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Case Number 482,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

FIRST STATE DEPOSITORY COMPANY, LLC and CERTIFIED ASSETS MANAGEMENT, INC.,	§	No. 482, 2013
Defendants Below, Appellants,	§	
v.	§	
ISRAEL DISCOUNT BANK OF NEW YORK,	§	On appeal from the Court of Chancery of the State of Delaware
Plaintiff Below, Appellee.	§	C.A. No. 7237-VCP

APPELLANTS' CORRECTED OPENING BRIEF

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NATURE OF PROCEEDINGS

Defendants-below entered a contract which provided a broad arbitration provision, with a narrow carve out for interpleader actions, which only one of the defendants could initiate, but did not. Notwithstanding the breadth of the arbitration provision for "any controversy or claim arising out of or in connection with" the agreement, and the inapplicability of the contractual interpleader exception, the Court of Chancery impermissibly resorted to hypotheticals in order to recharacterize the claims before it as an interpleader action when it plainly was not. In so doing, the Court of Chancery wrongly asserted subject matter jurisdiction where it otherwise had none.

This action arises out of financing arrangements collateralized by rare coins and precious metals. Appellee Israel Discount Bank of New York ("IDB") provided a multimillion dollar facility and revolver to non-party Republic National Business Credit, LLC ("Republic"). Republic, in turn, loaned funds to its clients in the precious metals industry. Republic's loan from IDB was secured by: (i) collateral pledged to Republic by its clients ("Client Collateral"), (ii) Republic's receivables on loans to its clients, and (iii) the Republic-client loan documents. IDB's loan with Republic contemplated that certain Client Collateral would be stored at depositories and required Republic to report to IDB weekly on the status and location of its collateral. One of Republic's clients was Appellant Certified

Assets Management, Inc. ("CAMI"), then an independent wholesaler of rare coins and precious metals.

Appellant First State Depository Company, LLC ("FSD") is a private depository company serving the precious metals and rare coin industry. FSD's relationship with its clients is governed by a Collateral Custody Account Agreement ("CCAA"). The CCAA is a tri-party agreement between FSD, Republic (as lender) and Republic's clients under which FSD establishes and operates an account for the benefit of both Republic and the borrower specifically to hold the rare coins, precious metals or other assets pledged to Republic as collateral. The CCAA requires arbitration pursuant to the American Arbitration Association rules of "any controversy or claim arising out of or in connection with this Agreement, or the breach thereof" "[e]xcept for interpleader suits" initiated by FSD. Under a separate letter agreement, IDB is a third party beneficiary of any CCAA between FSD, Republic and Republic's clients.

After a dispute arose regarding certain collateral, IDB sued FSD and CAMI in the Court of Chancery for breach of contract and conversion, asserting that FSD breached the CCAA between CAMI, Republic and FSD as well as the letter agreement, and that FSD and CAMI converted certain collateral. FSD and CAMI moved to dismiss in favor of arbitration, contending that the Court of Chancery lacked subject matter jurisdiction. The Court of Chancery denied the motion to

dismiss, finding that it and not the arbitrator was responsible for determining substantive arbitrability and IDB's claims were not subject to arbitration.[1] FSD and CAMI sought interlocutory appeal, which was denied. The case then went to trial and the Court of Chancery found FSD and CAMI liable for over $7 million.[2] Because the Court of Chancery never had subject matter jurisdiction over the dispute, the Court of Chancery's decisions must be reversed, and the judgment against FSD and CAMI vacated.

[1] A true and correct copy of the Court of Chancery's September 27, 2012 Memorandum Opinion [D.I. 132] denying the motion to dismiss is attached hereto as Exhibit A.

[2] A true and correct copy of the Court of Chancery's May 29, 2013 post-trial Memorandum Opinion [D.I. 196] is attached hereto as Exhibit B.

SUMMARY OF ARGUMENT

I. The Court Of Chancery Erred When It Decided The Issue Of Substantive Arbitrability, Because The Arbitration Clause Refers "Generally All" Disputes Arising Out Of The Contract To Arbitration, Incorporates A Set Of Arbitration Rules, And No Exceptions Apply.

II. The Court Of Chancery Erred When It Failed To Resolve the Arbitrability of IDB's Claims In Favor of Arbitration, as Provided In The CCAA.

III. The Court Of Chancery Lacked Subject Matter Jurisdiction And The Judgment Must Be Reversed And Vacated In Favor Of Arbitration.

STATEMENT OF FACTS

A. The Parties

Appellant-Defendant below FSD is a Delaware limited liability company with its principal place of business located in Wilmington, Delaware. A42 (Compl. ¶8). FSD is a private depository company of specialized precious metals and rare coins. (*Id.*). Appellant-Defendant below CAMI is a Delaware corporation. A42-43 (Compl. ¶9). CAMI was an independent wholesaler of rare coins and precious metals. FSD and CAMI shared office space at their Wilmington address. A49 (Compl. ¶27). Non-party Robert Higgins is the principal owner of FSD and CAMI. (*Id.*).

Appellee-Plaintiff below IDB is a bank organized under the laws of the State of New York with its principal place of business located in New York, New York. A42 (Compl. ¶ 7).

Non-party Republic is a California limited liability company with its principal place of business located in Encino, California. A43 (Compl. ¶10). Ned Fenton ("Fenton") is Republic's managing director. (*Id.*). Republic provides secured financing for the precious metals industry. (*Id.*).

