

*Original*

No. 35308-3-II

DIVISION II, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

LARRY NELSON and the marital community  
composed of Larry and Barbara Nelson,

Plaintiffs/Respondents

v.

WESTPORT SHIPYARD, INC.; J. ORIN EDSON  
and CHARLENE EDSON; and DARYL  
WAKEFIELD and KIM WAKEFIELD,

Defendants/Appellants

COURT OF APPEALS  
07 JAN 29 PM 3:59  
STATE OF WASHINGTON  
BY *[Signature]*  
IDENTITY

ON APPEAL FROM GRAYS HARBOR COUNTY SUPERIOR COURT  
(Hon. F. Mark McCauley)

APPELLANTS' OPENING BRIEF

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## ASSIGNMENTS OF ERROR

Defendants and Appellants Westport Shipyard, Inc., J. Orin and Charlene Edson, and Daryl and Kim Wakefield (collectively "defendants" or "Appellants") make the following assignments of error:

1. The trial court erred when it determined that the trial court, rather than an arbitrator, should hear plaintiff's challenge to the enforceability of the 2004 Shareholders Agreement as a whole. See Letter Ruling (July 21, 2006) (CP 498-99), Order Denying Motion to Compel Arbitration and Granting Motion for Leave to File Amended Answer With Counterclaims (Aug. 10, 2006) (CP 503-04).

2. The trial court erred when it determined that the claims, counterclaims, and defenses arising out of the 2004 Shareholders Agreement are not arbitrable. Id.

## STATEMENT OF ISSUES

The following issues pertain to the assignments of error:

1. Whether the trial court erred when it decided that it should hear plaintiff's challenge to the enforceability of the 2004 Shareholders Agreement as a whole, when the United States Supreme Court's decision in Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct.

1204, 163 L. Ed. 2d 1038 (2006),<sup>1</sup> mandates that an arbitrator must always hear and decide such a challenge. (Assignment of Error No. 1.)

2. Whether the trial court erred in deciding that the claims, counterclaims, and defenses related to enforceability and enforcement of the 2004 Shareholders Agreement are not arbitrable, where those issues "arise out of" the 2004 Shareholders Agreement. (Assignment of Error No. 2.)

## I.

### SUMMARY INTRODUCTION

Despite the detailed history of the facts of this case, this appeal presents a straightforward legal issue -- whether enforceability of an agreement between the parties should be determined by an arbitrator, as provided by the 2004 Shareholders Agreement, or by a court, as erroneously ruled by the trial judge below. Larry Nelson, plaintiff, is a former employee of Westport Shipyard, Inc. In 1998, Westport and its shareholders agreed to allow plaintiff to become a shareholder in the company. Over the course of the next three years, plaintiff purchased 460 shares of Westport. In each of the three Buy and Sell Agreements governing his four stock purchases, plaintiff agreed he would sell his

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<sup>1</sup>Although Buckeye has been assigned a U.S. reporter citation, pagination is not yet available. Accordingly, Appellants cite to the Supreme Court reporter.

shares back to the company, at an agreed-upon formula, in the event his employment with Westport ever ended (without regard to the reason for his separation from employment). That obligation was also memorialized in the 2004 Shareholders Agreement at issue in the instant lawsuit. Each of those four agreements contained an arbitration provision; the 2004 Shareholders Agreement signed by plaintiff provided specifically that the parties agreed to arbitrate all claims "arising out of" the 2004 Shareholders Agreement.

In June 2005, Westport decided to end plaintiff's employment and exercised its rights under the 2004 Shareholders Agreement to buy back plaintiff's shares based on his termination from employment. Plaintiff refused to sell back his shares. Two months later, the other shareholders voted to require plaintiff to sell his shares under the "unresolvable difference" provision in the 2004 Shareholders Agreement. Again, plaintiff refused to surrender the shares. In violation of the 2004 Shareholders Agreement, plaintiff continues to refuse to surrender the 460 shares of Westport stock

Westport notified plaintiff of its intention to commence arbitration under the 2004 Shareholders Agreement. In response, plaintiff filed suit against Westport and its shareholders, alleging, inter alia, that the 2004 Shareholders Agreement was void and that he was not bound by its terms.

Plaintiff also alleged a variety of other claims, such as discrimination, wrongful termination, "wage withholding," tortious interference with business expectancy, oppression of a minority shareholder, breach of fiduciary duty by a majority shareholder, and breach of the covenant of good faith and fair dealing. But plaintiff did not challenge the validity of the arbitration clause in the 2004 Shareholders Agreement, and plaintiff has since acknowledged it was his "understanding and intention" that the arbitration clause applied to the specific matters in the 2004 Shareholders Agreement. Nelson Decl., ¶ 19 (CP 113).

Defendants promptly moved to compel arbitration. The trial court denied the motion with the caveat that it was denying the motion "at this stage of the litigation." Defendants moved to clarify the trial court's order, to confirm that defendants' "counterclaims" (along with plaintiff's defenses to those counterclaims) "arising out of" the 2004 Shareholders Agreement would remain arbitrable. The trial court denied the motion to clarify. Accordingly, defendants commenced limited discovery with the intent of discovering additional facts to bring the issue of arbitration back to the court. New facts were discovered, including plaintiff's admission at his deposition: (1) that there were no misrepresentations made to him with regard to the nature of the buyout formula; and (2) that he was not denied an opportunity to suggest changes to any of the agreements he had signed,

including the 2004 Shareholders Agreement. Also during the course of discovery, the United States Supreme Court issued its decision in Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006). Buckeye clarified that, where a party challenges a contract containing an arbitration clause -- but not the arbitration clause itself -- an arbitrator, not the trial court, hears the challenge to enforceability of the contract. On the basis of the newly discovered facts and the Buckeye decision, defendants again moved to compel arbitration, seeking to arbitrate only issues "arising out of" the 2004 Shareholders Agreement. The trial court determined that defendants were entitled to bring this new motion, based on the exception the court had set in its earlier ruling denying the earlier motion "at this stage of the litigation." However, the trial court denied the new motion on its merits, concluding that: (1) because the arbitration clause was "narrow," Buckeye did not apply, and (2) the parties had not agreed to arbitrate challenges to the contract as a whole.

