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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.

APPELLANTS' REPLY BRIEF

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TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. ARGUMENT AND AUTHORITY	3
A. RESPONDENTS MISSTATE THE APPLICABLE STANDARD OF REVIEW	3
B. THE TRIAL COURT FAILED TO CONDUCT THE STATUTORILY REQUIRED REVIEW	4
1. <i>FIRST OPTIONS</i> HAS NO RELEVANCE TO THIS CASE BECAUSE THE STATUTORY GROUNDS FOR VACATUR CANNOT BE CONTRACTED OUT TO ARBITRATORS.	5
2. THERE IS NO EVIDENCE THAT THE PARTIES INTENDED TO SUBMIT THE ISSUE OF VACATUR TO ARBITRATION.	7
3. NO CASE—INCLUDING <i>FIRST</i> <i>OPTIONS</i> —HOLDS THAT SUBMITTING THE ISSUE OF DISQUALIFICATION TO ARBITRATION EFFECTIVELY WAIVES SUBSEQUENT JUDICIAL REVIEW FOR EVIDENT PARTIALITY OR PREJUDICIAL MISBEHAVIOR.	9
C. VACATUR IS REQUIRED BECAUSE THE RECORD SHOWS EXTENSIVE, MERITS-BASED, <i>EX PARTE</i> CONTACTS WITH MR. HARRIGAN.....	12
1. MR. HARRIGAN’S INVOICES UNDENIABLY DOCUMENT <i>EX PARTE</i> DISCUSSIONS ABOUT THE MERITS OF THE CASE.....	12

2.	THE TRIAL COURT ERRED BY GIVING CONCLUSIVE EFFECT TO AN INCOMPLETE, SELF-SERVING, NON-RECORD DECLARATION FROM RESPONDENTS' COUNSEL.....	15
3.	THE TRIAL COURT ERRED BY RENDERING JUDGMENT WITHOUT HOLDING AN EVIDENTIARY HEARING OR ALLOWING DISCOVERY.....	16
D.	MR. HARRIGAN'S FAILURE TO DISCLOSE HIS <i>EX PARTE</i> COMMUNICATIONS CREATES A REASONABLE IMPRESSION OF PARTIALITY.....	18
E.	VULCAN DID NOT WAIVE ITS RIGHTS TO CHALLENGE MR. HARRIGAN'S MISCONDUCT	19
F.	VACATUR IS ALSO REQUIRED BECAUSE THE ARBITRATORS EXCEEDED THEIR POWERS.....	21
1.	THE PANEL AWARDED RESPONDENTS A REMEDY FOR A BREACH ONLY "AS TO" OTHER EMPLOYEES.	22
2.	THE PANEL GROSSLY MISAPPLIED THE IMPLIED COVENANT TO AWARD RESPONDENTS A BENEFIT THEY SOUGHT BUT FAILED TO GAIN DURING NEGOTIATIONS.	24
V.	CONCLUSION.....	25

TABLE OF AUTHORITIES

	<u>Page</u>
Cases	
<i>Beebe Med. Ctr., Inc. v. InSight Health Services Corp.</i> , 751 A.2d 426 (Del. Ch. 1999)	10
<i>Boyhan v. Maguire</i> , 693 So.2d 659 (Fl. 1997).....	10
<i>Britz, Inc. v. Alfa-Laval Food & Dairy Co.</i> , 34 Cal. App. 4th 1085, 1102 (1995).....	10
<i>Butler v. Craft Eng. Const. Co., Inc.</i> , 67 Wn.App. 684, 691 (1992)	4
<i>Corporate Property Assocs. 14 Inc. v. CHR Holding Corp.</i> , 2008 Del. Ch. LEXIS 45 (Del. Ch. April 10, 2008).....	24
<i>Cytec Corp. v. Deka Prods. Ltd. Partnership</i> , 439 F.3d 27 (1 st Cir. 2006) 3	
<i>Fidelity Federal Bank v. Durga Ma Corp.</i> , 386 F.3d 1306 (9 th Cir. 2004)	20, 21
<i>First Options of Chicago, Inc. v. Kaplan</i> , 514 U.S. 938 (1995).....	passim
<i>Health Servs. Mgmt. Corp. v. Huges</i> , 975 F.2d 1253 (7 th Cir. 1992)	10
<i>Hoeft v. MVL Group, Inc.</i> , 343 F.3d 57 (2 nd Cir. 2003).....	2, 5
<i>In re Estate of Nelson</i> , 85 Wn.2d 602, 605-06 (1975).....	4
<i>Nationwide Mut. Ins. Co. v. Home Insurance</i> , 278 F.3d 621 (6 th Cir. 2002)	19
<i>New Regency Productions, Inc. v. Nippon Herald Films, Inc.</i> , 501 F.3d 1101 (9 th Cir. 2007).....	18
<i>Reeves Bros., Inc. v. Capital-Mercury Shirt Corp.</i> , 962 F. Supp. 408 (S.D.N.Y. 1997).....	10
<i>Sanko S.S. Co. v. Cook Indus.</i> , 495 F.2d 1260 (2 nd Cir. 1973)	17
<i>Schmitz v. Zilveti</i> , 20 F.3d 1043 (9 th Cir. 1994).....	3, 18

