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Commentary

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[Editor's Note: Andrew S. Dupre, a partner in the Wilmington, Delaware office of McCarter & English LLP, is a litigation specialist who focuses his practice on Delaware law corporate and commercial disputes in the Delaware Court of Chancery, and in arbitration. He regularly represents shareholders, corporations and their officers and directors in shareholder class and derivative actions, merger and acquisition disputes, and litigation involving corporate governance and fiduciary duty claims. Dual qualified as a solicitor of England & Wales and a member of the bar of Delaware, Andrew frequently represents Delaware affiliates of UK and Commonwealth entities and their directors in investment disputes. Any commentary or opinions do not reflect the opinions of McCarter & English LLP or LexisNexis®, Mealey Publications™. Copyright© 2021 by Andrew S. Dupre. Responses are welcome.]

Who decides whether a second arbitration is an impermissible collateral attack on a confirmed award from a first arbitration: the second arbitration tribunal or a court? For Delaware entities, the answer is the Delaware Court of Chancery, via an action to enjoin the second arbitration.

In *Gulf LNG Energy, LLC v. Eni USA Gas Mktg. LLC*, 242 A.3d 575 (Del. 2020), the Delaware Supreme Court definitively held that courts, and not arbitrators, must decide whether a second arbitration is a collateral attack disallowed by the Federal Arbitration Act (FAA), even if the controlling arbitration clause unequivocally assigns all jurisdictional questions to arbitration. For the first time in Delaware law, *Gulf LNG Energy* immunizes collateral attack arguments from Delaware's general deference to arbitration to decide substantive arbitrability. The Delaware Supreme Court rejected the argument that *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019) requires dismissal for arbitrators to determine the claim preclusive effect of a prior arbitration. A Delaware party asserting claim preclusion arising from a prior award now can have that argument determined on an expedited preliminary injunction schedule in the Court of Chancery.

Additionally, the Delaware Supreme Court has now stated that the finality contemplated by FAA Section 10 is broader than any common law res judicata or collateral estoppel test. Even claims that were expressly excluded from a confirmed award may be adjudicated by Delaware courts outside arbitration and deemed to be precluded collateral attacks if the remedy sought was contemplated or implicated by that prior confirmed award.

Delaware's status as a preferred residence for special-purpose investment vehicles, combined with the Delaware Court of Chancery's power to expeditiously enjoin arbitrations, renders *Gulf LNG Energy* an important precedent warranting close examination.

An ICDR Arbitration Awards $372 Million As Restitution For An LNG Contract Terminated For Commercial Frustration

In 2007, Eni USA Gas Mktg. (Eni) and Gulf LNG Energy (Gulf) signed a 20-year terminal use agreement (the contract), by which Gulf would build and

operate a terminal for Eni to import liquefied natural gas (LNG) to the United States. Gulf built the facility as contracted. Thereafter, the fracking boom forced Eni to abandon its importation plans. These specific Gulf and Eni vehicles were both Delaware entities.

In 2016, Eni demanded International Centre for Dispute Resolution (ICDR) arbitration (the first arbitration), seeking a declaration that the contract was unenforceable based on commercial frustration. Eni further alleged various breaches by Gulf, excusing Eni's further performance. Gulf counterclaimed for restitution. In 2018, the first arbitration declared that the contract was indeed terminated for commercial frustration and issued an award of restitution for $372 million after certain reductions (the award) to Gulf to compensate for its part performance. Because the tribunal awarded restitution, it declined to reach Eni's breach-of-contract arguments, deeming them "academic."

Later in 2018, Gulf sued Eni's parent in New York (the New York action) as the guarantor of Eni's obligations for the full 20-year term of the contract, for $900 million. Eni counterclaimed for breach on the same claims that the first arbitration tribunal had declined to rule upon as academic.

In 2019, Gulf and Eni stipulated to confirmation of the award by the Delaware Court of Chancery, and Eni paid the award in full.

