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T3 Enterprises, Inc. v. Safeguard Business Systems, Inc. Appellant's Brief Dckt. 45093

IN THE SUPREME COURT OF THE STATE OF IDAHO

T3 ENTERPRISES, INC., an Idaho corporation,

Plaintiff-Respondent,

vs.

SAFEGUARD BUSINESS SYSTEMS, INC., a Delaware corporation,

Defendant-Appellant.

Supreme Court Docket No. 45093-2017

Ada County No. CV-OC-2014-16400

APPELLANT'S BRIEF

Appeal from the District Court of the Fourth Judicial District for Ada County
Honorable Steven Hippler, District Judge, Presiding

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TABLE OF CONTENTS

TABLE OF CASES AND AUTHORITIES

Cases

Statutes

Rules

Other Authorities

STATEMENT OF THE CASE

This case involves an action by Respondent T3 Enterprises, Inc. ("T3") brought against Appellant Safeguard Business Systems, Inc. ("SBS") for breach of contract, tortious interference, conversion, deceptive trade practices, and accounting, which was required to be arbitrated pursuant to the parties' contract. On appeal, SBS challenges an irrational and excessive $4.3 million arbitration award that resulted from: (i) legal errors by the District Court regarding jurisdiction, forum selection, and attorney-client privilege, and (ii) the arbitrators exceeding their powers under the Federal Arbitration Act, 9 U.S.C. §§ 1 et seq. (the "FAA").

SBS is a Dallas-based company engaged in selling products to small businesses through a nationwide network of distributors. T3 is a distributor in Idaho that was required to arbitrate any disputes with SBS through a Dallas-administered arbitration under Texas substantive law. Due to an erroneous jurisdictional ruling by the District Court, however, T3's claims were instead ordered to be arbitrated in Boise before three attorney-arbitrators who had no prior experience with Texas law. That improperly-formed panel proceeded to disregard—and at times outright flout—Texas law to award $1.475 million in damages (plus $2.886 million in *doubled* attorneys' fees and expenses), relying largely on attorney-client privileged information the District Court had incorrectly ordered SBS to previously disclose. In addition, the award inconsistently provides future damages for 8-12 years as if the contract continued in force while declaring the contract "constructively terminated" under non-Texas law to award T3 the entire value of its business in a duplicative way. The resulting $4.3 million award thus far exceeds the contractual limit of "actual damages for commercial loss," particularly considering that T3's business grew 5-9% each year *after* the alleged breaches. [*See* R. 19632.] Such an inexplicable result reflects a panel that exceeded its power, committed manifest disregard of Texas law, and acted irrationally. This Court, exercising its *de novo* review, should vacate the award in full.

COURSE OF PROCEEDINGS

On August 26, 2014, T3 filed suit in Ada County district court alleging claims against SBS and others for breach of contract, tortious interference, conversion, deceptive trade practices, and accounting (the "District Court Action"). [R. 56.] In an amended complaint, a separate Safeguard distributor in Idaho—Thurston Enterprises, Inc. ("Thurston")—joined the District Court Action with its own claims against SBS and other defendants. [R. 273.][1]

On October 21, 2014, SBS answered and moved to enforce an arbitration clause in T3's contract requiring the claims against SBS to be arbitrated in Dallas through a proceeding administered by the American Arbitration Association's ("AAA") Dallas office. [R. 755-770, 7718-19 (¶ 21(B)).] T3 opposed on the basis that the Dallas proceeding it agreed to was unconscionable and against Idaho public policy. [R. 771-89.] After briefing, the District Court incorrectly determined it had jurisdiction to consider T3's objections and further erred by holding that Texas law would invalidate a Dallas forum, ultimately ordering the arbitration to occur in Idaho instead. [R. 987-88, 994.] As a result, in early 2015, T3 initiated an arbitration styled as *T3 Enterprises, Inc. v. Safeguard Business Systems, Inc.*, AAA No. 01-15-0002-6860, with the AAA's Denver office (the regional office for Idaho) as administered by Lance Tanaka (the "Arbitration"). [R. 7576, 7606, 7661.] Mr. Tanaka then formed a tribunal of three attorney-arbitrators—Maureen Beyers of Arizona, the Honorable Kenneth Kato (Ret.) of Washington, and Van Elmore of Colorado (the "Panel") [*see* R. 7576]—who, as reflected in their resumes, had no previous experience with Texas law. [*See* R. 13822-29.]

Thereafter, the parties agreed that discovery in the District Court Action (as determined under ordinary standards of Idaho law) could be used in the Arbitration. [R. 7597-98.]

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[1] SBS separately appeals a trial judgment in favor of Thurston (see Docket No. 45092-2017).

Accordingly, on March 24, 2016, the District Court issued an order that impacted both the court and arbitration proceeding by rejecting SBS's attorney-client privilege for thirty-five (35) internal communications between its General Counsel and employees/agents. [R. 2219-27.] As reflected in Issue 2 below, the Panel heavily relied on those documents in issuing its award.

On July 22, 2016, pre-hearing briefs were submitted in the Arbitration [R. 7814-39, 7842-71] and then evidentiary hearings were held in Boise in August 2016. [R. 8110 at 1:23-25.] At the conclusion of the hearings, the Panel requested limited additional briefing from the parties and proposed findings of fact/conclusions of law, which were simultaneously submitted by both parties on September 16, 2016. [R. 7949-70, 7972-8022, 8024-40, 8042-8108.]

Shortly thereafter, on October 5, 2016, the Panel issued an "<u>Interim Award</u>" finding SBS liable for breach of contract, tortious interference, and deceptive trade practices [R. 8143 at 34:12-14], and awarded the same damages for each theory allocated as follows: (i) $321,657.77 in past lost commissions; (ii) $373,473.76 in speculative future lost commissions for 8-12 years; (iii) $212,432.39 in so-called "preferential pricing" damages; and (iv) $566,143.61 for the entire value of T3's distributorship based on a "constructive termination" theory under New Jersey and Connecticut statutes. [R. 8135 (¶ 101), 8138 (¶¶ 112, 133).] After the Interim Award was issued, SBS immediately raised a question to the Panel regarding how such a constructive termination ruling would impact T3's post-termination contractual obligations (including a non-compete and requirement to return SBS's intellectual property and confidential information). [*See* R. 8148.] In response, T3 asserted it was electing to be fully discharged from the contract and would return only certain intellectual property. [*See* R. 8146-47.] On October 17, 2016, the Panel accepted T3's election in full and issued a "<u>Supplement to Interim Award</u>" [R. 8150-52] that required the return of intellectual property as agreed by T3, but otherwise "excused" T3 from having to comply with any of its post-termination obligations. [R. 8151-52 (¶¶ 136-138).] In particular, the

Panel improperly awarded T3 the customer lists and confidential information that, as plainly stated in the contract [*see* R. 7715 (¶ 13)], belongs to SBS. [*See* R. 8152 at 3:2-4].

On November 28, 2016, the Panel issued a ("Fee Order") that granted an additional $2,449,208.14 in attorneys' fees (after a 2.0x doubling of the "actual" incurred amount) and $437,126.28 in litigation expenses that are not recognized by Texas law. [R. 8263 at 7:4-12.]

On December 5, 2016, the Panel consolidated all its previous rulings into a Final Award of $4,362,041.95 (the "Arbitration Award") [R. 8266-67], which T3 immediately sought to confirm in the District Court Action while shortening the time to brief a motion to vacate based on a contention that the Arbitration Award would have *res judicata* effect in the ongoing trial of T3's separate claims for tortious interference against SBS's indirect parent company, the Deluxe Corporation ("Deluxe"). [*See* R. 45.] SBS's motion to vacate the award was thus filed on December 9, 2016, [R. 7662-8307] with opposition and reply briefs filed on December 12th and 19th, respectively. [R. 9059-75.] The District Court later stated it would withhold any ruling until after trial (where T3 failed to prove its tort claims against Deluxe [*see* R. 9135]). The parties thus agreed to an oral hearing on the motion to vacate/modify that occurred on February 21, 2017.

On March 29, 2017, the District Court denied SBS's motion to vacate and confirmed the Arbitration Award in full [R. 12739-53], then issued a final judgment confirming T3's award on May 5, 2017. [R. 12934-37.] SBS filed a notice of appeal on May 5, 2017 as well (which was last amended on August 16, 2017). [*See* R. 12938-97, 13630-13829.]

STATEMENT OF FACTS[2]

T3 is an Idaho corporation principally owned by Dawn Teply that entered into a distribution contract with SBS dated July 28, 2006 (the "Distributor Agreement"). [R. 7703, 7720.] The contract had an initial five-year term that was never renewed and thus, after 2011, expressly existed on a "month-to-month" basis. [R. 7711 (¶ 10(F)).] Indeed, as acknowledged by T3 in the arbitration hearings, the contract was terminable at will by either party. [R. 7877-78 at 1261:18-1262:2.] Under the Distributor Agreement, T3 is entitled to a commission of 30-35% on completed sales for the order of products it successfully solicits from customers and also receives a benefit of "account protection." [*See* R. 8112-13 (¶ 5).] Account protection gives a distributor the exclusive right to "commissions" generated on the sale of defined products to customers whom the distributor is first to establish a relationship with and maintain as active accounts. [*See* R. 8114 (¶ 4).] The right originated in the 1970's when there was only one billing point for each small business customer and one category of traditional paper products (*i.e.*, checks and forms) sold, without being updated through the years to address any technological changes or product growth in the industry. [*See* R. 5461-66 (arbitration testimony).]

The Distributor Agreement further contains key provisions concerning arbitration, choice of law, and limitations on remedies, the most relevant of which include:

- **Paragraph 21(B):**

> … ALL CONTROVERSIES, DISPUTES OR CLAIMS … ARISING OUT OF … (2) THE RELATIONSHIP OF THE PARTIES HERETO; (3) THE VALIDITY OF THIS AGREEMENT OR ANY RELATED AGREEMENT, OR ANY PROVISION THEREOF … *SHALL BE* SUBMITTED FOR ARBITRATION TO BE *ADMINISTERED BY THE DALLAS, TEXAS OFFICE*

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[2] These "facts" are derived largely from the Panel's Interim Award. SBS cites them solely for purposes of this appeal (and due to the limited review under the FAA) while reserving all rights to deny and disprove the Panel's inaccurate fact findings in any remand or other proceedings.

OF THE AMERICAN ARBITRATION ASSOCIATION ON DEMAND OF EITHER PARTY. SUCH ARBITRATION PROCEEDINGS *SHALL BE CONDUCTED IN DALLAS, TEXAS* …. [R. 7718-19 (emphasis added).]

- **Paragraph 18:**

… All matters relating to arbitration will be governed by the Federal Arbitration Act (9 U.S.C. §§ 1 et seq.). … [T]his Agreement, the distributorship and the relationship between you and Safeguard will be *governed and construed under and in accordance with the laws of Texas* …. [R. 7717 (emphasis added).]