<i>Superior Vision Services, Inc. v. Liastar Life Ins. Co.</i> , 2006 Del. Ch. LEXIS 160 (Del. Ch. August 25, 2006)	24
<i>Totem Marine Tug & Barge, Inc. v. N. Am. Towing, Inc.</i> , 607 F.2d 649 (5th Cir. 1979).....	12
<i>Univ. Commons-Urbana, Ltd. v. Universal Const., Inc.</i> , 304 F.3d 1331 (11th Cir. 2002).....	17
<i>Washington State Physicians Ins. Exchange & Ass'n v. Fisons Corp.</i> , 122 Wn.2d 299 (1993).....	20
<i>Williams v. NFL</i> , 582 F.3d 863 (8 th Cir. 2009)	19

Statutes

9 U.S.C. § 9.....	7
9 U.S.C. § 10.....	4, 5, 7
9 U.S.C. § 10(a)	passim
9 U.S.C. § 10(a)(2).....	1, 2, 4, 9, 18
9 U.S.C. § 10(a)(3).....	1, 2, 4, 9
9 U.S.C. § 10(a)(4).....	2, 7, 22

Other Authorities

AAA Code of Ethics, Canon II(D)	20
AAA Code of Ethics, Canon III.....	13
AAA Rule R-17(a).....	7, 8
AAA Rule R-18(a).....	12, 13, 20
AAA Rule R-46	8

I. INTRODUCTION

The Arbitration Award in this case should be vacated under §10(a) of the Federal Arbitration Act (“FAA”) on any of three separate grounds.

First, the undisputed law and facts here make clear that the Award was tainted by evident partiality and prejudicial misconduct under §§ 10(a)(2)-(3). As to the law, Respondents do not and cannot dispute that *ex parte* discussion of the merits with an arbitrator—in the selection process or any other time—is improper. As to the facts, Respondents do not and cannot dispute that they (1) provided copies of their draft pleading to an arbitrator candidate, and had *ex parte* discussions regarding the same; (2) submitted case evidence *ex parte* to the arbitrator; and (3) engaged in *ex parte* discussions with the arbitrator regarding factual issues. Neither Respondents nor the trial court has ever even attempted to articulate how these communications are not merits-based. At a minimum, these facts necessarily raise serious questions about the undisputed *ex parte* contacts, which must be resolved through evidentiary examination.

Second, where an arbitrator has had such *ex parte* discussions with a party, he or she must disclose them. Mr. Harrigan’s failure to do so is *prima facie* evidence creating a “reasonable impression of partiality.”

Recognizing that an independent review of the facts would necessarily lead to at least a *prima facie* finding of evident partiality (and

with no countervailing record evidence), Respondents contend that courts are disabled from performing the required statutory review because the parties here somehow transferred that task to Judge Lukens (and, thus, waived the right to independent judicial review). But they cannot cite a single case supporting either their contention that parties can contract away a court's review obligations under the FAA or their argument that a routine agreement to have private adjudicators resolve arbitrator disqualification somehow bars judicial review of an award on the separate question of vacatur under §§ 10(a)(2)-(3).

As a result, Respondents' consistent theme of "deference" is beside the point. Review of arbitration awards is deferential only insofar as the grounds for judicial vacatur are limited. But in examining the issues that the FAA does identify as grounds for vacatur, there is no deference due the arbitrator. This basic tenet is particularly important where, as here, the challenge goes to the integrity and impartiality of the arbitration itself. The FAA's statutorily enumerated grounds establish the "floor for judicial review" below which courts cannot—even with the parties' consent—descend. *Hoelt v. MVL Group, Inc.*, 343 F.3d 57, 64 (2d Cir. 2003).

Third, the Award must be vacated under § 10(a)(4) because the Panel exceeded its powers when it rendered an award that provides relief for a (supposed) breach of contract to persons who concededly did not

suffer any damages due to the breach. The law does not allow a breach as to John to enable relief as to Mary. The Arbitration Award nonetheless does just that. The Panel held that Vulcan breached the VEC Agreement not as to Respondents but as to certain other Vulcan employees. And yet it gave relief to Respondents for this breach. It did so proclaiming that the doctrine of good faith and fair dealing allowed it to invent a remedy for Respondents by implying terms that are flatly contradicted by both the terms of the parties' contract and what the parties discussed in their negotiations. Such a remedy disregarded binding Delaware law, which holds that the doctrine of good faith and fair dealing may not be used to imply contract terms unless it is absolutely clear that the parties would have agreed to such terms had they thought to negotiate them.

II. ARGUMENT AND AUTHORITY

A. RESPONDENTS MISSTATE THE APPLICABLE STANDARD OF REVIEW

This Court's review is *de novo* regarding the application of law and the relevant facts. This is true under federal law and Washington law.

