The Arbitration Newsletter

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

December, 2020

****

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]

****

Speculative Partiality

OOGC v. Chesapeake Exploration, LLC[2]

In deciding whether to vacate an arbitration award resolving an oil and gas dispute the Fifth Circuit Court of Appeals overturned a scathing district court opinion on grounds that the evidence for vacatur was "more 'speculative' than 'concrete.'"[3]

The original dispute between OOGC America ("OOGC") and Chesapeake Exploration ("Chesapeake") centered on whether Chesapeake overbilled OOGC for work rendered by Chesapeake's affiliates.[4] In late 2010 and early 2011, Chesapeake sold OOGC a partial interest in two oil and gas properties.[5] In their partnership agreements, all of which contained identical arbitration clauses, OOGC agreed that Chesapeake would perform all the work and bill OOGC for its share of the costs.[6] Chesapeake also billed OOGC for work performed by "affiliates" or "related parties," but the agreement required such work to be billed at competitive market rates and detailed in quarterly reports to OOGC.[7] In 2014, OOGC became concerned that Chesapeake was paying its affiliates and related parties above market rates and thus overbilling OOGC.[8] OOGC initiated arbitration seeking up to $210 million in damages for the overbilling.[9]

The agreements' arbitration clause required a panel of three arbitrators, none of whom could have performed work for Chesapeake "affiliates"[10] within the proceeding five years.[11] OOGC and

---

[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] OOGC Am., L.L.C. v. Chesapeake Expl., L.L.C., 975 F.3d 449 (5th Cir. 2020).

[3] *Id.* at 454.

[4] *Id.* at 451.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] The arbitration agreement did not preclude arbitrators who had done work for "related parties." *Id.*

[11] *Id.*

Chesapeake each selected one arbitrator, and the two arbitrators chose the final panel member.[12] Each arbitrator provided disclosures to AAA and neither party objected to any panel member.[13]

OOGC raised two breach of contract claims in the arbitration: 1) that Chesapeake overbilled OOGC for affiliate work, and 2) that Chesapeake failed to meet the quarterly reporting requirements under the agreements.[14] The panel also considered whether one specific company, FTS, whose compensation rates were challenged by OOGC, was a Chesapeake "affiliate" under the agreement.[15] In its first three of four hearings, the arbitration panel unanimously concluded that Chesapeake breached its reporting requirements, that FTS was not an "affiliate," defined in the agreement as being under the "control" of Chesapeake,[16] and that even assuming FTS was an affiliate or a related party, Chesapeake did not overcompensate FTS.[17]

OOGC then filed a claim in state court to vacate the arbitration award because the arbitrator selected by Chesapeake failed to disclose personal connections to the chairman of FTS's board of directors.[18] Chesapeake removed the case to the District Court for the Southern District of Texas and asked the court to confirm the arbitration award.

OOGC filed an amended motion to vacate in the federal district court arguing that the arbitrator in question "showed 'evident partiality' under 9 U.S.C. § 10(a)(2) and 'misbehavior by which the rights of a party have been prejudiced' under § 10(a)(3)."[19] OOGC alleged that in addition to his connection with the FTS chairman, the arbitrator had a personal relationship with the chairman's daughter and FTS's general counsel, both of whom previously worked at the arbitrator's law firm.[20] The district court stayed the remaining arbitration hearings pending further proceedings.[21]

OOGC also complained to AAA, who requested further disclosures from the arbitrator.[22] The further disclosures confirmed the alleged relationships, and AAA removed the arbitrator from the panel.[23] The remaining panel members were allowed to continue the arbitration without the third arbitrator.[24] OOGC asked the remaining arbitrators to stay the final hearing pending the district court proceedings, but they refused.[25] OOGC then moved to stay the arbitration in the district court, and the court granted the motion.[26]

The federal district court found that in addition to the limited disclosures provided to AAA, the arbitrator worked with FTS's chairman in at least six business ventures over the past decade and

