

NO. 65365-2

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON,
DIVISION ONE

VULCAN INC., a Washington corporation, VULCAN CAPITAL
PRIVATE EQUITY, INC., a Delaware corporation, and VCPE ORANGE
II, LLC, a Delaware limited liability company,

Appellants,

v.

DAVID CAPOBIANCO, an individual, and NAVIN THUKKARAM, an
individual,

Respondents.

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APPELLANTS' OPENING BRIEF

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I. INTRODUCTION

An arbitration award must be vacated for evident partiality and misconduct under §§ 10(a)(2) and 10(a)(3) of the Federal Arbitration Act (the “FAA”) where one party had significant, undisclosed pre-appointment *ex parte* communications with an arbitrator concerning the merits of a dispute. The law does not permit a party to test-drive and fine-tune its case *ex parte* before a decision-maker.

As a means of alternative dispute resolution, arbitration is encouraged and supported by statutes and case law, provided it is fair and impartial. Thus, the FAA provides for confirmation of arbitration awards subject to an irreducible safety-net of independent judicial review. This safety-net must be enforced or the integrity of arbitration is undermined.

Here, before appointing Arthur Harrigan as a purportedly neutral arbitrator, Respondents and their attorneys consulted in-person with Mr. Harrigan multiple times. Mr. Harrigan reviewed Respondents’ detailed draft arbitration demand (the work product of their attorney) at least three times. Mr. Harrigan was also provided and reviewed the central evidence in the case. Mr. Harrigan then developed questions for Respondents’ attorney based upon his review and analysis, and he discussed these questions with the attorney. All this took place while Respondents and their attorneys were drafting and revising the arbitration demand. And

Mr. Harrigan then sent Respondents a bill for his work.

This is not speculation or spin. These facts are confirmed by Mr. Harrigan's own invoices. Yet Respondents disclosed none of this to Vulcan when they appointed Mr. Harrigan as a "neutral." As for Mr. Harrigan, he made no mention of his work for Respondents in his arbitrator-disclosure form. He identified limited and collateral professional contacts with Respondents' attorneys' law firm in the past, described a glancing social acquaintance with Respondents' lead attorney, and stated no prior contacts at all with Respondents. Mr. Harrigan did not disclose the bill he'd sent Respondents one week prior.

The conduct at issue here is inconsistent with any standard of neutrality, impartiality, full disclosure, and ethical remove. Not just Vulcan but any reasonable person would have serious and justifiable doubts about Mr. Harrigan's impartiality upon learning these facts. This sort of conduct calls into question the integrity of arbitration and is why, in large part, the safety-net of § 10(a) of the FAA exists.

Vulcan thus brought a motion to vacate the arbitration award in the trial court. The court denied the motion and confirmed the award. In doing so, the court abdicated its statutory duty to independently assess the impartiality of the arbitrator and ignored the record evidence. The court's Memorandum and Opinion makes no mention at all of Mr. Harrigan's

invoices or the conduct they document, instead making the anodyne assertion that “there is no evidence before the court of inappropriate conduct during the pre-appointment contact.”

More than that, the court crafted out of whole cloth an untenable new standard for what is permissible *ex parte* communication in an arbitration. Under the American Arbitration Association’s Arbitration Rules, all *ex parte* communications with arbitrators are barred, with three narrow exceptions, none of which are case-specific. But the court held that “pre-appointment time spent with a candidate is case dependent” and that the circumstances of this case somehow “justify an in-depth pre-appointment process.” The court ignored the bright-line prohibition against discussing the merits and substituted an indeterminate sliding scale of permissible *ex parte* communication.

If affirmed, this decision would mark a sea-change in the ethical framework of arbitration and arbitrator selection and create substantial uncertainty as to what is required by arbitrator disclosures. If parties can discuss with an arbitrator candidate their side of the case as part of the ordinary retention process (and make subjective decisions about how “in-depth” such discussions can be), then there is no practical or enforceable limit to what they can communicate. Such a blanket immunization of pre-appointment “discussions” creates an exception to the prohibition against

ex parte contacts with a neutral that effectively swallows it whole. It also would arguably mandate counsel for arbitrating parties to affirmatively communicate about the merits with potential arbitrators because a failure to test-drive one's case (and ensure receptiveness) might be malpractice.

Separately, the court also erred in failing to vacate the Award under § 10(a)(4) of the FAA because the arbitrators exceeded their powers. While acknowledging that Respondents were at-will employees whom Vulcan lawfully terminated, the Award nonetheless vested them with interests whose vesting was expressly conditioned upon their employment at the time of future events that have yet to occur and may not occur for quite some time. It did so based on a fundamental disregard of Delaware law on the implied covenant of good faith and fair dealing, which allows a court to imply terms only where it is clear from the agreement what the parties would have agreed. While acknowledging that the parties' agreement did not provide for any accelerated vesting and that Vulcan had in fact rejected it in negotiations, the Award nonetheless granted it to Respondents under the guise of the implied covenant. The Panel treated the implied covenant as a *carte blanche* to imply whatever terms it deemed appropriate regardless of the parties' negotiations or agreement. In the words of the United States Supreme Court, the Panel improperly "dispens[ed] [its] own brand of industrial justice[.]"

II. ASSIGNMENTS OF ERROR

(A) The trial court erred by failing to perform its statutory duty to vacate the Award based on arbitrator misconduct and/or evident partiality under §§ 10(a)(2)-(3) of the FAA.

(B) The trial court erred by finding that the decision not to prospectively disqualify Mr. Harrigan was an independent “award” that itself had to be vacated under the FAA before the court could vacate the Award.

(C) The trial court erred by ignoring contemporaneous record evidence of misconduct and evident partiality and by denying Appellant’s motion for limited discovery.

(D) The trial court erred by failing to vacate the Award in light of the Arbitration Panel’s having exceeded its powers under § 10(a)(4) of the FAA.

III. STATEMENT OF THE CASE

A. THE UNDERLYING DISPUTE

Respondents David Capobianco and Navin Thukkaram were employed on an at-will basis as investment managers within the private-equity group (the “PEG”) of Vulcan Capital. CP 597. Their compensation agreement with Vulcan (the “VEC Agreement”)¹ allocated to them and other PEG investment managers a specified share of the profits earned from the investments they managed; this share was referred to as their “carry.” CP 599. Each investment manager’s share of the carry

¹ CP 160-198. There were three relevant agreements, one of which was the VEC Agreement. The parties agreed that the material aspects of the relevant provisions in the agreements operate identically. Thus, the parties and Panel referenced the VEC Agreement during the arbitration. CP 597, n.1.

vested over time according to the vesting provisions of the VEC Agreement. An initial percentage (15% - 35%) vested as of the date of the VEC Agreement. CP 171-72 at §§ 5(a)(i)(A)-(B) & 5(a)(iii)(A). An additional percentage up to 80% was to vest monthly over the course of three years, so long as the participant remained employed. CP 172 at §§ 5(a)(i)(C) & 5(a)(iii)(B). The final 20% would vest only upon disposition of the investment (an “Exit”), provided the participant was still employed at the time of the exit (the “Exit Vest”). CP 172 at §§ 5(a)(i)(D) & 5(a)(iii)(C). The VEC Agreement did not provide for any accelerated vesting in the event Vulcan terminated a PEG employee without cause.

Vulcan terminated Respondents and the other PEG personnel in October 2008.² CP 25:5-6. At that time of their termination, Respondents were each 80% vested in their shares of the carry. CP 25 at 12-18, CP 605 at 14-15. There had been no Exit from any of the investments, nor was any Exit impending. This remains true today. Respondents initiated arbitration claiming, among other things, that despite their pre-Exit termination, they were entitled to the 20% Exit Vest. CP 32 at 17-18.

B. THE ARBITRATION

The governing arbitration provision called for a tribunal of three

² Vulcan rehired four PEG personnel, but not Respondents. CP 25:5-6. The Panel viewed this as wrongful although all PEG employees were at-will. The resulting Award, a product of the Panel’s view, is flatly contrary to the applicable law. *See* § IV.D *infra*.

neutral arbitrators—one selected by each side and the third jointly appointed by the two party-selected arbitrators. CP 183 at § 10.8. Respondents selected Arthur Harrigan. Vulcan selected Judge Robert Alsdorf (Ret.). James A. Smith, Jr. was selected as the third arbitrator.

Following an evidentiary hearing, the arbitrators (the “Panel”) issued an interim award determining liability substantially in favor of Respondents on July 29, 2009. CP 595-615. Respondents thereafter produced Mr. Harrigan’s and its counsels’ invoices in support of their claim for attorneys’ fees and costs. CP 128 at ¶¶ 5-6, CP 199-215. Those invoices revealed for the first time the conduct that prompted Vulcan’s motion to vacate on the basis of arbitrator misconduct and partiality.

C. THE PARTIES’ REQUIREMENT OF ARBITRATOR NEUTRALITY

The parties agreed that each of the arbitrators was to be neutral at every stage of the proceedings. The VEC Agreement provided that the arbitration would be conducted under the Commercial Arbitration Rules of the American Arbitration Association (the “AAA Rules”). CP 183 at § 10.8. The AAA Rules require arbitrator neutrality. AAA Rule R-12(b), Rule R-17(a) (“[a]ny arbitrator shall be impartial and independent”).