"In an action to vacate or confirm an arbitral award, we typically review the district court's decision *de novo*," and "[t]his remains true whether the arbitrators' apparent error concerns a matter of law or a matter of fact." *Cytec Corp. v. Deka Prods. Ltd. Partnership*, 439 F.3d 27, 32 (1st Cir. 2006); *see also Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir. 1994)

(“Appellants question (1) the legal standard employed by the district court and (2) the application of that legal standard to facts. This court reviews both issues de novo.”). Washington courts also hold that appellate review of a trial court’s decision is *de novo*, for both legal conclusions and factual findings, where the decision is based on documentary submissions only and there is no evidentiary hearing with live testimony. *In re Estate of Nelson*, 85 Wn.2d 602, 605-06 (1975); *Butler v. Craft Eng. Const. Co., Inc.*, 67 Wn.App. 684, 691 (1992).

B. THE TRIAL COURT FAILED TO CONDUCT THE STATUTORILY REQUIRED REVIEW

Respondents’ central argument is as follows: where a party in arbitration brings a motion to disqualify an arbitrator based on conduct that indicates partiality and the motion is denied, then a trial court may not vacate the subsequent arbitration award under §§ 10(a)(2) – (3) unless it first (1) engages in an independent review of the disqualification decision, and (2) independently vacates that decision, separate and apart from the arbitration award, under § 10. *See, e.g.*, Resp. Br. at 21-29. But nothing in logic or case law supports the notion that courts are powerless to vacate awards tainted by evident partiality or misconduct merely because the parties have followed an interim procedure to disqualify arbitrators.

Respondents’ attempt to enlist the Supreme Court’s decision in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), in their

supports fails for two independent reasons. For one, *First Options* had nothing to do with whether parties can permissibly delegate to an arbitrator the judicial function of reviewing awards under § 10 of the FAA, and every case cited to this Court holds, without exception, that courts must perform this function. Secondly, even if the law permitted delegation of this judicial function, all agree that it would require the parties' manifest intent. Here, the parties manifested the opposite intent. Further, every case to address the issue holds that agreeing to a process for arbitrator disqualification in no way affects a party's right to judicial review of an arbitration award under the FAA.

1. ***First Options* has no relevance to this case because the statutory grounds for vacatur cannot be contracted out to arbitrators.**

Nothing in the FAA and no case applying it holds or even suggests that the courts' statutory duty to review arbitration awards and to vacate them where the § 10 safeguards have been breached can be abdicated by a court or limited by contract. *See Hoefl v. MVL Group, Inc.*, 343 F.3d 57, 64 (2nd Cir. 2003) ("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)."). Simply put, § 10(a) of the FAA may not be contracted away.

Respondents offer no authority holding otherwise. Indeed, *First*

Options does not so much as touch upon the question of whether an arbitrator could be delegated the courts' job in enforcing the statutory grounds for vacating an arbitration award. While *First Options* may be of note in clarifying the determination of who (a court or an arbitrator) decides the threshold question of arbitrability, the foundational rule the Court applies—and which Respondents tout—is unremarkable: arbitration is a matter of contract and, therefore, the parties' intent. Thus, “the question ‘who has the primary power to decide arbitrability’ turns upon what the parties agreed about that matter.” 514 U.S. at 943.

But the fact that parties may submit to private arbitrators matters on which the FAA is silent in no way supports the proposition advanced by Respondents and rejected by every case to have addressed the issue: that parties may contractually limit the courts' duty to vacate awards on the enumerated grounds. The trial court missed this key distinction between issues that the FAA directs courts to decide (which cannot be delegated) and the world of other disputed issues (which can).¹

¹ Respondents attempt to muddle this patent distinction by citing § 10(a)(4), which provides for vacatur if an arbitrator “exceeded [his] powers.” They argue that, under *First Options*, parties can effectively delegate that issue to arbitrators by permitting them to decide which issues are arbitrable. But if parties do agree to have an arbitrator decide arbitrability, then the arbitrator who does so is not “exceed[ing]” his powers. Nothing in *First Options* suggests that, in such a case, a party could not seek to vacate the award under § 10(a)(4), including review of whether the arbitrator “exceeded [his] powers.”

2. There is no evidence that the parties intended to submit the issue of vacatur to arbitration.

Even if *First Options* were relevant here, the question would be whether the parties had expressly agreed to submit to Judge Lukens the issue of whether to vacate the Arbitration Award under the FAA for “evident partiality” or “prejudicial misbehavior.” Resp. Br. at 19.

Plainly they did not. As an initial matter, the parties’ agreement to arbitrate expressly contemplates that any arbitration award will be subject to judicial review (*i.e.*, pursuant to §§ 9, 10 of the FAA). CP 183-84 at §§ 10.8, 10.9. No subsequent agreement between the parties ever changed that. This includes the parties’ Arbitration Protocol, in which they agreed to allow “a neutral third party [to] determine whether [a] challenged arbitrator shall be disqualified” under AAA Rule R-17(a), not whether any award should be vacated under § 10(a). CP 133 at § IV. Nowhere does the Protocol address or refer to the subject of judicial review of any award, much less contract away any party’s right to seek vacatur. CP 132-36; *cf.* CP 373 (subsequent Confidentiality Agreement providing that a motion to confirm or vacate could be brought in any court of competent jurisdiction).