- **Paragraph 17(C):**

THE DAMAGES RECOVERABLE BY EITHER PARTY HERETO FOR ANY CONTROVERSY OR CLAIM … *SHALL BE LIMITED TO ACTUAL DAMAGES FOR COMMERCIAL LOSS*. NEITHER PARTY HERETO SHALL BE LIABLE TO THE OTHER FOR PUNITIVE DAMAGES …. [R. 7717 (emphasis added).]

In 2013, Safeguard Acquisitions, Inc. ("SAI")—an affiliate of SBS—purchased Form Systems Inc. d/b/a DocuSource ("DocuSource") and Idaho Business Forms ("IBF"), two larger independent distributors in the Pacific Northwest. [R. 8119 (¶ 17), 8121 (¶ 23).] Prior to the acquisitions, DocuSource and IBF were well-established multi-million dollar businesses that sold products, in part, within some of the same geographic areas of Idaho as T3. [*See* R. 8119-20 (¶ 18).] Afterwards, the acquired companies continued selling the same products to their same historical accounts, only doing so as SBS-affiliated outlets. [R. 8121 (¶ 26).] Some of those sales, however, were to the same general organizations to which T3 was also selling low-volume amounts of traditional paper products (*i.e.*, checks, envelopes, forms), but largely involved complex unique customized products/services provided to different billing contacts within the larger customer organizations. [*See, e.g.*, R. 8127 (¶¶ 58-60).] In many cases, there were pre-existing contracts between DocuSource/IBF and their larger customers that T3 could not become a party to or properly service.

Once the acquisitions were completed in 2013, SBS's General Counsel (Michael Dunlap) attempted to negotiate with T3 regarding account protection rights related to DocuSource/IBF's ongoing sales to overlapping organizations. [*See* R. 8122 (¶ 32).] Summarizing due to the limited grounds for review of an arbitration award, the result of the negotiations were that T3 ended up selling its account protection rights as to some customers back to SBS while not agreeing to do so for others when it decided to file suit in August 2014. [*See, e.g.*, R. 8134 (¶ 95).] Notably, there was no evidence in the Arbitration that T3 suffered a loss at any time in regard to its own historical commission levels as a result of the acquisitions. To the contrary, T3's own profits indisputably grew after the acquisitions. In 2010, its commissions were $168,786.53 and increased each year thereafter as follows: $171,786.53 (+1.78%) in 2011; $181,300.37 (+5.54%) in 2012; $191,059.10 (+5.38%) in 2013; $199,458.03 (+4.40%) in 2014; and $219,354 (+9.98%) in 2015. [R. 8128-29 (¶ 68).] Further, T3 remained a distributor during the Arbitration hearings in August 2016 (as it does to this day) and, again, its commissions had increased by that point to more than $220,000 for the year of 2016. [R. 8129 (¶ 68).] As such, what T3 sought to recover by its claims was not any actual loss to its own historical business, but the *gross profits* (not "commissions") on sales by DocuSource/IBF, regardless of whether those unique product or service sales were for business T3 never offered or was able to service, or were provided to completely different areas of the greater customer organizations at issue under different existing contracts and to different billing contacts.

As set out in the Course of Proceedings, the Panel ultimately awarded $4.3 million to T3 not only for the alleged actual loss (*i.e.*, the gross profit on sales by DocuSource/IBF) but also the entire alleged current market value of T3's business, plus speculative future losses for "8 to 12 years," and doubled attorneys' fees and litigation expenses in total disregard of Texas law.

ISSUES PRESENTED ON APPEAL

1. Whether the District Court's decision to strike the Dallas arbitration process was an error that requires vacating the award in full.

2. Whether the District Court's overruling of SBS's claim of attorney-client privilege was an error that requires vacating the award in full.

3. Whether the District Court erred in denying SBS's motion to vacate the award based on the Arbitration Panel exceeding its powers under FAA § 10(a)(4).

STANDARDS OF REVIEW

Issue 1 raises issues of jurisdiction and arbitrability, which are questions of law over which this Court exercises free review. *See Wattenbarger v. A.G. Edwards & Sons, Inc.*, 150 Idaho 308, 315, 246 P.3d 961, 968 (2010); s*ee also H.F.L.P., LLC v. City of Twin Falls*, 157 Idaho 672, 678, 339 P.3d 557, 563 (2014). Subject matter jurisdiction may be raised at any time, including on appeal, and cannot be waived. *See Johnson v. Blaine Cty.*, 146 Idaho 916, 924, 204 P.3d 1127, 1135 (2009); *Troupis v. Summer*, 148 Idaho 77, 79, 218 P.3d 1138, 1140 (2009).

Rulings on discovery matters—such as attorney-client privilege for Issue 2—are subject to a trial court's sound discretion. *See Vaught v. Dairyland Ins. Co.*, 131 Idaho 357, 360, 956 P.2d 674, 677 (1998). To determine if there was an abuse of discretion, this Court considers whether the trial court: (1) correctly perceived the issue as one of discretion; (2) acted within the outer boundaries of its discretion and consistently with legal standards; and (3) reached its decision by an exercise of reason. *See Perry v. Magic Valley Reg'l Med. Ctr.*, 134 Idaho 46, 51, 995 P.2d 816, 821 (2000). Evidentiary matters are further subject to the requirement that an error must have affected a party's substantial right. *Id*.

Review of the Arbitration Award for purposes of Issue 3 is governed by the FAA, which applies to all arbitrations affecting interstate commerce or, pursuant to the parties' choice of Texas law, by their agreement that the FAA would govern arbitration. *See Hecla Mining Co. v. Bunker Hill Co.*, 101 Idaho 557, 561, 617 P.2d 861, 865 (1980) (when interstate commerce is involved, this Court "utilize[s] the [FAA] and the cases thereunder instead of Idaho's enactment of the Uniform Arbitration Act."); *In re Kellogg Brown & Root*, 80 S.W.3d 611, 617 (Tex. App. 2002) ("We hold that when, as here, the parties agree to arbitrate under the FAA, they are not required to establish that the transaction at issue involves or affects interstate commerce."). The grounds for vacating an award under the FAA include when "the arbitrators exceeded their powers," 9 U.S.C. § 10(a)(4), which is interpreted by federal courts to occur when:

- <u>Arbitrators disregard the parties' choice of law</u>, *see Coutee v. Barington Capital Grp., L.P.*, 336 F.3d 1128, 1134 (9th Cir. 2003) ("Arbitrators act beyond their authority if they fail to adhere to a valid, enforceable choice of law clause agreed upon by the parties.");

- <u>Arbitrators exhibit a "manifest disregard"[3] of the controlling law</u>, *see Comedy Club, Inc. v. Improv W. Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2009), <u>including by disregard of undisputed facts</u>, *see Coutee*, 336 F.3d at 1133 (courts cannot "confirm an arbitration award that is legally irreconcilable with the undisputed facts" and, "because facts and law are often intertwined, an arbitrator's failure to recognize undisputed, legally dispositive facts may properly be deemed a manifest disregard for the law");

- <u>The award violates an express limitation in the parties' contract</u>, *see Mich. Mut. Ins. Co. v. Unigard Sec. Ins. Co.*, 44 F.3d 826, 830 (9th Cir. 1995); *21st Century Fin. Servs., LLC v. Manchester Fin. Bank*, 747 F.3d 331, 336 (5th Cir. 2014) ("Where arbitrators act contrary to express contractual provisions, they have exceeded their powers.");

- <u>The award contains an inconsistency that renders it "completely irrational</u>," *see Comedy Club, Inc.*, 553 F.3d at 1288 (9th Cir. 2009); or

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[3] After the U.S. Supreme Court's *Hall Street* decision in 2008, some federal appellate circuits questioned whether "manifest disregard" remains valid. The Ninth Circuit and a majority of others hold it is still valid because, in essence, manifest disregard was always interpreted as one way an arbitrator exceeds their power under FAA § 10(a)(4). *See, e.g.*, *Comedy Club*, 553 F.3d at 1289-90. A minority of federal circuits no longer use the phrase as a "term of art" because they had interpreted manifest disregard to be a "nonstatutory" ground. *See, e.g.*, *Citigroup Glob. Mkts., Inc. v. Bacon*, 562 F.3d 349, 358 (5th Cir. 2009). For this appeal, SBS relies upon the statutory-based standards of manifest disregard approved by the majority of federal circuits.

- The award grants relief that offends public policy, *see Aramark Facility Servs. v. Serv. Emps. Int'l Union*, 530 F.3d 817, 823 (9th Cir. 2008) ("However, one narrow exception to this generally deferential review is the now-settled rule that a court need not, in fact cannot, enforce an award which violates public policy.").

An appellate court's review of an arbitration award under the FAA is *de novo* in all regards. *See Collins v. D.R. Horton, Inc.*, 505 F.3d 874, 879 (9th Cir. 2007).

COSTS AND ATTORNEYS' FEES ON APPEAL

Pursuant to I.A.R. 40, SBS requests an award of its costs on appeal. SBS does not seek an award of attorneys' fees on appeal because neither the FAA nor Texas law allows fees to be recovered for post-arbitration proceedings. [*See, e.g.*, R. 12903-05 (district court rejecting T3's request for attorneys' fees on same basis and citing authority).]

ARGUMENT

I. THE DISTRICT COURT'S DECISION TO STRIKE THE DALLAS ARBITRATION PROCESS WAS AN ERROR THAT REQUIRES VACATING THE AWARD IN FULL.

The Distribution Agreement between T3 and SBS mandates that any dispute be arbitrated in Dallas, Texas, in a proceeding administered by the Dallas office of the AAA. [R. 7718-19 (¶ 21(B)).] Texas law was chosen to govern all substantive state law matters with the FAA governing all arbitration matters. [R. 7717.] Accordingly, shortly after T3 filed suit, SBS moved to compel arbitration under the FAA. T3 responded by arguing the Dallas forum was unconscionable and against Idaho public policy and, ultimately, that the entire arbitration agreement was unenforceable. [*See* R. 773-82, 963-67.] The District Court denied T3's request to annul the entire arbitration clause, but struck the Dallas forum. [*See* R. 986-89, 994.]

The District Court's ruling was erroneous for two reasons: (i) the District Court did not have jurisdiction to address T3's objection to forum and (ii) there is no support for the legal conclusion that a Texas court would invalidate a Dallas forum on the basis of Idaho law when the parties agreed Texas law would govern the contract. The District Court's error substantially prejudiced SBS by eliminating the arbitration process agreed to by the parties in their contract (*i.e.*, administration by the Dallas office of the AAA in Dallas), and must be vacated in full.

A. The District Court Did Not Have Jurisdiction to Rule on the Forum, Rendering the Entire Arbitration Proceeding in Idaho Invalid.

