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ALTERNATIVE DISPUTE RESOLUTION

ARBITRATION: THE UNDERUSED ALTERNATIVE FOR OIL AND GAS DISPUTES

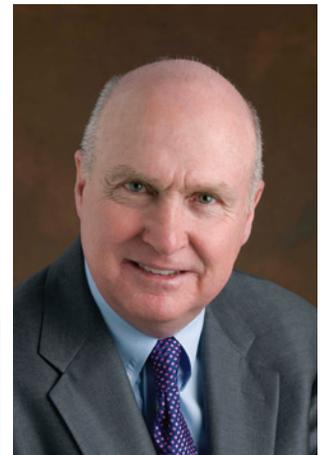
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Arbitration clauses are a staple in international energy contracts and oil and gas cases are the largest category of cases filed with ICSID, the World Bank's arbitration division (26 percent of recent cases filed, 39 percent counting other energy cases). Likewise, oil and gas cases frequently come before panels of all major international arbitration institutions. Yet the oil and gas industry too often avoids arbitration. Two widely used oil and gas form contracts—the AAPL Joint Operating Agreement and the Producers 88 oil and gas lease—almost never mention arbitration.

This article looks at why lessees, lessors, equity investors, operators, and other oilfield parties should consider wider use of arbitration.

Arbitration is better than commonly believed. The benefits of arbitration often outweigh the costs. Myths about delay, cost, and risk because of a limited ability to appeal are overblown and have led to an inefficient avoidance of this flexible consensual procedure.

1. What delay? Arbitration gives parties the power to shorten the longest part of a lawsuit, the discovery process, and set time limits for trial. Complaints about arbitration generally overlook the great delay in civil litigation, including



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appeals. Arbitration makes appeals less common and quicker to decide because of the intentionally narrow, deferential standard of review.

Parties can secure appeals by selecting provider rules that include a right to appeal, or by filing in jurisdictions whose state law, or federal interpretations of the Federal Arbitration Act, adheres to a broad interpretation of “manifest disregard” as a basis for reversal. JAMS, for example, has its Optional Arbitration Appeal Procedures, CPR an Appellate

Arbitration Procedure, and the AAA Optional Appellate Arbitration Rules. Parties may well find that they prefer an appeal before arbitrators rather than before a court of appeals, even though the latter is available “for free.” Indeed, there should be nothing stopping parties who have tried a case to judgment in civil court from agreeing to appeal in one of the arbitral forums.

Delay in arbitration often results from a failure to take advantage of the flexibility available in a well-structured arbitration. Arbitration gives parties

more control over pacing and invites party participation.

Speed is a dominant value in arbitration. The major arbitration rules limit discovery, trial, and time for award compared to state and federal courts. Arbitration gives parties a great deal of power over their case.

Parties can further increase speed by expressly agreeing with each other, after the arbitration is initiated, to A. forego many or all depositions, requests for admission, and interrogatories; B. use computer searches and sampling to narrow document production; C. use affidavits instead of direct testimony; D. “hot tub” experts and, for daring parties, jointly hire a single neutral expert in each expert area; and E. adopt even tighter time limits on discovery and the hearing. Parties tend to be most satisfied with procedures they help design.

2. Why overpriced? The biggest costs are controllable. Arbitration does include the cost of arbitrators and sometimes a provider fee. Threshold jurisdictional skirmishes and battles over the scope of arbitration can increase cost. But savings in discovery, trial time and limited appeal should far, far outweigh these costs.

In addition, significant arbitration costs appear only in a small number of cases. Most cases settle in arbitration just as in litigation. When settlement occurs, the arbitrators will have spent very little time on the case. In cases that do go all the way on the merits, the

tighter focus and greater speed should significantly outweigh any added costs.

A case tried to arbitrators, like a bench trial, should also require less preparation and explanation than a jury trial, providing a significant cost saving. Arbitrators should be sophisticated in commercial relationships, contracts and market concepts, and often are selected for a specific expertise. This is especially helpful in technical disputes such as those involving the oil and gas industry.

3. Unfair awards and lack of appeal? A third complaint about arbitration is most important because it goes to the quality of justice: the worry that there is no effective appeal from even very unfair awards.

Current practice indicates this perceived problem is exaggerated. Skilled, principled arbitrators are readily available through such organizations as JAMS, AAA, and FedArb and from the ranks of independent arbitrators. Providers require advanced training and enforce strict ethical guidelines. Their rosters include a significant number of respected former judges. Using panels for large cases provides a check on individual arbitrators.

4. The overlooked benefit: preserving the relationship. Parties often forget that arbitration can benefit their relationship, too. The impact of litigation on the ongoing business relationship of the parties is often one of the biggest costs of a lawsuit. A plaintiff may win every penny sought, but ruin goodwill laboriously developed over

decades. An arbitration that is quick, held before experts, and does not involve the aggressive questioning common in jury trials is more likely to preserve the relationship.

5. Agreeing to arbitrate after a dispute has arisen. Arbitration need not be agreed to only during initial contract negotiations. Parties should be open-minded about negotiating such clauses after disputes arise, too. In many ways, the parties are best equipped to customize procedures after their dispute has begun.

Once they know what is at stake, the parties are in a better position to decide how much time and money they want to invest on case preparation and trial, determine the skills and background their arbitrators should have, and know whether they want an appeal. They should know whether the case needs full or limited discovery. Even if parties differ on some factors, they each may value different arbitral benefits and arbitration may provide each what they most desire.

There are many reasons why arbitration should be the go-to procedure for many of the disputes that arise in the oil and gas industry. The process can be tailored to the needs of the parties, and many common objections to using arbitration are based on myths that do not hold up to scrutiny. Whether it's through an arbitration clause in an initial contract, or one chosen after a dispute arises, arbitration provides significant benefits to parties.