In light of Buckeye, there can be no reasonable dispute that an arbitrator, not the trial court, should hear plaintiff's challenges to enforceability of the 2004 Shareholders Agreement as a whole. The trial court's conclusion that "narrow" arbitration clauses are not subject to Buckeye's central holding was erroneous. The trial court's conclusion that

claims "arising out of" the 2004 Shareholders Agreement are not subject to arbitration was similarly erroneous and contrary to well established law expressly holding that those types of claims are completely arbitrable. The trial court's denial of defendants' motion to compel arbitration should be reversed, and the matter should be remanded, so that all claims "arising out of" the 2004 Shareholders Agreement, whether raised by plaintiff or defendants, are properly heard by an arbitrator.

## II.

### STATEMENT OF THE CASE

A. Westport Shipyard, Inc. Permits Plaintiff to Purchase Shares of the Company Subject to the Buyback and Arbitration Provisions of the Buy-Sell Agreements and the 2004 Shareholders Agreement.

Defendant and Appellant Westport Shipyard, Inc. ("Westport") is engaged in the business of manufacturing and selling semi-production motoryachts. The current shareholders are defendants and Appellants J. Orin Edson and Daryl Wakefield.

In late 1998, Westport and its shareholders agreed to allow Larry Nelson ("Mr. Nelson" or "plaintiff"), who was then employed by Westport, to become a shareholder. See Defendants' Motion to Compel Arbitration, at 2 (CP 31); Defendants' Motion to Compel Arbitration or, in the Alternative, for Leave to File Amended Answer With Counterclaims, at 2 (CP 391). Over the next three years, Mr. Nelson purchased

460 shares, or approximately two percent, of Westport stock, for a total price of \$327,833. Id. at 2 (CP 391); Plaintiff's First Amended Complaint for Damages, and Amended Complaint and Information on Quo Warranto ("First Amended Complaint") (CP 19). In doing so, Mr. Nelson agreed on three separate occasions that he would sell his shares back to the company in the event his employment with Westport ever ended. December 17, 1998 Buy and Sell Agreement at 1 ("1998 Agreement") (CP 56); December 8, 2000 Buy and Sell Agreement ("2000 Agreement"), at 1 (CP 59); December 17, 2001 Buy and Sell Agreement ("2001 Agreement") at 1 (CP 64). Mr. Nelson's obligation to sell back his shares upon termination was not only memorialized in each of the Buy-Sell Agreements signed by Mr. Nelson (id.), but also in the 2004 Shareholders Agreement executed by Mr. Nelson, his wife and the other shareholders ("2004 Shareholders Agreement"). See 2004 Shareholders Agreement, at 2 (CP 45).

Under Section 2.3 of the 2004 Shareholders Agreement, Westport's three employee shareholders (Mr. Nelson, defendant Daryl Wakefield and then-employee Richard Rust) agreed to sell their shares of Westport common stock back to Westport, at one and one-half times the company's net book value, upon the occurrence of any one of several events, including: (1) the termination of the employee's employment with

Westport, or (2) an "unresolvable difference" amongst the shareholders, upon which a majority vote of the then current shareholders shall determine which shareholder shall be bought out. See 2004 Shareholders Agreement, at 2 (CP 45). Section 6.5 of the 2004 Shareholders Agreement provided for mandatory arbitration of "disputes among any of the parties arising out of this Agreement." Id. at 9 (CP 52).

Mr. Nelson confirmed in his August 5, 2005 sworn declaration that he understood and agreed to the buyback requirements that attached to the Westport shares he was permitted to acquire:

When I first purchased shares in Westport Shipyard, I understood that shareholders of this closely held corporation wanted to restrict ownership of the shares and that I could not transfer my shares to anyone other than the corporation or other shareholders. I understood that they did not want me to be able to leave the company and keep my stock. I understood and agreed to those terms in the Buy-Sell agreements of 12/98, 12/00, and 12/01, that my ownership of shares did not include the right to transfer them except to the company or other shareholders. I also understood and agreed that the matters in the Buy-Sell agreements of 12/98, 12/00, and 12/01, i.e. the restriction against transfers and the determination of book value of the shares, would be subject to arbitration if there were any future dispute.

Declaration of Larry Nelson in Support of Plaintiff's Opposition to Motion to Compel Arbitration ("Nelson Decl."), ¶ 5 at 2 (CP 110). Mr. Nelson also stated under oath that he understood and agreed that all of his shareholder agreements "required" arbitration of matters arising out of the agreement. Id., ¶ 19 at 5 (CP 113). Referring to the 2004 Shareholders

Agreement, Mr. Nelson stated in his August 5, 2005 declaration: "It was my understanding and intention in that document that the arbitration clause was limited to just the specific matters in that agreement." Id.

B. Mr. Nelson's Breach of the 2004 Shareholders Agreement, and Appellants' Request for Arbitration.

Mr. Nelson's employment with Westport ended in June 2005. Following his termination, Westport notified Mr. Nelson that it was exercising its right under the 2004 Shareholders Agreement to purchase his shares at 1.5 times net book value based on the most recent audited financial statement, and tendered to Mr. Nelson \$1,086,570 for Mr. Nelson's 460 shares. June 24, 2005 Letter from Westport to plaintiff. See (CP 116-17).<sup>2</sup> Mr. Nelson refused to accept the tendered payment or to deliver his share certificates back to Westport. Declaration of Mary Welk in Support of Defendants' Motion to Compel Arbitration, ¶ 7 at 3 (CP 42). In response to Mr. Nelson's refusal to abide by the terms of the 2004 Shareholders Agreement, Westport notified Mr. Nelson of its intent to commence arbitration, as provided under Section 6.5 of the 2004 Shareholders Agreement. See Nelson Decl., ¶ 20 at 5-6(CP 113-14).