After SBS's motion to compel arbitration was filed in 2014, the District Court appropriately questioned, *sua sponte*, if it had jurisdiction to consider T3's argument that the Dallas forum was unconscionable or against public policy [*see* R. 978], but then incorrectly answered that question. In its order of December 17, 2014, the District Court first noted (properly) that FAA § 2 provides an arbitration agreement is enforceable unless subject to being revoked under a "generally applicable contract defense" [R. 980], and acknowledged substantial federal case law providing that procedural matters such as forum are for an arbitrator to decide. [R. 981 (citing cases).] However, the District Court distinguished that federal law on the grounds that none involved a challenge to forum by way of a generally applicable contract defense [R. 983], ultimately concluding: "where a forum selection clause is challenged pursuant to a contract defense, the issue becomes a substantive one for the court to decide rather than a matter of procedure for the arbitrator," and deeming T3's challenge a substantive one because it "place[d] the *validity* of the entire arbitration clause at issue." [R. 983-84 (emphasis added).]

That ruling was incorrect because Section 21(B)(3) of the Distributor Agreement provides that disputes concerning the "validity" of the agreement were themselves committed to arbitration [*see* R. 7718 (¶ 21(B)) ("… (3) THE VALIDITY OF THIS AGREEMENT … OR ANY PROVISION THEREOF … SHALL BE SUBMITTED FOR ARBITRATION" in Dallas)], and T3 did not raise any general contract defense to that specific delegation provision.

As such, the District Court had no jurisdiction to order the arbitration occur in Idaho. T3's objection to forum was supposed to be arbitrated in a proceeding administered from Dallas.

The conclusion that the District Court did not have jurisdiction is mandated by the U.S. Supreme Court's decision in *Rent-A-Center, W., Inc. v. Jackson,* 561 U.S. 63 (2010). In *Rent-A-Center*, the plaintiff similarly challenged an agreement to arbitrate on the basis it was unconscionable (under Nevada law) and the Ninth Circuit similarly decided, like the District Court here, that when "a party challenges an arbitration agreement as unconscionable, and thus asserts that he could not meaningfully assent to the agreement, the threshold question of unconscionability is for the court." *Id.* at 66-67. The U.S. Supreme Court reversed, however, because the contract contained a provision requiring disputes over the enforceability of the agreement to themselves be arbitrated in the first instance. *Id.* at 72-75 (labeling such a clause a "<u>delegation provision</u>"). Further, it mattered none that the delegation provision was part of a larger arbitration agreement challenged in whole as unconscionable by the plaintiff, because:

> Section 2 [of the FAA] operates on the <u>*specific*</u> "written provision" to "settle by arbitration a controversy" that the party seeks to enforce. Accordingly, unless Jackson challenged *the delegation provision* <u>*specifically*</u>, we must treat it as valid under § 2, and must enforce it under §§ 3 and 4, leaving any challenge to the validity of the [arbitration agreement] as a whole for the arbitrator.

Id. at 72 (emphasis added, clarification in brackets).[4] The same is true here. The delegation provision in Paragraph 21(B)(3) was not specifically challenged. [*See* R. 773-82.]. T3's objection to forum thus also had to be arbitrated in a proceeding administered by the AAA's Dallas office.

[4] *See also Tompkins v. 23andMe, Inc.*, 840 F.3d 1016, 1032 (9th Cir. 2016); *Parnell v. CashCall, Inc.*, 804 F.3d 1142, 1148 (11th Cir. 2015) (language requiring arbitration of "any issue concerning the validity, enforceability, or scope" of contract was delegation provision); *Danley v. Encore Capital Grp., Inc.*, 680 F. App'x 394, 397 (6th Cir. 2017) (same).

Consequently, the District Court's order to arbitrate in Idaho was invalid due to a lack of jurisdiction. *See Kantor v. Kantor*, 160 Idaho 803, 808, 379 P.3d 1073, 1078 (2016) ("judgments and orders made without subject matter jurisdiction are void"). The resulting Arbitration Award is void and must be vacated in full. *See, e.g., State v. Hartwig*, 150 Idaho 326, 328, 246 P.3d 979, 981-83 (2011) (vacating civil order issued in criminal case when court did not have jurisdiction); *see also Lower Colo. River Auth. v. Papalote Creek II, LLC*, 858 F.3d 916, 927 (5th Cir. 2017) (vacating arbitration award when district court did not have jurisdiction).

B. Alternatively, the District Court Erred as to Texas Law on Forum Selection and Thereby Violated Section 5 of the FAA.

Even if the District Court had jurisdiction to rule on the validity of the Dallas forum selection, it erred as a matter of law on the merits of that legal issue in a way that negated SBS's right to a Dallas-administered arbitration, which is a violation of FAA § 5 requiring vacatur.

In its December 17, 2014, order addressing the merits of the forum issue, the District Court first correctly ruled the parties validly chose Texas law—not Idaho law—to govern their dispute and that their choice of law must be enforced. [*See* R. 984-86 (citing I.C. § 28-1-301(a)).] Nevertheless, after concluding Idaho law did not apply, the District Court then went on to rule that a Texas court (applying Texas law) would invalidate the Dallas forum based on an Idaho statute (I.C. § 29-110(1) (hereinafter, the "Arbitration in Idaho Only Statute" or "AIO Statute")). [*See* R. 986-89.] That conclusion of law was an error. To illustrate, it is useful to break the District Court's circular analysis into its four component parts, which were:

1. I.C. § 28-1-301(a) requires enforcing the choice of Texas law. [R. 984-86.]
2. Texas has adopted *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) (hereinafter, "*The Bremen*") to assess forum selection clauses. [R. 987.]
3. *The Bremen* states that, for a forum selection clause to be valid, it must not contravene a strong public policy "**either** in the forum where the suit would

be brought, **or the forum from which the suit has been excluded**." [R. 987 (bolding added to reflect error in District Court's quotation of law).]

4. Texas law would apply *The Bremen*—as misquoted above—to rule the AIO Statute (I.C. § 29-110(1)) invalidates a Dallas forum. [R. 987-89.]

As highlighted in bold above, the District Court made a conspicuous error in its quotation of law. *The Bremen* does not consider the public policy of an "excluded" forum. *See* 407 U.S. at 15. Rather, the "excluded" language incorrectly attributed to *The Bremen* by the District Court comes solely from a Florida appellate court.[5] As discussed further below, that inaccuracy led the District Court to misapply Texas law on forum selection clauses (*i.e.*, No. 4 above).

On a more basic level, however, the District Court erred in how it did not give proper effect to Idaho's choice of law statute, I.C. § 28-1-301(a). It appears the District Court was under the unwarranted impression that the AIO Statute applies to every arbitration clause considered by an Idaho court regardless of an express choice-of-law provision. Nothing in the Idaho Code provides for such a broad application. Certainly a contract between two out-of-state parties brought to an Idaho court for adjudication (due perhaps to general jurisdiction), would not result in application of the AIO Statute to invalidate their agreement to arbitrate elsewhere. To the contrary, it would be the substantive law that *governs* the contract which controls. *See, e.g.*, *Sizemore v. Gulf Stream Coach, Inc.*, No. 1:11-CV-00511-MHW, 2012 WL 13041446, at *4 (D.

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[5] The District Court's misquote is derived from its reliance on *Cerami-Kote, Inc. v. Energywave Corp.*, 116 Idaho 56, 59, 773 P.2d 1143, 1146 (1989), a case involving Florida law, to make an improper assumption about Texas law. *Cerami-Kote* cited a Florida appellate case that, for unknown reason, added the "excluded" forum language to its citation of *The Bremen*. *See Maritime Ltd. P'ship v. Greenman Advert. Assocs., Inc.*, 455 So. 2d 1121, 1123 (Fla. Dist. Ct. App. 1984). But no "excluded" forum language exists in *The Bremen* or the Florida Supreme Court case that *Cerami-Kote* actually relied upon. *See Cerami-Kote*, 116 Idaho at 59 (citing *Manrique v. Fabbri*, 493 So. 2d 437, 438 (Fla. 1986)). More importantly, no Texas case has expanded on *The Bremen* like the Florida appellate court did in *Maritime*. Texas law plainly does not consider an "excluded" forum's policies when assessing a forum selection clause.

Idaho May 9, 2012) (finding AIO Statute inapplicable when parties selected Indiana law); *see also Fisk v. Royal Caribbean Cruises, Ltd.*, 141 Idaho 290, 108 P.3d 990 (2005) (rejecting AIO Statute when federal maritime law governed).[6] The same result should occur here due to the parties' choice of Texas law. When another state's law is selected in compliance with I.C. § 28-1-301(a), then the rest of Idaho law no longer applies (and, further, subsection (b) of I.C. § 28-1-301 lists statutes that survive the choice of law, but does not include the AIO Statute). As a result, given the parties' valid choice of Texas law—as the District Court ruled [*see* R. 984-86] and T3 never disputed [*see* R. 774]—there was no basis for applying the AIO Statute.

The District Court accordingly erred in concluding Texas law would apply the AIO Statute to invalidate a Dallas arbitration forum. As explained in footnote 5 above, the District Court erred in relying on Florida law to make its legal conclusion. The Texas cases cited (but not applied) by the District Court uniformly are guided by the public policy of Texas when analyzing forum selection clauses. [*See* R. 987-88 (District Court's order citing *In re Lyon Fin. Servs., Inc.*, 257 S.W.3d 228, 231-32 (Tex. 2008); *In re AIU Ins. Co.*, 148 S.W.3d 109, 111-13 (Tex. 2004)).] And, in Texas, there is no policy limiting where parties can arbitrate. To the contrary, Texas law has a very strong preference for enforcing forum selection clauses, even if it may otherwise impair substantive rights. *See, e.g.*, *In re Lyon*, 257 S.W.3d at 234 (holding inability to assert usury claim in Pennsylvania did not create public policy basis to deny enforcement of forum selection); *Young v. Valt.X Holdings, Inc.*, 336 S.W.3d 258, 263-66 (Tex. App. 2010) (enforcing forum selection clause claimed to contradict federal policy of anti-waiver of securities laws,

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[6] *See also Oregon-Idaho Utils., Inc. v. Skitter Cable TV, Inc.*, No. 1:16-CV-00228-EJL, 2017 WL 3446290, at *7 (D. Idaho Aug. 10, 2017) (noting that, if the AIO Statute "was determinative, striking down the forum selection clause would be routine rather than extraordinary, standing *Atlantic Marine* on its head.") (citations omitted).

noting plaintiff was free to reject contract on front end if it desired such protections); s*ee also Univ. Comput. Consulting Holding, Inc. v. Hillcrest Ford Lincoln-Mercury, Inc.*, Nos. 14-04-00819-CV, 14-04-01103-CV, 2005 WL 2149508, at *5 (Tex. App. Sept. 8, 2005) (rejecting *The Bremen* challenge to uphold out-of-state arbitration forum).

