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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' REPLY BRIEF

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INTRODUCTION

IDB goes to great length to impugn the bona fides of Defendants' appeal and re-litigate pre-judgment proceedings, but such conduct is entirely irrelevant to the question here -- arbitrability.[1] On appeal, this Court need not be concerned with any matter outside the narrow issue of whether the Court of Chancery had subject matter jurisdiction over IDB's claims. IDB puts the cart before the horse in its Answering Brief.[2] IDB's principal argument attempts to eviscerate all semblance of the CCAAs by reasoning that its claims were not arbitrable under *Parfi*. But IDB's own Complaint and the four corners of the contracts at issue demonstrate otherwise. IDB's claims regarding disposition of the collateral should have been arbitrated and the judgment below should be reversed and vacated. With respect to the threshold question of who should decide arbitrability, IDB contends that the interpleader exception is broader than an exception for injunctive relief. As shown below, this is inconsistent with the practical reality of injunction practice and its application.

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[1] When it comes to subject matter jurisdiction, "[e]quity, [ ] has nothing to do with the matter." *Wells Fargo Bank NW, N.A. v. TACA Int'l Airlines, S.A.*, 314 F. Supp.2d 195, 197 (S.D.N.Y. 2003) (noting the "federal court must be prepared to question its jurisdiction at any time, even after judgment or on appeal" despite instances where it may question the conduct of the litigants); *Chavin v. H.H. Rosin & Co.*, 246 A.2d 921, 922 (Del. 1968) (reversing judgment of specific performance for payment of rent when Supreme Court questioned subject matter jurisdiction *sua sponte*).

[2] D.I. 18. IDB leaves the threshold question to the tail end of its brief. Defendants present their arguments in reply in the same order as presented in the Opening Brief, which mirrors the questions the Court must address on appeal.

REBUTTAL FACTS

The facts pertinent to this appeal are limited:

1. In 2004, IDB entered into a substantial facility with Republic collateralized by Republic's accounts, inventory, receivables, client collateral and client loan documents. A43-45; A63; A65-67.

2. In 2005, Republic used IDB's loan proceeds to, in turn, loan CAMI, Lott and Ketterling money collateralized by the same client collateral Republic had pledged to IDB. A316.

3. Beginning on August 24, 2006, FSD and Republic entered into CCAAs with CAMI, Lott and Ketterling for the creation of multiple custody accounts (A173-223). Each CCAA was a client loan document and part of IDB's collateral. *See* A66. Each CCAA contained an arbitration clause. *See, e.g.*, A173-184, at §20.

4. Significantly, also on August 24, 2006, IDB, Republic and FSD signed a Bailment Agreement (A119-121) providing that IDB was an express third party beneficiary of the CCAAs (referred to as "Contracts") as follows:

> 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.

A119. The Bailment Agreement further cross-referenced the CCAAs in three other places: (i) in Section 2 regarding safekeeping and inspection, FSD was required to discuss with IDB matters relating to its performance "under this Agreement and under the Contracts" (A119); (ii) in Section 3, FSD was required to maintain "such other insurance as is required pursuant to the terms of the Contracts" (A120); and (iii) in Section 6, FSD was permitted to continue to follow Republic's instructions pursuant to the CCAAs pending further notice ("Until [FSD] has received written notification to the contrary from an officer of [IDB], [FSD] may continue to release the Property in accordance with instructions issued by [Republic]."). *Id*. The Bailment Agreement does not contain an integration clause or any other language suggesting it supersedes prior agreements.

5. On August 12, 2009, IDB signed a CCAA with FSD and Republic regarding the so-called Error Coins (A125-134) which it admits "required several revisions prior to agreeing to its terms." A.B. at 8. Notwithstanding having negotiated certain changes for its benefit in the CCAA, IDB did not alter, amend or delete the arbitration provision. A132 at §20.

6. For over three (3) years from the date of the Bailment Agreement, IDB allowed Republic to continue to instruct FSD under the CCAAs.

7. On December 23, 2009, IDB claims to have sent a letter instructing FSD not to release the collateral without IDB's consent. A46-47 (Compl. ¶21).