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<sup>2</sup>The \$1,086,570 tendered to Mr. Nelson in accordance with the provisions of the 2004 Shareholders Agreement represented a gain of \$758,737 on Mr. Nelson's investment of \$327,833, for his 460 shares purchased between 1999 and 2001. Compare (CP 394) with (CP 116).

In August 2005, the other shareholders invoked the "unresolvable difference" provision of the 2004 Shareholders Agreement, and Westport again gave Mr. Nelson notice of exercise of its right to purchase Mr. Nelson's shares. See August 17, 2005 Letter from Westport to plaintiff (CP 417). Mr. Nelson again refused to accept payment or deliver back the share certificates evidencing his shares, and is still in possession of 460 shares of the outstanding 21,540 shares. See Defendants' Motion to Compel Arbitration or, in the Alternative, for Leave to File Amended Answer With Counterclaims, at 2 (CP 391).

C. Procedural History of the Present Dispute Giving Rise to This Appeal.

1. Mr. Nelson Files Suit; Appellants Move to Stay Litigation and Compel Arbitration of His 2004 Shareholders Agreement Claims. Plaintiff filed a lawsuit against defendants and Appellants on June 24, 2005, and filed an amended complaint on July 15, 2005, claiming, inter alia, he was not bound by the 2004 Shareholders Agreement he had signed (in particular, the provisions requiring him to sell his shares back to Westport) and that Westport had discriminated against him in violation of the Washington Law Against Discrimination, Chapter 49.60 RCW. See generally Complaint for Damages, and Complaint for Information on Quo Warranto (CP 1-15); see also First Amended Complaint (CP 16-29).

On July 28, 2005, Westport notified plaintiff of Westport's intent, pursuant to Section 6.5 of the 2004 Shareholders Agreement, to arbitrate claims arising out of the Shareholders Agreement.<sup>3</sup> Appellants sought a stay of plaintiff's "shareholder claims arising under the parties' 2004 Shareholders Agreement," and sought to compel plaintiff to arbitrate those claims, as required under the 2004 Shareholders Agreement. See Defendants' Motion to Stay and Compel Arbitration ("Motion to Stay and Compel Arbitration") at 1 (CP 30).<sup>4</sup>

2. The Trial Court Denies Appellants' Motion to Stay and Compel Arbitration, but Leaves the Door Open for a Renewed Motion to Compel Arbitration at a Later Stage of the Litigation Following Discovery. On October 31, 2005, the trial court issued a letter ruling denying Appellants' Motion to Stay and Compel Arbitration, concluding that the "type of claims" raised by Mr. Nelson in this action did not "arise out of" the Shareholders Agreement, and thus were not subject to mandatory arbitration. See October 31, 2005 Letter Ruling (CP 131-32).

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<sup>3</sup>Pursuant to Section 6.5, arbitration is to be conducted by the American Arbitration Association ("AAA"). (CP 52.)

<sup>4</sup>The claims to be arbitrated are: the enforceability of the buyback provision in Section 2.34 of the 2004 Shareholders Agreement, the calculation of the buyback price in accordance with the formula in Section 2.4 of the 2004 Shareholders Agreement, and Westport's claim for repayment by Mr. Nelson of excess distributions for quarterly estimated tax payments.

The court's letter ruling began: "At this stage of the litigation, I am going to deny defendants' motion . . . ." Id. In the subsequent order denying the motion, the trial court interlined in the court's own hand that it was denying Appellants' motion "at this stage of the litigation." See Order Denying Appellants' Motion to Stay Litigation and Compel Arbitration filed on November 10, 2005 ("November 10th Order") (CP 133-35).

3. Appellants Move for Clarification of the Scope of the Court's Order; the Trial Court Denies Appellants' Motion for Clarification and Reaffirms Its November 10th Order. Following the November 10 Order, Appellants moved for clarification and specifically asked the court to state that the November 10th Order was not intended to bar defendant Westport from proceeding to AAA arbitration on Westport's own breach of contract claims against plaintiff arising out of the 2004 Shareholders Agreement. See Defendant Westport Shipyard's Memorandum in Support of Its Motion for Clarification at 2 (CP 142). Appellants brought that motion to determine the scope of arbitration related to Appellants' claims against plaintiff arising out of the 2004 Shareholders Agreement, and not to "rehash" the prior Motion to Stay and Compel Arbitration. See November 15, 2005 letter from James Sanders to Judge McCauley (CP 136-37).

The trial court denied Appellants' Motion for Clarification in an Order filed on January 3, 2006 ("January 3rd Order"). See January 3rd

Order (CP 225-26). The January 3rd Order simply stated that Appellants' Motion for Clarification was denied, leaving intact the court's October 31, 2005 letter ruling and its interlineated, handwritten proviso of the November 10th Order that Appellants' Motion to Stay and Compel Arbitration was denied "at this stage of the litigation." Id.

4. Appellants Engage in Limited Discovery to Explore the Factual Basis for Plaintiff's Challenges to the 2004 Shareholders Agreement. After those two orders were issued, Appellants engaged in limited discovery before bringing a renewed motion to compel arbitration. On January 12, 2006 and February 9, 2006, Appellants deposed plaintiff, see excerpts of Nelson depositions (CP 343-44), Exhibit A to Declaration of Natalie Leth, exploring the factual basis for plaintiff's challenge to the agreement he had signed. No other depositions were taken during the period prior to filing the April 2006 Motion to Compel Arbitration. In response to plaintiff's Note for Trial, Appellants, faced with the court's November 10th and January 3rd Orders denying arbitration "at this stage of the litigation," asked for an early trial date, in the event a trial would be necessary. See Defendants' Response to Plaintiff's Note for Trial and Initial Statement of Arbitrability (LCR 40(B); LMAR 2.1(A)) at 1 (CP 610). The court set a trial date of January 17, 2007. See Notice of Trial Date Setting (CP 621).

Appellants also filed a dispositive motion during that time period, which the court granted, dismissing a prayer for punitive damages on a nonarbitrable employment discrimination claim. See Defendants' Motion to Dismiss Plaintiff's Claim for Punitive Damages (CP 596-606)<sup>5</sup> and Order Granting Defendants' Motion to Dismiss Plaintiff's Claim for Punitive Damages (CP 648-49).