Further, an even more stringent rule of enforcement applies when a party seeks to avoid an arbitration forum it agreed to when the FAA governs. *See, e.g., Northrop Grumman Ship Sys., Inc. v. Ministry of Def. of Republic of Venezuela*, 575 F.3d 491, 503 (5th Cir. 2009) (arbitration-forum clauses "must be enforced, even if unreasonable" under *The Bremen*, given FAA's preemption of state law) (citations omitted).

As a result, even if the District Court had jurisdiction to rule on T3's objections to forum, the District Court erred as to its conclusions of Texas law. SBS and T3 specifically agreed, in bold all-capital terms, that all disputes would be decided in a Dallas-administered AAA arbitration in Dallas. [R. 7718 (¶ 21(B)).] The District Court negated that right by ordering the arbitration to occur in Idaho. [*See* R. 994.] As a jurisdictional matter, the Arbitration Award must be vacated because the entire Idaho proceeding was invalid. To the extent the District Court had jurisdiction and only erred as to Texas law, the outcome nonetheless is the same under FAA § 5.

Section 5 of the FAA states that, "[i]f in the [arbitration] agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method ***<u>shall</u>*** be followed." (emphasis added). A failure to strictly comply with the process required by a contract requires any subsequently-issued award to be vacated. For example, in *PoolRe Ins. Corp. v. Org. Strategies, Inc.*, 783 F.3d 256 (5th Cir. 2015), the Fifth Circuit vacated an award where the arbitrator was not selected by the B.W.I. Insurance Director of Anguilla as stated in the parties' contract, even though no such person actually existed. The Fifth Circuit found the procedural defect nonetheless fatal, holding that "awards made by arbitrators not appointed under the method provided in the parties' contract *must be vacated*." *Id.* at 263 (emphasis added). Several other federal circuits have held the same way for various procedural defects.[7]

The only basis not to vacate an award under FAA § 5 is due to a "trivial departure" or when a party waives the process required by the contract. Neither is at issue here. Arbitration is a matter that arises solely through the consent of the parties. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 682 (2010) (reciting principle and precedent). As a result, the failure to strictly follow the exact procedure stated in the parties' contract is always a non-trivial violation. A "trivial departure" occurs only in tangential ways outside the contract language itself, such as when an arbitration organization selected by the parties fails to follow its internal procedures. *See, e.g.*, *Bulko v. Morgan Stanley DW Inc.*, 450 F.3d 622, 625 (5th Cir. 2006) (failure of NASD to follow its own qualification standards trivial; distinguishing from cases where method for selecting arbitrators stated in parties' agreement). Further, a waiver of strict compliance with the process stated in an arbitration agreement occurs only when an aggrieved party's objection is not preserved by either: (i) raising it to the arbitrators, <u>*or*</u> (ii) an adverse court ruling. *See Brook v. Peak Int'l, Ltd.*, 294 F.3d 668, 674 (5th Cir. 2002), *opinion modified on reh'g* (July 9, 2002).

Here, there was no "trivial departure" because the Distributor Agreement explicitly states the arbitration was to be administered by the AAA's Dallas office and occur in Dallas, but, as a result of the District Court's order, it was administered by the AAA's Denver office (the regional office for Idaho) [*see* R. 7576, 7606, 7661 (Lance Tanaka in Denver)] and occurred in Boise. That failure alone requires vacating the Arbitration Award under FAA § 5. Nonetheless,

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[7] *See, e.g.*, *Cargill Rice, Inc. v. Empresea Nicaraguense Dealimentos Basicos*, 25 F.3d 223, 226 (4th Cir. 1994) (vacating award when contract required arbitrators appointed by mutual agreement and it was done without party input); *Avis Rent A Car Sys., Inc. v. Garage Emps. Union, Local 272*, 791 F.2d 22, 25 (2d Cir. 1986) (vacating award when arbitrator was appointed pursuant to collective bargaining agreement as opposed to by AAA as required in contract).

additional prejudice exists in that, if the process stated in the contract had been followed, then the claims would have been submitted to the AAA's Dallas office and there would have been a pool of arbitrators experienced with Texas law from which to form a panel. Instead, the AAA's Denver office formed a tribunal of attorneys who had no prior experience with Texas law. [*See* R. 13822-29 (arbitrator resumes).] The result, as discussed below in Issue 3, was a Panel that manifestly disregarded the controlling Texas law and exceeded its powers to issue an irrational $4.3 million award that violated several express contractual limitations and requirements.

Finally, there is no waiver because, again, the District Court affirmatively *ordered* the arbitration to occur in Idaho. [*See* R. 994 (stating "T3 shall submit its claims against SBS for arbitration in Idaho").] SBS's opposition was thus fully preserved for this appeal.

Accordingly, this Court should declare the Arbitration Award void due to the District Court's lack of jurisdiction. Nonetheless, even if the District Court had jurisdiction, this Court should vacate the Arbitration Award because the District Court violated FAA § 5.

II. THE DISTRICT COURT ERRED BY OVERRULING SBS'S ATTORNEY-CLIENT PRIVILEGE, WHICH REQUIRES VACATING THE AWARD IN FULL.

Several months prior to the August 2016 Arbitration hearings, the District Court separately made an incorrect ruling on attorney-client privilege that forced SBS to disclose privileged documents which, to its prejudice, were relied on by the Panel for its award. Under well-established Idaho law and public policy, that error requires vacating the Arbitration Award.

This issue has two components: (i) whether the District Court committed legal error in its order of March 24, 2016, as to attorney-client privilege [*see* R. 2219-28], and (ii) how that error affected the Arbitration. The first component is exactly the same for SBS's separate appeal of Thurston's trial judgment. [*See* R. 13636 (ninth bullet).] Further, given T3 and Thurston jointly moved for this discovery matter to be determined by the District Court [*see* R. 1618-19], this

Court's review now is done under the ordinary standards of Idaho law as opposed to the very limited FAA review. Accordingly, the initial argument in subsection A below is identical to that in the contemporaneously-filed brief for Thurston's appeal (see pp. 17-22 of that brief). The briefs differ in that subsection B below addresses how the error affected T3's Arbitration, whereas the brief in Thurston's appeal addresses the impact on the separate trial.

A. As a Matter of Idaho Law, the District Court Erred in Overruling SBS's Assertion of Attorney-Client Privilege.

In the discovery phase of the District Court proceeding (months prior to the arbitration hearings), T3 and Thurston jointly challenged SBS's assertion of attorney-client privilege over a few hundred emails that were redacted or withheld in full. In response, SBS's trial counsel conducted a second-level review of its privilege log and, for various reasons, withdrew privilege as to all but forty-one (41) documents, which was about 90% of what was initially logged. [*See* R. 1863-67, 10272 (¶ 31) (explaining reasons for de-designation).] That left in dispute internal communications to or from Michael Dunlap, SBS's General Counsel, involving his efforts to resolve account protection with T3/Thurston. The District Court reviewed those 41 documents *in camera* and rejected privilege for nearly all on the basis that they concerned "factual matters and business advice about the cross-over customers made in Dunlap's capacity as corporate secretary rather than purely legal issues." [R. 2226.] As demonstrated below, the District Court erred as to the legal standard of attorney-client privilege and materially prejudiced SBS. Specifically, Exhibits 157, 245, 266-70, 326-30, 336, 338, 352, 356-60, 362 (the "<u>Privileged Documents</u>") were ordered produced and used by T3/Thurston in both the trial and arbitration.

The standard of review is "abuse of discretion" with the additional requirement that any error must have affected a substantial right. *See Perry v. Magic Valley Reg'l Med. Ctr.*, 134 Idaho 46, 50-51, 995 P.2d 816, 820-21 (2000). In regard to attorney-client privilege specifically, the conclusion that a substantial right was impacted by improper disclosure is virtually automatic. *See, e.g.*, *Frontier Refining, Inc. v. Gorman-Rupp Co., Inc.*, 136 F.3d 695, 706 (10th Cir. 1998) ("There is too great a risk that a jury would accord significant or undue weight to the testimony and admissions of a party's own lawyers."). Indeed, this Court has stated the prejudicial effect of such an error "is obvious." *State v. Iwakiri*, 106 Idaho 618, 621, 682 P.2d 571, 574 (1984) (ruling erroneous disclosure mandated reversal of criminal conviction).

The applicable legal standard for attorney-client privilege in Idaho is established by the rule of evidence that provides a party with a right to not disclose "confidential communications made for the purpose of facilitating the rendition of professional legal services to the client." I.R.E. 502(b). The District Court identified that rule as controlling [R. 2220], but proceeded to water it down in two ways—(i) by creating a presumption against in-house attorneys and (ii) by construing the privilege to encompass only "purely legal matters"—then misapplied that weakened standard to Dunlap's internal communications about account protection matters.

First, there is no presumption against in-house attorneys. I.R.E. 502(b) does not distinguish between inside or outside counsel and refers only to a "lawyer." Yet, the District Court unilaterally declared the standard "stricter" for an in-house counsel; so much so that it would ***presume*** their communications are ***not*** for a legal purpose. [*See* R. 2221.] That was incorrect. Nothing in I.R.E. 502 creates a presumption and the majority of courts nationwide recognize a "lawyer's status as in-house counsel does not dilute the privilege." *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754, 758 (D.C. Cir. 2014); *see also, e.g.*, *United States v. Rowe*, 96 F.3d 1294, 1296 (9th Cir. 1996) ("In determining the existence of a privilege, no attempt is made to distinguish between inside and outside counsel."). Indeed, this Court has not applied a presumption against in-house attorneys in prior cases. *See, e.g.*, *Kirk v. Ford Motor Co.*, 141 Idaho 697, 704, 116 P.3d 27, 34 (2005) (applying privilege to in-house counsel without bias).

Second, the District Court erred by construing the privilege to cover only "purely legal matters" (and doing so inconsistently between the parties). [R. 2226.] I.R.E. 502(b) states it applies to any communication made to "*facilitate* … legal services." That is much broader than the District Court allowed and, indeed, the entire reason for the privilege is to encourage "full and frank communication" between lawyer and client, *see Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981), as also reflected in the comments of the Idaho State Bar Evidence Committee:

> The rule is intended to provide the privilege to *all* communications between the attorney and client, *and to others necessary to the communication process* or the rendition of professional legal services ….