After Respondents filed their Demand for Arbitration, the parties further agreed to an Arbitration Protocol that reiterated and confirmed that all three arbitrators were to be neutral and, specifically, that AAA Rule R-

17(a) would apply. CP 127-28 at ¶ 2, CP 132-36 at § IV. Those rules reflect the “presumption of neutrality” in Canon IX of The Code of Ethics for Arbitrators in Commercial Disputes (“Code of Ethics”), which applies “for all arbitrators, including party appointed arbitrators.” Code of Ethics, Note on Neutrality (www.abanet.org/dispute/commercial_disputes.pdf); CP 71-74 at ¶¶ 14-21. Further, the parties and the Panel also expressly confirmed that all the arbitrators were to be neutral. CP 230, 233, 238.

D. THE *EX PARTE* CONSULTATIONS WITH MR. HARRIGAN BEFORE HIS APPOINTMENT

Mr. Harrigan’s invoices show that his involvement in this matter began on November 25, 2008, nearly two months before he was appointed as a neutral arbitrator and two weeks before Respondents served their Demand. CP 200, 217-228. On that day, Mr. Harrigan spent 1.7 hours in an “[i]nterview with R. Yarmuth [Respondents’ lead attorney].” CP 200. Mr. Yarmuth’s invoices also reflect that he met with a number of potential arbitrators on November 25, but redact their identity. CP 205. While both invoices omit any reference to Respondents, it was later revealed that they too participated in that initial 1.7-hour interview of Mr. Harrigan.

A week later, on December 3, Mr. Harrigan spent 1.8 hours “[r]eview[ing the] draft demand again” and meeting with Mr. Yarmuth and Respondents a second time. CP 200 (emphasis supplied). Mr. Yarmuth’s invoice entry for that day describes a meeting with

Respondents “re: [the arbitration] demand and pending issues” but fails to mention that Mr. Harrigan was also there. CP 208 (emphasis supplied).

To this date, Vulcan does not know the particulars of the drafts presented to Mr. Harrigan; Respondents have never produced them. But the Demand ultimately filed is not a mere notice pleading; it is a detailed presentation of Respondents’ case that comprehensively argues their version of the facts and law over eleven single-spaced pages. CP 217-228.

On December 4, the day after the second meeting with Mr. Harrigan, Respondents’ attorneys “revise[d]” the demand and “work[ed] on finalizing” it. CP 209. Mr. Harrigan then took another 1.6 hours to “[r]ead [the] draft demand [again] and begin contract review[,] not[ing his] questions for clarification of facts.” CP 200. The next day (December 5, a Friday), Mr. Harrigan posed his “questions re background facts” in a 0.4-hour “[t]elephone conference with R. Yarmuth.” *Id.* Mr. Yarmuth then further “review[ed] and revise[ed] [the] demand.” CP 209.

The following Monday, after Mr. Harrigan had reviewed a draft Demand at least three times, met with Respondents and counsel twice, done a contract review and posed questions to Mr. Yarmuth, Respondents finalized and serve the Demand. On January 7, 2009, Mr. Harrigan invoiced Respondents for his work. CP 200. Respondents then named him as their party-appointed neutral arbitrator. *See generally* Appendix A.

E. THE FAILURE TO DISCLOSE

Pursuant to § III of the Arbitration Protocol, each of the arbitrators was directed to complete an Arbitrator Disclosure Form. CP 133, CP 251-58. The form was intended to satisfy the requirement of AAA Rule R-16 that arbitrators disclose “any circumstance likely to give rise to justifiable doubt as to the arbitrator’s impartiality or independence,” in order to allow the parties to “weigh [the arbitrators’] impartiality and independence.” CP 251; CP 71-74 at ¶¶ 14-21.

The Arbitrator Disclosure Form asked for disclosure of any “present or past personal or business relationship” Mr. Harrigan had with Respondents or their counsel CP 274 (Questions 2(a) and (b)). Regarding Respondents, Mr. Harrigan’s answer was simply “no.” *Id.* Regarding Mr. Yarmuth, Mr. Harrigan identified some limited contacts, including chance encounters over the years (such as that he had “met [Yarmuth] by coincidence at a few social/bar association events”). *Id.*

The Arbitrator Disclosure Form also included a broad, catch-all question to elicit anything else worthy of disclosure:

To the extent not previously provided, please describe in detail any financial, professional, or personal entanglement(s) between you and the parties or their legal counsel, or the subject matter of this dispute, which may give rise to a justifiable doubt as to your impartiality or independence to arbitrate this dispute.

CP 276. Mr. Harrigan’s conclusory response: “None.” *Id.* He did not

disclose that he had spent hours meeting with Respondents and their counsel, reviewing the draft Demand multiple times as it was being revised, reviewing the central contract at issue, and discussing his questions about the facts with Respondents' counsel. Neither Mr. Harrigan nor Respondents ever supplemented or corrected these disclosures. CP 130 at ¶ 13; *see also* CP 233, 234.

F. THE ARBITRATION DEMAND

Respondents' Arbitration Demand asserted claims for (1) breach of contract, (2) tortious interference, (3) breach of the implied covenant of good faith and fair dealing, (4) wrongful termination, and (5) wrongful withholding of wages. CP 227. The contract claims were based on Sections 4 and 5 (and, to a lesser extent, Section 7) of the VEC Agreement. CP 221-23 at ¶¶ 15-23. According to the Demand, these provisions meant that, no matter what, "the Carry belongs to the Team" and could not revert to Vulcan under any circumstances. CP 227 at ¶ 40.

The arbitration pleadings (both the Demand and Vulcan's Response) do not mention Section 10.4 of the VEC Agreement, which addresses how the plan can be amended and when it terminates. CP 217-228, CP 285-306. But on June 11, 2009, just prior to the Arbitration hearing, the Panel requested that "the parties address[] Section 10.4 of the [VEC Agreement] in their pre-hearing briefs and provide[] their respective

views concerning its impact on the issues in the case.”³ CP 308.

Following the Panel’s June 11 letter, Respondents argued for the first time in their arbitration brief that Vulcan breached § 10.4 of the VEC Agreement when it terminated Respondents and the other PEG employees. The Award ultimately adopted this argument, premising its conclusion that Vulcan breached the VEC Agreement solely on the theory that by firing all of the PEG managers and rehiring some, Vulcan sought to amend or terminate the plan in violation of § 10.4. CP 31:22 – 32:11.

G. THE AWARD AND LIABILITY

On July 29, 2009, the Arbitration Panel issued an Arbitration Award substantially in favor of Respondents. CP 23-43.

Acknowledging Respondents’ at-will employment status, the Award held that their termination was lawful and rejected their wrongful termination claim. CP 36:13-37:13. The Award also recognized that the VEC Agreement specifically provided that Respondents’ interests would vest over time up to 80%, and then “concluding with a final 20% portion (the ‘Exit Vest’) to occur only if the investment were sold while the employee was still working for Vulcan (or was deemed sold as provided in the Agreements).” CP 27:14-18 (emphasis supplied).

³ It was Mr. Harrigan who first raised this argument on June 10 at a hearing on Vulcan’s motion for summary judgment, and his invoices refer to analysis of the issue that same day. CP 130 at ¶ 16, CP 308, CP 311.

Because the termination of the entire PEG (all of whom were employed at-will) “created a situation that is not expressly addressed by the compensation provisions of the VEC Agreement” (CP 35:14-18), the Panel proclaimed its ability, under the implied covenant of good faith and fair dealing, to “fashion a remedy that reflects how the parties would probably have addressed these circumstances had they expressly dealt with them in the contract,” CP 13:20-21 (emphasis supplied). The result was to provide Respondents with 96% vesting—*i.e.*, an accelerated vesting of most but not all of the Exit Vest. CP 33:9-19. The Award made this remedy even while recognizing “it is clear that ... Vulcan would not agree during negotiations to an acceleration of the 20% Exit Vest in the event of a not for cause termination[.]” CP 35:24 – 36:1 (emphasis supplied). The ostensible “breach” underlying this remedy was Vulcan’s position that, under the VEC Agreement’s provision for reallocation of an employee’s unvested share of the carry upon termination, there was no reallocation if the entire PEG was terminated. While expressly finding that the VEC Agreement was silent on this subject, the Award nonetheless faulted Vulcan for attempting to “amend” the VEC’s reallocation provision. CP 32:6-9.

H. SUBSEQUENT PROCEDURAL MATTERS

The Arbitration Award issued on July 29, 2009 determined liability

but did not provide for specific damages; the Panel retained jurisdiction in order to make a “determination of amounts due and owing under this Award,” including attorneys’ fees and costs. CP 42.