5. The United States Supreme Court Issues a Decision Affecting the Scope of the Law of Arbitrability. Following the trial court's November 10th and January 3rd Orders, the United States Supreme Court issued its decision in Buckeye. In that case, similar to this one, a party claimed that the contract it had signed was unenforceable, based on alleged fraudulent inducement and other illegality at its inception. 126 S. Ct. at 1206-07. The party seeking to enforce the contract invoked the arbitration right, and the party challenging the enforceability of the agreement resisted going to arbitration. 126 S. Ct. at 1207. The Buckeye court held that, unless the "challenge is to the arbitration clause itself, the issue of a contract's validity is considered by the arbitrator in the first instance." 126 S. Ct. at 1209.

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<sup>5</sup>The Motion to Dismiss Plaintiff's Claim for Punitive Damages specifically referenced Appellants' continuing assertion that they were entitled to proceed to arbitration on plaintiff's claims arising out of the 2004 Shareholders Agreement. See Motion to Dismiss Plaintiff's Claim for Punitive Damages at 3 (CP 600).

6. Following Appellants' Discovery of New Facts Through Mr. Nelson's Deposition and the United States Supreme Court's Issuance of Its Decision in BUCKEYE, Appellants Renew Their Motion Seeking to Compel Arbitration of All Claims, Defenses and Counterclaims Arising out of the 2004 Shareholders Agreement. On April 10, 2006, following plaintiff's deposition and the Buckeye opinion, Appellants renewed their Motion to Compel Arbitration. In their renewed request, Appellants stated:

First, since the Court's earlier rulings, which left open the opportunity for Defendants to seek an order to compel arbitration at a later stage of the litigation, the United States Supreme Court has definitively ruled that claims challenging the underlying validity of an agreement containing an arbitration provision are to be decided in arbitration, not in court. Buckeye Cash Checking, [sic] Inc. v. Cardegna, \_\_\_ U.S. \_\_\_, 126 S. Ct. 1204, 1209-10 (No. 04-1246, [sic] February 21, 2006). Further, Mr. Nelson's testimony at his deposition confirms that there is no factual basis for his claim that the 2004 Shareholders Agreement he signed should be declared void due to claimed misrepresentations and coercion by defendant Orin Edson. Both the U.S. Supreme Court's Buckeye decision and Mr. Nelson's deposition testimony make clear that claims regarding enforcement or breach of the Shareholders Agreement, whether asserted by Mr. Nelson or Defendants, must be referred to arbitration for resolution.

Motion to Compel Arbitration at 3 (emphasis added) (CP 392). The excerpts from plaintiff's deposition referred to in the April 2006 Motion to Compel Arbitration, contained the new facts that, combined with the

recent Buckeye decision, supported the renewed motion.<sup>6</sup> See Deposition of Larry Nelson, attached to the Declaration of James Sanders in Support of Defendants' Motion for Partial Summary Judgment (CP 256-68).<sup>7</sup>

Appellants did not seek to compel arbitration of plaintiff's claims for damages for alleged discrimination, wrongful termination, "wage withholding," tortious interference with business expectancy, oppression of minority shareholder, breach of fiduciary duty by majority shareholder, and breach of covenant of good faith and fair dealing. Id. at 3-4 (CP 392-93). Appellants explained in their briefing before the trial court that they were seeking to compel arbitration only of plaintiff's claims (and Appellants' defense and counterclaims) regarding enforceability of the 2004 Shareholders Agreement, which would encompass both plaintiff's

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<sup>6</sup>Appellants also filed a motion for partial summary judgment on Plaintiff's contract formation defenses to enforcement of the 2004 Shareholders Agreement, and noted that motion to be heard in conjunction with the renewed Motion to Compel Arbitration. Cf. Defendants' Motion for Partial Summary Judgment at 1 (CP 235) with Defendants' Motion to Compel Arbitration at 1 (CP 390). In their reply, Appellants told the trial court that granting the Motion to Compel would move a decision on the Motion for Partial Summary Judgment from the court's jurisdiction to an arbitrator's. See Reply in Support of Motion for Partial Summary Judgment re Declaratory Relief at 1 (CP 422-23).

<sup>7</sup>Appellants also cited Mediterranean Enters., Inc. v. Ssangyong Corp., 708 F.2d 1458 (9th Cir. 1983), which involved nearly identical issues. Motion to Compel Arbitration at 12-13 (CP 401-02). Appellants explained that the Mediterranean court held that even "narrow" arbitration clauses encompass "disputes relating to the interpretation and performance of a contract." Id. at 13 (CP 402).

"formation" challenges, including misrepresentation and duress, and his "postformation" challenges, including his claim that he does not have to return his shares to Westport (as he and his wife agreed to do in the 2004 Shareholders Agreement), because of alleged shareholder "oppression" and/or an alleged "breach of a majority shareholder's fiduciary duties." Motion to Compel Arbitration at 3-4 (CP 392-93). Appellants argued that plaintiff's claims, as described above, "arise out of" the 2004 Shareholders Agreement, and therefore must be arbitrated. Id. at 4 (CP 393). Appellants also argued that the arbitrable claims include Appellants' "counterclaims" for plaintiff's breach of the 2004 Shareholders Agreement and for unjust enrichment, which were the subject of the stayed AAA proceeding. Id.<sup>8</sup>

7. The Trial Court Denies Appellants' Renewed Motion to Compel Arbitration, and Appellants Timely Appeal. In its August 10th Order, the trial court denied Appellants' April 2006 Motion to Compel Arbitration. The August 10th Order, unlike the prior orders, did not leave the door open to Appellants to renew their Motion to Compel Arbitration at a later stage in the litigation. Appellants duly filed their Notice of

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<sup>8</sup>The AAA has stayed the arbitration proceedings until resolution of the instant appeal. Letter from J. Johnson to J. Sanders and V. Vreeland (CP 177).