---

[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] "The Agreements define affiliates as entities over which a party 'directly or indirectly' exercises 'control.'" *Id.* at 457. The arbitration panel concluded that Chesapeake's minority interest in FTS ("from 24% to 30%") and two out of five to seven FTS board seats "were insufficient evidence of 'control.'" *Id.*
[17] *Id.* at 451–52.
[18] *Id.* at 452.
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.*

that the arbitrator had represented FTS in 2015, just one year prior to his selection to the panel.[27] Based on this information, the district court vacated the arbitration awards and held that "OOGC satisfied the 'evident partiality' standard under § 10(a)(2)."[28] The district court stated that "when [the arbitrator] claimed that he did not have professional or social connections with the parties or witnesses, he lied."[29] In its opinion, titled "Opinion on Arbitration Corruption," the district court called the arbitrator's actions deceitful and corrupt.[30] This led the arbitrator to file a motion to intervene allegedly to protect his reputation.[31] The district court denied the motion to intervene, Chesapeake appealed the district court decision, and the arbitrator filed a motion to intervene on appeal.[32]

The Fifth Circuit reviewed the district court's decision de novo, applying the test for evident partiality set forth in *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 476 F.3d 278 (5th Cir. 2007). Under that precedent, an "arbitrator's nondisclosure must involve a 'reasonable impression of bias' stemming from 'a significant compromising connection to the parties.'"[33] The party seeking to vacate the award must show "a concrete, not speculative impression of bias"[34] by "'produc[ing] specific facts from which a reasonable person *would have to conclude* that the arbitrator was partial to' its opponent."[35]

Chesapeake argued that since FTS was neither a witness nor a party in the arbitration and FTS did not have a stake in the arbitration, the arbitrator's relationship with FTS was not a "significant compromising relationship to the parties."[36] Even if the arbitrators ruled against Chesapeake, FTS would not be implicated in any damage award and would not be required to pay back any of the compensation received from Chesapeake.[37] Therefore, there was no incentive for the arbitrator to rule that FTS was or was not a Chesapeake affiliate.[38]

OOGC argued that the arbitrator was incentivized to rule that FTS was not an affiliate because doing so would allow him to continue to sit on the arbitrator panel.[39] Since the arbitration agreement precluded arbitrators from serving if they had worked for an affiliate in the previous 5 years, "[the arbitrator] was put in a position to decide his own status as a member of the panel—a decision that implicated his financial interest in continuing his employment as an arbitrator in the matter."[40]

OOGC argued that even if there is no evident partiality, the court should uphold the vacatur under 9 U.S.C. § 10(a)(4) because the arbitrator exceeded his powers by not being a neutral arbitrator,

---

[27] The arbitrator did not provide any of this information to AAA during its investigation. S*ee* OOGC Am., L.L.C. v. Chesapeake Expl., L.L.C., No. H-17-248, 2018 U.S. Dist. LEXIS 205615, at *5 (S.D. Tex. Dec. 5, 2018), *vacated*, 975 F.3d 449 (5th Cir. 2020).
[28] *OOGC Am.*, 975 F.3d at 452.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.* at 453 (quoting Positive Software Sols., Inc. v. New Century Mortg. Corp., 476 F.3d 278, 283 (5th Cir. 2007)).
[34] *Id.*
[35] *Id.* (quoting Cooper v. WestEnd Capital Mgmt., L.L.C., 832 F.3d 534, 545 (5th Cir. 2016) (emphasis added)).
[36] *Id.* at 454.
[37] *Id.* at 453–54.
[38] *Id.* at 454.
[39] *Id.*
[40] *Id.*

as required by the arbitration agreement.[41] The neutrality requirements, however, were not "arbitrator-selection" requirements; instead, they were arbitrator *qualification* requirements, which are distinguishable from *PoolRe* and for which no Fifth Circuit cases "[hold] that a failure to satisfy contractually specified qualifications warrants vacatur under § 10(a)(4)."[42] Additionally, the neutrality requirement only precluded parties who had worked for Chesapeake "affiliates," and OOGC failed to prove that the panel's unanimous decision on that issue was erroneous.[43]

The appeals court found OOGC's bias claims "more 'speculative' than 'concrete'" and concluded that OOGC failed to show an adequate basis for vacatur under sections 10(a)(2) or 10(a)(4).[44] The court noted, however, that even though OOGC failed to show evident partiality, the court did not endorse the actions of the arbitrator.[45] The arbitrator's motion to intervene was moot in view of the vacatur.[46]

OBSERVATIONS

1. Four separate hearings based on subject-matter, allowed for extraneous issues to develop as different unanimous rulings were made by the arbitrator panel.