On August 6, 2009, Respondents provided invoices to Vulcan’s counsel in support of their claim for attorneys’ fees and costs. CP 128 at ¶¶ 5-6, CP 200-15. On August 20, having first learned of Respondents’ and Mr. Harrigan’s substantive *ex parte* communications upon review of the invoices, Vulcan objected to the propriety of the Award so as to avoid any argument that it had waived its right to do so. CP 380. But recognizing that the Panel lacked authority to modify the Award under AAA Rule R-46 except with respect to clerical errors, Vulcan stated that it would “timely initiate appropriate proceedings in the Superior Court.” *Id.* Further, Vulcan understood that the parties had agreed regarding the remaining issues and thus, while maintaining its objections, stated it “w[ould] be stipulating regarding the ministerial issues that remain.” *Id.*

Respondents’ response was to file a “Motion to Confirm the Panels’ Authority.” CP 391-401. The motion requested “an Order confirming that the Panel has, for all purposes and times relevant, been impartial and independent, and the impartiality of the Panel has not been, and is not compromised.” CP 393 at 7-9. The Panel did not rule on the Motion to Confirm, but referred the matter to Judge Terry Lukens under

Section IV of the Arbitration Protocol. CP 133.

Vulcan then moved to disqualify Mr. Harrigan from any further participation in the Arbitration. Judge Lukens denied the motion. CP 44-58. His decision stated that “[t]he sole issue presented . . . is whether one of the party-appointed arbitrators should be disqualified under Rule 17(a)” of the AAA Rules. CP 44. According to the decision, “Rule 17(a) requires a finding of partiality, not merely an appearance of partiality.” CP 48. Without addressing Mr. Harrigan’s invoices, Judge Lukens concluded that there was “no evidence” to support the “mere supposition that something untoward must have happened here.” CP 47.

On February 9, 2010, the Panel issued its Final Arbitration Award, which incorporated (and attached) the prior July 29 Award regarding liability and Judge Lukens’ decision regarding disqualification. CP 17-58.

Vulcan then filed a motion to vacate the Award. CP 94-126. Vulcan also filed a motion to allow limited discovery. CP 528-37. Respondents filed a cross-motion seeking to have “two arbitration awards” confirmed, asserting that the Final Award and Judge Lukens’ decision on disqualification were the products of two separate arbitrations. CP 1-13.

The court granted Respondents’ motion and denied Vulcan’s motion to vacate, as well as its discovery motion. CP 586-630. In doing so, the court accepted Respondents’ argument that it could not

independently consider whether Mr. Harrigan had exhibited evident partiality or engaged in prejudicial misconduct under the FAA without first vacating Judge Lukens' decision not to disqualify him. CP 580:19-583:2. Alternatively, while purporting to conduct an independent review, the court parroted the "no evidence" conclusion from the disqualification decision, without any effort to address the invoices on which the motion to vacate was based. CP 583:4 – 584:23. The word "invoice" does not appear in the trial court's order. The court addressed Vulcan's § 10(a)(4) arguments with a single sentence: "The arguments fail for the reasons stated by [Respondents.]" CP 584:28-29. Judgment was entered in favor of Respondents on April 30, 2010. CP 631-687. Vulcan timely appealed.

IV. ARGUMENT AND AUTHORITY

A. APPLICABLE STANDARDS OF REVIEW.

A trial court's decision confirming an arbitration award and denying vacatur is reviewed *de novo*. *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996). Appellate review, like that of the trial court in the first instance, is framed by the FAA, which "enumerates limited grounds" on which a court may "vacate, modify or correct an arbitral award."⁴ *Lagstein v. Certain Underwriters at Lloyd's London*,

⁴ Because the underlying dispute arises from an employment relationship, the FAA rather than Washington's Uniform Arbitration Act is applicable. *EEOC v. Waffle House*,

607 F.3d 634, 640 (9th Cir. 2010) (citation omitted). The FAA authorizes a court to vacate an arbitration award in four circumstances:

- (1) where the award was procured by corruption, fraud, or undue means;
- (2) where there was evident partiality or corruption in the arbitrators, or either of them;
- (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
- (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a).

B. THE TRIAL COURT ABDICATED ITS STATUTORY DUTY TO REVIEW THE IMPARTIALITY OF THE ARBITRATOR

The FAA “reflects a legislative determination of the desirability of arbitration as an alternative to litigation. That same policy, however, is the basis for mandatory judicial intervention to preserve the sanctity of arbitration proceedings.” *Action Air Freight, Inc. v. Pilot Air Freight Corp.*, 769 F. Supp. 899, 901 (E.D. Pa. 1991) (emphasis supplied). Here, the trial court refused to engage in “mandatory judicial intervention.” *Id.* Instead, the court allowed a procedural order regarding disqualification to

534 U.S. 279, 289 (2002); RCW 7.04A.030(4) (Washington Act “does not apply to any arbitration agreement between employers and employees”).

effectively insulate the Award from judicial review for arbitrator misconduct or evident partiality. By adding an extra layer of deference atop the already deferential scheme constructed by the FAA, the court undermined the FAA’s careful compromise, eliminating the critical safeguards embodied in the statutory grounds for vacatur and endangering the “sanctity of the arbitration proceedings.” *Id.* Further, the trial court’s conclusion that moving for disqualification effectively waives subsequent judicial review for misconduct or bias is in direct conflict with decades of case law explaining that parties must move for disqualification of an arbitrator in order to preserve the right to judicial review.

1. The FAA Mandates Independent Judicial Review of Arbitrator Partiality Issues.

The basic premise of arbitration is simple: parties surrender their rights to a full, formal, judicial adjudication of their dispute and, in exchange, they receive private judging, which is ostensibly a faster and less costly way to resolve claims. The FAA enforces this trade-off by providing that courts will readily enforce arbitration awards—subject to the four exceptions set forth by the statute. 9 U.S.C. §§ 9-10. By guaranteeing an independent check on at least the basic fairness of the arbitral process, the statutory grounds for vacatur serve as the critical “safety net that hangs below” the general judicial deference to arbitrators. *Hoelt v. MVL Group, Inc.*, 343 F.3d 57, 63 (2nd Cir. 2003).

On a motion to vacate under § 10(a) of the Act, courts must review the impartiality of the arbitrators and the integrity of the arbitral process robustly. The fact that the grounds for vacatur are limited in no way suggests that courts should be less than vigilant in enforcing them. To the contrary, courts should be “even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review.” *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149 (1968). As part of this safety net, the FAA mandates that courts inquire into whether “there was evident partiality or corruption in the arbitrators” or whether they engaged in “misconduct ... [or] misbehavior by which the rights of any party have been prejudiced.” 9 U.S.C. §§ 10(a)(2)-(3). Whether arbitrators express a view of their own impartiality does not and cannot alter that standard. If “evident partiality” or “misconduct” or “misbehavior” exists, then the FAA demands vacatur.

This statutory duty cannot be abdicated by the court or contractually limited by the parties. “Since federal courts are not rubber stamps, parties may not, by private agreement, relieve them of their obligation to review arbitration awards for compliance with § 10(a).” *Hoelt*, 343 F.3d at 64. In *Hoelt*, the Second Circuit held that an agreement providing that an arbitrator’s decision “shall be binding and conclusive . . .

and shall not be subject to any type of review or appeal” did not and could not deprive the court of its obligation to review an arbitration award in accordance with the FAA. *Id.* at 66.

Mandatory independent judicial review of the statutory grounds for vacatur is essential to the policy underlying the FAA:

In enacting § 10(a), Congress impressed limited, but critical safeguards onto this process, ones that respected the importance and flexibility of private dispute resolution mechanisms, but at the same time barred federal courts from confirming awards tainted by partiality, a lack of elementary procedural fairness, corruption or similar misconduct. This balance would be eviscerated, and the integrity of the arbitration process would be compromised, if parties could require that awards, flawed for any of these reasons, must nevertheless be blessed by federal courts.

Hoelt, 343 F.3d at 64 (emphasis supplied). Simply put, § 10(a) of the FAA represents a “floor for judicial review of arbitration awards below which parties cannot require courts to go[.]” *Id.* at 64. This “confirmation-and-vacatur safety net” goes hand-in-hand with judicial deference to arbitration awards on the merits. *Id.* at 63; *cf. Mactec, Inc. v. Gorelick*, 427 F.3d 821, 829-30 (10th Cir. 2005) (arbitration agreement prohibiting appellate review of decision to confirm or vacate permissible only because it did not bar district-court review under the FAA).⁵

⁵ This principle is parallel to one recognized by the United States Supreme Court in *Hall Street Associates, LLC v. Mattell, Inc.*, 552 U.S. 576, 584 (2008), which held that §§ 10 and 11 of the FAA provide the “exclusive grounds” for vacatur and modification of

2. Even if the Statutory Grounds for Vacatur could be Waived by Agreement, the Parties Did Not Do So Here.

Notwithstanding that independent judicial review under § 10 of the FAA is mandatory, the trial court held that Vulcan lost that right by agreeing to submit requests for arbitrator disqualification to a third-party neutral (Judge Lukens). But if seeking to disqualify an arbitrator waives the right to challenge the eventual award, a party suspecting arbitrator bias would be forced to either seek disqualification (and thereby forfeit the right to challenge the award for evident partiality) or forfeit the right to challenge the award by not seeking disqualification.⁶

Recognizing this potential for unfairness, federal and state courts have uniformly held that the right to an independent check on arbitrator bias is not eliminated if a party requests disqualification of an arbitrator during an arbitration. More than sixty years ago, the Southern District of New York held that if a party objects to an arbitrator as biased and “such objection [is] overruled,” the party “will not be precluded from reasserting his objection, if necessary, when the confirmation of the award of the arbitrators comes before the proper judicial tribunal.” *San Carlo Opera*

arbitral awards—and cannot be expanded by contract. Just as the statutorily prescribed review cannot be expanded by private agreement, it cannot be limited by such either.