Appeal from the August 10th Order on September 1, 2006, well within the 30 day timeline provided for in RAP 5.2. (CP 506.)<sup>9</sup>

### III.

#### STANDARD OF REVIEW

Review of a trial court's decision to deny a motion to compel arbitration is de novo. See, e.g., Krueger Clinic Orthopaedics, L.L.C. v. Regence Blueshield, 157 Wn.2d 290, 298, 138 P.3d 936 (2006); see also Stein v. Geonerco, Inc., 105 Wn. App. 41, 45, 17 P.3d 1266 (2001); Ticknor v. Choice Hotels Int'l, Inc., 265 F.3d 931, 936 (9th Cir. 2001). The party opposing arbitration bears the burden of showing that the arbitration agreement is not enforceable. Zuver v. Airtouch Communications, Inc., 153 Wn.2d 293, 302, 103 P.3d 753 (2004); Stein, 105 Wn. App. at 48; Green Tree Fin. Corp. v. Randolph, 531 U.S. 79, 92, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000).

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<sup>9</sup>Plaintiff filed a motion to dismiss the appeal, alleging the appeal was untimely and/or that Appellants waived their right to arbitration. On October 12, 2006, the commissioner denied plaintiff's motion, concluding "that the appeal is timely and that Westport Shipyard's conduct has not waived its right to appeal. . . ." On November 8, 2006, plaintiff filed a Motion to Modify Commissioner's Ruling, which this Court denied on January 5, 2007.

#### IV.

#### ARGUMENT

In its letter ruling denying Appellants' Motion to Compel Arbitration and Granting Motion for Leave to File Amended Answer With Counterclaims, the trial court ruled that "the arbitration clause [in the 2004 Shareholders Agreement] is narrow, and the parties did not agree to arbitrate the validity of the Shareholders Agreement." See Letter Ruling (July 21, 2006) (CP 498-99); see also Order Denying Motion to Compel Arbitration and Granting Motion for Leave to File Amended Answer With Counterclaims (Aug. 10, 2006) (CP 503-04). In so ruling, the trial court misconstrued the holding of the Supreme Court's recent decision in Buckeye, as it relates to compelling arbitration pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 et seq.<sup>10</sup>

Specifically, the trial court erred in the first instance when it ruled that challenges to enforceability of the 2004 Shareholders Agreement

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<sup>10</sup>The FAA applies because of Westport Shipyard's extensive involvement in interstate commerce. See, e.g., Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 57, 123 S. Ct. 2037, 156 L. Ed. 2d 46 (2003) (holding that FAA applied to agreement because one of the parties "engaged in business throughout the . . . United States"); In re Profanchik, 31 S.W.3d 381, 385 (Tex. Ct. App. 2000) (holding that FAA applied to stock purchase/sale agreement, because it affected ownership of a corporation involved in interstate commerce); see also Garmo v. Dean, Witter, Reynolds, Inc., 101 Wn.2d 585, 589, 681 P.2d 253 (1984) (confirming that FAA applies to brokerage contract evidencing interstate commerce).

itself are to be heard by the trial court, rather than an arbitrator. The trial court's ruling was contrary to the Supreme Court's express holding in Buckeye, which makes clear that the trial court is only to determine challenges limited to the enforceability of the arbitration clause. The trial court then further erred by concluding that -- because the arbitration clause in the 2004 Shareholders Agreement is ostensibly a "narrow" arbitration clause -- claims, counterclaims, and affirmative defenses, related to the enforceability and plaintiff's breach of the 2004 Shareholders Agreement, were not arbitrable. That is contrary to well established case law that expressly provides that disputes over interpretation and performance of the underlying contract clearly fall under the scope of even a "narrow" arbitration clause. See, e.g., Mediterranean Enters., Inc. v. Ssangyong Corp., 708 F.2d 1458 (9th Cir. 1983). Accordingly, this Court should reverse.

A. There Is No Dispute That a Valid Arbitration Agreement Exists.

As a threshold matter, it is undisputed that a valid arbitration agreement exists. Section 6.5 of the 2004 Shareholders Agreement states:

**Arbitration.** In the event of any disputes among any of the parties arising out of this Agreement, then such disputes shall be submitted to arbitration pursuant to the Commercial Arbitration Rules of the American Arbitration Association.<sup>11</sup>

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<sup>11</sup>The 1998, 2000 and 2001 Buy and Sell Agreements signed by plaintiff also contained arbitration provisions that required arbitration  
(continued . . .)

2004 Shareholders Agreement, p. 9 (CP 52) (emphasis added).

Plaintiff does not dispute that he and his wife signed the Agreement. Id. at 10 (CP 53). Moreover, plaintiff testified he knew he was entering into an agreement to arbitrate any dispute arising out of the 2004 Shareholders Agreement:

I observed that the 2004 Shareholders Agreement presented to me to sign had the same type of arbitration provision as prior Buy-Sell agreements, and required arbitration only of matters arising from the agreement. It was my understanding and intention in that document that the arbitration clause was limited just to the specific matters in that agreement, and that I was not agreeing to submit to arbitration any other possible claims I might have then or later against the company or other shareholders, including Edson.

Nelson Decl., ¶ 19 (CP 113) (emphasis added). Plaintiff also testified he knew that the matters set forth in the 2004 Shareholders Agreement "would be subject to arbitration if there were any future dispute." Id., ¶ 5 (CP 110) (emphasis added).

In sum, plaintiff's testimony makes clear he is not separately challenging the arbitration provisions in the agreements he signed. Accordingly, the only remaining question is whether the trial court erred

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( . . . continued)

"necessary to carry out the terms and conditions" of those agreements, including the requirement that plaintiff sell back his shares of Westport stock upon termination of employment. See 1998 Buy and Sell Agreement, ¶ 1, ¶ 4 (CP 56, 57), 2000 Buy and Sell Agreement, ¶ 1, ¶ 4 (CP 59, 60), and 2001 Buy and Sell Agreement, ¶ 1, ¶ 4 (CP 64, 65).

in concluding that: (1) plaintiff's claims that the buyback provisions of the 2004 Shareholders Agreement are not enforceable against him, and defendants' counterclaims and defenses related to plaintiff's breach of that agreement, do not "arise out of" the 2004 Shareholders Agreement; and therefore, (2) those claims should be heard by the court, rather than an arbitrator. The answer to that question is an unequivocal "yes" -- the trial court's ruling was in error.

