Court; however, the arbitrator's ruling on indemnification in favor of Hall Street was upheld.³³

Both parties then appealed to the Ninth Circuit Court of Appeals.³⁴ The Ninth Circuit ruled in favor of Mattel, instructing the District Court on remand to "return to the application to confirm the original arbitration award (not the subsequent award revised after reversal), and . . . confirm that award, unless . . . the award should be vacated on the grounds allowable under 9 U.S.C. Section 10, or modified or corrected under the grounds allowable under 9 U.S.C. Section 11."³⁵

On remand, the District Court ruled in favor of Hall Street.³⁶ Following appeal, the Ninth Circuit reversed again.³⁷ The United States Supreme Court then granted certiorari on the issue of whether the grounds for vacatur and modification are exclusively identified in §§ 10 and 11 of the FAA.³⁸

²⁷ *Id.*

²⁸ *Id.* at 580.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 581.

³⁷ *Id.*

³⁸ *Id.*

As stated above, the U.S. Supreme Court in a 5-3 decision held that the grounds stated in the FAA §§ 10 and 11 for either vacating, or modifying or correcting an arbitration award constitute the exclusive grounds for expedited vacatur and modification of an arbitration award pursuant to the FAA.³⁹ The majority opinion written by Justice Souter first recited the national policy favoring arbitration and specific provisions of §§ 9, 10, and 11 of the FAA and also referenced the split in the Circuits over exclusivity and expansion by agreement.⁴⁰ The Court then proceeded to analyze Hall Street's two main arguments against exclusivity or in favor of expansion by agreement, which were (i) that expandable judicial review authority has been accepted as the law since *Wilko v. Swan*⁴¹ and (ii) "that the agreement to review for legal error ought to prevail simply because arbitration is a creature of contract, and the FAA is 'motivated, first and foremost, by a congressional desire to enforce agreements into which parties ha[ve] entered.'"⁴² The Court generally took a narrow, strict view of the FAA language in § 9, noting that "[u]nder the terms of § 9, a court 'must' confirm an arbitration award 'unless' it is vacated, modified, or corrected 'as prescribed' in §§ 10 and 11."⁴³

On Hall Street's first position, the Court stated that the "supposed" expansion by judicial interpretation of the *Wilko* language on the part of the various courts "is too much for *Wilko* to bear."⁴⁴ Rather, the Court ruled that *Wilko* stood against general review for an arbitrator's legal errors, and the language with the term "manifest disregard" may have been intended for a new ground, may merely have referred to the § 10 grounds collectively, or may have been a shorthand for the terms "guilty of misconduct" or "exceeded their powers" from the statutory language of the FAA.⁴⁵ However, the Court found "no reason to accord it the significance that Hall Street urges," and ruled that the presence of this language in *Wilko* did not mean that private parties could contract for greater judicial review than provided in the statute.⁴⁶

On Hall Street's second position, the Court also ruled that the argument fell short. The Court agreed that the FAA:

lets parties tailor some, even many features of arbitration by contract, including the way arbitrators are chosen, what their

³⁹ *Id.*

⁴⁰ *Id.* at 581-84.

⁴¹ *Id.* at 584.

⁴² *Id.* at 585.

⁴³ *Id.* at 582.

⁴⁴ *Id.* at 585.

⁴⁵ *Id.*

⁴⁶ *Id.*

qualifications should be, which issues are arbitrable, along with procedure and choice of substantive law. But to rest this case on the general policy of treating arbitration agreements as enforceable as such would be to beg the question, which is whether the FAA has textual features at odds with enforcing a contract to expand judicial review following the arbitration.

To that particular question we think the answer is yes, that the text compels a reading of §§ 10 and 11 categories as exclusive.⁴⁷

The Court based its reasoning on statutory interpretation, including reference to the old canon of construction *ejusdem generis*, which states that in interpreting a statute, a general term is limited to or confined to coverage of the specific terms it follows.⁴⁸ The Court noted that the statutory sections at issue did not even provide for “a textual hook for expansion” or a general term to allow judicial expansion of the enumerated specific instances of outrageous conduct to include “just any legal error.”⁴⁹ The Court went on to say that expanding the detailed categories goes against the clear language and mandate of § 9, and Congress’ use of words such as “must grant” and “prescribed” “does not sound remotely like a provision meant to tell a court what to do just in case the parties say nothing else.”⁵⁰ This led the Court to the ultimate conclusion that:

Instead of fighting the text, it makes more sense to see the three provisions, §§ 9-11, as substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway. Any other reading opens the door to the full-bore legal and evidentiary appeals that can “rende[r] informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process,” . . . and bring arbitration theory to grief in post-arbitration process.⁵¹

Justice Stevens joined Justice Kennedy in a dissenting opinion which focused on the FAA core purpose expressed in § 2 of the FAA “to abrogate the common-law rule against specific enforcement of arbitration agreements”⁵² and to ensure “that private arbitration agreements are

⁴⁷ *Id.*

⁴⁸ *Id.* at 586.

⁴⁹ *Id.*

⁵⁰ *Id.* at 587.

⁵¹ *Id.* at 588 (citations omitted).

⁵² *Id.* at 593 (quoting *Southland Corp. v. Keating*, 465 U.S. 1, 18 (1984)).

enforced according to their terms.”⁵³ Justice Stevens argued that the majority result conflicts with the FAA purpose and the statutory text does not compel a reading or interpretation inconsistent with the overriding interest of the FAA “in effectuating the clearly expressed intent of the contracting parties.”⁵⁴ He further argued that the majority’s decision was based in part on “an assumption that Congress intended to include the words ‘and no other’ in the grounds specified in §§ 10 and 11 for the vacatur and modification of awards.”⁵⁵

III. THE *HALL STREET* AFTERMATH – SCOPE AND UNANSWERED QUESTIONS

Much controversy has surrounded the *Hall Street* decision. The courts at the federal and state levels as well as commentators have joined the debate. Two highly regarded commentators, Professor Rau at the University of Texas and Professor Smit at Columbia University, critically reviewed the opinion and differed on the correctness of the decision.⁵⁶ Professor Rau disagreed with the decision and reasoning,⁵⁷ while Professor Smit agreed with the decision but found fault in the Court’s rationale for the holding and the unanswered questions it raised.⁵⁸ The courts are in no less disarray.