B. IDB's Loan Agreements with Republic

IDB and Republic entered into a $20 million Revolving Credit Agreement and related loan documents, as amended, dating back to December 27, 2004. A43-45; A703 (Compl. ¶¶12-16; Joint Pre-Trial Order at 2). Fenton and his wife

personally guaranteed Republic's repayment of debt to IDB. A279-314 (Mot. Dismiss Ex. 1). As part of the loan, IDB took a security interest in all of Republic's accounts, inventory and equipment, including its receivables. A43-44; A60-108 (Compl. ¶12; Compl. Ex. A).

C. Republic Loans Funds to CAMI

Republic then loaned funds to CAMI[3] pursuant to a May 10, 2005 Revolving Loan and Security Agreement (the "Loan Agreement") in order to finance "the normal course of" CAMI's rare coin and precious metals business. A316 (Mot. Dismiss Ex. 2, at 1). The Loan Agreement was collateralized by CAMI's coins and precious metals and after acquired inventory. A318-19 (*Id*. at §4). Under the Loan Agreement, Republic was permitted to designate a depository to hold its collateral. A316 (*Id*. at §1).

D. FSD, Republic and CAMI Enter Into Collateral Custody Account Agreements

Sometime in 2006, Republic requested that IDB authorize the transfer of certain collateral to FSD. (Ex. B at 6). In order to document the maintenance and storage of collateral at FSD, Republic and CAMI entered into several CCAAs on August 24, 2006. *See, e.g.*, A327-77 (Mot. Dismiss Exs. 4, 5, 6, 7). Each CCAA created a named custody account "specifically to hold Assets pledged to [Republic]

[3] Borrowers Lott and Ketterling entered into loan agreements and later transactions on similar terms. Given that the forms of the agreements are identical, we focus solely on the CAMI transactions in this brief. *See* A245, 248 (Mot. Dismiss Revised Op. Brief at 4 n.1, 7 nn.2-3).

as collateral for the funds borrowed by [CAMI] (the 'Security Interest')." A328, 340, 353, 366 (*Id*. at 1). Republic expressly warranted in the CCAA that: (i) "all of [its] direction to [FSD] concerning delivery, deposit, transfer or shipment of Assets will be authorized," (ii) the person executing the CCAA, *i.e.*, Fenton, was duly authorized to do so on behalf of Republic, and (iii) all representations made to FSD pursuant to the CCAA were true and that Republic's performance would comply with all applicable law. A331, 343, 356, 369 (*Id*. at §12). Republic held FSD harmless from any liability or losses FSD might suffer as a result of its reliance on Republic. (*Id*.). However, if FSD did act in accordance with Republic's instructions, it was protected. A330, 342, 355, 368 (*Id*. at §9D). Fenton was Republic's Authorized Signer. A334, 346, 372 (*Id.* at 7).

In recognition of the fact that FSD was merely establishing and operating an account to hold assets, Republic and CAMI agreed that FSD was not a guarantor of the assets/collateral, nor would FSD be liable for any incidental or consequential damages associated with any loss to the assets. A330-31, 342-43, 355-56, 368-69 (*Id.* at §§9B, 10).

Republic, CAMI and FSD waived (with one limited exception) the right to litigate any claim or controversy arising out of or in connection with the CCAA and expressly agreed that such claims or controversies must be settled through binding arbitration in Delaware.

> Jurisdiction, Venue And Waiver. Except for any interpleader suits, the Parties agree that any controversy or claim arising out of or in connection with this Agreement, or the breach thereof, shall be settled by arbitration in accordance with the commercial arbitration rules of the American Arbitration Association and judgment on the award rendered by the arbitrator or arbitrators may be entered in any court having jurisdiction thereof. The Parties agree arbitration that any party initiates shall be held in the State of Delaware.

A333, 345, 358, 371 (*Id.* at §20).

During the pendency of the CCAAs, FSD provided Collateral Detail Reports to Republic, which in turn sent them to IDB. A428 (Mot. Dismiss Ex. 15, ¶6).

E. The Bailment Agreement

On August 24, 2006, the same day as FSD, Republic and CAMI entered into the CCAAs, IDB delivered, and FSD and Republic acknowledged and confirmed, a letter regarding IDB's financing arrangements with Republic (the "Bailee Agreement," sometimes the "Bailee Letter" in the record below). A378-83 (Mot. Dismiss Ex. 8).

> As part of the financing arrangement by Israel Discount Bank of New York ("Secured Party") to Republic National Business Credit LLC ("Company"), Company has pledged and granted to Secured Party a security interest in and continuing general lien and security interest in and upon Company's assets, including, but not limited to, its present and future interest in property presently held by you ("Bailee") [FSD] and which may be shipped to and stored with Bailee from time to time in the future (the "Property") pursuant to separate agreements between Bailee, Company and Company's

> clients (collectively and individually, the "Contracts"). Bailee [FSD] and Company [Republic] acknowledge and agree that Secured Party [IDB] is a third party beneficiary of such Contracts. . . .

A379 (*Id*. at 1). Later that same year, Republic assigned the CAMI loan to IDB. A406-07 (Mot. Dismiss Ex. 10).