A Second Arbitration Reasserts Contract Claims That The First Arbitration Declined To Adjudicate and Is Challenged By An Action To Enjoin Arbitration

Five months later, after the 90-day window for vacating the award had expired, Eni filed a second ICDR arbitration (the second arbitration). Eni asserted the same breach-of-contract claims as in the first arbitration and in the New York action. But this time, Eni further asserted a claim of negligent misrepresentation, alleging that Gulf procured the award by misstating facts to the first arbitration tribunal about collateral sources available to recoup losses caused by the termination.

Gulf filed an expedited declaratory judgment action in the Delaware Court of Chancery to enjoin Eni from proceeding with the second arbitration. Gulf argued that the second arbitration was a disguised attempt to vacate or modify the award outside the 90-day window of FAA Section 10. Gulf argued that the second arbitration constituted an impermissible collateral attack if it either sought to rectify a wrong done by the first arbitration or challenged the process of the first arbitration.

Opposing the injunction, Eni first argued that the question of whether the first arbitration barred the claims in the second arbitration was itself arbitrable, based on the contract's express consignment of all jurisdictional challenges to arbitration. Eni argued that the United States Supreme Court's opinion in *Henry Schein* abnegated prior case law declining to defer to arbitration jurisdiction for claims that are "wholly groundless."

Second, Eni argued that its claims were not covered by the award. The first arbitration expressly eschewed ruling upon Eni's breach-of-contract claims as "academic", and no fact-finder had yet been presented with Eni's negligent misrepresentation claims, which it characterized as germane to not just the contract but the parties' overall relationship. Eni argued that the injunction would have the effect of robbing it of achieving adjudication of those claims in any forum anywhere.

In Delaware, Courts Rather Than Arbitrators Hold Jurisdiction To Rule On Whether A Second Arbitration Is A Collateral Attack On A Confirmed Award.

The Court of Chancery first ruled that courts hold jurisdiction to enjoin collateral attacks on confirmed awards, even if those awards rest upon contracts that clearly and unmistakably consign jurisdictional questions to arbitration. The Delaware Supreme Court affirmed that jurisdictional holding.

The Court recognized a clear tension in persuasive case law on substantive arbitrability. One line of cases strongly favors arbitration of any question clearly and unmistakably covered by an arbitration clause, including the jurisdictional issues arising from the second arbitration. But another line of precedent strongly favors the courts' duty to enforce the finality of confirmed arbitration awards under FAA Section

10. Should the Court defer to the arbitrators on the question of whether a prior award precludes a second arbitration in order to honor the arbitration-deference precedent? Or should the Court enjoin the second arbitration to vindicate the FAA's finality precedent?

The Court of Chancery stated a compromise ruling, only for the Supreme Court to reverse with an emphatic endorsement of the finality precedent.

First, the Court of Chancery enjoined Eni's negligent misrepresentation claim as an untimely collateral attack on the process of the first arbitration. Though its analysis was curt because the question was only lightly briefed, the Court held that the FAA's jurisdictional empowerment to confirm the award *implies* further jurisdiction to enjoin collateral attacks on that same award, contractual consignment of "all jurisdictional disputes" to arbitration notwithstanding. In so ruling, the Court distinguished collateral attacks on confirmed awards from *Henry Schein*, which holds that arbitrators rather than courts hold jurisdiction to dispose of wholly groundless assertions of arbitration jurisdiction. If an arbitration claim is wholly groundless because it collaterally attacks a confirmed award, then courts rather than arbitrators will dispose of it, *Henry Schein* notwithstanding.

The Delaware Supreme Court affirmed, holding that Eni's allegation that Gulf had misstated facts in the first arbitration was functionally the same as alleging that Gulf had procured the award through "undue means" as contemplated by FAA Section 10. Therefore, FAA Section 10's jurisdictional limit of 90 days to challenge the award for undue means applied and barred a second arbitration over allegations of negligent misrepresentation as a matter of jurisdiction conferred by statute.