What seems clear from the holding in *Hall Street* is that the grounds in the FAA for vacatur, modification, or correction for judicial review of an arbitral award rendered solely pursuant to the FAA are exclusive and may not be expanded by the parties in an arbitration agreement. This ostensibly laid to rest the general question and conflict over whether parties could expand arbitral award judicial review by contract under the FAA. However, the Court’s treatment of “manifest disregard;” the Court’s qualification of the decision as only applying to FAA judicial review; and the Court’s statement that other means to judicial review outside the FAA may exist, such as state

⁵³ *Id.* (quoting *Volt Information Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478, (1989)).

⁵⁴ *Id.* at 595 (stating that “A listing of grounds that must always be available to contracting parties simply does not speak to the question whether they may agree to additional grounds for judicial review.”).

⁵⁵ *Id.* at 594.

⁵⁶ See Alan Scott Rau, *Fear of Freedom*, 17 AM. REV. INT’L ARB. (Special Section: *Hall Street Associates, L.L.C. v. Mattel, Inc.*) 469 (2008); Hans Smit, *Hall Street Associates v. Mattel: A Critical Comment*, 17 AM. REV. INT’L ARB. (Special Section: *Hall Street Associates, L.L.C. v. Mattel, Inc.*) 513 (2008).

⁵⁷ See Rau, *supra* note 56.

⁵⁸ See Smit, *supra* note 56.

statutes and common law, have led to what one commentator refers to as “The Hall Street Hangover.”⁵⁹

Generally, the FAA provisions and the court-developed common law doctrines for judicial review of arbitral awards have co-existed since the FAA enactment in 1925.⁶⁰ The non-statutory vacatur doctrines have included “manifest disregard,” “arbitrary and capricious,” “completely irrational,” and “violation of public policy.”⁶¹ Other arguments outside of the FAA but finding effect in the courts have included, “contained a factual error,” “did not draw their essence from the agreement,” “had a punitive, excessive, or unauthorized remedy,” “were unconstitutional,” “were invalid because there was no arbitration agreement,” and “resulted from an agreement to allow parties to expand and define their own standards of review.”⁶² Thus, it was not unusual for courts to find extra-statutory bases for review outside of the arbitration agreement, or to allow parties to contract for a different standard of review for awards than that expressly set forth in the FAA.

The *Hall Street* decision did not specifically say that all non-statutory, common law, or contractual avenues for judicial review were abolished, rendered null, or extinguished by its decision. Rather, the Court stated:

In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well. The FAA is not the only way into the court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable. But here we speak only to the scope of the expeditious judicial review under §§ 9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement or arbitration awards.⁶³

The most widely applied non-statutory standard in both federal and state courts is “manifest disregard.”⁶⁴ At least one view is that “manifest

⁵⁹ See Codie Henderson, Note, *Business Law—The Hall Street Hangover: Recovering and Discovering Avenues for Review of Arbitration Awards; Hall Street Assocs. v. Mattel, Inc.*, 128 S.Ct. 1396 (2008), 10 WYO. L. REV. 299 (2010).

⁶⁰ See LeRoy, *supra* note 8; see also Weston, *supra* note 8; Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905 (2010).

⁶¹ Leroy, *supra* note 8, at 174.

⁶² *Id.* at 174-75.

⁶³ *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 590 (2008).

⁶⁴ See generally Leroy, *supra* note 8 (setting forth research regarding the adoption of the manifest disregard standard).

disregard” has subsumed all non-statutory, common law grounds, except perhaps “public policy.”⁶⁵ Prior to *Hall Street*, all federal Circuit Courts had adopted the “manifest disregard” ground as a possible basis for vacating an arbitral award. The three possible sources for the courts’ understanding and applying this ground have been:

1. As an independent, judicially created ground for review of arbitration awards;
2. As a turn of phrase used in interpreting the §10 grounds for vacating an award; and
3. As a synonym for FAA §10(a)(4) allowing vacatur where an arbitrator “exceeded their powers.”⁶⁶

The U.S. Supreme Court addressed “manifest disregard” specifically in the *Hall Street* opinion, referring to the *Wilko v. Swan* case and language that gave rise to the doctrine and further acknowledging the differences between the Federal Circuit Courts regarding whether it is an independent ground for review or a shorthand for certain statutory grounds. The Court stated:

Maybe the term ‘manifest disregard’ was meant to name a new ground for review, but maybe it merely referred to the §10 grounds collectively, rather than adding to them . . . Or, as some courts have thought, “manifest disregard” may have been shorthand for § 10(a)(3) or § 10(a)(4), the paragraphs authorizing vacatur when the arbitrators were “guilty of misconduct” or “exceeded their powers.”⁶⁷

The Federal Circuit Courts are now divided on whether “manifest disregard,” in particular, or any other non-statutory, common law ground survives the *Hall Street* decision.⁶⁸ There are three ways the federal and state courts have decided the issue since *Hall Street*:

1. The FAA grounds in § 10 are exclusive, and *Hall Street* abolished “manifest disregard” as an independent ground for judicial review – so the doctrine is eliminated and no longer available or applicable;
2. “Manifest disregard” is a “judicial gloss” for all of the § 10 grounds for vacatur – so the court could still apply existing precedent as long

⁶⁵ *Id.*

⁶⁶ *Id.* at 160-73; Weston, *supra* note 8, at 941-45.

⁶⁷ *Hall Street*, 552 U.S. at 585.