F. IDB Enters Into Its Own CCAA With FSD And Republic After it Becomes Undercollateralized on Republic's Loan

In the summer of 2009, one of the world's largest coin wholesalers, National Gold Exchange, Inc. ("NGE"), one of Republic's significant borrowers, filed for chapter 11 bankruptcy protection. (Ex. B at 10-11). The bankruptcy became necessary when NGE's largest creditor (not Republic) seized millions of dollars of coins pledged as loan collateral, including coins released by FSD to be displayed at trade shows. (*Id*.). As a result, IDB found itself undercollateralized on Republic's loans by over $4.8 million. (*Id*.). To address the collateral deficiency, an affiliate of Fenton agreed to assign IDB 9,000 numismatic "missing edge error coins" (the "Error Coins") as additional collateral. (*Id*.). IDB valued the Error Coins at $9 million. (*Id*.).

On or about August 12, 2009, IDB, Republic and FSD entered into a CCAA to create an account for the benefit of IDB to hold assets pledged by Republic to IDB as security (the "2009 CCAA"). A124-34 (Compl. Ex. D). Under the 2009 CCAA, "all certified coins, certified currency and/or bank notes, collectibles, rare

coins, precious metal bullion coins, and anything else … stored by [FSD] now or hereinafter deposited in the above referenced Account is subject to the Security Interest of Lender." A125 (*Id*. at 1). Like the prior CCAAs entered by Republic, IDB agreed to the identical arbitration provision. A132 (*Id*. at §20).

G. Republic and IDB Amend the Loan Agreement

On or about November 1, 2011, Republic and IDB amended the Loan Agreement for the seventh time (the "Seventh Amendment") in order to reduce Republic's borrowing limit with IDB. A109-17 (Compl. Ex. B). The Seventh Amendment also provided:

> Inspection of Collateral. The Borrower acknowledges and agrees that the Lender is entitled to inspect, appraise and secure the Collateral. The Lender has agreed to enter into this Amendment based, in part, upon the Borrower's agreement that it will cooperate with the Lender to ensure that [FSD] will grant the Lender access to inspect the Collateral. The Borrower further acknowledges and agrees that the Lender has required, as a condition to the execution and delivery of this Amendment, that the Lender inspect the collateral on or before January 6, 2012. In the event the Lender is not given access by [FSD] to complete its inspection of the Collateral on or before January 6, 2012, such failure shall constitute an Event of Default.

A110 (*Id.* at §2).

H. IDB's Complaint in this Action

After a dispute arose regarding IDB's inspection and instruction rights, IDB filed suit in the Court of Chancery on February 13, 2012, asserting breach of the

Bailment Agreement and the 2009 CCAA against FSD and conversion against FSD and CAMI (IDB later dismissed the conversion claim against FSD). A56-58; A732-33 (Compl. ¶¶46-55; Nov. 18, 2012 Letter). In its Complaint, IDB also asserted that the 2009 CCAA "does not supersede the [Bailment Agreement], but covers additional collateral pledged to IDB." A47 (Compl. ¶22). Thus, IDB conceded the co-existence and viability of the CCAAs in its pleading below.

ARGUMENT

I. THE COURT OF CHANCERY ERRED WHEN IT DECIDED THE ISSUE OF SUBSTANTIVE ARBITRABILITY, BECAUSE THE ARBITRATION CLAUSE REFERS "GENERALLY ALL" DISPUTES ARISING OUT OF THE CONTRACT TO ARBITRATION, INCORPORATES A SET OF ARBITRATION RULES, AND NO EXCEPTIONS APPLY.

A. QUESTION PRESENTED

Did the Court of Chancery Court commit legal error by refusing to dismiss the Complaint in favor of arbitration? FSD and CAMI preserved this issue for appeal in their Motion to Dismiss and supporting briefs. A257-60 (Mot. Dismiss Revised Op. Brief at §I.B.1).

B. STANDARD OF REVIEW

The Supreme Court reviews a trial court's denial of a motion to dismiss under a *de novo* standard of review.[4] To the extent that the Court of Chancery's rulings are legal in nature, this Court also reviews them *de novo*.[5] The interpretation of contract language includes questions of law which are also subject to *de novo* review.[6]

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[4] *CCS Investors, LLC v. Brown*, 977 A.2d 301, 322 (Del. 2009); *AeroGlobal Capital Mgmt., LLC v. Cirrus Indus., Inc.*, 871 A.2d 428, 437 (Del. 2005).

[5] *See In re The Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 48 (Del. 2006).

[6] *See Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 n.4 (Del. 1998).

C. MERITS OF THE ARGUMENT

1. <u>The Court Failed to Resolve Substantive Arbitrability in Favor of the Arbitrator Under *Willie Gary*</u>

It is well-settled that "the public policy of Delaware favors arbitration."[7] As such, "Courts may not consider any aspect of the merits of the claim sought to be arbitrated, no matter how frivolous they appear."[8] Thus, Delaware courts strive to honor the reasonable expectations of contracting parties concerning arbitration of their claims, and "ordinarily resolve any doubts as to arbitrability in favor of arbitration."[9]

When the topic of arbitration is raised during litigation, two threshold issues arise: (1) whether the claims being litigated should be resolved in arbitration (the issue of "arbitrability"), and (2) whether the issue of arbitrability should be decided by the court or the arbitrator (the issue of "substantive arbitrability").[10] If substantive arbitrability is resolved in favor of the arbitrator, then the court will not determine the arbitrability of the specific claims, deferring instead to the arbitrator.[11]

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[7] *SBC Interactive, Inc. v. Corporate Media Partners*, 714 A.2d 758, 761 (Del. 1998) (citing *Graham v. State Farm Ins. Co.*, 565 A.2d 908, 911 (Del. 1989)).