In Delaware, a Claim Not Covered by Res Judicata Effect of a First Award May Nonetheless Be Barred as a Collateral Attack

Second, the Court of Chancery declined to enjoin Eni from pursuing its breach-of-contract allegations in the second arbitration. Adopting Gulf's proposed jurisdiction test, the Court held that the contract claims did not seek to redress a wrong or attack the process of the award, because the first arbitration eschewed ruling upon contract claims therein. The award could not be read to finalize claims that it expressly excluded from adjudication. The Court of Chancery noted that the contract's arbitration clause was exceptionally broad, consigning all jurisdictional questions to arbitration in the manner contemplated by *Henry Schein*. The Court of Chancery therefore declined to enjoin Eni from pursuing its contract claims in the second arbitration, leaving the question of claim preclusion to the jurisdiction of the second arbitration tribunal.

The Delaware Supreme Court reversed, over a rare dissent by Justice Vaughn. The Supreme Court read the collateral attack test more broadly, to bar any action that sought to "appeal" *the result* of the first arbitration. The Supreme Court held that the relevant test for a collateral attack was not whether the contract claims had been adjudicated, and instead ruled that "Eni's breach of contract claims aim to modify the Final Award by revisiting the core issue in the First Arbitration—was the contract terminated and, if so, what is the appropriate remedy?" Thus the *issue* of the first arbitration, broadly defined as contract termination and resulting remedy, controlled whether Eni could be enjoined from pursuing contract claims in the second arbitration despite express exclusion of those breach claims from the award. The "issue" and the "remedy" rather than the particular claims in a res judicata or collateral estoppel analysis were case dispositive.

Gulf LNG Energy Can Be Applied To Enjoin Second, "Follow-On" Arbitrations

Gulf LNG Energy potentially represents a significant expansion of the jurisdiction of Delaware courts to enjoin foreign arbitrations involving a Delaware party or a Delaware law contract.

The Delaware test for substantive arbitrability was established by *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76 (Del. 2006) and is generally known as *Willie Gary*. The *Willie Gary* test of substantive arbitrability empowered arbitrators, rather than courts, to decide arbitrability whenever a contract "clearly and unmistakably" designates all disputes to arbitration, and references a set of arbitration rules under which arbitrators are empowered to decide arbitrability. Subsequent Delaware authority evolved the *Willie Gary* test to resolve any doubts about arbitrability in favor of arbitration.

Prior to *Gulf LNG Energy*, an assertion that a prior award did not bar subsequent claims likely would have been arbitrable unless wholly groundless—and perhaps even if wholly groundless, as the Delaware Supreme Court has not yet opined on the import of *Henry Schein* to Delaware's substantive arbitrability precedents. The Delaware Supreme Court's analysis of Eni's negligent misrepresentation claim neatly fits Delaware precedent on courts declining to defer to arbitration for wholly groundless claims.

Post *Gulf LNG Energy*, a party seeking to block second arbitrations need only move for an injunction in the Delaware Court of Chancery. An invocation of FAA Section 10 now seems to be adequate to imply jurisdiction of Delaware courts, even if the relevant contract consigns jurisdiction disputes to arbitration. Moreover, it appears that the Delaware Supreme Court will exercise that jurisdiction to favor claim preclusion with vigor. Even claims that a prior arbitration expressly declined to adjudicate may be precluded if they implicate the "result" of that prior arbitration. Because money is virtually always the result of arbitration, any monetary claim arguably may be precluded by a prior arbitration award.

Gulf LNG Energy does offer some (scant) comfort to claimants in second arbitration proceedings. Eni's negligent misrepresentation claim seems to have been built solely for the second arbitration, perhaps without reference to its detrimental effect on arguments for the Delaware courts to defer to that arbitration's jurisdiction. The Court of Chancery deemed it a "transparent tactic," while the Supreme Court termed it a "thinly disguised effort" to appeal the award. Such pleading language could be eschewed by later litigants. Moreover, the Supreme Court's analysis of Eni's contract claims quotes Eni's prayer for relief in the second arbitration, which expressly seeks recoupment of the funds it paid to satisfy the award from the first arbitration. Again hindsight, subsequent litigants could avoid that pleading pitfall by framing the relief as exclusive to a second arbitration.