Far from agreeing to submit the issue of vacatur to arbitration, the parties expressly agreed not to. Under the Arbitration Protocol, AAA Rule R-46 applied to the arbitration proceeding and this rule prohibits arbitrators from vacating an award. Vulcan noted this fact when it first

objected to Mr. Harrigan's undisclosed *ex parte* contacts:

[U]nder AAA Rule R-46, ... the Panel is “not empowered to redetermine the merits of any claim already decided.” ... The Superior Court is the tribunal with jurisdiction to address the vacation of the Award[.]

CP 380 (emphasis supplied.) Respondents never took issue with this statement. Nor did Judge Lukens purport to exercise such jurisdiction, stating that “[t]he sole issue presented [to him] for decision [wa]s whether one of the party-appointed arbitrators in the underlying action should be disqualified under Rule 17(a)[.]” CP 44.² In sum, whether the Award was subject to vacatur under any of the grounds set out in § 10(a) was expressly reserved for the Superior Court.

Respondents cannot dispute these facts. Instead, they strain to conflate and confuse the issues. They argue that Vulcan “urged the trial court to ‘independently assess the merits of the disqualification issue.’” Resp. Br. at 11, 20 (emphasis supplied). But they neglect to mention that the quote is from the trial court’s order, which misstates Vulcan’s position: Vulcan never asked the trial court to review the “disqualification issue” under any standard. Similarly, Respondents suggest that “the parties

² Judge Lukens not only did not decide whether to vacate the award; he also applied a different standard. While vacatur is required in instances of evident partiality, Judge Lukens concluded that “Rule 17(a) requires a finding of partiality, not merely an appearance of partiality” and “I cannot make that finding on the record before me.” CP 48. Contrary to Respondents’ suggestion (*e.g.*, Resp. Brief at 1), there was no evidentiary hearing before Judge Lukens.

agreed to submit allegations of arbitrator partiality to arbitration.” Resp. Br. at 22. This vague overstatement misleadingly suggests that the parties agreed to arbitrate the issues of evident partiality or misconduct under §§ 10(a)(2) – (3) of the FAA.³ Without these semantic sleights of hand, Respondents have no argument; the parties never agreed to arbitrate Vulcan’s rights under the FAA.

3. No case—including *First Options*—holds that submitting the issue of disqualification to arbitration effectively waives subsequent judicial review for evident partiality or prejudicial misbehavior.

The only evidence that Respondents even contend reflects an intent to empower Judge Lukens to determine whether the Arbitration Award should be vacated is the parties’ agreement (in the Arbitration Protocol) regarding arbitrator disqualification. But common sense and uniform case law establish that agreeing to a process for resolving arbitrator disqualification does not waive independent judicial review of a final award for evident partiality or misconduct. No case suggests otherwise.

If there were cases supporting their position, surely Respondents would have cited them. But *First Options* has never been read to mean, as Respondents argue, that a disqualification decision made in an arbitration

³ Respondents know better. Elsewhere, they describe the parties’ actual agreement. Resp. Br. at 19 (the parties did “express[] their intent to arbitrate a particular issue or grievance related to the arbitration itself” – *i.e.*, “the issue of arbitrator disqualification.”)

proceeding must itself be vacated under § 10(a) before a court may vacate the final award for evident partiality. Every case cited to this Court involving such circumstances holds the opposite: a party does “not waive its right to seek an independent ruling by the court on its post-arbitration, evident partiality claim” merely by agreeing to a procedure for resolution of disqualification motions. *Beebe Med. Ctr., Inc. v. InSight Health Services Corp.*, 751 A.2d 426, 440 (Del. Ch. 1999).⁴

Because they have no cases of their own to cite, Respondents’ only answer is to try to distinguish these authorities on the basis that they involved resolution of disqualification motions before an AAA special committee, while this case involves resolution of a disqualification motion before Judge Lukens.⁵ But that is a distinction without a difference. The holding and rationale in all these cases is that interim disqualification

⁴ *Accord Reeves Bros., Inc. v. Capital-Mercury Shirt Corp.*, 962 F. Supp. 408, 413-15 (S.D.N.Y. 1997); *Boyhan v. Maguire*, 693 So.2d 659, 662 (Fl. 1997); *Britz, Inc. v. Alfa-Laval Food & Dairy Co.*, 34 Cal. App. 4th 1085, 1102 (1995); *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253, 1263 (7th Cir. 1992).