[8] *Id.* (citations omitted).

[9] *Parfi Holding AB v. Mirror Image Internet, Inc.*, 817 A.2d 149, 155-56 (Del. 2002).

[10] *McLaughlin v. McCann*, 942 A.2d 616, 620-21 (Del. Ch. 2008).

[11] *Id.* at 621.

In *Willie Gary*,[12] this Court established the standard for determining substantive arbitrability. The Court held that substantive arbitrability is committed to the courts unless the parties clearly and unmistakably provide otherwise in an arbitration clause.[13] In Delaware, to "clearly and unmistakably" delegate substantive arbitrability to the arbitrator, it must be established that arbitration clause both (1) "generally provides for arbitration of all disputes" (the "first prong"), and (2) "incorporates a set of arbitration rules that empower arbitrators to decide arbitrability" (the "second prong").[14]

Here, the Court of Chancery misapplied the first prong under *Willie Gary*. (Ex. A at 11-12). Specifically, the Court of Chancery erred when it held that "because the arbitration provisions do not provide for the arbitration of *all* disputes, this Court is responsible for answering questions of substantive arbitrability." (*Id.* at 14 (emphasis added)). In so holding, the Court of Chancery ignored the modifier, "generally," specifically articulated in *Willie Gary* and the express language of the sole carve out agreed to by the parties. In doing so it set a higher standard by finding that the narrow carve out for interpleader actions (which were not at issue, *see infra* §I.C.2), meant that not all disputes were referred to

[12] *James & Jackson LLC v. Willie Gary LLC*, 906 A.2d 76 (Del. 2006).

[13] *Id.* at 78-79.

[14] *Id.* at 80. The second prong is not at issue here. *See* A555 (Mot. Dismiss Hg. Transcript, June 1, 2012, 6:19 (recognizing that the arbitration clause references the American Arbitration Association ("AAA") Rules).

arbitration and, therefore, the Court of Chancery was entitled to determine substantive arbitrability. (Ex. A at 13-14).[15]

Since the *Willie Gary* decision seven years ago, this Court has not discussed the meaning of the first prong of a substantive arbitrability determination, *i.e.*, "generally provides for arbitration of all disputes." Several lower courts, however, have interpreted this prong, and the teachings of those courts suggest that the Court of Chancery here gave far too much weight to the narrow interpleader carve out.[16]

In *McLaughlin*, a case decided on the heels of *Willie Gary*, the Court of Chancery explained why the first prong does not require that an arbitration clause

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[15] *See also* A554 (*Id.* at 5:1-14):

> THE COURT: Okay. I'm proceeding on the assumption that it might be broad, but this is not a Willie Gary situation where the Court would defer to the arbitrator to make the substantive arbitrability decision, and the reason is that it is not so broad as to fall within Willie Gary. *Willie Gary talks about a situation where it's clear from the agreement that all claims are to be, no matter what their nature, are to be sent to the arbitrator.*
>
> . . .
>
> It's clear from this agreement, interpleader, at least, is not to be sent to the arbitrator. So in my view, this is not within Willie Gary. Substantive arbitrability is for the Court to decide.

(emphasis added); A555 (*Id.* at 6:16-23) (THE COURT: "If you had an arbitration provision that *clearly sent all claims no matter what their nature* to the arbitrator, the fact that you also have a AAA rules reference probably would get you there. . . . But without that, you don't get there.") (emphasis added).

[16] *See, e.g.*, *ORIX LF, LP v. InsCap Asset Mgmt., LLC*, 2010 WL 1463404 (Del. Ch. Apr. 13, 2010); *Lefkowitz v. HWF Holdings, LLC*, 2009 WL 3806299 (Del. Ch. Nov. 13, 2009); *Carder v. Carl M. Freeman Cmtys., LLC*, 2009 WL 106510 (Del. Ch. Jan. 5, 2009); *McLaughlin*, 942 A.2d 616; *Brown v. T-Ink, LLC*, 2007 WL 4302594 (Del. Ch. Dec. 4, 2007); *BAYPO L.P. v. Tech. JV, LP*, 940 A.2d 20 (Del. Ch. 2007).

refer all disputes to arbitration without exception for an arbitrator to determine substantive arbitrability under the *Willie Gary* standard.[17] Most significantly, the Court of Chancery noted that one of the cases cited by this Court in support of the "generally provides for arbitration of all disputes" requirement addressed an arbitration clause which, like the arbitration clause here, contained a material exception, but did not bar reference of the substantive arbitrability question to the arbitrator.[18] The *McLaughlin* Court concluded that *Willie Gary*'s "generally provides for arbitration of all disputes" language means "that the carveouts and exceptions to committing disputes to arbitration *should not be so obviously broad and substantial* as to overcome a heavy presumption that the parties agreed by referencing the AAA Rules and deciding to use AAA arbitration to resolve a wide range of disputes" that the arbitrator, and not the court, would resolve disputes about substantive arbitrability.[19]

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[17] 942 A.2d at 623-24.

[18] *Id.* at 624 (citing *Cong. Constr. Co. v. Geer Woods, Inc.*, 2005 WL 3657933, at *2-3 (D. Conn. Dec. 29, 2005) (finding a clear and unmistakable intent to arbitrate arbitrability even though the arbitration clause "contained language that [the plaintiff] believe[d] except[ed] consequential damage claims from arbitration")).