⁶⁸ Leroy, *supra* note 8, at 180.

as the reasoning did not extend beyond one of the enumerated grounds; and

3. “Manifest disregard” is shorthand for § 10(a)(3) or § 10(a)(4) – so that the court could still apply existing precedent to it as a statutory ground.⁶⁹

The breakdown of the split between the Federal Circuit Courts reflects that the Fifth, Eighth, and Eleventh Circuits follow the “abolished” line of reasoning.⁷⁰ The Second Circuit continues to apply the doctrine under the “judicial gloss” reasoning.⁷¹ The Ninth Circuit continues to apply the doctrine under the “shorthand” reasoning.⁷² The First, Sixth, and Tenth Circuits have expressed hints or views in dicta or unpublished opinions but have not directly addressed and expressed their positions.⁷³ The remaining Third, Fourth, Seventh, and D.C. Circuits have not yet written on the question.⁷⁴

The state courts that have addressed the question of contractual judicial expansion and a non-statutory or common law ground, particularly “manifest disregard,” are also divided on approach. The Alabama Supreme Court has adopted the “abolished” position and supplemental grounds are no longer applicable.⁷⁵ Colorado questions the applicability of any non-statutory bases after *Hall Street*.⁷⁶ California, Wisconsin, and Indiana courts have ruled or assumed that “manifest disregard” still survives under one or the other of the above approaches.⁷⁷ In May 2011, Texas addressed the issue of contractual agreements to expand judicial review in the *Nafta Traders* decision.

IV. THE TAA AND *NAFTA TRADERS, INC. v. QUINN*

In May, 2011, the Texas Supreme Court handed down its decision in *NAFTA Traders, Inc. v. Quinn*.⁷⁸ The Court directly addressed the holding in *Hall Street* in light of the TAA.⁷⁹ The TAA provides for confirming, vacatur,

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Volvo Trucks N.A., Inc. v. Dolphin Line, Inc.*, 50 So.3d 1050 (Ala. 2010).

⁷⁶ *Barnett v. Elite Props.*, No. 09CA0693, 2010 WL 2105940, at *6 (Colo. App. May 27, 2010).

⁷⁷ Leroy, *supra* note 8, at 181.

⁷⁸ 339 S.W.3d 84 (Tex. 2011).

⁷⁹ TEX. CIV. PRAC. & REM. CODE §§ 171.001 - .098. All references to the TAA are to these provisions.

and modification of arbitral awards on grounds nearly identical to those in §§ 10 and 11 of the FAA. The provision of the TAA that corresponds to § 9 in the FAA states that “[u]nless grounds are offered for vacating, modifying, or correcting an award under section 171.088 or 171.091 [of the TAA], the court, on application of a party, shall confirm the award.”⁸⁰ Applying the TAA, the Texas Supreme Court reached a different conclusion than the U.S. Supreme Court in *Hall Street*, and in rejecting *Hall Street* the Texas high court decided that the criteria in the TAA were not exclusive and the parties could supplement judicial review in the arbitration agreement.⁸¹

Prior to the litigation leading to the decision in *Nafta Traders*, Margaret Quinn (“Quinn”) was Vice President of Operations for Nafta Traders, Inc. (“Nafta Traders”), an international re-distributor of athletic apparel and footwear.⁸² Quinn was terminated by Nafta Traders when the company reduced its workforce in response to declining business.⁸³ Quinn sued Nafta Traders, alleging her termination was motivated by sex discrimination.⁸⁴ The handbook for employees of Nafta Traders required binding arbitration to resolve disputes arising incident to the employment relationship; however, the handbook did not specify whether state or federal law would apply.⁸⁵ Nafta Traders responded to Quinn’s lawsuit by moving to compel arbitration under the Federal Arbitration Act.⁸⁶ Quinn did not object, and an agreed order was signed directing the parties to arbitration.⁸⁷

Following arbitration, Quinn received an award of \$30,000 in back pay, \$30,000 in mental anguish damages, \$29,031 in “special damages,” \$104,828 in attorney fees, and costs.⁸⁸ Quinn filed a motion to confirm the arbitration decision under the TAA.⁸⁹ In response, Nafta Traders moved for vacatur under the FAA, the TAA, common law, and a section captioned “Arbitration” of the Nafta Traders’ employee handbook, which provided in relevant part:

The arbitrator does not have authority (i) to render a decision which contains a reversible error of state or federal law, or (ii) to apply a

⁸⁰ TEX. CIV. PRAC. & REM. CODE § 171.087.

⁸¹ *Nafta Traders*, 339 S.W.3d at 101 (Tex. 2011).

⁸² *Id.* at 87.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.* at 87-88.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

cause of action or remedy not expressly provided for under existing state or federal law.⁹⁰

Nafta Traders argued that the agreement on the limitations of the arbitrator's authority effectively expanded the narrow scope of judicial review otherwise allowed by the TAA and FAA.⁹¹ As specific grounds for vacatur, Nafta Traders contended that (i) the arbitrator improperly applied federal sex discrimination law to Quinn's claim, although she had only alleged violation of state law; (ii) the evidence was factually insufficient to support a finding of sex discrimination; (iii) the attorneys fee award was improper; (iv) the "special damages" award was a double recovery of lost wages; and (v) the evidence did not support a recovery of mental anguish damages.⁹² The District Court confirmed the arbitrator's award without comment on Nafta Traders' complaints and Nafta Traders appealed.⁹³ The Dallas Court of Appeals applied the TAA rather than the FAA, but decided that the similarity of the two statutes justified construing the TAA like the U.S. Supreme Court construed the FAA in *Hall Street*.⁹⁴ The Dallas Court of Appeals affirmed the trial court ruling that "parties seeking judicial review of an arbitration award covered under the TAA cannot contractually agree to expand the scope of that review and are instead limited to judicial review based on the statutory grounds enumerated in the statute."⁹⁵

Nafta Traders also argued in the Court of Appeals that the arbitrator exceeded his power by issuing an erroneous award when the arbitration agreement expressly denied his authority to commit reversible error or apply an action or remedy contrary to state or federal law.⁹⁶ The argument implicated a statutory ground in section 171.088(a)(3)(A) of the TAA.⁹⁷ The Dallas Court of Appeals rejected the argument by saying that an arbitrator exceeds his power by deciding issues not submitted to arbitration but not by deciding submitted issues erroneously.⁹⁸ The Court further expressed that Nafta Traders was trying to invoke the ground to accomplish indirectly what *Hall Street* already determined Nafta Traders could not do directly, that is

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 88-89.