⁵ Respondents are wrong in their suggestion that the exercise of independent judicial review in *Beebe* was based on the fact that the AAA had not produced a record supporting its denial of the earlier disqualification motion. After concluding that a party does not waive the right to independent judicial review by agreeing to a disqualification process, the court went on to say, in the alternative, that the AAA’s decision in that case could not “withstand even the deferential scrutiny given to arbitration awards” because it did not hold a hearing on the motion. 751 A.2d at 441. Instead, the AAA “adopt[ed] wholesale the view of the facts advocated by one of the parties’ attorneys.” *Id.* at 442. That is exactly what Judge Lukens did in this case, by bizarrely deciding that “th[e] factual recitation [provided by Yarmuth, Respondents’ counsel] must be considered as a verity.” CP 46. Even *Beebe*’s alternative holding supports Vulcan.

procedures are different from, and do not waive or limit, subsequent judicial review for partiality—which is equally true whether the private disqualification panel is an AAA special committee or some other private arbitrator. This is particularly true here, where Respondents concede the sole reason for the provision in the Arbitration Protocol referring disqualification decisions to a neutral third party was to “address[] functions that would otherwise have been performed by the AAA.” CP 4:22-23. Simply put, Judge Lukens took the place of the AAA; there is no reason to treat him differently.

Beyond the evidence and the applicable law, the trial court never considered the dispositive threshold issue of whether the parties intended to empower Judge Lukens to resolve the question of vacatur. Apparently misled by Respondents’ rhetoric, the court considered only whether Judge Lukens’ decision constituted a separate “award.” CP 580-81. Having (incorrectly) determined that the Lukens Decision was a separate “award,” the court concluded that it was required to “defer” to it, thus evading its obligation to review the Arbitration Award under § 10(a). As Respondents now concede, such labels are irrelevant—the parties’ intent is what matters. Resp. Br. 24-25. Because the court never addressed this issue, its decision cannot be affirmed.

C. VACATUR IS REQUIRED BECAUSE THE RECORD SHOWS EXTENSIVE, MERITS-BASED, *EX PARTE* CONTACTS WITH MR. HARRIGAN

The undisputed law and facts demonstrate partiality and misconduct—and the trial court’s legal error. Respondents concede the law: *Ex parte* communications with an arbitrator about the merits of a dispute are impermissible. And the record evidence—the invoices from Mr. Harrigan and Respondents’ counsel—plainly shows that these merits discussions occurred. Respondents have no answer; instead, they simply repeat *ad nauseam* that Vulcan has “no evidence” of misconduct and urge deference to a court that reached its decision by treating as gospel a self-serving declaration from one of Respondents’ lawyers, which was never submitted to the court and which has been abandoned on appeal.

1. Mr. Harrigan’s invoices undeniably document *ex parte* discussions about the merits of the case.

Respondents do not contest the applicable legal standard or the related ethical framework. *Ex parte* discussion of the merits is improper. *Totem Marine Tug & Barge, Inc. v. N. Am. Towing, Inc.*, 607 F.2d 649, 653 (5th Cir. 1979); AAA Rule R-18(a) (“No party . . . shall communicate *ex parte* with an arbitrator or a candidate for arbitrator concerning the arbitration.”); AAA Code of Ethics, Canon III. Parties may only speak *ex parte* with arbitrator candidates about (1) “the general nature of the controversy”; (2) “the candidate’s qualifications, availability, or

independence in relation to the parties”; and (3) “the suitability of candidates for selection as a third arbitrator.” AAA Rule R-18(a).⁶

The record evidence is also indisputable. Mr. Harrigan met with Respondents and their counsel on two different occasions for several hours; Mr. Harrigan reviewed Respondents’ Arbitration Demand at least three times as it was being drafted and revised; Mr. Harrigan discussed the draft Demand with Respondents and their counsel; Mr. Harrigan reviewed the central evidence in the case, the parties’ contract; Mr. Harrigan noted questions “for clarification of facts” and he posed those questions to Respondents’ counsel; and Mr. Harrigan then sent a bill for his work to Respondents. CP 200, 202, 204-06, 208-10.

In light of the conceded law and undisputed evidence, the only question posed is whether that evidence conclusively demonstrates that Mr. Harrigan discussed the merits of the arbitration with Respondents or their counsel – or whether Respondents might create a factual dispute. What the record evidence shows on its face is that such discussions took place; surely it at least would allow a rational fact-finder to so conclude.

Respondents’ insistence to the contrary is remarkably detached

⁶ Respondents suggest at one point that that vacatur is discretionary (whereas confirmation is mandatory). Resp. Br. at 18. But the FAA grounds for vacatur are not hortatory. In every case where a movant has satisfied one or more § 10(a) grounds, the award is vacated. Respondents do not and cannot cite a single case where a court utilized its “discretion” and did not vacate the award.

from the actual record. After quoting Mr. Harrigan’s invoices—including the lines documenting his repeated review of the draft Demand, his “contract review,” and his “conference with [Respondents’ counsel] with questions re background facts”—Respondents baldly assert that “nothing” in these records supports Vulcan’s claim that Mr. Harrigan discussed the merits. Resp. Br. at 31. If Respondents’ detailed allegations, the contract at issue, and the relevant background facts do not count as the “merits” in Respondents’ view, then it is not clear what constitutes “merits.”