[19] *Id.* (emphasis added) (citation omitted).

Several other courts concur with and follow the approach taken in *McLaughlin*.[20]

An example of a "broad carve-out" is found in *Brown v. T-Ink, LLC*.[21] There, the Court of Chancery held that because the arbitration clause only referred "disputes concerning the 'interpretation or performance' of the [subject agreement] to arbitration, not a broader set of disputes, and certainly not all disputes[,]" the Court of Chancery, not the arbitrator, would determine questions of substantive arbitrability.[22]

Conversely, a narrow carve out was found in the arbitration clause at issue in *BAYPO L.P. v. Tech. JV, LP.*, which permitted the parties to pursue injunctive or equitable relief to protect their interests before, during, or after the arbitration process.[23] The Court of Chancery held that the presence of the carve out did not require the Court to determine substantive arbitrability, because it was "narrowly

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[20] *See Carder*, 2009 WL 106510, at *6 (interpreting *Willie Gary* and its progeny as requiring "*something less than* a clause that refers to arbitration every conceivable cause of action related to or in connection with the contract.") (emphasis added). *See also Lefkowitz*, 2009 WL 3806299, at *8 (interpreting the first prong to mean "generally refers all disputes to arbitration *without any broad carve-outs*.") (emphasis added).

[21] 2007 WL 4302594 (Del. Ch. Dec. 4, 2007).

[22] *Id.* at *10-11. *See also Willie Gary*, 942 A.2d at 81 (permitting non-breaching members of the company to pursue in court claims for specific performance and injunctive relief).

[23] 940 A.2d at 26.

tailored to provide the parties with limited ancillary relief."[24] Similarly, in *ORIX LF, LP v. InsCap Asset Mgmt., LLC*, the arbitration clause committed all disputes to arbitration except issues related to the determination of whether the fund's manager committed any one of six enumerated forms of misconduct.[25] The latter issues were instead subject to a "special proceeding" pursuant to agreed-upon procedures.[26] Under those circumstances, the Court of Chancery determined that *Willie Gary*'s first prong was met.[27]

It is settled law that the first prong of *Willie Gary* does not require that a clause refer to arbitration every conceivable cause of action related to or in connection with the contract.[28] Here, the carve out is solely for interpleader actions and therefore is not "so obviously broad and substantial" to overcome the parties' clear intent to commit questions of substantive arbitrability to the arbitrator by generally referring all disputes to arbitration and incorporating the AAA Rules. Rather, the interpleader carve out is narrow and analogous to those in *BAYPO* (for

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[24] *Id.* at 26-27.

[25] 2010 WL 1463404, at *3.

[26] *Id.*

[27] *See id.* at *7 ("Here, the record demonstrates to my satisfaction that not only issues of procedural arbitrability but also of substantive arbitrability are for the arbitrator to decide.").

[28] *Carder*, 2009 WL 106510, at *6.

limited ancillary relief)[29] and *ORIX* (for one specifically-defined proceeding). Thus, the single and un-invoked interpleader carve out here is simply insufficient for the Court to have disregarded the parties' stated intent to submit arbitrability issues to the arbitrator.[30]

Here, the arbitration clause in the CCAA generally refers all disputes to arbitration, incorporates the AAA Rules on arbitrability, and contains only one narrowly-tailored carve out, which under *Willie Gary* and its progeny, render the determination of substantive arbitrability the sole province of the arbitrator. The Court of Chancery has therefore committed reversible error by holding otherwise and the judgment must be vacated.

2. Because The Narrow Interpleader Exception Does Not Apply, the Issue of Arbitrability Belongs to the Arbitrator

To support its ruling that the Court was responsible for determining substantive arbitrability, the Court of Chancery characterized IDB's breach of contract claim as one "to enforce its right under the Bailment Agreement to control

[29] The Court of Chancery here rejected the comparison to *BAYPO*, which addressed an arbitration clause with a carve out for "injunctive *or equitable* relief." 940 A.2d at 26 (emphasis added). Significantly, the Court of Chancery, in reviewing *BAYPO*, focused only on the injunctive relief portion of the carve out and ignored the possibility of broader equitable relief. *See* Ex. A at 13 ("In *BAYPO*, the arbitration clause excluded requests for temporary injunctive relief from its scope."); *id.* at 13-14 ("the carve-out . . . is for interpleader actions, not injunctive relief."). Had the Court of Chancery considered the full carve out for "injunctive *or equitable* relief," it would have found that the interpleader carve out is actually an even narrower type of "limited ancillary relief" than that contemplated in *BAYPO*.

[30] 906 A.2d at 80.

the disposition of collateral in the possession of bailee FSD." (Ex. A. at 14). The Court equated IDB's claims with the interpleader suit exception in the arbitration clause: "*If* FSD faced competing instructions from IDB and Republic or CAMI, *for example, one viable alternative* to ignoring IDB's instructions and potentially breaching its contractual obligations *would be* to commence an interpleader action." (*Id.*) (emphasis added). But the Court's reasoning is flawed for two reasons.