⁶ AAA Rule R-37 (“Any party who proceeds with the arbitration after knowledge that any provision or requirement of these rules has not been complied with and who fails to state an objection in writing shall be deemed to have waived the right to object.”).

Co. v. Conley, 72 F. Supp. 825, 833 (S.D.N.Y. 1946) (emphasis supplied).

Recent case law confirms that a motion to disqualify an arbitrator “is not a bar to an independent judicial examination.” *Beebe Med. Ctr., Inc. v. InSight Health Services Corp.*, 751 A.2d 426, 440 (Del. Ch. 1999) (submission of arbitrator bias issue to AAA in accordance with its rules “in [no] way limits or bars a court from considering the issue when properly raised in a proceeding to vacate an award”).⁷ *Britz, Inc. v. Alfa-Laval Food & Dairy Co.*, 34 Cal. App. 4th 1085 (1995), is illustrative: The arbitrator entered an interim award before disclosing that he had a business relationship with one of the attorneys, and the plaintiff unsuccessfully moved to disqualify him. *Id.* at 1091-92. After a final award was entered, the plaintiff moved to vacate it for evident partiality. *Id.* at 1096. Addressing the weight to give to the prior disqualification decision, the court reasoned:

In light of the explicit statutory authorization of judicial determination of “evident prejudice” of arbitrators . . . we hold that a trial court considering a petition to confirm or vacate an arbitration award is required to determine, *de*

⁷ See also *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253, 1263 (7th Cir. 1992) (a party objecting to an arbitrator before the AAA “will not be precluded from reasserting his objection, if necessary, when confirmation of the award of arbitrators comes before a proper judicial tribunal”); *Reeves Bros., Inc. v. Capital-Mercury Shirt Corp.*, 962 F. Supp. 408, 413-15 (S.D.N.Y. 1997) (performing an independent review of whether the arbitrator was evidently partial even though the AAA had denied the party’s prior request to disqualify the arbitrator); *Boyhan v. Maguire*, 693 So.2d 659, 662 (Fl. 1997) (holding that the AAA rule on disqualification of an arbitrator “does not address the vacation of an award after an arbitrator has been challenged but continues to serve”).

novo, whether the circumstances disclose a reasonable impression of arbitrator bias, when that issue is properly raised by a party to the arbitration.

Id. at 1102.

Not only does case law reject the proposition that seeking disqualification waives the right to subsequent judicial review, it holds that parties must request disqualification in order to preserve the right to later challenge the award on grounds of bias. *See San Carlo Opera Co.*, 72 F. Supp. at 833 (“His silence and inaction constitute a waiver of the objection.”); *Beebe*, 751 A.2d at 440-41 (noting that courts have “required compliance” with AAA rules and procedures for disqualification motions “but only to preserve the evident partiality issue for judicial review”). Thus, the trial court’s decision places parties in a Catch-22: they cannot challenge a biased award in court if they do pursue disqualification and cannot challenge a biased award in court if they do not pursue disqualification—*i.e.*, courts never have opportunity directly to apply § 10(a)(2) of the FAA. That is not how the FAA was intended to operate; rather, as other courts have held, the rule must be that seeking disqualification in no way waives the right to challenge the final award in court on grounds of arbitrator bias or misconduct.

Such a rule coincides with the general principle that waivers of statutory rights are not readily inferred. Indeed, “a statutory right

conferred on a private party, but affecting the public interest, may not be waived or released if such waiver or release contravenes the statutory policy.” *Brooklyn Sav. Bank v. O’Neil*, 324 U.S. 697, 704 (1945); *see also Hoelt*, 343, F.3d at 64 (§ 10(a) of the FAA comprises “critical safeguards” ensuring that integrity of the arbitration process is not compromised). In this case, far from waiving the right to judicial review of the ultimate arbitration award, the parties—and Vulcan independently—repeatedly took steps to preserve that right:

- At the outset, the agreement to arbitrate specifically contemplates that any arbitration award will be subject to judicial review. CP 183 at § 10.8.
- Once arbitration was initiated, the parties entered a Confidentiality Agreement and Protective Order, which reiterates that “a party may seek to enforce or vacate any award in this Arbitration in a court of competent jurisdiction[.]” CP 373.
- When Vulcan learned, after the Panel had rendered its initial award, of the substantive *ex parte* communications between Mr. Harrigan and Respondents, Vulcan objected and gave notice of its intent to move to vacate in “the tribunal with jurisdiction to address the vacation of the Award” – *i.e.*, the “Superior Court.” CP 380.
- In the disqualification briefing, Respondents argued that Vulcan’s motion to disqualify Mr. Harrigan prospectively should be decided as if it were a motion to vacate. In response, Vulcan pointed out that “whether a court thinks that [Mr. Harrigan’s bias] warrants vacatur is not at issue before [Judge Lukens]” but would be a basis for vacatur in a subsequent proceeding. CP 363-64.

The record demonstrates that the parties did not intend any more than expressly agreed: Judge Lukens' decision on a motion to disqualify would be final and binding for purposes of the arbitration. The parties did not waive the judicial review of impartiality under § 10(a) of the FAA.

3. There is but one arbitration at issue and *First Options* is factually and legally inapposite.

Although the parties clearly did not wave the statutory right to challenge the Award on evident-partiality grounds, the trial court nevertheless concluded that they somehow lost it. It did so by adopting Respondents' argument that Judge Lukens' decision was itself an independent arbitration "award" and that, under *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the trial court "must defer" to it unless that decision—separate and apart from the Arbitration Award—"exhibited corruption, fraud, or one of the other statutory bases for vacating an arbitrator's decision." CP 13 at 6-13; CP 417:22-418:4; *see also* CP 580:19 – 582:14. This proposition and the court's holding are factually erroneous and legally unsupportable.

Respondents' argument that there were two separate "final binding arbitration awards" that must each independently be confirmed or vacated is pure sophistry. CP 2 at 1-2; CP 12 at 15-16. There was one arbitration and one arbitration award. Under the VEC Agreement (CP 183 at § 10.8),

Respondents initiated the underlying arbitration by filing a Demand for Arbitration. Pursuant to that Demand, a three-arbitrator panel was convened, a hearing took place, and the Panel rendered an initial award regarding liability and a Final Award incorporating the initial award and setting forth specific damages. CP 17-50.

As part of the arbitration, the parties agreed on a Protocol to provide necessary procedural guidance given that the arbitration was to be “conducted according to the [the AAA Rules], but without the involvement of the AAA,” CP 132 at § 1.⁸ In AAA-administered arbitrations, disqualification issues are addressed by the AAA under Rule R-17(b). Because the parties chose not to use the AAA’s services here, they agreed that, if “a Party seeks to disqualify an arbitrator for one of the reasons set forth in Rule 17(a),” then a “neutral third party shall determine whether the challenged arbitrator shall be disqualified.” CP 133 at § IV.

Judge Lukens’ decision denying Vulcan’s motion to disqualify was an interlocutory decision on a procedural matter, collateral to but rendered within the arbitration. It did not address or decide Respondents’ claims; it did not determine liability or damages; and it was not an “award.” The fact that, as the court noted, “Judge Lukens’ decision was rendered in an

⁸ Respondents acknowledge that the Arbitration Protocol “addressed functions that would otherwise have been performed by the AAA.” CP 4:22-23.

arbitration” (CP 580:19), does not mean that it was itself an arbitration award subject to confirmation or vacatur under the FAA.⁹

Even if Judge Lukens’ decision were itself an arbitration award, *First Options* would still be irrelevant. *First Options* is one of a series of cases decided by the United States Supreme Court that address threshold or “gateway” issues of arbitration, in particular whether certain matters are arbitrable and who (a court or an arbitrator) decides. *First Options* stands for the proposition that arbitration is a matter of contract subject to ordinary state-law principles governing contract formation. 514 U.S. at 944; see also *Rent-a-Center, West, Inc. v. Jackson*, 130 S.Ct. 2772, 2777 (2010) (*First Options* is one of a “line of cases [that] merely reflect[] the principle that arbitration is a matter of contract”). In *First Options*, there was no agreement to arbitrate; the threshold issue of arbitrability was not delegated to an arbitrator, but was for the court to decide. 514 U.S. at 947.

Here, Vulcan’s motion to vacate did not question arbitrability or any other matter that might implicate *First Options*. Vulcan does not dispute that the parties agreed to submit the procedural issue of arbitrator

⁹ The trial court stated that Vulcan argued that Judge Lukens’ decision “was not entered in an arbitration proceeding.” CP 580 at 20-22. Of course, Judge Lukens’ decision occurred within the arbitration; Vulcan’s argument, then and now, is that Judge Lukens’ decision was not the product of a separate arbitration process and it was not a final arbitration award subject to court review and confirmation or vacatur under the FAA. See, e.g., CP 112-14, CP 339-41, CP 519-20. Among other things, the case caption for Judge Lukens’ decision is identical to that of the actual arbitration award, labeling Respondents as the “[c]laimants” and Vulcan as the “[r]espondents.”

disqualification to Judge Lukens; nor has Vulcan challenged Judge Lukens' interlocutory decision on that issue. Rather, Vulcan seeks vacatur of the final Award, an issue which the parties could not and did not agree to arbitrate and that Judge Lukens expressly did not decide.