Respondents also try to justify their provision of the draft Demands and the contract to Mr. Harrigan on the grounds that these documents “contained the names of twenty individuals and nineteen entities with some connection to the parties or the dispute,” thus allowing Mr. Harrigan to evaluate whether he had any conflicts. Resp. Br. at 33 n.12. Why Mr. Harrigan could not simply have been given a list of those individuals and entities, instead of an advocacy document laying out all of Respondents’ legal claims and factual allegations, goes unexplained.

The only record evidence raises, at a minimum, a strong inference that Mr. Harrigan did what Respondents concede is improper: discuss the merits of the dispute with only one side. Respondents are unwilling or unable to rebut that inference by addressing or explaining what transpired between them and Mr. Harrigan. Accordingly, the Award is tainted by

both evident partiality and prejudicial misbehavior and must be vacated.

2. The trial court erred by giving conclusive effect to an incomplete, self-serving, non-record declaration from Respondents' counsel.

Notwithstanding the above, the trial court held that there was “no evidence before the court of inappropriate conduct” during the *ex parte* interactions between Mr. Harrigan and Respondents. CP 583:24-25. In sole support of this pronouncement, which flies in the face of the invoices, the court quotes Respondents' counsel's self-serving declaration that he asked no questions of Mr. Harrigan and received no “input” from him. CP 583:25 – 584:3. For multiple reasons, this was reversible error.

First, this after-the-fact declaration of Respondents' counsel was never submitted to the trial court and is not part of the record. Rather, it was submitted to Judge Lukens in opposition to Vulcan's motion to disqualify. The court's reliance on this non-record declaration was not only improper, but also belies the court's claim to have conducted a truly independent review of Mr. Harrigan's partiality and misconduct.

Second, even if the declaration had been properly submitted to the court, it cannot eliminate the contrary evidence (*i.e.*, the invoices) and thus permit a judgment in Respondents' favor. The most that Respondents could claim is that a factual dispute exists about what transpired during the *ex parte* communications, which no one disputes occurred. But, of course,

if there is a material dispute of fact, the fact-finder must resolve it by holding an evidentiary hearing—and the trial court did not. Instead, the trial court apparently followed the lead of Judge Lukens, who had bizarrely decided that counsel’s declaration—the factual allegations of one side—“must be considered as a verity.” CP 46.

Third, even if the declaration had been properly submitted to the court and could somehow be accepted at face value, it could not justify judgment in Respondents’ favor. Even if Mr. Harrigan was asked no questions and provided no “input,” vacatur is still required if Respondents and their counsel spent hours arguing their side of the case *to* him. The declaration carefully avoids denying any such *ex parte* argument to Mr. Harrigan and therefore stops short of denying improper contacts.

Perhaps recognizing these many flaws, Respondents in their brief do not even mention the declaration, which was the only basis for the trial court’s “independent” determination that nothing untoward occurred. This abandonment only confirms that the court’s judgment must be reversed.

3. The trial court erred by rendering judgment without holding an evidentiary hearing or allowing discovery.

The trial court, in accepting as true Respondents’ contested version of the facts, held no evidentiary hearing and permitted no discovery. Yet in light of the strong inference that impermissible merits-based discussions

occurred, there could be no judgment in Respondents' favor without such fact-finding. Resolving material factual disputes is what courts do, in cases seeking vacatur of arbitration awards, as in all others. *See, e.g., Univ. Commons-Urbana, Ltd. v. Universal Const., Inc.*, 304 F.3d 1331, 1341-42 (11th Cir. 2002) (remanding for fact-finding regarding "evident partiality"); *Sanko S.S. Co. v. Cook Indus.*, 495 F.2d 1260, 1263 (2nd Cir. 1973) (remanding "so that an evidentiary hearing may be held and the full extent and nature of the relationships at issue may be ascertained").

Respondents' only answer is that Vulcan somehow "waived" or abandoned its right to discovery. Resp. Br. at 46-49. That is both irrelevant as a matter of law and wrong as a matter of fact.

Even if Vulcan had not sought discovery, this would not free the trial court from its obligation to resolve factual disputes. If the court had doubts about the accuracy or meaning of the invoices, it should have held an evidentiary hearing and engaged in independent fact-finding—not ignored the evidence on one side and assumed the truth on the other.

Nor did Vulcan waive or abandon its discovery request. Its position in the trial court is the same as its position now: namely, that "no discovery is necessary [because] the invoices would give any reasonable person ... an impression [of partiality]." CP 566:5-6. Thus, Vulcan took the position taken by every litigant who files a motion for summary

judgment: that judgment in its favor is warranted as a matter of law on the basis of the undisputed facts; so “discovery” is not “necessary.” That hardly waives a litigant’s right to discovery and a hearing if the court disagrees and believes that there is a material factual dispute. And the court would be obliged to resolve the dispute.