⁹⁴ *Id.* The U.S. Supreme Court decided *Hall Street* after oral argument in *Nafta Traders* but before the Texas Court of Appeals' opinion was issued.

⁹⁵ *Id.* at 89 (quoting *Quinn v. NAFTA Traders, Inc.*, 257 S.W.3d 795 (Tex. App. – Dallas, 2008)).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

expand judicial review by contract.⁹⁹ The Court concluded that none of Nafta Traders' arguments fell within a statutory ground.¹⁰⁰

Nafta appealed to the Texas Supreme Court, and Justice Hecht delivered the opinion of the Court. In a 9-0 decision, the Court addressed two principal questions: whether the TAA, like the FAA (as decided in *Hall Street*), "precludes an agreement for judicial review of an arbitration award for reversible error, and if not, whether the FAA preempts enforcement of such an agreement."¹⁰¹ The Court answered both in the negative and reversed the Court of Appeals.¹⁰²

On the first issue, the Texas Supreme Court recognized that it must follow *Hall Street* in applying the FAA, but the Court stated that it would make its own judgment in construing the TAA.¹⁰³ The Court's rationale began with the specific ground for vacatur or modification of an award found in the TAA, that "the arbitrators ... exceeded their powers."¹⁰⁴ Furthermore, the Court noted that "[a]n arbitrator derives his power from the parties' agreement to submit to arbitration."¹⁰⁵ The Texas Supreme Court quoted the U.S. Supreme Court's decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*,¹⁰⁶ as follows:

Whether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must give effect to the contractual rights and expectations of the parties. In this endeavor, as with any other contract, the parties' intentions control. This is because an arbitrator derives his or her powers from the parties' agreement to forgo the legal process and submit their disputes to private dispute resolution.¹⁰⁷

Quinn argued that the agreement limiting the arbitrator's authority was in effect broadening judicial review of the arbitration award just like the agreement in *Hall Street*.¹⁰⁸ She argued that this is not permitted under the TAA for the same reasons that the U.S. Supreme Court recited in *Hall Street* regarding the FAA.¹⁰⁹ The Texas Supreme Court noted that the U.S.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 87.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ TEX. CIV. PRAC. & REM. CODE § 171.088(a)(3)(A).

¹⁰⁵ *Nafta Traders*, 339 S.W.3d at 91 (quoting *In re Gulf Exploration, LLC*, 289 S.W.3d 836, 839 (Tex. 2009)).

¹⁰⁶ 130 S.Ct. 1758, 1773-74 (2010).

¹⁰⁷ *Id.*

¹⁰⁸ *Nafta Traders*, 339 S.W.3d at 91 (Tex. 2011).

¹⁰⁹ *Id.*

Supreme Court based its decision on the textual framework of the FAA and the policy favoring limited review expressed in the FAA’s statutory language¹¹⁰ and that the parties and the Court in *Hall Street* framed the issue as “expandable judicial review authority.”¹¹¹ However, the Texas Supreme Court viewed the agreement in *Nafta Traders* as the “flip-side” to such a frame, “limited arbitral decision-making authority.”¹¹²

Even though the parties in *Hall Street* did not couch their agreement in the specific terms of limited authority in an award that was not supported by the law, that was the practical effect of what they were attempting to do. The *Hall Street* parties were therefore attempting to do indirectly what the *Nafta Traders* parties were doing directly – limit the arbitrator’s authority.¹¹³ In *Hall Street*, the U.S. Supreme Court did not discuss FAA § 10(a)(4), which provides for vacatur for an arbitrator exceeding his or her powers like the TAA provision in § 171.088(a)(3)(A). The Texas Supreme Court held that this section undercuts the U.S. Supreme Court’s textual analysis,¹¹⁴ reasoning that if the parties agree that the arbitrator’s authority shall be limited to that of a judge to not reach a decision based on reversible error, “in other words, that an arbitrator should have no more power than a judge,” then a motion to vacate for exceeding that authority is “firmly grounded in the text of Section 10.”¹¹⁵ According to the U.S. Supreme Court’s reasoning, an arbitrator can never exceed his or her power by committing reversible error within § 10, regardless of the parties’ agreement. Whether this reasoning is “at odds with expanded judicial review depends on whether the right to contract to circumscribe arbitral authority includes limiting the authority to err in decision-making.”¹¹⁶ According to the Texas Supreme Court, the ultimate question was “whether parties can agree to limit an arbitrator’s power to err.”¹¹⁷

The Texas Supreme Court proceeded to discuss the U.S. Supreme Court’s policy declarations for the FAA in *Hall Street*, predominantly “limited review” and “resolving disputes straightaway” – couched as expeditious resolution of claims.¹¹⁸ The Texas Supreme Court rejected this reasoning and cited the U.S. Supreme Court’s own repeated affirmations that “the principal purpose of the FAA is to ensure that private arbitration

¹¹⁰ *Id.* at 92.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 93.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 94.

agreements are enforced according to their terms.”¹¹⁹ A policy of limited judicial review in an agreement would be inimical to such purpose as well as the “national policy favoring arbitration” established by Congress in the FAA.¹²⁰

According to the Texas Supreme Court’s rationale, searching for a policy rationale to the *Hall Street* reasoning was unavailing, so the consideration came back to the statutory text, and the Court stated:

The problem comes down to this. Under the TAA (and the FAA), an arbitration award must be vacated if the arbitrator exceeds his powers. Generally, an arbitrator’s powers are determined by agreement of the parties. Can the parties agree that an arbitrator has no more power than a judge, so that his decision is subject to review, the same as a judicial decision? *Hall Street* answers no, based on an analysis of the FAA’s text that ignores the provision that raises the problem, and a policy that may be at odds with the national policy favoring arbitration. With great respect, we are unable to conclude that *Hall Street*’s analysis of the FAA provides a persuasive basis for construing the TAA the same way.