B. The Trial Court Erred When It Determined That It, Rather Than an Arbitrator, Should Hear Plaintiff's Challenges to Enforceability of the Contract as a Whole.

1. The United States Supreme Court's Intervening Decision in BUCKEYE Establishes That, Where the Challenge Is to the Contract as a Whole and Not the Arbitration Clause Itself, the Dispute Must Be Decided by the Arbitrator. On February 21, 2006, the United States Supreme Court issued its ruling in Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006). The Buckeye Court outlined three relevant principles. The Court reaffirmed the principle first set forth in Prima Paint Corp. v. Flood & Conklin Manufacturing Co., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), that arbitration clauses are severable, and also reaffirmed and clarified that principles applicable to arbitration clauses apply equally in state and federal court. Buckeye, 126 S. Ct. at 1209.

The crux of the Buckeye ruling, however, was the resolution of what types of challenges should be heard by an arbitrator rather than a court. The Supreme Court recognized two types of challenges to arbitration agreements: (1) a challenge specifically to the agreement to arbitrate, and (2) a challenge to the contract as a whole. Id. at 1208. The latter type of challenge encompasses those challenges "on a ground that directly affects the entire agreement (e.g., the agreement was fraudulently induced), or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid." Id. The Court held that where there is a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, the issue of the contract's validity is to be determined by an arbitrator. Id. at 1209; see also Nagrampa v. Mailcoups, Inc., 469 F.3d 1257, 1269-71 (9th Cir. 2006) (applying Buckeye, court hears specific challenges to the validity of the arbitration agreement but not challenges to the contract as a whole; efforts to invalidate entire contract must be sent to arbitrator).

2. Plaintiff Challenges the Validity of the 2004 Shareholders Agreement as a Whole; Those Claims Should Be Heard by an Arbitrator.

To determine whether a plaintiff is challenging the validity of the arbitration provision or the validity of the contract as a whole, the court must "examine the crux of the complaint." Nagrampa, 469 F.3d at 1266.

Here, plaintiff alleges in his complaint that Mr. Edson wrongfully induced his acceptance of the 2004 Shareholders Agreement through misrepresentation and coercion. See First Amended Complaint ¶¶ 3.24, 9.2, and 9.5 (CP 22, 27). Specifically, plaintiff alleges:

9.2 The conduct, acts and omissions of defendant EDSON constitute duress or coercion and/or misrepresentation rendering the Shareholders Agreement of 12/04 void and unenforceable.

9.5 The [2004] Shareholders Agreement, to the extent it purports to control any aspect of this matter, or any claim for damages, should be declared invalid, and set aside as void and unenforceable.

First Amended Complaint (CP 27) (emphasis added).

Nowhere in his complaint does plaintiff challenge the validity of the arbitration provision in Section 6.5 of the 2004 Shareholders Agreement.<sup>12</sup> As discussed above, plaintiff admits he (1) was aware of the provision, and (2) understood that it applied to disputes arising out of the 2004 Shareholders Agreement. Nelson Decl., ¶¶ 5, 19 (CP 110, 113). There can be no reasonable dispute that plaintiff's claims arising out of the 2004 Shareholders Agreement must be heard by an arbitrator pursuant to

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<sup>12</sup>Similarly, nowhere in plaintiff's briefing before the trial court on Defendants' Motion to Compel did plaintiff allege he was challenging the validity of the arbitration provision, rather than the validity and enforceability of the contract as a whole.

the Supreme Court's express holding in Buckeye. The remaining issue is which claims, raised by both plaintiff and defendants, are arbitrable. The trial court erred in that analysis, as well.

C. The Trial Court Erred When It Concluded That Plaintiff's Claims and Appellants' Counterclaims and Defenses, "Arising out of" the 2004 Shareholders Agreement, Are Not Arbitrable.

As noted above, the trial court based its denial of Appellants' Motion to Compel Arbitration on the premise that the arbitration clause in the 2004 Shareholders Agreement is "narrow," concluding that "the parties did not agree to arbitrate the validity of the Shareholders Agreement." (CP 498-99, 503-04.) That conclusion is flawed in two respects. First, the trial court appears to have presumed that, because the arbitration provision is ostensibly "narrow," it should tend toward denying the motion to compel arbitration. That position is contrary to the abundance of federal and state law governing enforcement of arbitration clauses. Second, the trial court's conclusion ignores the plain language of the arbitration clause as applied to the limited issues Appellants seek to arbitrate. The trial court erred, and its ruling should be reversed.

1. The Court's Role Is Limited: The Court Must Issue an Order Compelling Arbitration if the Party Moving to Compel Satisfies the Threshold Test. There is no dispute that the FAA applies to the 2004 Shareholders Agreement. See Plaintiff's Opposition to Motion to Stay

Litigation and to Compel Arbitration, p. 3 n.1 (CP 86). By its terms, the FAA "leaves no place for the exercise of discretion by a [] court, but instead mandates that [] courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed." Chiron Corp. v. Ortho Diagnostic Sys., Inc., 207 F.3d 1126, 1130 (9th Cir. 2000) (emphasis in original) (quoting Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 218, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985)).

"The court's role under the Act is therefore limited to determining (1) whether a valid agreement to arbitrate exists and, if it does, (2) whether the agreement encompasses the dispute at issue." Chiron, 207 F.3d at 1130 (internal citations omitted); see also 9 U.S.C. § 4. If the answer to both inquiries is "yes," the court must enforce the arbitration agreement. Id.