2. Ultimately, by the time of the fourth hearing, an issue had surfaced regarding one panel member's prior undisclosed relationships with a non-party company related to the dispute.

3. An objection at this juncture to AAA resulted in the non-disclosing arbitrator being removed from the panel by AAA.

4. The remaining two panel members were scheduled to hear the fourth hearing, but before the fourth hearing the losing party moved the district court to vacate the award on "evident partiality," among other FAA vacatur grounds.

5. The Fifth Circuit continues to harden its test for "evident partiality" in non-disclosure or inadequate disclosure cases as stated in *Positive Software* and *Cooper v. WestEnd Capital Management*:
   a. A "reasonable impression of bias" that is "concrete not speculative" must be shown;[47]
   b. "[S]temming from a significant compromising connection to the parties";[48]
   c. "Specific facts" are required;[49]
   d. "[F]rom which a reasonable person **would have to conclude** that the arbitrator was partial to" the moving party's opponent.[50] (Emphasis added.)

---

[41] *Id.* OOGC cited to *PoolRE Ins. v. Organizational Strategies, Inc.*, where the Fith Circuit held that an arbitrator exceeded his powers by presiding over an arbitration after having not been "selected according to the contract-specified method." *Id.* at 457 (quoting PoolRe Ins. v. Organizational Strategies, Inc., 783 F.3d 256 (5th Cir. 2015)).
[42] *Id.* at 456–57.
[43] *Id.* at 457.
[44] *Id.* at 454 and 457.
[45] *Id.* at 457.
[46] *Id.* at 458.
[47] *Id.* at 453.
[48] *Id.*
[49] *Id.*
[50] *Id.* at 453 (quoting Positive Software Sols., Inc. v. New Century Mortg. Corp., 476 F.3d 278, 283 (5th Cir. 2007), and Cooper v. WestEnd Capital Mgmt., L.L.C., 832 F.3d 534, 545 (5th Cir. 2016)).

6. The "would have to conclude" standard is not in the *TUCO* test for "evident partiality" under the Texas General Arbitration Act.[51]

7. The Fifth Circuit in *OOGC* devoted extensive discussion to evidentiary support for vacatur offered by the moving party and concluded that much of the evidence was speculative.[52]

8. Only the following federal circuits use the "would have to conclude" standard for "evident partiality": 1st, 2nd, 3rd, 4th, 5th, and 6th.[53]

9. A major issue in this case was the arbitration agreement provision that required all arbitrators, as an arbitrator qualification, not to have performed work for Chesapeake "affiliates" within five years prior to appointment, which required a determination by the arbitrator panel of what entities qualified as a Chesapeake affiliate.[54]

[51] Burlington N.R.R. v. TUCO, 960 S.W.2d 629, 639 (Tex. 1997).
[52] OOGC, 927 F.3d at 453-56.
[53] *See* JCI Commc'ns., Inc. v. IBEW, Local 103, 324 F.3d 42 (1st Cir. 2003); Morelite Constr. Corp. v. N.Y. City Dist. Council Carpenters Benefit Funds, 748 F.2d 79, (2d Cir. 1984); Freeman v. Pittsburgh Glass Works, LLC, 709 F.3d 240, 253 (3d Cir. 2013); ANR Coal Co., Inc. v. Cogentrix of N.C., Inc., 173 F.3d 493 (4th Cir. 1999); Cooper v. WestEnd Capital Mgmt., L.L.C., 832 F.3d 534 (5th Cir. 2016); Nationwide Mut. Ins. Co. v. Home Ins. Co., 429 F.3d 640 (6th Cir. 2005). The 7th Circuit adopted a similar strict standard. *See* Health Services Management Corp. v. Hughes, 975 F.2d 1253, 1264 (7th Cir. 1992) (holding that bias "must be direct, definite and capable of demonstration rather than remote, uncertain or speculative").
[54] 927 F.3d at 456-57 (citing *PoolRe* as an "arbitrator-selection" case and *Bulko v. Morgan Stanley DW Inc.*, 450 F.3d 622,624 (5th Cir. 2006) as an "arbitrator-qualification" case). This meant that 9 U.S.C. §10(a)(4) was inapplicable to this "arbitrator-qualification" case.