First, under the terms of the CCAA, only *FSD* has the right to initiate an interpleader suit, which it did not. A330, 342, 355, 368 (Mot. Dismiss Exs. 4, 5, 6, 7 at §9C). IDB filed suit for breach of contract and conversion. It was therefore improper for the Court to utilize a hypothetical to construe the action so as to fit into the narrow interpleader carve out expressly agreed to by the parties to be for FDB's benefit for purposes of a substantive arbitrability analysis.[31]

Second, the Court's holding allows the exception to swallow the rule. The CCAA exists solely to govern the collateral held by FSD. Notwithstanding the fact that the Bailment Agreement was executed "in connection with" the CCAA and specifically provides that IDB is a third party beneficiary of the CCAA, under the

[31] The Court of Chancery's resort to speculation and hypothetical in a substantive arbitrability analysis in this instance, but its decision to refuse to do so on the issue of arbitrability just recently, creates confusion in the law. *See Medicis Pharma. Corp. v. Anacor Pharma., Inc.*, 2013 WL 4509652, at *10 n.59 (Del. Ch. Aug. 12, 2013) (denying motion to dismiss in favor of arbitration and declining to speculate on "circumstances [that] do not exist in this case" but "conceivably could"). Hypotheticals have no place in the realm of objective contract interpretation.

Court of Chancery's line of thinking, *any* claim under the CCAA or the Bailment Agreement relating to the disposition of collateral "could be" the subject of an interpleader suit. Consequently, the Court of Chancery's holding renders the mandatory arbitration provision superfluous, contrary to settled principles of contract interpretation and impermissibly re-writes the contract so as to eviscerate mandatory arbitration in favor of the narrow interpleader exception for any claim related to the collateral.[32]

Moreover, the Court of Chancery's holding was tantamount to penalizing FSD for failing to initiate an interpleader action. Such an interpretation has been disfavored. In *Holladay v. Patton*, then-Vice Chancellor Steele refused to fault an insurance company for paying out proceeds to a named beneficiary without having initiated an interpleader action.[33] "The language of Rule 22 is permissive, not mandatory. The opportunity presented by the rules does not impose a mandatory obligation on insurance companies to invoke the interpleader procedure."[34]

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[32] *See Maloney-Refaie v. Bridge at Sch., Inc.*, 958 A.2d 871, 884 n.35 (Del. Ch. 2008) (granting motion to dismiss in favor of arbitration and finding that plaintiff's argument would "violate the age-old principle that contracts must not be interpreted so as to render clauses superfluous or meaningless") (citation omitted); *Mehiel v. Solo Cup Co.*, 2005 WL 3074723, at *3 (Del. Ch. Nov. 3, 2005), *aff'd*, 906 A.2d 806 (Del. 2006) ("In the absence of carve-out or exclusivity terms in the contract language, I will not now step in and rewrite the contract in order to limit those protections.").

[33] 1995 WL 54437 (Del. Ch. Jan. 4, 1995).

[34] *Id*. at *3 (citing *Accord Benefit Trust Life Ins. Co. v. Union Nat'l Bank of Pittsburgh*, 776 F.2d 1174, 1177 (3d Cir. 1985)).

Likewise, just because the CCAA gives FSD the right to initiate an interpleader action in certain circumstances, does not nullify FSD's arbitration rights for all other cases implicating the collateral where it does not file an interpleader action.[35] For these reasons, the Court of Chancery misapplied the interpleader exception in the arbitration clause and should have resolved the issue of substantive arbitrability in favor of the arbitrator. The judgment below must be reversed for lack of subject matter jurisdiction and vacated in favor of arbitration.[36]

[35] *See eCommerce Indus., Inc. v. MWA Intelligence, Inc.*, 2013 WL 5621678, at *45 (Del. Ch. Oct. 4, 2013) ("Moreover, the mere fact that MWA's claim involves licensed intellectual property does not bring it within the exception. If it did, then nearly any claim brought under the Agreement would fall under the exception as well, thus causing the exception to swallow the rule.").

[36] *See Pettinaro Constr. Co., Inc. v. Harry C. Partridge, Jr., & Sons, Inc.*, 408 A.2d 957, 961 (Del. Ch. 1979) (noting that "a court, otherwise competent to hear the dispute, is ousted of its jurisdiction by the arbitration process.").

II. THE COURT OF CHANCERY ERRED WHEN IT FAILED TO RESOLVE THE ARBITRABILITY OF IDB'S CLAIMS IN FAVOR OF ARBITRATION, AS PROVIDED IN THE CCAA.

A. QUESTION PRESENTED

Did the Court of Chancery err when it refused to apply the arbitration provision in the CCAA, where the Bailment Agreement refers back to the CCAA and expressly provides that IDB was a third party beneficiary of the CCAA? FSD and CAMI preserved this issue in their motion to dismiss papers. A-260-63 (Mot. Dismiss Revised Op. Brief at §I.B.2-3).

B. STANDARD OF REVIEW

The Supreme Court reviews a trial court's denial of a motion to dismiss under a *de novo* standard of review.[37]

C. MERITS OF THE ARGUMENT

The Court of Chancery ruled that IDB's claims for breach were not arbitrable because they where governed by the Bailment Agreement and not the CCAA or its arbitration provision. Though the Court of Chancery applied the framework set forth by this Court in *Parfi*,[38] it gave too much weight to the interpleader exception in the arbitration clause in order to characterize the entire clause as narrow so as to retain jurisdiction over IDB's claims. Moreover, the

[37] *CCS Investors*, 977 A.2d at 322; *AeroGlobal Capital*, 871 A.2d at 437.

[38] 817 A.2d 149.