Here, there is no dispute that the parties' agreement to arbitrate disputes "arising out of" the 2004 Shareholders Agreement is valid. See § IV.A, supra. The only question remaining is the scope of the issues subject to arbitration. More than two decades ago, in Mediterranean Enters., Inc. v. Ssangyong Corp., 708 F.2d 1458 (9th Cir. 1983), the Ninth Circuit expressly declared that these types of disputes are plainly arbitrable, even when they arise out of contracts with "narrow" arbitration

clauses. Here, the trial court got it wrong when it concluded to the contrary.

2. The Federal Arbitration Act Contains a Strong Policy Favoring Arbitration: Any Doubts Concerning Whether Claims or Issues Are Arbitrable Should Be Resolved in Favor of Arbitration -- Even if the Arbitration Provision Is Arguably "Narrow." The strong policy favoring arbitration is well settled, and case law is replete with the repeated proclamation that the FAA contains a liberal federal policy favoring enforcing arbitration agreements. See, e.g., Zuver, 153 Wn.2d at 301 n.2 ("Washington State also has a strong public policy favoring arbitration of disputes") (citing Int'l Ass'n of Fire Fighters, Local 46 v. City of Everett, 146 Wn.2d 29, 51, 42 P.3d 1265 (2002)); see also Mendez v. Palm Harbor Homes, Inc., 111 Wn. App. 446, 454, 45 P.3d 594 (2002); Perez v. Mid-Century Ins. Co., 85 Wn. App. 760, 765, 934 P.2d 731 (1997).

The Supreme Court in Buckeye reaffirmed this bedrock principle. Buckeye, 126 S. Ct. at 1207 (citing "national policy favoring arbitration"). As the Court previously stated, the FAA "create[s] a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." Moses H. Cone Mem'l Hosp., 460 U.S. at 24; see also Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc., 473 U.S. 614, 625, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985); Moses H.

Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983) (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967)); Republic of Nicaragua v. Standard Fruit Co., 937 F.2d 469, 478 (9th Cir. 1991) (all holding that the scope of arbitration clauses must be construed liberally). There can be no reasonable dispute that, applying this long and well settled line of federal and state cases, arbitration is the preferred forum.

Consistent with this principle, courts have repeatedly held that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." See, e.g., Moses H. Cone Mem'l Hosp., 460 U.S. at 24-25; Zuver, 153 Wn.2d at 301 (mandating that "[c]ourts must indulge every presumption in favor of arbitration" (internal quotation marks and citation omitted)). Thus, "a contractual dispute is arbitrable unless it can be said 'with positive assurance' that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute." Kamaya Co. v. American Prop. Consultants, Ltd., 91 Wn. App. 703, 714, 959 P.2d 1140 (1998), rev. denied, 137 Wn.2d 1012, 978 P.2d 1099 (1999) (internal quotation marks altered) (quoting ML Park Place Corp. v. Hedreen, 71 Wn. App. 727, 739, 862 P.2d 602 (1993), rev. denied, 124 Wn.2d 1005, 877 P.2d 1288 (1994), in turn quoting United Steelworkers v. Warrior &

Gulf Navigation Co., 363 U.S. 574, 582-83, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960)).

In applying this fundamental principle, the Ninth Circuit observed that "the clear weight of authority holds that the most minimal indication of the parties' intent to arbitrate must be given full effect." Republic of Nicaragua, 937 F.2d at 478 (emphasis added). Indeed, the FAA mandates that courts "rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation." Dean Witter, 470 U.S. at 221; cf. Mediterranean, 708 F.2d 1465 (affirming stay so that three of nine claims would be properly heard by arbitrator prior to the remaining claims). It is against this well established jurisprudential backdrop that this Court must determine whether the trial court erred in denying Appellants' motion to compel arbitration of the claims, counterclaims, and defenses arising out of the 2004 Shareholders Agreement.

3. Even "Narrow" Arbitration Clauses Encompass Disputes and Controversies Relating to Interpretation of the Contract, and Issues Related to Performance, Including Counterclaims and Defenses. The trial court cited the "narrow" arbitration clause as a basis for denying Appellants' motion to compel arbitration, concluding that the parties did not agree to arbitrate the validity of the 2004 Shareholders Agreement. July 21, 2006 Letter Ruling (CP 498-99). That conclusion is patently wrong.

a. The Trial Court Ignored Well Established Principles of Arbitrability When It Denied Defendants' Motion to Compel on the Basis of the Ostensibly "Narrow" Arbitration Clause. Even "narrow" arbitration clauses apply to "disputes and controversies relating to interpretation of the contract and matters of performance." Mediterranean, 708 F.2d at 1464. In Mediterranean, the arbitration clause provided:

Any disputes arising hereunder or following the formation of joint venture [sic] shall be settled through binding arbitration pursuant to the Korean-U.S. Arbitration Agreement, with arbitration to take place in Seoul, Korea.

708 F.2d at 1461 (emphasis added). The complaint in that case alleged six counts against defendants, including "breach of contract and breach of fiduciary duty (counts 1, 2 and 4), inducing and conspiracy to induce breach of contract [related to a separate agreement] (count 7), quantum meruit (count 8), and conversion (count 9)." Id. The trial court ordered arbitration of counts 1, 2 and 4, and stayed the trial court proceedings until the arbitration concluded. Id.

The Ninth Circuit affirmed the trial court's grant of defendants' motion to compel arbitration. The court observed that the phrase "arising hereunder" has been called "relatively narrow." Id. at 1464 (quoting Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 364 (S.D.N.Y. 1966)). Nonetheless, the court expressly held:

Counts 1, 2 and 4, alleging breach of the Agreement and breach of the fiduciary duty created by the Agreement, clearly fall within the scope of the arbitration clause and are thus proper subjects for arbitration.

.....

By sending "the issues raised by" counts 1, 2 and 4 to arbitration, the district court authorized the arbitrator, in accordance with the expressed intention of the parties, to decide those issues relating to the interpretation and performance of the Agreement. [The claims for breach of contract and breach of fiduciary duty created by the contract] appear to be completely arbitrable.

Id. at 1464, 1465 (emphasis added).

