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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CLARITY REGARDING "DELEGATION"

TotalEnergies E&P USA, Inc. v. MP Gulf of Mexico, LLC, 2023 Tex. LEXIS 315*; 667 S.W.3d 694; 66 Tex. Sup. J. 591 (2023)

In a first impression decision, the Texas Supreme Court has found that the adoption of the American Arbitration Association ("**AAA**") Commercial Arbitration Rules or similar arbitration rules in an arbitration agreement constitutes a "clear and unmistakable" delegation of arbitrability issues to the arbitrator not the courts.[2]

TotalEnergies ("**TE**") and MP Gulf ("**MPG**") co-owned oil and gas leases in the Chinook Unit[3] in the Gulf of Mexico and entered into the "Chinook Operating Agreement" with MPG as the operator. MPG owned all the nearby leases known as the "Cascade Unit."[4] TE and MPG agreed to create a "Common System" to "process, store, and transport production from all the leases in both the Chinook and Cascade Units with MPG the Common System operator." This "Common System" was created by the parties' "System Operating Agreement," which was subject to the parties' "Cost Sharing Agreement" for the "Common System."[5] TE and MPG owned equal interests in the Common System, although TE only owned one-third interest in the Chinook Unit and no interest in the Cascade Unit.[6] MPG funded all costs in the Common System and billed the two parties (TE and MPG) according to the Cost Sharing Agreement and according to each owner's equity interest in the Common System (50%/50%).

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[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel.

[2] TotalEnergies E&P USA, Inc. v. MP Gulf of Mexico, LLC, 2023 Tex. LEXIS 315*, *14-15; 667 S.W.3d 694; 66 Tex. Sup. J. 591 (Opinion Delivered April 14, 2023; Corrected Opinion Issued June 9, 2023) ("We have not previously decided whether an agreement to arbitrate in accordance with the AAA rules establishes a clear and unmistakable agreement to delegate arbitrability issues to the arbitrator."); *see also* 2023 Tex. LEXIS 315, *13fn8 for the creation of the "clear and unmistakable" standard.

[3] TE owned one-third (1/3rd) of the Chinook Unit and MPG owned two-thirds (2/3rds) of the Chinook Unit.

[4] 2023 Tex. LEXIS 315, *2.

[5] *Ibid.*

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

Ten years later when MPG, as operator, proposed re-entry in the Chinook No. 6, TE declined under the Chinook Operating Agreement. MPG re-entered the Chinook No. 6 and later billed TE approximately $41 million for TE's 16.665% of the Common System's Chinook No. 6 costs.[7]

MPG requested arbitration according to the Common System's System Operating Agreement to which TE objected citing the Common System's Cost Sharing Agreement, which had no arbitration agreement. TE also filed a declaratory judgment lawsuit in Harris County, Texas asking the court to declare that MPG determine TE's costs, if any, by use of the Chinook Operating Agreement.[8] TE did not ask the Harris County District Court to interpret or enforce the Chinook Operating Agreement because it required arbitration administered by the International Institute for Conflict Prevention & Resolution ("CPR").[9] TE instituted CPR arbitration requesting determination of the parties' rights under the Chinook Operating Agreement. MPG then initiated AAA arbitration claiming TE breached the System Operating Agreement by refusing to reimburse MPG the $41 million re-entry costs and seeking declaratory judgment for allocation of re-entry costs according to the Cost Sharing Agreement.[10] The Texas Supreme Court observed that whether TE owed MPG $41 million in re-entry costs now involved "three separate proceedings before three separate tribunals, based on three different dispute resolution clauses in the parties' three written agreements."[11]

MPG asked the Harris County District Court to send the question of the AAA arbitration to the arbitrator because the System Operating Agreement's arbitration contract delegated arbitrability issues to the arbitrator based on R-7(a) of the AAA Commercial Arbitration Rules adopted by the parties.[12] TE objected stating that the parties' adoption of the AAA Commercial Arbitration Rules did not "delegate arbitrability questions to the arbitrator."[13]