M. CLARK, REPORT OF THE IDAHO STATE BAR EVIDENCE COMMITTEE, C502, p.6 re Subsection (b) (Dec. 16, 1983, Supp. 1985) (emphasis added). That goal necessarily requires discussing facts and business matters related to legal services and, as such, courts routinely apply the privilege to "counseling and planning" and "business decision-making" when an attorney is involved due to his or her "knowledge and discretion in the law." *See United States v. Chen*, 99 F.3d 1495, 1501-02 (9th Cir. 1996).[8] Further, communications about negotiations a lawyer engages in with a third party inherently entail the discussion of non-privileged facts, but the lawyer-client communication nevertheless remains privileged. *See Studiengesellschaft v. Novamont*, No. 77 Civ. 4722, 1980 U.S. Dist. LEXIS 15042 at *5 (S.D.N.Y. Nov. 17, 1980) (ruling privilege applies to internal communications regarding attorney negotiations if dispute is "essentially a legal one involving rights and duties under … [a] contract.").[9] Thus, contrary to the

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[8] *See also Willnerd*, 2010 WL 5391270 at *3 ("Open communication assists lawyers in rendering legal advice, not only to represent their clients in ongoing litigation, but also to prevent litigation by advising clients to conform their conduct to the law and by addressing legal concerns that may inhibit clients from engaging in otherwise lawful and socially beneficial activities.").

[9] *See id.* at *5-6 (privilege applied because attorney-negotiator's "purpose was to resolve an essentially legal dispute, in circumstances marked by legal uncertainty. In those circumstances,

District Court's view, the communication of even purely *non*-legal matters is protected if the overall purpose involves a legal service. I.R.E. 502(b); *Willnerd v. Sybase, Inc.*, No. 1:09-cv-500-BLW, 2010 WL 5391270 at *3 (D. Idaho Dec. 22, 2010) (the "communication[] of facts are privileged even if the original facts are not"). Notably, the District Court recognized as much when ruling T3/Thurston's attorney agreements were not discoverable [*see* R. 2225 (noting parties can be compelled to testify as to facts "but the communication [between lawyer and client] itself remains privileged")], yet applied a different standard for SBS's privilege. It is hard to reconcile the District Court's about-face on that legal point as anything less than arbitrary.

Compared to the proper legal standard, it is clear the District Court abused its discretion in ordering the Privileged Documents produced because they are all confidential internal communications between lawyer and client representatives made in the overall context[10] of a legal service being provided by SBS's General Counsel, Michael Dunlap [*see* R. 1875-76 (¶ 5)], regardless of whether they encompassed factual or business matters. For example:

- Exhibit 245 is an email between SBS's lawyer, Dunlap, and SBS employees specifically concerning his "account protection resolution work." [*See also* Ex. 269 (referring to "IBF account protection"), Ex. 157 (containing statements from Dunlap about "honor[ing] account protection").]
- Exhibit 266 is an email between Dunlap and IBF's post-acquisition manager, Tressa McLaughlin—at a time when IBF was an affiliate of SBS—concerning

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his actions were informed by his legal expertise. That his goal may have been to make the most financially favorable deal possible for his client does not alter these facts."); *see also Boss Mfg. Co. v. Hugo Boss AG*, No. 97 CIV. 8495, 1999 WL 47324 SHS MHD, at *2 (S.D.N.Y. Feb. 1, 1999) (privilege applied to internal discussion of commercial matters because "fundamental consideration animating the discussions and counsel's involvement in those discussions was the need to protect the legal interests of Hugo Boss").

[10] *See In re Lidoderm Antitrust Litig.*, No. 14-md-02521-WHO, 2015 WL 7566741 at *3 (N.D. Cal. Nov. 25, 2015) (report by attorney of settlement negotiations protected when, "considered as a whole and in context," it was made in connection with a legal purpose).

details of the accounts Dunlap was addressing with T3. [*See also* Ex. 269 (continuation of same); Ex. 352 (Dunlap giving input on same to client).]

- Exhibit 327 is an email from Dunlap to SBS's President, J.J. Sorrenti, speaking of a "risk" in account protection interpretation he identified from his past negotiations. [*See also* Ex. 267 (Dunlap noting he was "represent[ing] his client"); Ex. 336 (Dunlap reporting thoughts to Sorrenti about negotiations with T3), Ex. 330 (same); Exs. 358, 360 (Sorrenti requesting Dunlap's review of draft communication regarding account protection).]

Certainly a few of the Privileged Documents could be interpreted to contain unflattering comments that T3/Thurston will no doubt seek to highlight [*see, e.g.*, Ex. 357 (Sorrenti expressing frustration with T3 negotiations, stating: "… She's not impressing me [and] she should be trying."); Ex. 359 (Dunlap asserting "… she doesn't have an or else")], but they all occurred within the context of efforts to resolve account protection and, thus, fall within the realm of "full and frank" discussion. Indeed, T3 and Thurston have consistently stressed that Dunlap's efforts were nothing less than an attempt to address rights and duties under their contracts [*see* Tr. Vol. I at 888:20-890:1] or to "avoid litigation" [*see* R. 4437 (Thurston Decl., ¶ 14)], which directly resulted in the Privileged Documents. [*See, e.g.*, Tr. Vol. II at 1282:2-15 (testimony regarding Exhibit 327), 1302:23-1304:21 (testimony regarding Exhibit 359).]

As a result, the District Court's characterization of Dunlap as acting in a business role in regard to the Privileged Documents, due to his secondary title of corporate secretary, was not an "exercise of reason." In-house attorneys often hold such a title, but only for record-keeping purposes. *See Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 790 n.38 (Del. Ch. 2016) (discussing duties of corporate secretary). It was not rational for the District Court to conclude that Dunlap's negotiations with T3/Thurston about account protection, and subsequent internal communications, were done as a corporate secretary rather than a lawyer. Providing a legal service was Dunlap's primary function. As expected of in-house counsel, his role in preacquisition due diligence was to assess the *legal risks* [*see* Ex. 48 at 48.9; Tr. Vol. I at 467:16-18, 1133:21-1134:10; Tr. Vol. II at 2014:19-2015:5] and then try to address those legal risks by negotiating directly with T3/Thurston. [*See* Tr. Vol. I at 371:8-21, 416:7-10.] The written agreements that resulted from those negotiations, each executed by T3 and Thurston, expressly state they were a "resolution" of account protection issues. [*See* Ex. 1009, 1063.]

Accepting the District Court's reasoning would effectively negate the ability of in-house lawyers to counsel their clients on a day-to-day basis, creating a loophole that undermines the established law and public policy favoring full and frank internal discussions between lawyers and clients. The District Court abused its discretion. This Court should: (i) reverse the District Court's order of March 24, 2016; (ii) require T3/Thurston and their counsel to return or destroy all privileged information; and (iii) vacate both the arbitration award and trial judgment.

B. The Arbitration Award Should be Vacated Because the Privileged Documents Were Used and Relied on by the Arbitration Panel.

As noted previously, the erroneous admission of attorney-client privileged material inherently prejudices the right to a fair proceeding. *See Iwakiri*, 106 Idaho at 621; *see also Frontier Refining*, 136 F.3d at 706. That consequence is logically the same regardless of whether the adjudication occurs by way of a trial or arbitration. Nevertheless, to the extent the District Court's error is subject to being treated differently in this appeal because it resulted in an Arbitration Award, the strong public policy behind attorney-client privilege still requires vacatur.

Federal courts reviewing arbitration awards have long recognized and applied a rule that they will not uphold an award if it would require a court to sanction a violation of public policy. *See Aramark Facility Servs. v. Serv. Emps. Int'l Union*, 530 F.3d 817, 823 (9th Cir. 2008) (noting it is a "now-settled rule that a court need not, in fact cannot, enforce an award which violates public policy") (citation omitted). For an arbitration award to violate public policy, there must be: (1) "an explicit, well defined and dominant policy"; and (2) "the policy should be one that specifically militates against the relief ordered by the arbitrator." *Id.* The erroneous disclosure of the Privileged Documents in this case qualifies under both prongs.

First, it is indisputable that the attorney-client privilege is a "well defined and dominant policy" under federal law, Texas law, and long-standing Idaho law.[11] Second, that dominant policy is upheld in this circumstance only by vacating the Arbitration Award because the privileged information was explicitly relied upon by the Panel for its decision-making. In fact, several Privileged Documents are directly *quoted* throughout the award:

- Exhibit 157 is quoted at Paragraphs 32, 111, and 129 of the Interim Award [R. 8122, 8137-38, 8141-42];
- Exhibit 327 is quoted at Paragraphs 32 and 111 of the Interim Award [R. 8122, 8137-38];
- Exhibit 330 is quoted at Paragraph 129 of the Interim Award [R. 8141-42]; and
- Exhibit 359 is quoted at Paragraph 128 of the Interim Award. [R. 8141.]

Accordingly, the risk identified by the Tenth Circuit in *Frontier Refining*—that a factfinder "would accord significant or undue weight to the testimony and admissions of a party's own lawyers," 136 F.3d at 706—is readily apparent from the Arbitration Award itself.

[11] *See Upjohn*, 449 U.S. at 389 ("The attorney–client privilege is the oldest of the privileges for confidential communications known to the common law.") (citation omitted); *Paxton v. City of Dallas*, 509 S.W.3d 247, 259 (Tex. 2017) ("The attorney-client privilege holds a special place among privileges: it is the oldest and most venerated of the common law privileges of confidential communications. As the most sacred of all legally recognized privileges, its preservation is essential to the just and orderly operation of our legal system. … The attorney-client privilege exists—and has been a cornerstone of our legal system for nearly 500 years—because the interests protected and secured by the promise of confidentiality are not merely significant; they are quintessentially imperative.") (citations and editing omitted); *Ex parte Niday*, 15 Idaho 559, 566, 98 P. 845 (1908) (recognizing privilege early in 1900s).

Like this Court did in *Iwakiri*, 106 Idaho at 621, it should reverse the result of the District Court's error, which, in this instance, means vacating the entire Arbitration Award.

III. THE DISTRICT COURT ERRED IN DENYING SBS'S MOTION TO VACATE THE AWARD BASED ON THE ARBITRATION PANEL EXCEEDING ITS POWER.

As noted, a substantial prejudicial consequence of the District Court's error in striking the Dallas forum and ordering the parties' to arbitrate in Idaho was the tribunal formed by the AAA's Denver office had no prior experience with Texas law. [*See* R. 13822-29.] Predictably, that Panel proceeded to ignore and misinterpret several aspects of Texas law (as well as misconstrue factual issues). Under the FAA, ordinary factual and legal errors usually cannot be corrected because, in agreeing to arbitrate, a party trades full appellate review for speed and informality. *See Moore v. Omnicare, Inc.*, 141 Idaho 809, 815, 118 P.3d 141, 147 (2005). Of course, as detailed in connection with Issue 1, SBS did not receive the Dallas-administered arbitration for which it bargained. The Arbitration Award should be vacated for that reason alone. Nonetheless, the Panel's award of $4.3 million so greatly contradicts express contractual limitations on damages, manifestly disregards the parties' choice of Texas law, and defies rationality (as well as violates public policy) that the award itself is contrary to the agreement to arbitrate. When arbitrators exceed their power in such a way, their decisions are no longer entitled to any deference. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 671 (2010) (arbitrator's "own brand of industrial justice" unenforceable); *see also PoolRe Ins. Corp. v. Org. Strategies, Inc.*, 783 F.3d 256, 262 (5th Cir. 2015) ("However, where the arbitrator exceeds the express limitations of his contractual mandate, judicial deference is at an end.").