8. On February 13, 2012, IDB filed suit in the Court of Chancery asserting two causes of action: Count I for breach of the Bailment Agreement and breach of the 2009 CCAA, and Count II for conversion. A38-59 (Compl. ¶¶46-55). In its Complaint, IDB asserted that its rights under the Bailment Agreement had been trampled upon for the *very same* reasons that the 2009 CCAA had been infringed. IDB claimed that FSD breached the Bailment Agreement and the 2009 CCAA by denying IDB access for inspections or audits, removing and marketing certain collateral without permission, and refusing to allow IDB to transfer the collateral to another depository. A57 (Compl. ¶50). IDB's claims for breach of the Bailment Agreement and conversion are coextensive of its claims for breach of the 2009 CCAA. Each contract provides for rights to examine or audit the collateral. A127 (CCAA §7), A119-120 (Bailment Agreement §2). Each contract addresses removal of or marketing of the collateral without authorization. A126 (CCAA §3), A119-120 (Bailment Agreement §§1, 2, 4). And each contract contains provisions regarding prompt removal of the collateral. A126-127 (CCAA §4), A120 (Bailment Agreement §6).

ARGUMENT

I. ACTIONS FOR INJUNCTIVE RELIEF ARE FAR BROADER THAN INTERPLEADER ACTIONS SUCH THAT THE ARBITRABILITY OF IDB'S CLAIMS SHOULD HAVE BEEN LEFT TO THE PROVINCE OF THE ARBITRATOR

In support of the decision below, IDB contends that the first prong of this Court's substantive arbitrability standard established in *Willie Gary*[3] was not met because the carve out in the arbitration clause here for interpleader actions is "at least as broad as . . . and broader than" the carve outs for injunctive relief in the arbitration clauses in *Willie Gary*[4] and *BAYPO*,[5] respectively.[6] Thus, IDB asserts that the interpleader exception is so broad that the clause does not "generally provide for the arbitration of all disputes." This is simply not correct. The filing of an interpleader action and securing an order authorizing the deposit of funds with the Court can often be accomplished in relatively short order. Thus, an

[3] *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 80 (Del. 2006) (noting that a substantive arbitrability determination is delegated to the arbitrator if it is established that an 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")). The second prong is not at issue here. *See* Corrected O.B. 14.

[4] *See* 942 A.2d at 81 (permitting non-breaching members of the company to pursue in court claims for specific performance and injunctive relief); *see also* Corrected O.B. 17.

[5] *See BAYPO L.P. v. Tech. JV, LP*, 940 A.2d 20, 26-27 (Del. Ch. 2007) (permitting the parties to pursue injunctive or equitable relief to protect their interests before, during, or after the arbitration process); *see also* Corrected O.B. 17-18.

[6] A.B. 20-21. Notably, IDB essentially concedes that the "generally…all" language in *Willie Gary* is ambiguous as it does not cite any cases articulating how broad an arbitration carve out must be to overcome the first prong. Instead, it wrongly and unsuccessfully attempts to show that an interpleader action is as broad as or broader than injunctive relief.

interpleader action is generally a very narrow procedural "device by which a limited fund may be distributed among several claimants."[7] It is a straightforward action which involves commencing a lawsuit for the purpose of depositing contested funds into the court's registry and obtaining a discharge for the party subject to competing instructions.[8] An interpleader action typically would *not* include an award of compensatory damages against the depositor of the funds (the hypothetical role the Court of Chancery analogized to FSD).

By way of contrast, the very nature of an action for injunctive relief is inherently broader than an interpleader action, and generally entails first the prosecution and issuance of a TRO, and then document production, depositions, briefing, and a preliminary injunction hearing.[9] Moreover, an injunction is applicable to a far broader array of disputes than an interpleader ever could be.

Thus, IDB's argument that the first prong of a substantive arbitrability determination under *Willie Gary* was not met because the carve out in the arbitration clause here for interpleader actions is "at least as broad as…and broader than" the carve outs for injunctive relief is simply unsupported and incorrect. Of

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[7] *Prof'l Underwriters Liab. Ins. Co. v. Zakrzewski*, 2006 WL 3872847, at *3 (Del. Ch. Dec. 12, 2006).

[8] Ct. Ch. R. 22.

[9] *Compare* Ct. Ch. R. 22 *with* Ct. Ch. R. 65. *See also* http://courts.delaware.gov/Chancery/docs/Model_Scheduling_Stipulation_PI.pdf (sample Court of Chancery scheduling order for preliminary injunction).

the two, an interpleader is a far narrower procedural carve out. And the carve out here is even more narrow yet, as it was limited by the contract to be solely available to FSD. Thus, by its plain language, the carve out does not permit even the other contract signatories to invoke the interpleader exception. By its ruling, the Court of Chancery wrongly gave to IDB, a third party beneficiary, rights greater than the other signatories to the CCAAs.[10]

As the Courts in *Willie Gary* and *BAYPO* both held that the injunctive relief carve outs were sufficiently narrow to delegate the respective substantive arbitrability determination to the arbitrator,[11] the Court of Chancery's finding here with respect to the interpleader exception is in error. All issues of substantive arbitrability should have been reserved for the arbitrator and the Court should not have reached the arbitrability question once it was divested of jurisdiction.