Court of Chancery misapplied the "traditional principles of contract and agency law"[39] that equitably conferred signatory status on IDB, *i.e.*, its third party beneficiary status, as well as the doctrines of equitable estoppel, agency, assumption and assignment.

1. **The Arbitration Clause is Broad Enough Under *Parfi* So As To Cover IDB's Claims**

The first step to analyzing substantive arbitrability under *Parfi*, is to "determine whether the arbitration clause is broad or narrow in scope."[40] The Court of Chancery recognized that the arbitration clause in the CCAA "commits the parties to arbitrate 'any controversy or claim arising out of or in connection with this Agreement'" and that such language is normally broad in scope and indicative of "an intent to arbitrate all matters that touch on the rights created by the agreement." (Ex. A at 15-16). However, the Court compounded its earlier error with respect to its overly broad interpretation of the interpleader exception (*see supra* §I.C.2), and found the claims in dispute were analogous enough to the exception to consider the arbitration clause narrow. (*Id.*). But this holding again sets established law on its head and allows the exception to swallow the rule. Simply because an arbitration clause has an exception does not mean it is not broad

[39] *NAMA Holdings, LLC v. Related World Mkt. Ctr., LLC*, 922 A.2d 417, 430 (Del. Ch. 2007) (citing *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Int'l, S.A.S.*, 269 F.3d 187, 194 (3d Cir. 2001)).

[40] *Parfi*, 817 A.2d at 155.

or that it does not evidence an intent to arbitrate all disputes.[41] If an arbitration clause is broad in scope and provides for arbitration of "any controversy or claim arising out of or in connection with" the agreement -- as the CCAA provides – settled law is that "the court will defer to arbitration any issues that touch on contract rights or contract performance."[42] The Court of Chancery erred when it characterized the arbitration clause as narrow, instead of broad.

The second step of the substantive arbitrability analysis under *Parfi* is to "apply the relevant scope of the provision to the asserted legal claim to determine whether the claim falls within the scope of the contractual provisions that require arbitration" – not to apply hypotheticals.[43] It cannot be said that IDB's causes of action did not "touch on contract rights or contract performance" of the CCAA. First, IDB sued for breach of its instruction rights in ***both*** the Bailment Agreement and the CCAA, explicitly acknowledging the inter-relation of the agreements,[44] as

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[41] *See Willie Gary*, 942 A.2d at 624 (citing *Cong. Constr.*, 2005 WL 3657933, at *2-3 (exception for consequential damage claims did not eviscerate intent that arbitration provision generally provides for arbitration of all disputes); *Halpern Med. Servs., LLC v. Geary*, 2012 WL 691623, at *1-2 (Del. Ch. Feb. 17, 2012) (finding arbitration clause "undoubtedly broad in scope" with wording very close to that at issue in *Parfi*, notwithstanding "certain exceptions to arbitration clause not implicated in this case"); *McLaughlin*, 942 A.2d at 624.

[42] *Parfi*, 817 A.2d at 155.

[43] *Id*.

[44] *See Westendorf v. Gateway 2000, Inc*., 2000 WL 307369, at 4 (Del. Ch. Mar. 16, 2000), *aff'd*, 763 A.2d 92 (Del. 2000) (then-Vice Chancellor Steele, when faced with a plaintiff seeking to avoid arbitration under one contract which did not contain an arbitration provision, while a companion contract did: "I find that this suggested result would run contrary to the

it must, given that the collateral held under the CCAA is the identical collateral governed by the Bailment Agreement and the contracts were executed on the same day.[45] A56-57 (Compl., Count I). IDB also sued for conversion of the collateral held under the CCAA. The conversion claim is, therefore, a claim that "arises out of or in connection with" the CCAA. A57-58. (*Id.*, Count II).[46] Second, the Bailment Agreement and the CCAA have substantial overlapping provisions, including provisions dealing with safekeeping, inspection, insurance, identification of property and custodial rights – the same rights pursued in IDB's Complaint. Indeed, IDB sued for breach under both agreements, because FSD acted as custodian of the collateral under both the provisions of the Bailment Agreement and the provisions of the collateral custody account under the CCAA. Given the breadth of the arbitration clause covering matters "in connection with" the CCAA, such as the Bailment Agreement, once the Court of Chancery had decided that it, and not the arbitrator, should decide questions of substantive arbitrability, the

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intended interrelationship between the two agreements, and would contradict explicit public policy to interpret broadly arbitration clauses.")

[45] IDB should have been equitably estopped from avoiding arbitration having brought a claim under the CCAA while simultaneously disavowing the arbitration provision. *See E.I. DuPont*, 269 F.3d at 199; *Town of Smyrna v. Kent Cnty. Levy Court*, 2004 WL 2671745, at *4 (Del. Ch. Nov. 9, 2004).

[46] *See Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 1987 WL 16508, at *3 (Del. Ch. Sept. 8, 1987) *aff'd*, 545 A.2d 1171 (Del. 1988) (holding tort claims arbitrable where there was a sufficient connection between the tort claims and the contract).