To be clear, arbitration arises solely from—and an arbitrator's power is consequently constrained by—the agreement of the parties. Thus, the FAA provides for vacating an award "where the arbitrators exceeded their powers," 9 U.S.C § 10(a)(4), which can occur in several ways, including: not applying the parties' choice of law; violating other terms of their contract; or issuing an award contrary to public policy. [*See* Standards of Review, *supra*, pp. 9-10.] In addition, federal courts have interpreted FAA § 10(a)(4) such that an award must be vacated when an arbitrator "manifestly disregards" the law or the award is "completely irrational." This Court fully recognizes and applies those standards to an arbitration award governed by the FAA. *See Hecla Mining Co. v. Bunker Hill Co.*, 101 Idaho 557, 564-66, 617 P.2d 861, 868-70 (1980); *see also Carroll v. MBNA Am. Bank*, 148 Idaho 261, 265 n.2, 220 P.3d 1080, 1084 n.2 (2009); *Barbee v. WMA Sec., Inc.*, 143 Idaho 391, 396 n.4, 146 P.3d 657, 662 n.4 (2006).

SBS thus seeks to vacate T3's Arbitration Award on the grounds that the Panel exceeded its power and violated the FAA by: (i) ignoring the parties' choice of Texas law to declare the distributorship "constructively terminated" based on Connecticut/New Jersey statutes; (ii) irrationally ruling T3 could recover future losses as if the contract continued while also terminating the contract and excusing T3 from its post-termination obligations in the contract; (iii) awarding gross profits in manifest disregard of Texas law requiring proof of "net" loss; (iv) awarding 8-12 years of future damages despite an undisputed month-to-month term of the contract; and (v) re-writing the contract to award attorneys' fees and expenses on the basis of AAA procedural rules, and doubling the fees incurred by T3 to award an amount far beyond the express contractual limit of "actual damages for commercial loss."

If this Court does not grant relief on the basis of Issues 1 or 2, SBS requests the Court vacate the Arbitration Award under the standards of federal arbitration law.

A. The Panel Exceeded its Power by Declaring a "Constructive Termination" Based on Connecticut/New Jersey Law.

Paragraph 18 of the Distributor Agreement provides that "the distributorship and the relationship between [T3] and Safeguard will be governed and construed under and in accordance with the laws of Texas ….” [R. 7717.] Yet, the Panel paid no heed to that mandate by awarding $566,143.61 to T3 for a supposed “constructive termination” of its distributorship on the basis of non-Texas law. [R. 8134-35 at ¶¶ 97-101.] In doing so, the Panel exceeded its power.

To begin with, no party sought a constructive termination [*see* Tr. Vol. III at 684:2-15 (T3’s counsel acknowledging to District Court that the Panel came up with the termination theory on its own)].[12] Then, to support its manufactured theory, the Panel expressly relied on four cases outside of Texas law. [R. 8134-35 (¶ 98).] Two cases cited by the Panel declared a constructive termination based on other states’ statutes—Connecticut and New Jersey[13]—and the other two did not involve (or mention) termination at all.[14] Under the Ninth Circuit’s standard in *Coutee v. Barington Capital*, an arbitrator’s failure to adhere to the parties’ choice of law violates FAA § 10(a)(4) if it is not a “harmless error,” meaning the arbitrator could not have

[12] T3 did seek (not in its arbitration demand, but only in briefing later) to “revoke acceptance of the franchise and return it to Safeguard for its market value” based on Texas’s version of the Uniform Commercial Code. [*See* R. 7838, 7998 (¶ 123).] Revoking acceptance, however, is fundamentally different from termination. Revocation puts the parties back in the position they would have been had no contract formed, while termination concedes a valid contract existed. Accordingly, if the Panel had granted T3’s request for revocation, there would no distributorship to value at $566,143.61. Thus it is doubly baffling that the Panel denied T3’s “revocation” theory [*see* R. 8134-35 (¶¶ 97-98)] but nevertheless proceeded to craft a constructive termination theory on its own outside of Texas law to award T3 the entire value of its distributorship.

[13] In *Petereit v. S.B. Thomas, Inc.*, 63 F.3d 1169 (2d Cir. 1995), distributors of baked-bread products claimed they should be treated as franchisors under the Connecticut Franchise Act and argued they were “constructively terminated” when the manufacturer realigned their geographic territories. The Second Circuit affirmed a ruling that, under the Connecticut statute, the distributors were “constructively terminated.” In *Maintainco, Inc. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 408 N.J. Super. 461, 474–75, 975 A.2d 510, 518 (App. Div. 2009), a New Jersey court held it was a “constructive termination” under the New Jersey Franchise Act for a franchisor to “directly or indirectly … cancel or fail to renew a franchise without good cause.”

[14] The Panel’s reliance on *Gossard v. Adia Servs., Inc.*, 723 So. 2d 182 (Fla. 1998) and *Carvel Corp. v. Baker*, 79 F. Supp. 2d 53 (D. Conn. 1997), is puzzling. There is no termination in either.

made the same award under the proper law. 336 F.3d 1128, 1134-35 (9th Cir. 2003). Here, the Panel could not have declared a constructive termination under Texas law. Texas does not have a franchise statute and no court in Texas has approved a theory for "constructive termination" of a franchisee. Therefore, the Panel's violation was not harmless error.

At the trial court level, however, T3 argued—and the District Court accepted—a contention that, since no Texas court had affirmatively "rejected"[15] a constructive termination theory, the Panel was merely "looking to persuasive case law to determine how a Texas court may rule" if presented with the issue. [R. 12746.] That was error because no court (and certainly no arbitrator) has authority to create new ***statutory*** rights as the Panel did here and there is no authority interpreting the FAA in a way that allows an arbitrator to predict or make new law of any kind. Given that an arbitrator's power arises solely from the parties' agreement, they must apply the law chosen by the parties as it exists as opposed to speculating how a court or legislature could change, extend, or add to that law in the future because, otherwise, the parties' choice of law is eviscerated. Arbitrators would be free to disregard the chosen law at will and award whatever they want under the guise of "predicting" how that law might change in the future. This Court should not sanction such an unprecedented and limitless expansion of arbitrator power under the FAA.

[15] The District Court found it particularly relevant that SBS had "not pointed to any Texas authority contradicting or rejecting the [constructive termination] theory." [R. 12746.] SBS maintains it is not proper to require a party to prove a negative—*i.e.*, that something which does not exist in Texas law has been rejected by a court—but, when it became clear at the hearing this was an issue for the District Court, SBS requested, and was not granted, the opportunity for supplemental briefing. [*See* Tr. Vol. III at 641:10-21.] More research has since been done and, in this Court's *de novo* review, SBS notes that Texas previously had a statute applicable to certain "dealer agreements" similar to the New Jersey and Connecticut statutes, but it was repealed in 2011. *See* TEX. BUS. & COMM. CODE Ch. 55 (West 2011) [Repealed by Acts 2011, 82nd Leg., Ch. 1039 (H.B. 3079) § 3, eff. Sept. 1, 2011]. As such, in that regard, Texas has affirmatively rejected any constructive termination theory that could arise from a franchise statute.

Further, the suggestion that the Panel in this matter was attempting to predict how a Texas court may rule if asked to declare a constructive termination is a fiction created by T3's attorneys after-the-fact because: (i) no request for termination was ever presented to the Panel and (ii) there is no suggestion in the Interim Award that the Panel was predicting Texas law. Quite the contrary, the Panel skipped past Texas law to grant T3 new statutory rights on the basis of Connecticut/New Jersey franchise acts. That is the epitome of an arbitrator improperly doling out his or her "own brand of industrial justice." ***Stolt-Nielsen S.A.***, 559 U.S. at 671.

Therefore, the Arbitration Award must be vacated in full under FAA § 10(a)(4) or, in the alternative, vacated at least in regard to the constructive termination ruling (representing $566,143.61 in damages) and Fee Order ($2,449,208.14) since, under Texas law, attorneys' fees are predicated on each specific "cause of action" upon which a party prevails. *See, e.g.*, *Green Int'l, Inc. v. Solis*, 951 S.W.2d 384, 389 (Tex. 1997) ("A failure to segregate attorney's fees in a case containing multiple causes of action, only some of which entitle the recovery of attorney's fees, can result in the recovery of zero attorney's fees.").

B. The Panel Irrationally Contradicted Law and Logic by Terminating the Contract and, at the Same Time, Awarding Future Contract Benefits.

Shortly after the Panel issued its Interim Award declaring a constructive termination, SBS requested clarification as to T3's post-termination obligations in the contract. [R. 8146-48.] In response, T3 declared it was electing a full discharge due to breach. [*Id.*] The Panel accepted that election and thus issued the Supplement to Interim Award that defied all reason by *both* discharging T3 from all its post-termination obligations under the contract (including a non-compete and requirement to return SBS's confidential information) while still awarding 8-12 years of future damages as if the contract continued in force.

It is a basic principle of law that, when a contract is materially breached, the non-breaching party must elect to: (i) treat the breach as discharging all future performance (which applies to *both* parties) or (ii) continue performance and demand the same from the other party. If the non-breaching party demands any future performance from the other party, it remains bound to all its own obligations under the contract. *See Henry v. Masson*, 333 S.W.3d 825, 840 (Tex. App. 2010). As such, a plaintiff cannot both be discharged from its own obligations and receive future performance from the other party, whether termed a present value of future damages or otherwise. *See id.* at 840-41. If a party elects discharge from its future obligations, as T3 did here, then the contract immediately ends and both parties have no further obligations. [*See* R. 19652.] T3's expert on damages, Robert Taylor, discussed that elementary point when he testified before the Panel that, if the distributorship were to end at any time, "then there would be *no number* for the future." [R. 7900 at 1666:16-21 (emphasis added).] The Arbitration Award violates that clear principle of law and logic by granting T3 future benefits for 8-12 years [R. 8133-34 (¶¶ 92-94)] while also declaring the Distributor Agreement "is hereby terminated" and T3 is "excuse[d] of any performance … of the post term covenant against competition," and further allowing T3 to illegally keep SBS's confidential information. [*See* R. 8151-52 (¶¶ 136-138); R. 7715 (¶ 13) (T3 agreeing customer lists are "confidential information belonging to Safeguard").] Such inconsistency defies reason. There is no conceivable way T3 can have both.[16]

As a result, the Arbitration Award must be vacated as "completely irrational." An award is completely irrational when it "fails to draw its essence from the agreement of the parties,"

[16] Under Paragraph 12(A) of the Distributor Agreement, T3 could receive 50% of its historical commissions for two years after a termination. [R. 7713.] However, the Panel's future damages could not be supported on the basis of Paragraph 12(A) because that provision is subject to post-termination conditions that still conflict with T3's election of discharge. [*Id.*]

Comedy Club, Inc. v. Improv W. Assocs., 553 F.3d 1277, 1288 (9th Cir. 2009), which means "an award may not stand if it does not meet the test of fundamental rationality." *Swift Indus., Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1131 (3d Cir. 1972) (ruling $6 million cash bond to cover max liability of $1.5 million not yet incurred was irrational).