[10] *See*, *NAMA Holdings, LLC v. Related World Mkt. Ctr., LLC*, 922 A.2d 417, 431 (Del. Ch. 2007) (with regard to enforcing an arbitration clause, "The law is clear that…a third-party beneficiary of the agreement has no greater rights to compel *or avoid* arbitration than does one of the signatories to the contract.") (emphasis added); *Delmar News, Inc. v. Jacobs Oil Co.*, 584 A.2d 531, 534 (Del. Super. Ct. 1990) ("It is axiomatic that a third-party beneficiary to a contract can have no greater rights under the contract than the signatories thereto." (citing 2 *Williston on Contracts*, 3d Ed. § 364A (1959)).

[11] Corrected O.B. 17-18.

II. IDB'S ENTIRE ARGUMENT AGAINST THE ARBITRABILITY OF ITS CLAIMS UNDER *PARFI* RESTS ON A DISAVOWAL OF ITS OWN COMPLAINT

IDB asserts in its Answering Brief that notwithstanding the Court of Chancery's recognition that the facts required one, a substantive arbitrability determination was unnecessary here because IDB's suit against Defendants rests solely on the Bailment Agreement (which does not contain an arbitration clause), and not the CCAAs (which require arbitration of all disputes except for an interpleader action asserted by FSD).[12] IDB later admits, however, that it explicitly brought claims on at least one of the CCAAs -- the 2009 CCAA (as defined in the Corrected Opening Brief)[13] -- which contains an arbitration clause identical to all of the other CCAAs.[14] IDB contends however, that the 2009 CCAA arbitration clause is not relevant, however, because the claim related to the 2009 CCAA was "mooted" during the litigation.[15] Whether or not this claim was voluntarily "mooted" at some point is not relevant to the question of substantive arbitrability here,[16] as that determination must be made on the face of the

[12] A.B. 15-16.

[13] D.I. 15.

[14] A.B. 29-30.

[15] A.B. 29.

[16] We note that IDB chose not to amend its complaint in response to the Motion to Dismiss. *See* Ct. Ch. R. 15(aaa).

pleading.[17] What is relevant is the fact that IDB chose to sue on one contract which had an arbitration clause (the 2009 CCAA), as well as a second contract (the Bailment Agreement) which refers back to the CCAAs multiple times and relates to the same subject collateral. Thus, when Defendants sought to dismiss the Complaint for lack of subject matter jurisdiction, the Court of Chancery was required to make its determination from the face of the Complaint,[18] which contained the claim IDB now argues was mooted. Plaintiff's argument is simply a red herring and is inconsistent with established Delaware law. One cannot "moot" or dismiss a claim to defeat an arbitration clause.[19] Consistent with the Court of Chancery's holding in *Ishimaru,* this Court should disregard IDB's argument as a transparent attempt to downplay the ramification of its pled facts to escape the arbitration clause.

IDB next argues that the arbitration clause in the 2009 CCAA is irrelevant because the 2009 CCAA relates to certain "error coins" and not the Property

[17] *Janowski v. Div. of State Police*, 981 A.2d 1166, 1169 (Del. 2009) ("We determine subject matter jurisdiction from the face of the complaint at the time of filing and assume that all material factual allegations are true.").

[18] Corrected O.B. 29.

[19] *See Ishimaru v. Fung*, 2005 WL 2899680, at *9-10 (Del. Ch. Oct. 26, 2005) (applying an arbitration provision to a plaintiff's claims despite "amending her complaint in a manner that to a cynic would appear purposely designed to retract pled facts that, if true, made it more difficult for her to escape the [a]rbitration [c]lause.").