The Harris County trial court granted TE's motion to stay the AAA arbitration and denied MPG's motion to compel arbitration.[14] The Twelfth Court of Appeals reversed the trial court and rendered judgment compelling the AAA arbitration, ruling that the parties' arbitration agreement in the System Operating Agreement "delegated the arbitrability issue to the AAA arbitrator."[15] The Texas Supreme Court affirmed the Twelfth Court of Appeal's judgment.[16]

The Texas Supreme Court defined "arbitrability" as "[a] dispute over whether parties agreed to resolve their controversies through arbitration," which "typically encompasses three

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[7] *Id.* at *3-4.
[8] *Id.* at *5.
[9] *Id.* at 5-6; TE also instituted a CPR arbitration on the same day it filed the Harris County lawsuit, asking the arbitrator to determine the parties' rights under the Chinook Operating Agreement (*see* 2023 Tex. LEXIS 315, *6).
[10] 2023 Tex. LEXIS 315, *6-7; *see* System Operating Agreement §16.16.1, with use of AAA Commercial Arbitration Rules.
[11] 2023 Tex. LEXIS 315, *7.
[12] *Id.* at *9-10.
[13] *Id.* at *10.
[14] *Ibid.*
[15] *Id.* at *10-11.
[16] *Id.* at *42.

distinct disagreements."[17] The Court observed the sequence of answering these three questions as last question first (who (court or arbitrator) decides who resolves the merits), second question second (who decides the merits), and first question last (what are the merits in dispute).[18]

The Texas Supreme Court held that the parties arbitration contract in the Common System's System Operating Agreement expressly adopted the AAA Commercial Arbitration Rules and procedures, which clearly and unmistakably delegated authority to the arbitrator to determine "arbitrability" issues.[19] The carve-out language limiting some claims in the parties' arbitration contract in question did not prevent the clear and unmistakable delegation of the claims not subject to the carve-out limitations.[20] The carve-out did not limit the scope of the arbitrator's authority to decide "arbitrability" issues.

The Texas Supreme Court also found that the determination of which agreement(s) applied to the question of whether TE owed MPG $41 million – Chinook Operating Agreement, System Operating Agreement, or System Cost Sharing Agreement was for the arbitrator to decide.[21]

OBSERVATIONS

1. The parties' delegation of arbitrability issues to the arbitrator must be clear and unmistakable.[22]

2. "Clear and unmistakable" does not include mere references to the AAA rules or the parties' rights to request assistance from the AAA.[23]

3. The clear and unmistakable language can include all or less than all of the claims based on what the parties' arbitration agreement says.

4. R-7 of AAA Commercial Arbitration Rules (2022) has the language necessary to create delegation to the arbitrator.

5. Nothing prevents parties adding additional delegation language to their arbitration agreements in support of or explanation for the language adopting the AAA Commercial Arbitration Rules.

6. Other AAA arbitration rules and other arbitral institutions have rules that convey the same or similar R-7 authority in their respective rules, but the majority of cases involve arbitration agreements that purport to adopt the AAA Commercial Arbitration Rules that contain R-7.

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[17] *Id.* at *11 (the merits of the dispute; merits resolved in arbitration or in the courts; and who (court or arbitrator) decides who resolves the merits).
[18] *Ibid.*
[19] *Id.* at *14, *18-19, and *23.
[20] *Id.* at *24-38.
[21] *Id.* at *39-42.
[22] *Id.* at *19 (citing other examples of language that does delegate); *see also supra* footnote 2.
[23] R-7 (2022).

7. The U.S. Supreme Court has not decided the specific delegation question confronted in this case.[24]

8. All but one federal circuit court (i.e., the Seventh Circuit) and ten state supreme courts have answered this specific delegation question based on adoption of AAA's Commercial Arbitration Rules or similar arbitration rules used by parties in their respective arbitration agreements.[25]

[24] 2013 Tex. LEXIS 315, *14-17fn11.
[25] *Id.* at *17-18.