A controlling example of how the Panel's award is "completely irrational" comes from the facts of the Ninth Circuit's *Comedy Club* opinion. In that case, the arbitrator's decision to revoke a defendant's (CCI's) license to open new clubs under the "Improv" brand, while simultaneously enforcing a non-compete preventing CCI from opening other *non*-Improv clubs, was <u>rational</u> because the trademark agreement at issue had not been terminated. *See Comedy Club*, 553 F.3d at 1289, 1290 n. 14. Rather, the plaintiff (Improv West) *elected to continue the contract* and enforce performance as to the clubs CCI owned and would continue to operate for the remaining term of the agreement (to 2019). *Id.* The Ninth Circuit specifically stressed, however, that the arbitrator's decision would have been <u>irrational</u> if the opposite occurred: *i.e.*, if the plaintiff had elected to end the contract. *See id.* at 1288 ("Both parties agree that if the Trademark Agreement is no longer in effect then the … covenant not to compete similarly would no longer be in effect, and the arbitrator's award would be considered irrational."). The inverse scenario condemned as irrational by *Comedy Club* is precisely what the Panel did here. The Arbitration Award fully terminates the contract at T3's own election (awarding $566,143.61 as the lost market value of its entire distributorship), yet inconsistently treats the contract as continuing to also award $373,473.76 in future commissions for 8-12 years. Under *Comedy Club*, that inherent contradiction is "completely irrational" and requires the award to be vacated.

In addition, awarding post-termination future damages without requiring T3 to comply with its own obligations violates the express contract limitation that only "actual damages for commercial loss" could be awarded (thereby crossing into prohibited punitive/exemplary damages). [*See* R. 7717 (¶ 17(C)), 7719 (¶ 21(B)).] The award should be vacated for that reason as well. *See, e.g.*, *Coast Trading Co., Inc. v. Pac. Molasses Co.*, 681 F.2d 1195, 1198 (9th Cir. 1982) (vacating award as "contrary to remedies provided in the contract").

Moreover, an award of the entire alleged lost market value of the distributorship, plus future damages, is a double recovery that is against public policy. Again, to vacate on such grounds, there must be an "explicit, well defined and dominant policy" and it must be "one that specifically militates against the relief ordered by the arbitrator." *Aramark Facility Servs. v. Serv. Emps. Int'l Union*, 530 F.3d 817, 823 (9th Cir. 2008). Under well-established Texas law, double recoveries are against public policy because they violate the "one satisfaction" rule. *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 303 (Tex. 2006) ("There can be but one recovery for one injury, and the fact that there may be more than one theory of liability does not modify this rule."); *Temple v. FDIC*, 988 F.2d 24, 26 (5th Cir. 1993) ("The one satisfaction rule is based on the notion that allowing a double recovery is ordinarily against public policy."); *see Am. Foreign Ins. Co. v. Reichert*, 140 Idaho 394, 399, 94 P.3d 699, 704 (Idaho 2004) (same).

As a result, the Arbitration Award must be vacated either: (i) as "completely irrational"; (ii) for violating an express contract prohibition; or (iii) on grounds of public policy.

In response to SBS's motion to vacate at the District Court level, T3 asserted the Panel's award was not irrational when characterizing the $373,473.76 amount not as "future benefits under the T3 Distributor Agreement," but instead as part of a "lost asset value going forward." [R. 8454.] The District Court adopted that view. [R. 12747 (using same "lost asset going forward" phrase).] However, that was plain error because, to the extent the Panel's award is valid at all, T3 is bound by the arbitrators' findings on disputed facts no less than is SBS and the Panel repeatedly declared it was awarding $373,473.76 for *future* lost commissions [*see* R. 8133-34 (¶¶ 92-94)], while $566,143.61 was awarded as the lost market value of T3's entire business. [*See* R.

8135 (¶ 100).] Under the FAA, the District Court was required to defer to the Panel's findings on those points. *See Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 1102 (9th Cir. 2003). If the District Court had followed that law instead of deferring to T3's re-characterization of the futures damages awarded by the Panel, it would have been left with no choice but to conclude the Arbitration Award contains a fundamental inconsistency that cannot be upheld. This Court, exercising its *de novo* review, should vacate the Arbitration Award in full or, alternatively, at least strike the future damages element ($373,473.76).

C. The Panel Manifestly Disregarded Texas Law and the Contract to Award Damages Based on Gross Profits Rather Than Net Profit.

Additionally, the Panel's award of "lost commissions" (past and future) was a manifest disregard of Texas law because the amounts were based on gross profits and revenue instead of a net commission payable to T3 under the terms of its contract. To be clear, distributors like T3 act solely as sales agents [*see* R. 7704 (¶ 5(A)) (contract stating "[t]he relationship between Safeguard and you shall be that of principal and independent sales agent …")] who solicit orders to be placed with SBS in return for a commission of around 30-35% on completed sales. [*See* R. 7899 at 1662:16-1663:6.][17] That is the most a distributor could receive under its contract in regard to any account protection claim. Further, T3 and SBS expressly bargained that, upon a "termination" by either party, the most T3 could receive in the future was, *subject to certain post-termination obligations*,[18] a reduced percentage of commissions as to repeat sales, and only for two years, as provided in Paragraph 12(A) of the contract:

[17] Once a customer places an order with a distributor, SBS handles all other aspects of a sale—*e.g.*, invoicing, shipping, collecting payment, guarantees, returns—and a commission is remitted to the distributor. [*See generally* R. 8111 (¶ 1).]

[18] Paragraph 12(A) makes post-termination payments subject to a non-compete and return of SBS's confidential information, which is inconsistent with T3's discharge. [See, *supra*, note 16].

> If Safeguard terminates this Agreement for any of the reasons set forth in Paragraph 10 … or if you terminate this Agreement, Safeguard will … pay you (or your beneficiaries) for two (2) years after the effective date of termination, fifty percent (50%) of the commissions generated on all repeat sales of Safeguard Systems that are made during such period to customers from whom you were entitled to receive commissions while this Agreement was still in effect …

[R. 7714 (¶ 12(A)).] The Panel, however, awarded "gross profits" to T3 on past sales by DocuSource/IBF and "one times annual revenue" for future sales (representing 8-12 years of commissions into the future). That was a manifest disregard of the controlling Texas law.

Under Ninth Circuit precedent, manifest disregard occurs when the record shows an arbitrator "recognized the applicable law and then ignored it." *Comedy Club*, 553 F.3d at 1290. The law ignored must be "well defined, explicit, and clearly applicable." *Carter v. Health Net of Cal., Inc.*, 374 F.3d 830, 838 (9th Cir. 2004). At the lower court level, the District Court added a further requirement that an arbitrator must first explicitly "state" in writing the law being ignored before it rises to the level of manifest disregard. [*See* R. 12743-44.] That was an error of law as to the legal standard because it allows arbitrators to disregard applicable law by simply not writing it out in their award. Rather, as stated in *Comedy Club*, the standard turns on whether an arbitrator "recognized" the law. 553 F.3d at 1290. The Second Circuit has ruled that to mean the applicable law can be: (i) "imputed" by what the parties identified to the arbitrators, or (ii) "inferred" if the controlling law is "so obvious that it would be instantly perceived as such by the average person qualified to serve as an arbitrator." *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 390 (2d Cir. 2003). That is the legal standard the District Court should have applied and, when done here, it is clear the "well defined … explicit" Texas law requiring proof of net profit lost was applicable and manifestly disregarded by the Panel.

First, Texas law explicitly provides the "correct measure of damages for loss of profits is net profits" and that damages may not be based on "gross revenue or gross profits." *Exel Transp.*

Servs., Inc. v. Aim High Logistics Servs., LLC, 323 S.W.3d 224, 232 (Tex. App. 2010). Net profits are "what remains in the conduct of business after deducting from its total receipts all of the expenses incurred in carrying on the business." *Id.* As such, Texas courts reverse awards where there is no "showing that expenses were deducted in arriving at net profits lost." *See, e.g.*, *Texaco, Inc. v. Phan*, 137 S.W.3d 763, 772 (Tex. App. 2004). ***Second***, the record reflects the controlling Texas law was "clearly applicable." Both T3 and its expert, Robert Taylor, acknowledged that commissions are not calculated until after fees are deducted. [*See* R. 7880 at 1273:7-19, R. 7898 at 1627:17-1628:16, 7900 at 1668:2-13; *see also* R. 7737, 19641.] Yet, Taylor did not do that for his damage calculations. [R. 7900 at 1667:4-8 ("Q. And all that you did, again, with respect to this category, was look at the gross profit of IBF, correct? A. Yes, sir. That was the ultimate number."). He simply took the sales of DocuSource/IBF—*i.e.*, the retail price paid by customers—and subtracted an accounting concept called the "base price" to derive gross profits. [*See, e.g.*, R. 7920-21 ("Grand Total-Sales"), 7922-23 ("Grand Total-Base Price"), 7924-25 ("Grand Total-GP"); *see also* R. 19642.] Further, in regard to future commissions, Taylor used a "one times annual *revenue*" metric that covered at least 8-12 years. [R. 7896 at 1606:17-1608:9, 7899-7900 at 1665:22-1666:8.] ***Third***, the Panel was explicitly informed that Texas law does not allow damages to be based on gross profits or revenue. SBS's post-hearing brief identified the precise Texas cases recited above [*see* R. 8102-03 (¶ 100)] and detailed the insufficiency of Taylor's calculations. [R. 8070 (¶ 64).] T3 offered no controverting law and, in fact, boldly declared it sought gross profits. [*See* R. 7994 (¶ 103).]

Despite being made aware of the controlling Texas law, the Panel adopted Taylor's calculations to award gross profits on sales in the amount of $321,657.77[19] [R. 8129 (¶ 70), 8133

[19] [*See* R. 7946 (Taylor's "gross profits" of $315,756.18 for IBF and $5,901.59 for DocuSource add up to the Panel's $321,657.77).]

(¶ 91)] and future damages of $373,473.76 based on Taylor's revenue metric (although, unlike Thurston's trial, that was at least reduced to account for the undisputed fact DocuSource no longer sold in Idaho). [R. 8134 (¶¶ 93-94); *see also* R. 8129 (¶ 71).] Accordingly, this Court should vacate the award in full or, alternatively, the total past and future damages ($695,131.53).