[W]e agree that delay and resulting expense are concerns that arbitration is intended, at least, to alleviate. But equally grievous is a post-arbitration process that refuses to correct errors as the parties intended, and of equal concern is a civil justice system that allows parties an alternative to litigation only if they are willing to risk an unreviewable decision.¹²¹

The Texas Supreme Court went on to reaffirm Texas policy and law adhering to broad freedom of contract and found nothing in the TAA conflicting with the policy, stating:

On the contrary, the purpose of the TAA is to facilitate arbitration agreements. . . . Specifically, the TAA contains no policy against parties’ agreeing to limit the authority of an arbitrator to that of a judge, but rather, an express provision requiring vacatur when “arbitrators [have] exceeded their powers.” . . . Accordingly, we hold that the TAA presents no impediment to an agreement that limits the authority of an arbitrator in deciding a matter and thus

¹¹⁹ *Id.*

¹²⁰ *Id.* at 95 (citing *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984)).

¹²¹ *Id.* at 95 (footnotes omitted).

allows for judicial review of an arbitration award for reversible error.¹²²

The Texas Court thus declined to follow the U.S. Supreme Court's reasoning from *Hall Street* and held that the TAA did not preclude an arbitration agreement from limiting the arbitrator's authority in deciding a matter and allowing judicial review of an award for reversible error.¹²³

V. PREEMPTION

A. *The Preemption Ruling in Nafta Traders*

The second broad question addressed by the Texas Supreme Court in *Nafta Traders* was whether its decision and accompanying rule for the TAA was preempted by the FAA and the contrary holding in *Hall Street*. The agreement in *NAFTA Traders* was covered by both state and federal law, since the parties did not specifically choose one or the other. When both laws apply, the Texas Supreme Court held that "state law is preempted 'to the extent that it actually conflicts with federal law – that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"¹²⁴ Thus, the Texas Supreme Court held that because the provision for expanded judicial review did not directly conflict with the federal policy of enforcing arbitration clauses enshrined in the FAA, it was not preempted.¹²⁵

The Texas Supreme Court relied extensively on the U.S. Supreme Court's explanation of the FAA's preemptive effect in *Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*¹²⁶ In *Volt*, the parties chose California law to govern their arbitration agreement.¹²⁷ The California law contained a provision that allowed a stay of arbitration pending resolution of related litigation,¹²⁸ while the FAA contained no such provision.¹²⁹ As a result, the U.S. Supreme Court held that the state law was not preempted, concluding that the FAA's purpose is not defeated by conducting arbitration under state-law procedures different from the federal

¹²² *Id.* at 97.

¹²³ *Id.*

¹²⁴ *Id.* at 97-98 (footnote omitted).

¹²⁵ *Id.*

¹²⁶ 489 U.S. 468 (1989).

¹²⁷ *Id.* at 470.

¹²⁸ *Id.* at 471.

¹²⁹ *Id.* at 472.

statute.¹³⁰ The Texas Supreme Court seized upon the following language in that case:

While Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage “was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.” Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so, . . . nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.¹³¹

The Texas Supreme Court construed the language to mean that “FAA-preemption is aimed at state-law hindrances to enforcement of arbitration agreements not applicable to contracts generally.”¹³² Specifically, the court held that:

The FAA only preempts the TAA if: (1) the agreement is in writing, (2) it involves interstate commerce, (3) it can withstand scrutiny under traditional contract defenses under state law, and (4) state law affects the enforceability of the agreement. . . . The mere fact that a contract affects interstate commerce, thus triggering the FAA, does not preclude enforcement under the TAA as well. For the FAA to preempt the TAA, state law must refuse to enforce an arbitration agreement that the FAA would enforce, either because (1) the TAA has expressly exempted the agreement from coverage, or (2) the TAA has imposed an enforceability requirement not found in the FAA.¹³³

The lesson from *Volt*, according to the Texas Supreme Court is “that the FAA does not preempt all state-law impediments to arbitration; it preempts state-law impediments to arbitration agreements.”¹³⁴ In light of *Volt*, the Texas Supreme Court did not read the *Hall Street* opinion as displacing the principal basis of preemption as protection of parties’ arbitration agreements.

¹³⁰ *Id.* at 478-79.

¹³¹ *Id.* at 478 (citations omitted).

¹³² *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 98 (Tex. 2011).

¹³³ *Id.*

¹³⁴ *Id.* at 100.

This is particularly true in view of the U.S. Supreme Court's language in *Hall Street*, which states:

In holding that [FAA] §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well. The FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable. But here we speak only to the scope of the expeditious judicial review under §§ 9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement of arbitration awards.¹³⁵

Therefore, the Texas Supreme Court's construction of the TAA that allows agreements to enlarge judicial review is not an impediment to the enforcement of the parties' agreement, but rather advances the enforcement of the agreement according to the intentions and expectations of the parties. In addition, the *Hall Street* opinion expressly contemplates that the FAA will not preempt state law allowing expanded judicial review.