Vulcan submits that the uncontested invoices are sufficient to vacate the Award. If this Court agrees, no discovery is needed and no further fact-finding is necessary. But if the Court does not find the record evidence sufficient for vacatur, then, at the very least, further fact-finding is required in order to test the *prima facie* evidence of partiality.

D. MR. HARRIGAN’S FAILURE TO DISCLOSE HIS *EX PARTE* COMMUNICATIONS CREATES A REASONABLE IMPRESSION OF PARTIALITY

Vacatur is also required here because Mr. Harrigan failed to disclose his substantive pre-appointment contacts with Respondents and their counsel. In non-disclosure cases, the standard for “evident partiality” under § 10(a)(2) is whether the non-disclosure creates a “reasonable impression of partiality.” *Schmitz v. Zilveti*, 20 F.3d 1043, 1046 (9th Cir. 1994). “[W]here an arbitrator . . . knows of a material relationship with a party and fails to disclose it, a reasonable person would have to conclude that the arbitrator was evidently partial.” *New Regency Productions, Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1108 (9th Cir. 2007)

(affirming vacatur for evident partiality). Contrary to Respondents' suggestion, no evidence of ill motive is required. "Evident partiality' is distinct from actual bias." *Id.* at 1105.⁷

Here, 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. This impression is only exacerbated when one considers the vanilla disclosures that Mr. Harrigan did make. CP 273-77.

E. VULCAN DID NOT WAIVE ITS RIGHTS TO CHALLENGE MR. HARRIGAN'S MISCONDUCT

In a further attempt to erect a procedural roadblock to judicial review of their misconduct, Respondents argue that Vulcan waived its right to challenge the propriety of the pre-appointment discussions with Mr. Harrigan because Vulcan did not specifically ask about them. Resp. Br. at 38-41. But the disclosure form did inquire broadly about the arbitrator's contacts and relationship with Respondents and their counsel, and knowledge of the "subject matter of this dispute"—all of which should have elicited good faith disclosure of the *ex parte* contacts. Mr.

⁷ Motive is irrelevant in non-disclosure cases and neither of the cases that Respondents cite (*see* Resp. Br. at 35) holds otherwise. In both *Williams v. NFL*, 582 F.3d 863 (8th Cir. 2009) and *Nationwide Mut. Ins. Co. v. Home Insurance*, 278 F.3d 621 (6th Cir. 2002), the court first determined that the plaintiff had waived objection to non-disclosure before going on to address whether there was actual bias. Neither case requires a showing of improper motive to vacate an award based on non-disclosure.

Harrigan had a duty to disclose anything suggesting improper contacts, a duty which could not be evaded through legalistic hair-splitting.⁸ CP 273-77. Both the applicable law and the AAA Code of Ethics require that “[a]rbitrators [must] err on the side of disclosure.” *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 152 (1968); *see also* Code of Ethics, Canon II(D).

Absent notice of misconduct, arbitrating parties are reasonably entitled to assume that arbitrators are acting ethically and in accordance with applicable rules and law—particularly where there has been specific agreement on such rules and repeated confirmation of arbitrator neutrality.⁹ Vulcan need not specifically ask whether there were “improper *ex parte* contacts” or “violations of the AAA Code of Ethics” to preserve its right to object to them if they occurred. When Vulcan learned of the improper communications between Mr. Harrigan and Respondents and their counsel, it objected immediately. CP 379-80. Respondents’ citation of inapposite law only confirms the absence of any waiver.

At the time of *Fidelity Federal Bank v. Durga Ma Corp.*, 386 F.3d 1306 (9th Cir. 2004), and in contrast to the present, the applicable AAA

⁸ *Washington State Physicians Ins. Exchange & Ass’n v. Fisons Corp.*, 122 Wn.2d 299 (1993) addresses and sanctions analogous hair-splitting in the discovery context.

⁹ *See, e.g.*, CP 238 (email from Respondents’ counsel: “each arbitrator should be a neutral, consistent with AAA Rule 18(a)”).

rules included a presumption that a party-appointed arbitrator was not neutral, but rather would be partial to the appointing party. After appointment but before the hearing in that case, the parties and the party-appointed arbitrators agreed that they would “‘act neutrally’ when considering the evidence and rendering an award.” *Id.* at 1309. Despite knowing that the arbitrator was “initially retained and appointed by Durga Ma as a non-neutral party-appointed arbitrator,” Fidelity did not request any disclosures. *Id.* at 1313. Thus, *Fidelity* merely adopts “a rule that places the burden on parties to obtain disclosure statements from arbitrators who were initially party-appointed [and presumptively non-neutral] but later agree to act neutrally.” *Id.*

Neither the facts nor the “rationale” of *Fidelity* have any bearing. Here, the arbitrators were required, presumed, and confirmed to be neutral – at every step of the way. Unlike *Fidelity*, the parties here required broad disclosures that, had they been answered accurately and completely, would have put Vulcan on notice of the *ex parte* communications between Mr. Harrigan and Respondents. Prior to its receipt of the invoices, Vulcan had no reason or obligation to ask whether Mr. Harrigan had violated the accepted law and ethical rules, and its not so doing was not a waiver.