Court should have found IDB's claims arbitrable. Because the Court of Chancery lacked subject matter jurisdiction over IDB's claims, the judgment below must be reversed and vacated.[47]

2. IDB's Claims Were Arbitrable Under the Doctrines of Third Party Beneficiary, Agency, Assumption and Assignment

IDB's claims were arbitrable under basic principles of contract interpretation, as well, such that FSD was entitled to enforce the arbitration clause against IDB, even though it was not a party to the CCAA. "[C]ourts have recognized several theories under which a nonsignatory to a contract may nonetheless be bound by an arbitration provision contained in the agreement, including (1) incorporation by reference, (2) assumption, (3) agency, (4) veil piercing/alter ego, (5) third-party beneficiary, and (6) equitable estoppel."[48] Here, a number of theories apply. First, the Bailment Agreement designates IDB as an express and intended third party beneficiary of "separate agreements between [FSD], [Republic] and [Republic's] clients" defined as the "Contracts" in the opening paragraph of the Bailment Agreement and which "Contracts" are

[47] *See Pettinaro*, 408 A.2d at 961 (noting that "a court, otherwise competent to hear the dispute, is ousted of its jurisdiction by the arbitration process.").

[48] *Kuroda v. SPJS Holdings, L.L.C.*, 2010 WL 4880659, at *3 (Del. Ch. Nov. 30, 2010) (citing *NAMA Holdings*, 922 A.2d at 430-31 & n.26)).

explicitly cross-referenced in the Bailment Agreement.[49] A379 (Mot. Dismiss Ex. 8, at 1). As an intended third party beneficiary of the CCAA, IDB should be bound to the same extent as the signatory, Republic.[50] If the third party beneficiary clause does not incorporate the arbitration provision for disputes relating to the collateral, what does it cover? The Court of Chancery's holding renders the third party beneficiary clause meaningless. Second, under each of the CCAA and the Bailment Agreement, FSD was acting for the ultimate benefit of IDB, explicitly under the Bailment Agreement, but impliedly under CCAA, given that Republic had (i) granted IDB a security interest over property stored with FSD at least as of the August 24, 2006 date of the Bailment Agreement, and (ii) assigned the loan to IDB as of November 14, 2006. A379; A406-07 (Mot. Dismiss Ex. 8, at 1; Mot. Dismiss Ex. 10). Thus, under principles of agency, assumption and assignment, IDB was bound by the arbitration clause in the same manner as Republic.[51]

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[49] *But see* Ex. A at 21 (finding that Bailment Agreement did not incorporate the provisions of the CCAAs).

[50] *NAMA Holdings*, 922 A.2d at 431 (citing *E.I. DuPont*, 269 F.3d at 195-98).

[51] *See id.* (citing *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 776-77 (2d Cir. 1995).

III. THE COURT OF CHANCERY LACKED SUBJECT MATTER JURISDICTION AND THE JUDGMENT MUST BE REVERSED AND VACATED IN FAVOR OF ARBITRATION.

A. QUESTION PRESENTED

Must the Court of Chancery's judgment be reversed for lack of subject matter jurisdiction? FSD and CAMI preserved this issue for appeal in their Motion to Dismiss and supporting briefs. A257 (Mot. Dismiss Revised Op. Brief at § I.A).

B. STANDARD OF REVIEW

Issues of subject matter jurisdiction involve questions of law that the Supreme Court reviews *de novo.*[52] In assessing whether the trial court had subject matter jurisdiction, this Court makes its determination from the face of the complaint at the time of filing and assumes that all material factual allegations are true.[53]

C. MERITS OF THE ARGUMENT

"If a court lacks subject matter jurisdiction, its decision is a nullity."[54] This rule applies even if a matter has been decided on the merits through summary

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[52] *Asbestos Workers Local Union No. 42 Welfare Fund v. Brewster*, 940 A.2d 935, 940 (Del. 2007); *Candlewood Timber Grp., LLC v. Pan Am. Energy, LLC*, 859 A.2d 989, 997 (Del. 2004) ("On questions of subject matter jurisdiction, the applicable standard of review by this Court is whether the trial court correctly formulated and applied legal principles. The scope of our review is *de novo.*").

[53] *Janowski v. Div. of State Police, Dep't of Safety & Homeland Sec.*, 981 A.2d 1166, 1169 (Del. 2009) (*en banc*).

[54] *Thompson v. Lynch*, 990 A.2d 432, 434 (Del. 2010) (citing *Bruno v. Western Pac. R.R. Co.*, 1986 WL 16474, at *1 (Del. Mar. 7, 1986); *Bruce E.M. v. Dorothea A.M.*, 455 A.2d 866, 871 (Del. 1983)).

judgment or progressed all the way through trial.[55] For the reasons discussed herein, the judgment of the Court of Chancery must be reversed and vacated and the case dismissed in favor of arbitration.

[55] *Nelson v. Russo*, 844 A.2d 301 (Del. 2004) (*en banc*) (reversing and remanding Superior Court summary judgment for lack of subject matter jurisdiction); *Yost v. Johnson*, 591 A.2d 178 (Del. 1991) (reversing, after trial, Family Court's decision to uphold subject matter jurisdiction as "incorrect under the circumstances"). *See also In re The Majestic Star Casino, LLC*, 716 F.3d 736 (3d Cir. 2013) (vacating summary judgment for debtor due to lack of standing and remanding with directions to dismiss the complaint for lack of jurisdiction); *State Farm Mut. Auto. Ins. Co. v. Powell*, 87 F.3d 93 (3d Cir. 1996) (summary judgment reversed and remanded in favor of dismissal where subject matter jurisdiction was lacking due to insufficient amount in controversy).

CONCLUSION

For all of the foregoing reasons, the judgment of the Court of Chancery should be reversed and vacated in favor of arbitration.

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