The Texas Supreme Court did not stop with the answering of the two primary questions. After determining that the TAA allowed expanded judicial review by agreement and that the TAA was not preempted by the FAA in this regard, the Texas Supreme Court concluded the opinion with qualifications and caveats. Mere choice of the TAA to govern the agreement or specifically choosing not to be governed by the FAA does not provide expanded judicial review. "The matter is left to the agreement of the parties. . . . [A]bsent clear agreement, the default under the TAA, and the only course permitted by the FAA, is restricted judicial review."¹³⁶ Furthermore, a mere agreement for expanded judicial review is in itself not enough. The parties must ensure a sufficient record of the proceedings and complaints must have been preserved as if the award was a judgment going up on appeal. Additionally, the parties may not agree to a different standard of review than would be applicable to a judicial appeal.¹³⁷

B. Preemption Issues Going Forward

Open preemption issues remain with respect to the scope of judicial review of arbitration awards. Will the conclusion of the Texas Supreme

¹³⁵ *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 590 (2008).

¹³⁶ *Nafta Traders*, 339 S.W.3d at 101.

¹³⁷ *Id.* at 101-02.

Court on the issue of preemption be followed by the U.S. Supreme Court? Will choice of law provisions where parties specifically choose state arbitration law as the basis for judicial review of an award be followed, or will they be preempted by federal law? Do FAA §§ 9-11 apply exclusively in federal courts, but not in state courts? The U.S. Supreme Court has not yet ruled on these specific preemption issues and its previous rulings on preemption and the FAA have been somewhat confusing and conflicting, making it difficult to determine how these issues will be resolved. While the language in *Hall Street* indicates that the U.S. Supreme Court may be open to the preemption reasoning utilized in *Nafta Traders* allowing expanded judicial review, the method of statutory construction used by the Court in *Hall Street* can easily lead to the opposite conclusion – that expanded judicial review is preempted, in both state and federal court, if the arbitration at issue is subject to the FAA.

In *Hall Street*, the U.S. Supreme Court relied heavily, and almost exclusively, upon the text of the statute itself in reaching its conclusion. The text of the particular sections of the FAA at issue can be interpreted as an indicator of express Congressional intent to preempt state law and establish a national standard for both state and federal courts reviewing arbitration awards:

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon *the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title.*¹³⁸

Thus, while the U.S. Supreme Court did give credence to the fact that more expansive judicial review under state statutes was “arguable,”¹³⁹ their own method of strict and literal construction of the statutory language would seem to eliminate that argument. The language of this provision, taken at face value, appears to expressly state that all arbitration awards covered by the FAA may only be modified, corrected, or vacated as set forth in the FAA. There is no indication in this provision of intent to allow an applicable state statute or the common law to undercut this policy. The U.S. Supreme Court has not yet addressed whether §§ 9-11 of the FAA apply to state courts.¹⁴⁰

¹³⁸ 9 U.S.C. § 9 (emphasis added).

¹³⁹ *Hall Street*, 552 U.S. at 588.

¹⁴⁰ See Drahozal, *supra* note 60, at 924.

Some commentators have asserted that by their terms, these provisions should be interpreted as applying only to federal courts, and have no, or very limited, applicability to FAA cases in state court.¹⁴¹ However, a strict reading of the statute does not support such a conclusion.

Section 9 of the FAA does not refer only to judicial review by federal courts, it refers to any court that the parties specify, and then proceeds to state that any such court “must grant” an order confirming the award, except for the reasons set forth in §§ 10 & 11. Thus, while FAA §§ 10 and 11 specifically reference only federal courts,¹⁴² they are incorporated by reference in § 9, which applies those sections to *any* court specified by the parties.¹⁴³ If the U.S. Supreme Court continues to construe this provision as literally as it did in *Hall Street*, then it would appear that the proper interpretation of this provision is that it requires *any* court, not just federal courts, specified by the parties to enter a judgment confirming the award unless the statutory reasons for vacatur or modification are met. If this language is as mandatory and dogmatic as the *Hall Street* opinion makes it out to be, any state arbitration statute which allows for more expansive judicial review is in direct conflict with this statutory language and is arguably preempted if the FAA also applies to the arbitration agreement at issue.

Indeed, language used by the U.S. Supreme Court in *Hall Street* would seem to support such an approach. In reaching its conclusion, the Court stated that §§ 9-11 of the FAA set forth a “national policy favoring arbitration with just the limited review needed to maintain arbitration’s essential virtue of resolving disputes straightaway.”¹⁴⁴ If the standard of judicial review of an arbitration award can be modified simply by seeking enforcement under a state statute that allows a lower standard of review, such a “national policy” could hardly be fulfilled.

¹⁴¹ *Id.* (“If sections 9 and 10 of the FAA apply in their entirety in state court, their preemptive effect presumably is the same as described above—precluding reliance on state laws permitting expanded review. But the more likely result is that sections 9 and 10 of the FAA do not apply in state court—that, consistent with their terms, they apply only in federal court.”) (citing 4 Ian R. Meneil, Richard E. Speidel & Thomas J. Stipanowich, *Federal Arbitration Law: Agreements, Awards, and Remedies under the Federal Arbitration Act* §§ 38.1.4-6 (Supp. 1999) (“[w]ith one exception, the courts in which FAA §§ 9-11 proceedings are to take place were obviously intended by Congress to be federal, not state, courts. The one exception is under FAA §9, where the parties have the power to and do specify a court for confirmation, with nothing in the section explicitly limiting their power of selection to federal courts. Thus, for example, a clause providing for entry of judgment in a New York state court would appear to be effective under FAA § 9.”)).

¹⁴² 9 U.S.C. §§ 10 & 11.

¹⁴³ 9 U.S.C. § 9.

¹⁴⁴ *Hall Street*, 552 U.S. at 588.

The only exception one could arguably find in the language of the statute is that it expressly refers only to courts which the parties have specified in their agreement.¹⁴⁵ The language of this provision is not limited to federal courts. This is clear from the fact that the provision later expressly discusses that if no such election is made by the parties, then application for enforcement of an award can be made to a federal court.¹⁴⁶ Thus, while FAA § 9 clearly applies to state courts, it can be argued to apply only to state courts specified by the parties in the arbitration agreement. If this is truly what the statute says, then the results from such an interpretation are quite bizarre. Parties wishing to contract for expanded judicial review under state law would essentially be penalized for using a forum selection clause.