Ultimately, it is beside the point what semantic label is attached to Judge Lukens' decision not to disqualify Mr. Harrigan from prospective participation on the Panel. Even under a broad reading of *First Options* so as to apply it to this case (for which there is no support in the case law), the issue is what the parties intended. *First Options*, 514 U.S. at 945 (warning that courts cannot "force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide"). There is no indication that by agreeing to a process to resolve arbitrator-disqualification issues in a non-AAA-administered arbitration, Vulcan intended to give up its right to seek independent judicial review of the arbitration Award for evident partiality. By nonetheless concluding that it "must" grant the motion to confirm the Disqualification Decision" absent grounds to vacate Judge Lukens' decision (CP 582:12-13, 586) the court made a fundamental error of law.

C. THE EXTENSIVE, SUBSTANTIVE, UNDISCLOSED AND EX PARTE COMMUNICATIONS BETWEEN RESPONDENTS AND THE ARBITRATOR REQUIRE VACATUR OF THE AWARD

The trial court also held, in the alternative and seemingly as an

after-thought, that even if it had to conduct its own independent analysis of the Award under the FAA, it would find no flaws justifying vacatur. CP 583:3 – 584.23. If that holding were permitted to stand, it would all but guarantee that hours of undisclosed, merits-based discussion with purportedly neutral arbitrators becomes the new norm in arbitrations.

An arbitration award should be vacated where “there was evident partiality” in the arbitrator or “the arbitrators were guilty of misconduct . . . [or] any other misbehavior by which the rights of any party have been prejudiced.” 9 U.S.C. §§ 10(a)(2)-(3). By requiring vacatur in these circumstances, Congress intended to “provide not merely for any arbitration but for an impartial one.” *Commonwealth Coatings*, 393 U.S. at 147. The extensive, substantive, *ex parte* communications among Mr. Harrigan, Respondents, and their counsel constitute prejudicial misbehavior under § 10(a)(3) and demonstrate evident partiality under § 10(a)(2). Moreover, the failure to disclose that conduct both exacerbates the initial problem and is itself an independent reason to vacate the Award.

1. An Arbitrator Engages In Prejudicial Misconduct, And Displays Partiality, By Having Substantial Communications With a Party Concerning the Merits of the Dispute.

There can be no dispute that an “actual improper contact between a party to the arbitration . . . and an arbitrator would of course be impermissible.” *Pompano-Windy City Partners v. Bear, Stearns & Co.*,

698 F. Supp. 504, 518 (S.D.N.Y. 1988). Nor is there any dispute that *ex parte* discussion of the merits is plainly improper contact. *See, e.g., Totem Marine Tug & Barge, Inc. v. N. Am. Towing, Inc.*, 607 F.2d 649, 653 (5th Cir. 1979) (vacating award because “*ex parte* receipt of evidence bearing on this matter constituted misbehavior by the arbitrators prejudicial to [party’s] rights”). To the contrary, the rules agreed to by the parties expressly prohibit *ex parte* communications between party and arbitrator concerning the merits. *See, e.g.*, AAA Rule R-18(a) (“No party . . . shall communicate *ex parte* with an arbitrator or a candidate for arbitrator concerning the arbitration.”); Rule R-31(a) (“All evidence shall be taken in the presence of all of the arbitrators and all of the parties”). The sole exceptions allow a party to (1) “advise [an arbitrator] candidate of the general nature of the controversy”; (2) “discuss the candidate’s qualifications, availability, or independence in relation to the parties”; and (3) “discuss the suitability of candidates for selection as a third arbitrator.”

The AAA Code of Ethics for arbitrators likewise prohibits prospective arbitrators from engaging in *ex parte* communications other than to (1) “ask about the identities of the parties, counsel, or witnesses and the general nature of the case” or (2) “respond to inquiries from a party or its counsel designed to determine his or her suitability and availability for the appointment.” Code of Ethics, Canon III. The Code

warns that “[i]n any such dialogue, the prospective arbitrator may only receive information from a party or its counsel disclosing the general nature of the dispute but should not permit them to discuss the merits of the case.” *Id.* (emphasis added); *see also* CP 71-73, 82 at ¶¶ 14-17, 37.

The uncontested standard is thus that parties may not talk to arbitrators at all other than to assess the arbitrators availability (a calendar check), suitability (based on a brief description of the general nature of the dispute), and lack of conflicts. But these pragmatic concessions to the need for limited administrative interactions are subject to a bright-line prohibition against any communications going to the merits of the dispute.

The universal prohibition on *ex parte* discussion of the merits is no mere formality. “The inconsistency of secret *ex parte* contacts with the notion of a fair hearing and with the principles of fairness implicit in due process has long been recognized.” *U.S. Lines v. Federal Maritime Comm’n*, 584 F.2d 519, 539 (D.C. Cir. 1978). When a party is permitted to make arguments to an adjudicator outside the opposing party’s presence, the latter litigant has no opportunity to respond, no chance to correct errors in the presentation, and no way to know what seeds his opponent planted in the decisionmaker’s mind.

2. There Were Substantial Communications With Respondents Concerning The Merits.

The only contemporaneous record evidence—the billing invoices

of Mr. Harrigan and Respondents' counsel—establishes that:

- Mr. Harrigan reviewed Respondents' Arbitration Demand no less than three (3) times as it was being drafted and revised.
- Mr. Harrigan met with Respondents and counsel on two different occasions for several hours.
- Mr. Harrigan discussed the draft demand at a meeting with Mr. Yarmuth and Respondents.
- In addition to reviewing the demand, Mr. Harrigan reviewed the parties' contract and he noted questions "for clarification of facts."
- Mr. Harrigan posed his questions to Mr. Yarmuth.
- Respondents' counsel reviewed and revised the Demand after each discussion with Mr. Harrigan.
- Mr. Harrigan sent Respondents a bill for his work.

CP 200, 202, 204-06, 208-10; *see also* Appendix A.

The invoice entries show that Mr. Harrigan's *ex parte* communications with Respondents transgressed appropriate boundaries, delving well into the merits of the case. The three hours spent in meetings with Respondents and their counsel alone suggests that Mr. Harrigan was exposed to Respondents' view of the merits. But no inference is needed, because the direct evidence confirms that he learned about the merits of the dispute, by repeatedly reviewing drafts of Respondents' Demand, a full-blown recitation of their arguments. By reviewing drafts multiple times and discussing this work-product with Respondents and counsel—

let alone analyzing the contracts at issue, “not[ing] questions for clarification of facts,” and posing these questions to Mr. Yarmuth—Mr. Harrigan communicated *ex parte* about matters well beyond the “general nature of the controversy,” which is all that Rule R-18 permits.

Whether the purpose of these interactions was to gauge Mr. Harrigan’s receptiveness to Respondents’ claims (as might be inferred from their parallel interactions with other potential arbitrators) or to take the first crack at winning him over in a non-adversarial setting, they were equally impermissible under the uncontested governing law.

These facts are reminiscent of *Metropolitan Property and Casualty Ins. Co. v. J.C. Penny Casualty Ins. Co.*, 780 F. Supp. 885 (D. Conn. 1991). There, the defendant chose an arbitrator who had engaged in *ex parte* meetings with defendant, discussed the merits of the case, and received documentary evidence from the defendant regarding “material facts of the dispute.” *Id.* at 890. The court held that the arbitrator’s conduct could be deemed “inconsistent with the Code of Ethics and [the arbitrator’s duty] to treat the parties fairly at all stages of the proceedings, exercise independent judgment throughout, and remain free from outside pressures” and thus “provides a reasonable basis for which to sustain a claim of . . . arbitrator misconduct” under the FAA. *Id.* at 893. But there is one very significant difference between *Metropolitan Property* and this

case: Unlike Mr. Harrigan, the arbitrator in *Metropolitan Property* was appointed to serve as a non-neutral arbitrator—*i.e.*, he was expected to be on the defendant’s side. *Id.* at 891-92.

Nonetheless, the trial court somehow concluded that there was no possibility that the clear rules against *ex parte* communication had been violated. It did so by assuming the truth of the factual allegations made by Respondents, turning on its head the rule that disputed facts must be resolved in an evidentiary hearing; one side’s version cannot be “accepted” as true, particularly where arbitrator misconduct is at issue. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-50 (1986); *Univ. Commons-Urbana, Ltd. v. Universal Const., Inc.*, 304 F.3d 1331, 1341-42 (11th Cir. 2002). The court also treated as gospel the “facts” as stated by Judge Lukens (CP 583:24 – CP 584:3), who had bizarrely concluded that “[Mr. Yarmuth’s] factual recitation must be considered a verity” and that “the only facts are presented by Mr. Yarmuth,” CP 46, CP 48 (emphasis supplied). So the court relied exclusively on the facts found by Judge Lukens, who relied exclusively on a self-serving declaration submitted by Respondents’ counsel. That is not how any court resolves factual disputes among litigants.