Appellants seek to arbitrate precisely the same type of claims here -- plaintiff's claim that he should not have to abide by the "buyback provision" in Section 6.5 of the 2004 Shareholders Agreement, and Appellants' claims that plaintiff must comply with those provisions. Yet the trial court failed to adhere to the clear directive set forth in Mediterranean, and denied Appellants' motion to arbitrate those very claims. This Court should apply the longstanding principles laid down in Mediterranean and reverse the trial court's erroneous decision.

b. Plaintiff's Concession Regarding the Scope of the Arbitration Clause Is Sufficient to Mandate Arbitration of Claims "Arising out of" the 2004 Shareholders Agreement. Plaintiff concedes that the arbitration clause applies to claims "arising out of" the 2004 Shareholders Agreement. Nelson Decl. ¶ 19 (CP 113). Certainly plaintiff's own

concession to that fact establishes "the most minimal indication of the parties' intent to arbitrate." Republic of Nicaragua, 937 F.2d at 478 (emphasis added). As mandated by our Supreme Court, the court "must indulge every presumption in 'favor of arbitration.'" Zuver, 153 Wn.2d at 301. The trial court here failed to apply that presumption and instead chose to ignore the language of the arbitration clause, which applies to all claims "arising out of" the 2004 Shareholders Agreement. All of plaintiff's claims related to his assertion that the buyback provisions of the 2004 Shareholders Agreement are not enforceable -- including, but not limited to his claims of misrepresentation and coercion regarding the very formation of the contract at issue -- are thus arbitrable under Section 6.5.

Furthermore, nothing in the case law or the arbitration clause itself limits arbitrable issues to only those claims raised by plaintiff. Indeed, as noted above, Appellants have already filed a Demand for Arbitration with the American Arbitration Association on their claims regarding the buyback provision and other issues that plainly arise out of the 2004 Shareholders Agreement, which proceedings are stayed pending resolution of this appeal. See Demand for Arbitration (CP 164); letter from J. Johnson to J. Sanders and V. Vreeland (CP 177). At the heart of the dispute over arbitrability is plaintiff's "declaratory relief" claim that the 2004 Shareholders Agreement is not binding on him. Cf. Zurich

American Ins. Co. v. Watts Indus. Inc., 466 F.3d 577, 581 (7th Cir. 2006) (affirming trial court's ruling that affirmative defense to arbitration agreement is arbitrable).<sup>13</sup>

Moreover, plaintiff cannot avoid arbitration by simply alleging that a "breach of fiduciary duty" prevents defendants from buying back his stock. If a claim falls under the ambit of the arbitration clause -- regardless of how the claim is labeled -- it must be arbitrated.

4. Appellants Limited Their Motion to Compel Arbitration to Only Claims "Arising out of" the 2004 Shareholders Agreement.

Appellants confirmed in their April 2006 motion to compel arbitration that they were seeking to transfer only particular claims to arbitration.

This [April 2006] motion does not seek to compel arbitration of Mr. Nelson's discrimination, wrongful termination, "wage withholding," or tortious interference claims, which include Mr. Nelson's claims for damages reflecting a buy-back of his Westport shares . . . . Likewise, to the extent Mr. Nelson's claims of "oppression" and "breach of fiduciary duty by majority shareholders" address anything other than the enforceability of the Shareholders Agreement (that is, such claims that would not "arise out of" the 2004 Shareholders Agreement), those would also remain before the Court. However, to the extent Mr. Nelson raises arguments of "oppression" or "breach of fiduciary duty" as a means of avoiding enforcement of the Shareholders Agreement, any such arguments necessarily relate directly to claims "arising

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<sup>13</sup>For example, a claim of unjust enrichment arising out of a breach of a joint venture partnership agreement is an arbitrable claim. Industra/Matrix Joint Venture v. Pope & Talbot, Inc., 341 Or. 321, 334, 142 P.3d 1044 (2006).

out of' the Shareholders Agreement and must be decided in arbitration pursuant to the Supreme Court's Buckeye decision.

Defendants' Motion to Compel Arbitration or, in the Alternative, for Leave to File Amended Answer With Counterclaims, pp. 3-4 (CP 392-93) (emphasis added). There can be no reasonable dispute that any claim that goes to the validity and enforceability of the 2004 Shareholders Agreement as a whole, and related counterclaims and defenses, must be heard by an arbitrator.

V.

CONCLUSION

The trial court erroneously denied Appellants' motion to arbitrate the claims, counterclaims, and defenses that "arise out of," and therefore fall within the ambit of, the arbitration clause in the 2004 Shareholders Agreement. Appellants respectfully request that this Court reverse the trial court's ruling and remand the matter, so that those claims contemplated by the arbitration clause in Section 6.5 of the 2004 Shareholders Agreement can be heard and decided by an arbitrator.

RESPECTFULLY SUBMITTED this 29<sup>th</sup> day of January, 2007.

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DIVISION II, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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LARRY NELSON and BARBARA NELSON,

Plaintiffs/Respondents

v.

WESTPORT SHIPYARD, INC.; J. ORIN EDSON  
and CHARLENE EDSON; and DARYL  
WAKEFIELD and KIM WAKEFIELD,

Defendants/Appellants

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ON APPEAL FROM GRAYS HARBOR COUNTY SUPERIOR COURT  
(Hon. F. Mark McCauley)

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DECLARATION OF SERVICE

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I, Kathryn Savaria, declare under penalty of perjury as follows:

1. I am now and at all times herein mentioned, a citizen of the United States and resident of the State of Washington, over the age of eighteen years, not a party to the above-captioned action, and competent to testify as a witness.

2. I am employed with the law firm of Lane Powell PC, 1420 Fifth Avenue, Suite 4100, Seattle, Washington.

3. On January 29, 2007, I caused to be served true copies of the following documents:

Appellants' Opening Brief

on the following parties in the manner as indicated below:

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STATE OF WASHINGTON  
BY \_\_\_\_\_ DEPUTY  
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DIVISION II

The foregoing statements are made under penalty of perjury under the laws of the State of Washington and are true and correct.

Signed at Seattle, Washington, this 29th day of January, 2007.

Kathryn Savaria  
Kathryn Savaria