If the parties to the agreement contract for a specific state's standard of judicial review to apply but do not include a forum selection clause, then they would have the opportunity for expanded judicial review, but *only if* there was no basis for removal to federal court. If the case is removed to federal court, and if § 9 of the FAA means what its text appears to mean, then the federal court is bound to apply the exclusive standard of judicial review found in §§ 10-11. However, if the parties utilize a forum selection clause which states the award may only be enforced in a particular state court, the result under § 9 would be that by specifically choosing a state court, you have essentially contracted for the exclusive federal court standard of review. Under such a strict interpretation of § 9, the only time the parties could have the standard of judicial review that they desire is when they contract for a specific state law to apply, fail to contract for a specific state forum, and there is no basis for federal court jurisdiction. Such a result seems nonsensical, and obviously does not fulfill the federal policy of ensuring "the enforceability, according to their terms, of private agreements to operate."¹⁴⁷

Following the rigid statutory interpretation utilized in *Hall Street* would appear to indicate that the above result is correct. If the text of FAA § 9 is to be strictly applied, then it is difficult to reach another result. The only arguments that remain are that either Congress did not really mean that § 9 applies only to state courts when the parties specifically name the court, but applies to all cases governed by the FAA regardless of the forum, or that Congress intended for these provisions to apply only to federal courts. Neither of these interpretations appears to be the most accurate reading of this statute, although both of these alternative readings lead to more sensible results.

¹⁴⁵ 9 U.S.C. § 9; McNeil et al., *supra* note 141.

¹⁴⁶ 9 U.S.C. § 9.

¹⁴⁷ Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 476 (1989).

The conclusion that §§ 9-11 of the FAA have some, or even complete, preemptive effect, whether in state and federal court or only in federal court, is not precluded by prior Supreme Court precedence holding that the FAA does not completely preempt state arbitration law. The Supreme Court has held that “[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration.”¹⁴⁸ However, this broad, sweeping language refers only to the substantive provisions of the FAA dealing with how arbitration provisions are enforced, not with judicial enforcement of rulings after arbitration has been held.¹⁴⁹ Commentators have referred to this distinction as the “front end” and “back end” of arbitration.¹⁵⁰ The U.S. Supreme Court has tacitly acknowledged that such a distinction is relevant, as the pre-emptive effect of the statute need not be determined by the statute as a whole; the analysis can and should be done on a provision by provision basis.¹⁵¹

The Texas Supreme Court relied heavily on the *Volt* opinion in determining that the FAA did not preempt the result in *Nafta Traders*. However, *Volt* was also a “front end” arbitrability claim. In that case, the Supreme Court took great care to point out that it involved enforcing the parties’ agreement with respect to *how* they could arbitrate their claims and that their choice to use state law rather than the FAA was not in conflict with the policies of the FAA.¹⁵² However, the policies undergirding the FAA which were discussed in that case were entirely different than the policies expressed by the Court in *Hall Street* with respect to judicial review. If the purpose of the FAA with respect to judicial review truly is to create a “national policy” favoring limited judicial review,¹⁵³ it is not at all clear that

¹⁴⁸ *Id.* at 477 (citing *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956)).

¹⁴⁹ *Id.*

¹⁵⁰ See, e.g., Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 417 (2004) (“At one end of the continuum, state laws that deal with ‘front end’ issues (the agreement to arbitrate and the arbitrability of a dispute) and ‘back end’ issues (modification, confirmation, and vacatur of awards) are most likely to be preempted.”); Stephen L. Hayford, *Federal Preemption and Vacatur: The Bookend Issues Under the Revised Uniform Arbitration Act*, 2001 J. DISP. RESOL. 67, 74-75. While we disagree with Professor Drahozal’s conclusions with respect to likelihood of preemption, the distinction between “front end” and “back end” issues is important and relevant.

¹⁵¹ *Volt*, 489 U.S. at 477. The Supreme Court acknowledged that “While we have held that the FAA’s ‘substantive’ provisions - §§ 1 and 2 - are applicable in state and federal court . . . we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court . . . are nonetheless applicable in state court.” *Id.* (citations omitted). There is no reason that this same reasoning cannot apply to each provision of the FAA with respect to preemption. It is certainly within the power of Congress to pass a law which preempts (whether express implied) certain portions, but not others, of state law on the subject being regulated.

¹⁵² *Volt*, 489 U.S. at 478-79.

¹⁵³ *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 588 (2008).

the policies and reasoning discussed in *Volt* and other preemption cases discussing these “front end” preemption issues are even relevant to the preemption analysis in cases involving the “back end” issue of judicial review.

Ultimately, when the U.S. Supreme Court addresses a case on this issue, the result will be determined by whether the Court takes a more policy-based approach or textualist approach to the interpretation of the statute and its preemptive effect. The make-up of the Court has changed since the ruling in the *Hall Street* decision, but five of the justices in the majority from *Hall Street* are still on the Court as of the time of this writing. However, further changes to the Court may occur by the time this issue comes before it. The optimal result would be for the Court to take a more policy-based approach, and rule that parties can indeed contract for enforcement of any arbitration award under the state law of their choice and that the FAA does not preempt such a result. This result gives parties more contractual options with respect to how their agreements will be enforced, providing them with valuable flexibility. However, given the result and method of analysis utilized in *Hall Street*, it is far from clear that the result reached in *Nafta Traders* and other state courts will be followed by the U.S. Supreme Court when it finally addresses this important issue.