Even if one accepts Mr. Yarmuth’s self-serving declaration, serious unanswered questions remain. The declaration is tellingly and

selectively worded: While Mr. Yarmuth insists that “[a]t no time were any questions asked of Mr. Harrigan, or was any input received from him, regarding the merits of the dispute” (CP 45, emphasis supplied), *ex parte* communications are equally improper when they run from party to adjudicator. Mr. Yarmuth could have spent hours arguing the merits of the dispute to Mr. Harrigan, explaining Respondents’ version of the facts, or impressing upon him the legal theory upon which Respondents sought recovery—and his declaration does not deny it.

Moreover, the story told by Respondents and accepted without question by the trial court is facially implausible. It does not take over five hours (and two in-person meetings) to check a schedule, determine whether an individual has the necessary background to adjudicate a non-technical contract dispute, and run a conflicts check.

The trial court held that the facts of this case (“complex contracts, high finances, and a prominent Seattle businessman”) somehow required “an in-depth pre-appointment process” (CP 583:16-21). This speculation is contrary to the law and cannot substitute for the record facts. But the court failed even to describe the record facts: There is no mention in the opinion of Mr. Harrigan’s own invoices. Further, the court made no effort to explain how Mr. Harrigan’s admitted conduct comports with Rule R-18(a) or falls within its narrow exceptions—*i.e.*, how iterative reviewing

of one party's work product, reviewing evidence, posing questions of one party's counsel, and meeting for hours with the party and its counsel mesh with the exclusively administrative exceptions of Rule R-18(a).

The trial court's casual assertion that some circumstances "justify an in-depth pre-appointment process," without any explanation of what is permissible, effectively obliterates the clear *ex parte* prohibition of Rule R-18(a) and substitutes in its place a fuzzy and subjective sliding-scale. If allowed to stand, parties would be encouraged to freely engage arbitrators in pre-appointment merits discussions, and the integrity and reputation of the entire system of private arbitration would be compromised.

3. Evident Partiality Exists Where an Arbitrator Fails to Disclose Facts That Create A Reasonable Impression of Partiality.

Even if Mr. Harrigan's *ex parte* review and discussion of Respondents' evidence and arguments were not sufficient to vacate the award, his failure to disclose the conduct is.

An arbitration award must be vacated for "evident partiality" under § 10(a)(2) when non-disclosure creates a "reasonable impression of partiality." *Schmitz v. Zilveti*, 20 F.3d 1043, 1046 (9th Cir. 1994).¹⁰ When

¹⁰ See also *Olson v. Merrill Lynch, Pierce, Fenner & Smith*, 51 F.3d 157, 159 (8th Cir. 1995) (vacating award because failure to disclose tie to a party created "impression of possible bias"); *Middlesex Mut. Ins. Co. v. Levine*, 675 F.2d 1197, 1201-02 (11th Cir. 1982) (vacating where arbitrator failed to disclose involvement in a legal dispute with a

non-disclosure supports an inference that the arbitrator knowingly kept quiet about facts bearing upon his impartiality, courts routinely vacate arbitration awards. *See, e.g., Valrose Maui, Inc. v. Maclyn Morris, Inc.*, 105 F. Supp. 2d 1118, 1120-24 (D. Haw. 2000) (vacating award where counsel for one party discussed with arbitrator the possibility of mediating unrelated case, and arbitrator did not disclose communication); *Crow Construction Co. v. Brown Assocs. Inc.*, 264 F. Supp. 2d 217, 225 (E.D. Pa. 2003) (similar); *see also Metropolitan Property*, 780 F. Supp. at 890 (arbitrator's non-disclosure is basis to sustain claim of evident partiality).

But even where an arbitrator was unaware of facts suggestive of partiality, courts have ordered vacatur. *See, e.g., Schmitz*, 20 F.3d at 1044-48 (vacating award where arbitrator failed to discover, and therefore failed to disclose, that his law firm represented parent company of one party in a number of cases); *New Regency Productions, Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101 (9th Cir. 2007) (similar).¹¹

Here, the disclosure form asked Mr. Harrigan to disclose any professional or other business relationship with Respondents or their counsel. CP 274. Surely when a legal professional consults with a

party); *Sanko S.S. Co. v. Cook Indus.*, 495 F.2d 1260, 1263-64 (2nd Cir. 1973) (evident partiality present when undisclosed facts "might create an impression of possible bias").

¹¹ Even where an award is the unanimous decision of a three-member panel, evident partiality on the part of just one arbitrator mandates vacatur. *Schmitz*, 20 F.3d at 1049.

party—reviews its work product, assesses evidence and poses questions—such a relationship has been created. Further, “any time money changes hands directly between an arbitrator and a representative of one of the parties involved in a pending arbitration before that arbitrator, disclosure must take place.” *Crow Constr. Co.*, 264 F. Supp. 2d at 225. Yet Mr. Harrigan failed to disclose the invoices he had sent Respondents. CP 274.

Mr. Harrigan was also asked to disclose any “entanglement(s) between [him] and the parties or their legal counsel, or the subject matter of this dispute, which may give rise to a justifiable doubt as to your impartiality or independence to arbitrate this dispute.” CP 276 (emphasis supplied.) It is inconceivable that 5.5 hours spent meeting *ex parte* with one side and its counsel, reviewing and discussing their draft arbitration demand and discussing questions about the facts, could not have amounted to an “entanglement . . . [with] the subject matter of th[e] dispute.” And if there were “[a]ny doubt as to whether or not disclosure [wa]s to be made[, it] should [have] be[en] resolved in favor of disclosure.” Code of Ethics, Canon II(D); *Commonwealth Coatings*, 393 U.S. at 152 (“arbitrators [must] err on the side of disclosure”); CP 78-83 at ¶¶ 28-38.

Mr. Harrigan’s *undisclosed ex parte* contacts and relationship with Respondents, and his substantive involvement in the matter before his appointment, more than creates a reasonable impression of partiality and

thus constitutes an independent basis for vacatur.

4. At The Very Least, A Remand For Fact-Finding Is Required.

Assuming *arguendo* that Mr. Harrigan’s invoices (and those of Mr. Yarmuth, which confirm the scope and significance of the *ex parte* communications) do not themselves mandate vacatur, at a minimum a remand is required in order to allow for discovery or other fact-finding.

Fact-finding is sometimes necessary to resolve objections raised under § 10(a) of the FAA.¹² Even “arbitrators may be deposed regarding claims of bias or prejudice.” *Hoelt*, 343 F.3d at 67. Once *prima facie* evidence of partiality is presented, an evidentiary hearing should be held. *Univ. Commons-Urbana*, 304 F.3d at 1341-42 (vacating confirmed award and remanding for fact-finding regarding “evident partiality”; noting that “interactions between and arbitrator and a party’s counsel, especially those concurrent with the arbitration, can pose a potential conflict”).

In this case, there are facial inconsistencies between the record evidence (the invoices) and the story told by Respondents’ counsel. These

¹² See *Legion Ins. Co. v. Ins. Gen. Agency, Inc.*, 822 F.2d 541, 542-43 (5th Cir. 1987) (“Some motions challenging arbitration awards may require evidentiary hearings outside the scope of the pleadings and arbitration record Such matters as misconduct or bias of the arbitrators cannot be gauged on the face of the arbitral record alone.”); *Sanko*, 495 F.2d at 1262-63 (holding that “discrepancies [between disclosures and apparent conflicts] require that [the case] be remanded so that an evidentiary hearing may be held and the full extent and nature of the relationship as issue may be entertained”).

factual disputes must be resolved before the Award can be confirmed consistent with the FAA. Vulcan submits that the contemporaneous evidence of improper *ex parte* discussions is clear and indisputable; it more than satisfies §§ 10(a)(2)-(3). But if this Court disagrees, it should remand for a proper evaluation of the statutory grounds for vacatur, complete with discovery and fact-finding.

D. THE ARBITRATORS EXCEEDED THEIR POWERS

An arbitration award should be vacated where the arbitrators exceeded their powers in making it. 9 U.S.C. § 10(a)(4). Arbitrators exceed their powers when an award exhibits a “manifest disregard of the law” or “fails to draw its essence from the agreement” between the parties, *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1288 (9th Cir. 2009)—for example, by knowingly ignoring applicable law, *id.* at 1290, or by disregarding or modifying unambiguous contract provisions, *Patten v. Signator Ins. Agency, Inc.*, 441 F.3d 230, 235 (4th Cir. 2006). “[C]ourts are neither entitled nor encouraged simply to ‘rubber stamp’ the interpretations and decisions of arbitrators.” *Bob Schultz Motors, Inc. v. Kawasaki Motors Corp., U.S.A.*, 334 F.3d 721, 725 (8th Cir. 2003).¹³

¹³ See also *Comedy Club*, 553 F.2d at 1286-93 (vacating award that purported to apply to non-parties to contract and enforcing covenant not to compete beyond permissible legal limits); *Gas Aggregation Inc. v. Howard Avista Energy, LLC*, 319 F.3d 1060, 1068-69 (8th Cir. 2003) (vacating award under Minnesota Consumer Fraud Act in a matter involving a non-consumer transaction); *PMA Capital Ins. Co. v. Platinum*

In this case, the Panel exceeded its powers in three respects. First, the Award reasoned that by terminating all PEG employees (and with them, the VEC Agreement) and rehiring some of them, Vulcan breached the contract “as to the rehired employees.” But Respondents were not rehired, making this conclusion irrelevant. Second, citing the implied covenant of good faith and fair dealing, the Award gave Respondents a benefit that they did not and could not obtain through negotiation—one that Vulcan expressly rejected during bargaining. Finally, the Award premised Vulcan’s “breach” of the VEC Agreement on a supposed attempt to amend provisions that the Panel expressly said were not in the agreement. At bottom, the Award substituted the Panel’s view of fairness for what the sophisticated contracting parties had voluntarily agreed, with the goal of punishing Vulcan even though Respondents were concededly not harmed by the Panel’s creative theories of breach—*i.e.*, the Panel “simply imposed its own conception of sound policy.” *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 130 S. Ct. 1758, 1762 (2010).