F. VACATUR IS ALSO REQUIRED BECAUSE THE ARBITRATORS EXCEEDED THEIR POWERS

Vacatur is required because the Panel exceeded its powers in

violation of § 10(a)(4). Here, the Panel held that Respondents were lawfully terminated, yet it (1) awarded damages to Respondents even though, on the Panel's own theory, Vulcan only breached the contract as to other persons, and (2) invoked the covenant of good faith and fair dealing to grant Respondents a right and remedy that they did not and could not obtain in negotiations. The Award substituted the Panel's unfounded notion of fairness for what the parties' contract required, in manifest disregard of the applicable and binding law.

1. The Panel Awarded Respondents a Remedy for a Breach Only "As To" Other Employees.

Respondents concede that they were at-will employees, whom the Panel found were lawfully terminated. Resp. Br. at 43. Thus, there could be no breach of contract arising from Respondents' termination.

The Panel held that Vulcan's decision to "simultaneously terminate the Private Equity Team and then rehire certain team members, in an effort to stop the incentive compensation plan," was effectively an attempt to amend the Plan (and, thus, to breach it) "as to the rehired employees." CP 34:24 – CP 35:2 (emphasis supplied); *see also* CP 31:26 – 32:9, CP 35:3 – 13. The Panel reasoned that by firing and rehiring certain employees, those employees were deprived of the unvested carry previously allocated to Respondents (*i.e.*, the Exit Vest), which otherwise would have reverted to those employees, the remaining team members,

once Respondents were terminated. Under no circumstances would the lawfully-terminated Respondents have a right to that unvested carry.

Because they were terminated and not re-hired, Respondents were contractually excluded from any portion of the unvested carry regardless of whether Vulcan engaged in a mass termination and partial rehiring. The firing and re-hiring of the other employees arguably affected how to divide up and re-allocate Respondents' share of the unvested carry among these other employees. CP 31:26 – 32:10; CP 35:4 – 35:13. Yet the Panel held that its analysis of this purported breach as to the rehired employees “will govern the remedies available to [Respondents].” CP 32:12.

Aside from citing boilerplate cases and generalities about “deference,” all Respondents have to say about this fundamental flaw in the Award, is the naked assertion (lacking any citation) that the Panel did find a breach “as to Claimants.” Resp. Br. at 42. This is demonstrably untrue. The Award discovers a breach only “as to the rehired employees.” CP 35:2. Respondents cannot explain why any such breach has relevance to them, or how it could possibly give rise to, much less govern, remedies for them. There is no factual nexus or legal support for, on the one hand, the Panel’s finding of breach “as to” rehired employees and, on the other hand, its Award in favor of Respondents for breach of contract.

2. The Panel Grossly Misapplied The Implied Covenant To Award Respondents a Benefit They Sought But Failed To Gain During Negotiations.

Delaware law imposes stringent limitations on the use of the implied covenant of good faith and fair dealing. Neither a court (nor an arbitration panel) may “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). The implied covenant “may not be applied to give [a party] contractual protections that “[it] failed to secure at the bargaining table.” *Corp. Property Assocs. 14 Inc. v. CHR Holding Corp.*, 2008 Del. Ch. LEXIS 45, at *17-18 (Del. Ch. April 10, 2008).

Respondents do not contest the applicable law. Nor do they dispute Vulcan’s analysis of that law in light of the relevant facts. Instead, the sum and substance of Respondents’ counter-argument is that the matter was previously briefed. Resp. Br. at 44. That is no answer at all.

By its improper use of the implied covenant, the Panel did what Delaware law forbids. The Award re-writes the VEC Agreement and invokes the implied covenant to “fashion” a remedy for Respondents that gives them the very thing they tried and failed to obtain during “protracted and detailed” negotiations. CP 33:9-11, CP 26:24; *see also* CP 35:24 (Panel acknowledges that “it is clear” that Vulcan would not agree during

negotiations to any accelerated Exit Vest).

There is no permissible legal basis for using the implied covenant to provide Respondents the very benefit they failed to secure at the bargaining table. Such an Award stands in manifest disregard of Delaware law and cannot be sustained, deference or not.

V. CONCLUSION

For any one of three grounds under Section 10(a) of the FAA, the Judgment entered against Vulcan should be vacated. Vulcan is further entitled to its fees, both below and on this appeal.

Submitted this 29th day of September 2010.

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CERTIFICATE OF SERVICE

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

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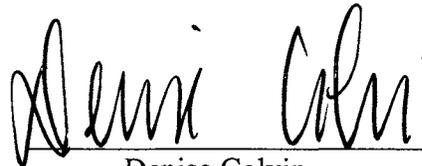
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I hereby certify, under penalty of perjury under the laws of the State of Washington, that the foregoing is true and correct.

DATED this 29th day of September 2010, at Seattle, Washington.



Denise Colvin

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