(which IDB defines to include all collateral *except* the error coins).[20] This too is an artful attempt by IDB to recast its pleading. In the very first paragraph of its Complaint, IDB plainly states that it is seeking relief with respect to $17 million of numismatic coin collateral, including the so-called "error coins."[21]

Thus, at the time of its Complaint, IDB considered the "error coins" part of its numismatic coin collateral on which its claims rest. IDB's alleged view to the contrary is revisionist and is no more than a transparent attempt to avoid the ramifications of its claims as pled. A plain reading of the Complaint reveals that: (i) Plaintiff relies on both the 2009 CCAA and the Bailment Agreement,[22] (ii) the earlier CCAAs were contemplated at the time of the execution of the Bailment Agreement, which incorporates by reference the terms of those CCAAs in multiple places, and (iii) the rights IDB asserted in its Complaint arose from both contracts. It is settled law that where there are two closely related agreements – one containing an arbitration clause and the other not – the court should defer to arbitration because under those circumstances, litigating certain claims and arbitrating others, "is not only inappropriate, but inefficient and contrary to judicial

[20] Compare A.B. 5 (defining "Property") with A.B. 30 (explaining the significance of the "error coins").

[21] A42 (Compl. ¶1).

[22] A47-49 (Compl. ¶¶22-26); A56 (Count I).

interest in expeditious resolution of controversies."[23] Moreover, IDB admits that disputes relating to the "error coins" are subject to arbitration.[24] That admission supports Defendants' position that the entire dispute should have been arbitrated as all of the collateral – even the "error coins" – was governed by a CCAA, which required arbitration.

In sum, IDB's attempt to limit its action as one to enforce its rights under *only* the Bailment Agreement and cloak itself under *Parfi* is artificial at best, just as its *post hoc* contention that its "ultimate claims" were under the Bailment Agreement not only disregards the plain allegations of its Complaint, but also the intended and inherent relationship between the Bailment Agreement and the CCAAs.[25] Notably, any alleged violation of the 2009 CCAA would also apply to the earlier CCAAs given IDB's Complaint on the entire $17 million of its collateral (not just the Error Coins) and the express terms of the Bailment

[23] *Salzman v. Canaan Capital Partners, L.P.*, 1996 WL 422341, at *5 (Del. Ch. July 23, 1996) (granting stay). In *Salzman*, the plaintiff sought dissolution against three Delaware limited partnerships. Although two of the three partnership agreements did not require the parties to arbitrate the dissolution issue, because one agreement required arbitration, given the "identity of facts and parties involved" and that "the arbitration panel's factual findings with respect to one [defendant] also will be dispositive of the dissolution claims against the other two," the Court stayed the case in favor of arbitration. *Id*. at *1.

[24] A48-49 (Compl. ¶26) (acknowledging arbitration provision within 2009 CCAA).

[25] A.B. at 1.

Agreement.[26] IDB's claim that the earlier CCAAs are not relevant is belied by the plain language of its own Complaint and the very nature of the contracts at issue.

IDB cites only one new case, *Vituli*, to support its proposition that the CCAA's arbitration clause does not apply to its claims.[27] *Vituli* is inapposite. In that case an employee sued under an employment contract. The defendant moved to dismiss and to compel arbitration by invoking a company-wide memo purporting to subject all employees' claims against the company to arbitration.[28] The plaintiff's employment agreement, however, contained no such arbitration provision, the agreement did not refer to the memo, and, importantly, the memo was not referred to or incorporated into the pleadings.[29] For these reasons, the Court refused to compel arbitration finding that the memo purportedly requiring arbitration went "beyond the case's initial pleadings," which is inappropriate at the motion to dismiss stage.[30] Here the facts are markedly dissimilar. The 2009 CCAA is expressly part of the Complaint and IDB's claim for breach in Count I. Moreover, each CCAA, including the 2009 CCAA, contains an arbitration clause. The Bailment Agreement, relating to the same collateral covered by the CCAAs,

[26] *See* A38 (Compl. ¶1).

[27] A.B. 16-17.

[28] *Vituli v. Carrols Corp.*, 2013 WL 2423091, at *1 (Del. Super. Ct. Mar. 28, 2013).

[29] *Id.*

[30] *Id.*

makes repeated reference to various terms of the CCAAs and designates IDB as an express third party beneficiary of all of the CCAAs. Plaintiff's reliance on *Vituli* is misplaced.

The remaining cases cited by IDB are likewise unhelpful as they merely stand for the unremarkable proposition that a non-signatory ordinarily cannot be bound by a contract that it did not sign.[31] Each of these cases also is readily distinguishable as none involved a dispute over whether claims were subject to arbitration; and in fact, none dealt with arbitration at all.