1. The Panel Awarded Respondents a Remedy for a Breach Solely “As To” Other Employees.

When Vulcan terminated Respondents, their unvested carry (*i.e.*, the Exit Vest) ordinarily would have been temporarily reallocated to

Underwriters Bermuda, Ltd., 659 F. Supp. 2d 631 (E.D. Pa. 2009) (similar).

remaining PEG employees (and then would have reverted to Vulcan after nine months) under Section 4 of the VEC Agreement. CP 171. But because Vulcan terminated all PEG employees, there were no “remaining participants” in the plan, and Vulcan’s position was that the unvested carry was thus immediately (rather than nine months later) reallocated to Vulcan.¹⁴ This evidently struck the Panel as an unfair attempt to deprive the rehired employees of Respondents’ unvested carry. The Panel held that the decision to “simultaneously terminate the Private Equity Team and then rehire certain team members, in an effort to stop the incentive compensation plan,” was, in effect, a breach of the plan “as to the rehired employees.” CP 34:24 – CP 35:2 (emphasis supplied).

Of course, this might be an issue (if at all) between Vulcan and the rehired employees. But Respondents were never rehired. They were lawfully terminated, and excluded from any portion of the unvested carry, regardless of whether Vulcan had engaged in the mass-termination and rehiring. There is no possible link between the Panel’s finding of breach “as to” the rehired employees, and its Award in favor of Respondents.

In short, even if the Panel were correct that Vulcan somehow

¹⁴ This allowed Vulcan to structure future reallocations under a new, more rational plan, which it did with respect to the rehired employees. And, in fact, Vulcan subsequently negotiated with the re-hired PEG employees a new bonus plan, and each PEG employee who might theoretically have had a claim against Vulcan for some portion of Respondents’ unvested carry remains employed by Vulcan to this day.

breached the VEC Agreement to the detriment of the remaining PEG employees, Respondents were the wrong plaintiffs to assert such a claim. They were at-will employees, lawfully terminated, and without any entitlement to accelerated vesting. The Award provides them with a windfall to which they have no contractual or other legal entitlement.

2. The Award Disregards and is Contrary to the At-Will Doctrine under Delaware law.

Respondents were employed at will. CP 25:7, CP 182 at § 10.1. Under Delaware law, “an employee at-will can be terminated for any reason, with or without cause.” *Lord v. Souder*, 748 A.2d 393, 398 (Del. 2000) (emphasis supplied). “Any reason” includes avoiding a future obligation to pay an employee as-yet unearned compensation, *E.I. DuPont De Nemours & Co. v. Pressman*, 679 A.2d 436, 441 (Del. 1996), and preventing an employee’s rights or benefits from vesting, *Sargent v. Tenaska, Inc.*, 108 F.3d 5, 7 (1st Cir. 1997).¹⁵ Thus, the Award acknowledges, terminating Respondents was lawful. CP 36:13-37:13.

Yet the Award premises Vulcan’s liability on the purpose behind

¹⁵ In *Sargent*, a terminated at-will employee claimed interests that had not vested at the time of his termination, alleging that the termination was for the purpose of preventing vesting in breach of the covenant of good faith and fair dealing. Because he could not show that the unvested interests “specifically and identifiably correspond[ed] to [his] past services,” the court affirmed summary judgment in favor of the employer. 108 F.3d at 9; see also *Titsch v. Reliance Group, Inc.*, 548 F. Supp. 983, 985-87 (S.D.N.Y. 1982) (employee had no claim for breach of implied covenant of good faith based on termination to prevent exercise of stock options because plaintiff was employed at will).

their termination. The Panel faulted Vulcan for the termination-and-rehire because it was done “to stop the incentive compensation plan.” CP 34:24 – CP 35:2. This ignores the rule that at-will employees may be terminated for any reason—including “to stop the incentive compensation plan.”

3. The Award Does What Delaware Law on the Covenant of Good Faith Prohibits.

Under the VEC Agreement, full vesting of an employee’s carry (*i.e.*, the Exit Vest) would only occur upon the disposition of an asset, and only if the employee was still employed at the time of the exit. CP 27:15-18, 172 at §§ 5(a)(i)(D) and 5(a)(iii)(C). Respondents agreed that participation in the compensation plan under the VEC Agreement did not “confer upon [them or any other employee] the right to continue in the employ of Vulcan . . . or to interfere with or limit in any way the right of Vulcan . . . to terminate any employee’s employment.” CP 182 at § 10.1. And the Panel confirmed that they were lawfully terminated.

The VEC Agreement does not allow for accelerated vesting upon termination or under any circumstances. As the Panel acknowledged, the parties discussed the subject of accelerated vesting during “protracted and detailed” pre-contract negotiations, and Respondents’ “request for an Exit Vest in the event of a not for cause termination was unequivocally rejected by [Vulcan].” CP 26:24, 32:19-20 (emphasis supplied).

And yet the Award gives Respondents “80% of their previously

unvested interest (20%), or 96% for purposes of the ‘Exit Vest.’” CP 33:16-19. It does so under the Panel’s self-proclaimed “right to fashion an appropriate remedy pursuant to the covenant of good faith and fair dealing.” CP 33:9-11. Not only does Delaware law not provide a “right” to “fashion” this remedy under the circumstances; it flatly prohibits it.

The implied covenant of good faith and fair dealing “embodies the law’s expectation that ‘each party to a contract will act with good faith toward the other with respect to the subject matter of the contract.’” *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1032 (Del. Ch. 2006) (citation omitted). It “is not a panacea for the disgruntled litigant.” *Fisk Ventures, LLC v. Segal*, 2008 Del. Ch. LEXIS 158 (Del. Ch. May 7, 2008). There are stringent limitations as to its application.

First, “the implied covenant of good faith and fair dealing may not be applied to give [a party] contractual protections that ‘[it] failed to secure at the bargaining table.’” *Corporate Property Assocs. 14 Inc. v. CHR Holding Corp.*, 2008 Del. Ch. LEXIS 45, at *17-18 (Del. Ch. April 10, 2008). “Courts will not rewrite contractual language covering particular topics just because one party failed to extract as complete a range of protections as it, after the fact, claims to have desired during the negotiations process.” *Allied Capital Corp.*, 910 A.2d at 1034.

Second, “[e]xisting contract terms control . . . such that implied

good faith cannot be used to circumvent the parties' bargain[.]” *Dunlap v. State Farm Fire and Casualty Co.*, 878 A.2d 434, 441 (Del. 2005).

Rather, it must be “clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as breach of the implied covenant of good faith – had they thought to negotiate with respect to the matter.” *Katz v. Oak Industries, Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986); *Allied Capital*, 910 A.2d at 1033 n.24 (“The test is whether it is clear from what was expressly agreed upon that the parties meant to prohibit the conduct at issue.”) (Emphasis in original). The implied covenant “cannot be invoked where the contract itself expressly covers the subject at issue.” *Fisk Ventures*, 2008 Del. Ch. LEXIS 158, at *37.

Finally, “[t]he Court, of course, may not substitute its notions of fairness for the terms of the agreement reached by the parties.” *Superior Vision Services, Inc. v. Liastar Life Ins. Co.*, 2006 Del. Ch. LEXIS 160, at *21 (Del. Ch. August 25, 2006); *Cincinnati SMSA Limited Partnership v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998) (“[I]t is not the proper role of a court to rewrite or supply omitted provisions to a written agreement.”); *Allied Capital*, 910 A.2d at 1035 (“[C]ourts should be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide for it.”).

Here, the VEC Agreement comprehensively covered the subject at issue—*i.e.*, vesting of Profits Interests and the effect of termination of employment upon vesting. Under it, full vesting was contingent upon the passage of time and continued employment with Vulcan. *See* CP 172 at § 5(a)(i)(C) & (D). What the Panel did here is precisely what Delaware law prohibits: implying a new contractual obligation where the subject matter is already addressed by the contract and no such obligation is provided.