C. *International Dimensions*

While a full treatment of the subject is outside the scope of this Article, it bears noting that the issue of preemption is further obfuscated when international dimensions are considered. The United States has adopted the Convention on the Recognition of Foreign Arbitral Awards of June 10, 1958 (hereinafter the “New York Convention”), which governs the enforceability of international commercial arbitration awards.¹⁵⁴ An arbitration award falls under the New York Convention when it involves a legal relationship that is considered commercial and either one or more of the parties is not a United States citizen or the relationship “involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states.”¹⁵⁵ The scope of this provision applying the New York Convention is quite broad, and thus the New York Convention could potentially apply to two United States citizens who have arbitrated domestically with respect to an international issue.

In spite of the fact that the New York Convention was adopted over forty years ago, commentators have noted that “there is still an absence of

¹⁵⁴ 9 U.S.C. § 201.

¹⁵⁵ 9 U.S.C. § 202.

consensus on the application of the Convention.”¹⁵⁶ Although domestic courts have been consistent in the application of the New York Convention to arbitrations conducted abroad for which enforcement is sought in the United States, courts have been less consistent in their application of the New York Convention to international arbitrations conducted domestically.¹⁵⁷ While the terms of the FAA clearly apply the New York Convention to international arbitrations conducted within the United States, domestic courts have still often applied Chapter 1 of the FAA (relating to domestic arbitrations) rather than applying the New York Convention via Chapter 2.¹⁵⁸

This confusion and inconsistency in the application of the New York Convention adds an extra layer of problems to the domestic issues with preemption already discussed. For example, suppose two United States citizens have a contractual dispute regarding international property, and the terms of the contract require arbitration of the dispute within the United States. Further, suppose that the parties have contracted for application of Texas law to apply to the contract, exclusive enforcement under the TAA, and expanded judicial review. A court, whether state or federal, would have three potential standards of judicial review to apply – Chapter 1 of the FAA, the New York Convention via Chapter 2 of the FAA (which may or may not allow for expanded judicial review),¹⁵⁹ or the expanded judicial review contracted for by the parties via the TAA. In this situation, the issue of preemption is once again critical to whether the parties will receive the expanded judicial review in their contract.

Under its express terms, it appears that Chapter 2 of the FAA should apply, which requires enforcement of the award under the New York Convention. The language of Chapter 2 with respect to the bases for review is mandatory, like that of Chapter 1, and states that courts “shall” confirm unless there is a ground for refusal under the New York Convention.¹⁶⁰ If the

¹⁵⁶ Richard W. Hulbert, *The Case for a Coherent Application of Chapter 2 of the Federal Arbitration Act*, 22 AM. REV. INT’L ARB. 45, 45 (2011).

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* at 46 (“In a nutshell, the principal source of the difficulties is the continued insistence by some, though not all, federal courts that Chapter 1 of the Federal Arbitration Act, the now venerable legislation enacted in 1925, still has an independent and decisive role to play in determining the legal effectiveness of an international award subject to the New York Convention of 1958, if that award is rendered in the United States.”).

¹⁵⁹ Heide Iravani and W. Michael Reisman, *The Changing Relation of National Courts and International Commercial Arbitration*, 21 AM. REV. INT’L ARB. 5, 19 (2010) (“The issue of whether parties should be able to contract for expanded judicial review once an award has been rendered is controversial within the world of commercial arbitration.”).

¹⁶⁰ 9 U.S.C. § 207 (“Within three years after an arbitral award falling under the Convention is made, any party to the arbitration may apply to any court having jurisdiction under this chapter for an order confirming the award as against any other party to the arbitration. The court shall

reasoning of *Hall Street* is applied to this provision and the bases for review under the New York Convention, then the result would be that expanded judicial review would not be allowed. The question then is whether the reasoning of *Hall Street* should also be applied to the New York Convention. Since the bases for vacating an award under the New York Convention are relatively similar to those found in the FAA, if the parties are not allowed to have the expanded judicial review they contracted for, the result would essentially be the same as if the court had applied Chapter 1 of the FAA.¹⁶¹ If the court decides that despite its terms Chapter 2 of the FAA does not apply, once again the issue of whether Chapter 1 of the FAA preempts enforcement under the TAA will determine whether expanded judicial review is allowed.

VI. IMPLICATIONS AND CONCLUSION

The implications of the rulings in *Hall Street* and *Nafta Traders* and the resulting preemption issues are substantial for parties drafting arbitration agreements. Due to the uncertainty of how the issue of preemption will be resolved, there is no “safe” course of action for contract drafters. If parties attempt to be very thorough and precise in how they draft their arbitration agreement, they can potentially draft themselves into a corner, as discussed above.¹⁶² Parties may seek a safe harbor for the expanded judicial review that they desire by including both choice of law and forum selection clauses, but the forum selection clause may have the opposite of its intended effect and force application of the limited judicial review of the FAA. Thus, how the arbitration agreement is drafted depends largely upon how the drafter feels this issue will be resolved by the Supreme Court. Given the schizophrenic nature of the U.S. Supreme Court’s opinions on this issue, predicting how it will ultimately be resolved is difficult.

In Texas and other states that have expressly stated that expanded judicial review by contract is allowable and not preempted by the FAA, the best course of action appears to be to draft the arbitration agreement with an express choice of law provision providing for exclusive enforcement under state arbitration law and a forum selection clause requiring that the award may only be enforced in that state’s court. Such provisions are generally given effect, and can be used to prevent the enforcement action from ending up in federal court, where the preemption of the state law by the FAA is

confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in said Convention.”).

¹⁶¹ Irvani and Reisman, *supra* note 159 at 19 (noting that the bases for vacatur of the domestic award track those set forth in Article V of the New York Convention).

¹⁶² See *supra* Part V.

more likely. Courts in states like Texas which have rejected the *Hall Street* reasoning under state law are required to follow the precedent established by their own high court over any contrary federal precedent other than the U.S. Supreme Court, and thus the wishes of the parties will be followed unless and until the U.S. Supreme Court