Conclusion

Gulf LNG Energy renders it relatively simple to obtain an injunction against a second, follow-on arbitration against a Delaware party or on a Delaware law contract. The party seeking the injunction need only allege that the second arbitration collaterally attacks the result of the prior arbitration outside the deadlines established by FAA Section 10. The Delaware Court of Chancery is required to exercise jurisdiction to hear the injunction argument, notwithstanding the United States Supreme Court's guidance that even wholly groundless substantive arbitrability disputes must be decided by arbitrators. The test for obtaining the injunction is also more lenient than Delaware's common law tests for res judicata and collateral estoppel. The injunction motion need only show that the result, meaning the net monetary award, of the first arbitration would be changed by the second arbitration.

Endnotes

1. *Gulf LNG Energy, LLC v. Eni USA Gas Mktg., LLC*, 2019 Del. Ch. LEXIS 1403 at *4 (Del. Ch. Dec. 30, 2019). This factual outline is taken from the Court of Chancery's trial court opinion, which was rev'd in part.
2. *Id.* at *5.
3. *Id.* at *6.
4. *Id.* at *3.
5. *Id.* at *6.
6. *Id.*
7. *Id.*
8. *Id.* at *10.
9. *Id.* at *7.
10. *Id.* at *8.
11. *Id.* at *8-9.
12. *Id.* at *9-10.
13. *Id.* at *10.
14. *Id.*
15. *Id.*

16. *Id.* at *10-11.

17. *Id.*

18. *Id*. at *25-26.

19. *Id.* at *18-19.

20. *Id.* at *20-21; citing *Henry Schein*, 139 S. Ct. at 529.

21. *Id.*

22. *Id*. at *29-30.

23. 243 A.3d at 590.

24. 2019 Del. Ch. LEXIS 1403 at *14-20.

25. *Id.* at *18-20; *citing Henry Schein*, 139 S. Ct. at 529; J*ohn Hancock Mut. Life Ins. Co. v. Olick*, 151 F.3d 132 (3rd Cir. 1998); C*itigroup, Inc. v. Abu Dhabi Inv. Auth.*, 776 F.3d 126 (2nd Cir. 2015).

26. *Id.* at 14-17; citing Prudential Sec. v. Hornsby, 865 F. Supp. 447 (N.D. IL 1994); Decker v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 205 F.3d 906 (6th Cir. 2000); Arrowood Indem. Co. v. Equitas Ins. Ltd., 2015 U.S. Dist. LEXIS 99787 (S.D. NY Jul. 30, 2015).

27. *Id.* at *31-32.

28. 2019 Del. Ch. LEXIS 1403 at *26-20.

29. *Id.*

30. 243 A.3d at 590.

31. *Id.*

32. 2019 Del. Ch. LEXIS 1403 at *34.

33. *Id.*

34. *Id.* at *35.

35. *Id.*

36. 243 A.3d at 590.

37. *Id.* at 592.

38. *Id.* at 590-592.

39. By statute, Delaware courts hold subject matter jurisdiction over claims of breach of Delaware law contracts, notwithstanding any other lack of connection to Delaware. 10 Del. C. §2708.

40. *See, e.g., McLaughlin v. McCann*, 942 A.2d 616 (Del. Ch. 2008) (Delaware version of the wholly groundless exception).

41. Though unstated, the Supreme Court appears to have applied a version of the "common nucleus of operative facts" test familiar to Delaware practitioners from the progeny of *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281 (Del. 1970). *McWane* is a venue decision, which states that a Delaware court should stay or dismiss in favor of a prior filed action, adjudicating a common nucleus of operative facts between similar parties, in a forum capable of dispensing prompt and complete justice. A McWane analysis does not require precise identity of claims or parties, but requires only that the second-filed dispute invoke a common nucleus of operative facts to the first-filed action. See, e.g., *Choice Hotels Int'l, Inc. v. Columbus-Hunt Park DR. BNK Investors, L.L.C.*, 2009 Del. Ch. LEXIS 185 (Del. Ch. Oct. 15, 2009) (expounding upon the "common nucleus of operative fact" element).

42. 2019 Del. Ch. LEXIS 1403 at *32.

43. 243 A.3d at 587; citing *Federated Rural Elec. Ins. Exch. v. Nationwide Mut. Ins. Co.*, 134 F. Supp. 2d 923, 927 (S.D. Ohio 2001).

44. *Id.* at 591. ■

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