Still worse, the Panel awarded Respondents what they expressly tried and failed to obtain through negotiations. Respondents admitted that the accelerated Exit Vest relief was sought repeatedly during negotiations, and that Vulcan was consistently unwilling to agree to it. “The implied covenant is not a fall-back position to be argued when you now wish [you] had done a better job of negotiating the contract in the first place.” *Allied Capital*, 910 A.2d at 1035. There is no basis for invoking the covenant to provide Respondents the very benefit they unsuccessfully sought in negotiations. *Alliance Data Systems Corp. v. Blackstone Capital Partners V.L.P.*, 963 A.2d 746 (Del. Ch. 2009) (dismissing implied covenant claim on 12(b)(6) motion; in context of failed merger agreement, relief sought by plaintiff would impermissibly “impose an after-the-fact obligation on [defendant] that [plaintiff] was unable to obtain in the contractual

negotiations and contradict the plain terms of [the parties' contract].”¹⁶

4. The Panel Exceeded Its Powers in Finding A Breach of § 10.4 of the VEC Agreement.

Reallocation of the unvested portion of an employee's share of the carry upon his termination is addressed in Section 4 of the VEC Agreement, and vesting is addressed in Section 5. Because there had been no exit from any of the investments in question when it terminated Respondents, Vulcan took the position that they were 80% vested under Section 5. And because the other PEG employees were terminated at the same time, Vulcan believed that their unvested carry was reallocated to Vulcan. It is this position that, according to the Panel, made the termination a breach—*i.e.*, Vulcan's interpretation of Section 4.

Yet the Panel could not find that anything Vulcan did actually violated Section 4. To the contrary, the Panel concluded that Section 4 does not address the circumstances presented here—this is the very basis for invoking the implied covenant and fair dealing to remedy the “breach.”

¹⁶ See also *Corporate Property Associates*, 2008 Del. Ch. LEXIS 45 at *19 (12(b)(6) dismissal of claim for breach of the implied covenant; because the parties had discussed the agreement's anti-dilution provisions generally, its silence regarding cash dividends indicated that the parties did not agree to prohibit them); *Cincinnati SMSA*, 708 A.2d at 991 *Cincinnati SMSA Limited Partnership v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989 (Del. 1998) (affirming dismissal of implied covenant claim on a non-compete even though development of the technology at issue was unforeseen and it was no different, from consumer perspective, than technology covered by the non-compete), *Fisk Ventures*, 2008 Del. Ch. LEXIS 158 (dismissing implied covenant claim; court refuses to engage in “post-hoc refashioning” of the parties' contractual agreements).

CP 34:19-35:2, CP 35:19-36:3. Thus, the Award finds a breach of the VEC Agreement by conduct that wrongfully “amended” one of its provisions but did not—and could not—actually breach the provision ostensibly amended. This impenetrability of this logic itself reveals an effort on the part of the Panel to find a breach where none was apparent. Thus, it is no coincidence that the Panel—and specifically Mr. Harrigan—first injected this theory into the case. *See supra* at §§ III.E-F and n.3.

Similar efforts on the part of arbitrators resulted in vacatur in *International Association of Machine & Aerospace Workers v. Lourdes Hospital, Inc.*, 958 F.2d 154, 155 (6th Cir. 1992), where an employee argued that her employer’s failure to pay her time-and-a-half for a shift that it had required her to work was a violation of the parties’ employment agreement. Although the employment agreement gave the employer the right to schedule employees as necessary, the arbitrator decided that the employer’s actions were an attempt to use its power to schedule to circumvent the schedule-change and on-call requirements of the contract and therefore entered an award in favor of the employee. *Id.* at 157. The court held that this reasoning failed to draw its essence from the agreement and required vacatur: “We do not believe that the exercise of a right specifically given in the bargaining agreement, the right to schedule, can be abused or that a remedy exists for such an alleged abuse.” *Id.*

Here, too, the Panel apparently felt that Vulcan's unquestioned right to terminate Respondents was somehow abused because of the manner in which it exercised the right. But this does not permit the Panel to simply "fashion" a breach the way it fashioned a remedy.

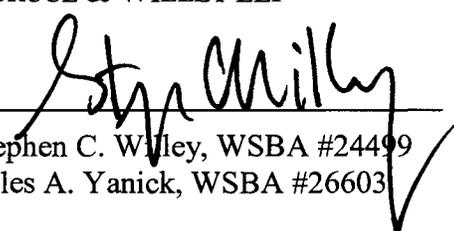
V. CONCLUSION

The Judgment entered against Vulcan should be vacated, the trial court's order confirming the Arbitration Award should be reversed, and the trial court should be instructed to vacate the Arbitration Award and award to Vulcan its attorneys' fees incurred in the arbitration in accordance with § 10.8 of the VEC Agreement. Additionally, pursuant to RAP 18.1(b) and RCW 4.84.330, Vulcan respectfully requests an award of attorneys' fees and expenses incurred with respect to this appeal.

Submitted this 30th day of July 2010.

SAVITT BRUCE & WILLEY LLP

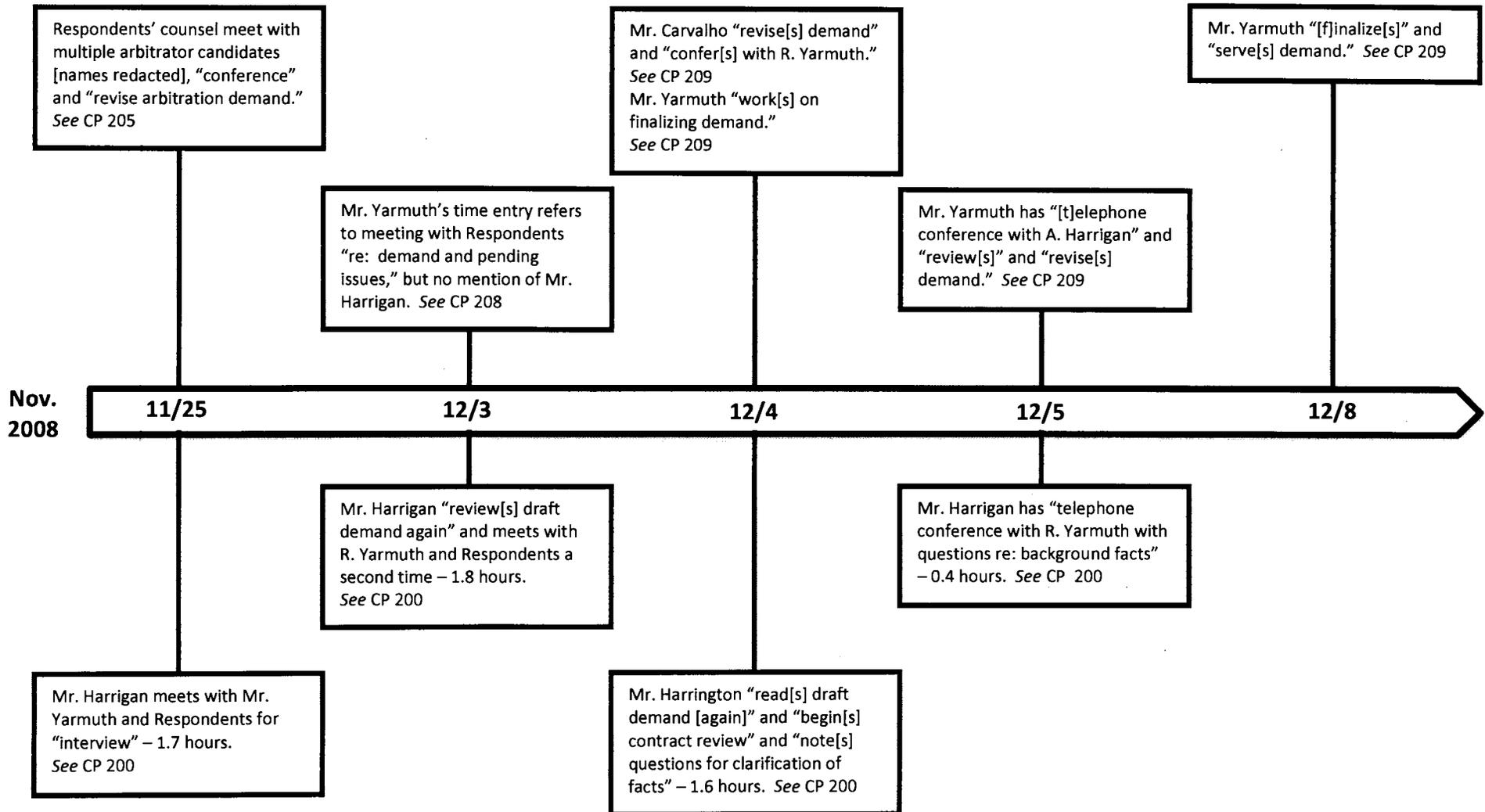
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Appendix A

Documented pre-arbitration *ex parte* communications and interactions between Arbitrator Harrigan and Respondents and their counsel



CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this date I caused a copy of the attached document – APPELLANTS’ OPENING BRIEF – to be hand delivered to the attorneys of record listed below:

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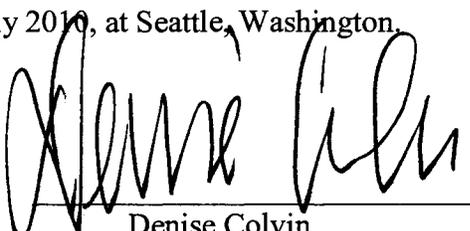
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I hereby certify, under penalty of perjury under the laws of the State of Washington, that the foregoing is true and correct.

DATED this 30th day of July 2010, at Seattle, Washington.



Denise Colvin

2010 JUL 30 PM 4:24
DENISE COLVIN