D. The Panel Manifestly Disregarded the Undisputed Month-to-Month Nature of the Contract to Award Future Losses for 8-12 Years.

Further, in regard to future lost commissions specifically, the Panel ignored that the distributorship unambiguously existed only on a "month-to-month" terminable basis [R. 7711 (¶ 10(F)); *see also* R. 19645], which was admitted by T3 in its testimony. [*See* R. 7877-78 at 1261:18-1262:2.] As such, the terminable nature was an undisputed fact; which limits arbitrator power. *See Coutee v. Barington Capital Grp., L.P.*, 336 F.3d 1128, 1133 (9th Cir. 2003) (stating courts cannot "confirm an arbitration award that is legally irreconcilable with the undisputed facts" and that, "because facts and law are often intertwined, an arbitrator's failure to recognize undisputed, legally dispositive facts may properly be deemed a manifest disregard for the law").

Here, Taylor testified his calculation for $373,473.76 in future damages—based on the "one times annual revenue" metric—would compensate T3 for "8 to 12 years" into the future, or even into "perpetuity." [R. 7899-7900 at 1665:22-1666:8.] Yet, as a matter of law, the term of a contract inherently limits the amount and availability of future profits a party could expect to receive as damages. *See Mood v. Kronos Prods., Inc.*, 245 S.W.3d 8, 13 (Tex. App. 2007) (rejecting award of lost profits for ten years into the future when the contract could be terminated on sixty days' notice); *see also Atlas Copco Tools, Inc. v. Air Power Tool & Hoist, Inc.*, 131 S.W.3d 203, 208 (Tex. App. 2004) (rejecting lost profits when expert did not consider year-to-year renewable term of contract). Under the undisputed facts, the most T3 could have been awarded for future losses was limited to the monthly term of the contract (*i.e.*, 30 days of future losses), which is far exceeded by an award extending for 8-12 years into the future.

SBS specifically identified the *Mood* and *Atlas Copco* cases to the Panel and discussed the application of *Atlas Copco* at length in its post-hearing briefing. [R. 8099-8101 (¶¶ 93-95), 8104 (¶ 102).] T3, for its part, did not address the issue at all. [*See generally* R. 7949-8022.] Yet the Panel awarded the full $373,473.76 anyway. This Court should independently vacate the 8-12 years of future losses awarded based on the undisputed month-to-month contract term.

E. The Panel Disregarded Texas Law and Express Contract Limitations to Award a Doubled Amount of Attorneys' Fees and Litigation Expenses.

The portion of the Arbitration Award granting T3 a recovery of $2,449,208.14 in attorneys' fees and $437,126.28 in "expenses"—which together are more than *twice* the damages (*see* R. 19657)—should also be vacated. To award so much the Panel had to re-write the contract, which exceeds an arbitrator's power under FAA § 10(a)(4). *See, e.g.*, *PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd.*, 659 F. Supp. 2d 631, 636 (E.D. Pa. 2009), *aff'd*, 400 F. App'x 654 (3d Cir. 2010); *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184, 187 (8th Cir. 1988) ("The arbitrator's authority, however, is not unlimited. Although the arbitrator may interpret ambiguous language, the arbitrator may not disregard or modify unambiguous contract provisions."). Furthermore, the Panel's multiplication of attorneys' fees incurred (by 2.0x) violates the express contractual limit of "actual damages for commercial loss."

1. The Panel Could Not Rely on AAA Rule 47.

In its Fee Order, the Panel claimed it had power to award attorneys' fees and costs beyond Texas law because Paragraph 21(B) of the Distributor Agreement incorporates the AAA's Commercial Arbitration Rules (the "<u>Rules</u>"). [*See* R. 8257-59 (relying on AAA

Rule 47).[20]] However, the contract does not state the AAA Rules would supply a substantive basis to govern any claim or relief. Rather, Paragraph 21(B) merely states the arbitration "shall be *conducted*" under the AAA's Rules. [R. 7718-19 (emphasis added).] Fees and costs are substantive matters that are governed by the parties' choice of Texas law. *See Rapp Collins Worldwide, Inc. v. Mohr*, 982 S.W.2d 478, 487 (Tex. App. 1998) ("We conclude the issue of attorneys' fees is a substantive part of a lawsuit and therefore should be governed by the law of the state governing the substantive issues."); *see also Fairmont Supply Co. v. Hooks Indus., Inc.*, 177 S.W.3d 529, 535–36 (Tex. App. 2005) (same). Further, as this Court has ruled before, the phrase "shall be conducted" reflects that the AAA Rules merely provided a procedural framework for arbitration and not a substantive basis for any relief. *See Moore v. Omnicare, Inc.*, 141 Idaho 809, 817-18, 118 P.3d 141, 149-50 (2005) (ruling the AAA Rules are procedural such that arbitrators could not use former version of Rule 47 (*i.e.*, rule 43) to award fees).

Contrary to the Panel's suggestion as well, the parties did not agree by their submissions to give the Panel "jurisdiction" to use AAA Rule 47 as a substantive basis to award fees and costs. [*See* R. 8258 at 2:12-18 (Panel asserting as much).] Both T3's demand for arbitration and SBS's response requested fees and costs generically [*see* R. 7787, 7810] and then T3's post-hearing briefing sought fees solely on the basis of Texas law. [R. 8177-78.] The only AAA rule mentioned by T3 was "Rule 43," and then only to note it allows arbitrators to grant any relief proper "within the scope of the agreement of the parties." [R. 8177.] T3 accordingly went on to recite that the Distributor Agreement required the application of Texas law. [*See generally* R.

[20] AAA Rule 47 itself states arbitrators can only award relief "within the scope of the agreement of the parties" [*see* R. 8272], which points right back to the contract and Texas law.

8177-8202.] As a result, the question of whether attorneys' fees were to be governed by AAA Rule 47 or Texas law was never an issue for the Panel to decide.

The Panel's use of AAA Rule 47 was not harmless error either. At a minimum, AAA Rule 47 was used to: (i) ignore the requirement in Texas law that a party formally "present" their claims before fees may be awarded [R. 8258 at 2:21-23];[21] (ii) grant attorneys' fees for unsegregated legal work occurring outside the Arbitration (and in the District Court Action) [R. 8259-60 at 3:11-4:2];[22] and (iii) award litigation "costs" that are specifically disallowed by Texas law; such as the full amount of expert witness fees.[23] [R. 8258 at 2:24-28.] Accordingly, the Fee Order should be vacated in full.

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[21] Absent evidence of timely presentment, no attorneys' fees can be awarded. *See Kahn v. Seely*, 980 S.W.2d 794, 800 (Tex. App. 1998). The Panel shrugged off that deficiency on the basis that "[t]here is no AAA Commercial Rule that requires T3 to 'present' its demand for attorneys' fees to SBS." [*See* R. 8258 at 2:21-23.]

[22] Texas allows unsegregated fees only for intertwined *claims*, not proceedings. *See Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 311 (Tex. 2006) ("[F]ee claimants have always been required to segregate fees between *claims* for which they are recoverable and *claims* for which they are not") (emphasis added); *see also Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 819 (Tex. 1997) (stating "jury must decide the question of attorney's fees specifically in light of the work performed *in the very case* for which the fee is sought.") (emphasis added). The Panel ignored that by awarding fees incurred in the District Court Action.

[23] The Panel awarded T3 litigation expenses—*e.g.*, expert witness fees ($220,000), postage ($8,000), document vendor fees ($27,000), and $34,000 in photocopying/binders—as "costs" [R. 8199-820] when costs in Texas are strictly limited to "those paid to courts or their officers." *In re Nalle Plastics Family Ltd. P'ship*, 406 S.W.3d 168, 175 (Tex. 2013); *see also Bundren v. Holly Oaks Townhomes Ass'n*, 347 S.W.3d 421, 440 (Tex. App. 2011) (expert witness fees not recoverable); *Shenandoah Assocs. v. J & K Properties, Inc.*, 741 S.W.2d 470, 487 (Tex. App. 1987) (barring all "expenses incurred in preparation of trial"). Indeed, *Nalle* explicitly rejected the notion that "litigation costs" are recoverable. 406 S.W.3d at 175-76. Yet, the Panel granted T3 all the expenses it sought to recover on the basis that "costs" in Texas were only a "subset of the larger category of expenses" recoverable under AAA Rule 47. [R. 8258 at 2:24-28.]

2. The Doubled Attorneys' Fees Violate an Express Contract Limit of "Actual Damages for Commercial Loss."

Furthermore, in its Fee Order, the Panel determined the "*actual* attorneys' fees" incurred by T3 were $1,222,604.07 and then applied a "2.0 multiplier" to double that to $2,449,208.14. [R. 8263 at 7:4-10; *see also* R. 19657, 19664.] Texas law allows a lodestar amount (hours worked multiplied by a "reasonable" rate) to be increased by a multiplier in some instances, but there is no authority for a windfall recovery of millions in fees beyond any actual loss. [*See* R. 8253 (citing cases).] The Distributor Agreement unambiguously states that all amounts recoverable by either party "… SHALL BE LIMITED TO *ACTUAL* DAMAGES FOR COMMERCIAL LOSS" and specifically bars punitive/exemplary awards. [R. 7717 (¶ 17(C)); *see also* 7719 (¶ 21(B)).] The Panel plainly violated that express limitation on its power, which is a violation of the FAA. *See, e.g., Coast Trading Co., Inc. v. Pac. Molasses Co.*, 681 F.2d 1195, 1198 (9th Cir. 1982) (vacating award as "contrary to remedies provided in the contract"). The most the Panel legitimately had power to award in attorneys' fees were those it determined T3 had actually incurred. This Court, in its *de novo* review, should vacate the Fee Order.

CONCLUSION

Based on the foregoing arguments and the record, SBS requests this Court to:

1. Reverse the District Court's ruling that it had jurisdiction to consider T3's objection to forum [R. 984] and vacate the resulting Arbitration Award or, alternatively (if jurisdiction existed), reverse the District Court's ruling that Texas law requires striking the Dallas forum [R. 989-90] and vacate the resulting Arbitration Award for violating FAA § 5;

2. Reverse the District Court's overruling of SBS's attorney-client privilege [R. 2227] and order: (a) T3 and its counsel to return and/or destroy all privileged information disclosed to them; and (b) that the Arbitration Award is vacated in full;

3. Vacate the Arbitration Award under FAA § 10(a)(4) and corresponding federal case law, or, alternatively, vacate the award in substantial parts in accordance with the arguments and record presented in connection with Issue 3 herein; and

4. Award SBS its costs on appeal.

DATED THIS 8th day of March, 2018

HAWLEY TROXELL ENNIS & HAWLEY LLP

By ______________________________

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By ______________________________

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 8th day of March, 2018, I caused to be served a true copy of the foregoing APPELLANT'S BRIEF by the method indicated below, and addressed to each of the following:

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