What is significant here, and what IDB attempts to mask by misdirection, is the fact that IDB, a sophisticated party, admits that it participated in the drafting of the 2009 CCAA and agreed to its terms, including the arbitration clause: "[w]hen [it] received the form CCAA from FSD, *it required several revisions* prior to agreeing to its terms."[32] Thus, IDB, had the opportunity to remove the arbitration language, but consciously chose not to do so.[33] IDB was also aware at that time that all prior CCAAs to which the Bailment Agreement referred contained the same arbitration clause.

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[31] A.B. 17-18 (citing *Allied Capital Corp v. GC-Sun Holdings, L.P.*, 910 A.2d 1020 (Del. Ch. 2006); *Union Oil Co. v. Mobil Pipeline Co.*, 2006 WL 3770834 (Del. Ch. Dec. 15, 2006); *EBG Holdings LLC v. Vredezicht's Gravenhage 109 B.V.*, 2008 WL 4057745 (Del. Ch. Sept. 2, 2008); *Caldera Props.-Lewes/Rehobeth VII, LLC v. Ridings Dev., LLC*, 2008 WL 3323926 (Del. Super. Ct. June 19, 2008)).

[32] A.B. 8 (emphasis added).

[33] *See, e.g.*, A124-134 at §20.

IDB's after-the fact attempts to distance itself from its negotiated status as a named beneficiary in the CCAAs likewise fail. The admitted facts establish that (*even if* the 2009 CCAA was not in the Complaint), IDB, FSD and Republic participated in the drafting of and signed the Bailment Agreement on the same day that FSD, Republic and CAMI signed two other CCAAs, and that the Bailment Agreement refers to the terms of those CCAAs repeatedly. Then, three years later, IDB signed its own CCAA containing the same arbitration clause present in all the other CCAAs. These facts alone demonstrate that the Bailment Agreement and the CCAAs were always related and intended to be related and considered together. The plain and intended meaning of those documents requires arbitration in *all* cases where IDB is a plaintiff.

III. IDB'S ATTEMPT TO ESCAPE ITS THIRD PARTY BENEFICIARY STATUS IN THE CCAAs AS A MEANS OF DISTINGUISHING ITS CLAIMS UNDER *PARFI* FAILS

In a final attempt to distance itself from the intended and acknowledged connection between the Bailment Agreement and the CCAAs, IDB argues that Defendants' third party beneficiary and agency arguments fail.[34] Instead, however, IDB's own "freedom of contract" argument militates against the arguments it propounds.[35] If, as IDB argues, each word of a contract must be given its explicit meaning without any regard to the intention and understanding of the parties to that contract, then the Bailment Agreement's third party beneficiary language, as well as each reference to the CCAAs in the Bailment Agreement, must be strictly construed. Thus, applying IDB's thinking, as a third party beneficiary of the CCAAs pursuant to the Bailment Agreement (including the 2009 CCAA), the arbitration clause should have been enforced, thereby divesting the Court of Chancery of subject matter jurisdiction.

Notwithstanding this, IDB argues that neither the principles of agency nor the fact that it is explicitly named as a third party beneficiary under the Bailment Agreement bring its claims within the scope of the CCAAs' arbitration clause. In doing so, IDB ignores the fact that the Bailment Agreement and the CCAAs are

[34] A.B. 33-34.

[35] S*ee supra* § II.

inextricably intertwined given that they relate to the same collateral at the core of this dispute and the first two CCAAs were executed *on the same day* as the Bailment Agreement in 2006. IDB's attempt to parse out the language of the two agreements defies reasoning and ignores the reality and practical intent of the agreements and its own understanding of those agreements at the time of its pleading. This after-the-fact recharacterization of its agreements and its claims is not credible, and in any event, is not relevant to the Court's proper review to determine substantive arbitrability.

IDB cites to only one case, *E.I. DuPont*,[36] for the proposition that a third party beneficiary to an agreement with an arbitration clause can only be compelled to arbitrate its claims if the claims asserted arise from that third party beneficiary status.[37] IDB's reliance on *E.I. DuPont* is also misplaced. In that case, the written contract at issue, which required arbitration, contained no express third party beneficiary clause, rather, it was argued that the parent company was a beneficiary of a contract involving its subsidiary, even if the contract was silent on the subject, and could therefore be compelled to arbitrate, even as a non-signatory. Here, IDB is a signatory to a contract requiring arbitration – the 2009 CCAA – a contract which it sued upon. And, it is a signatory to a contract designating it a third party

[36] *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Interms., S.A.S.*, 269 F.3d 187 (3d Cir. 2001).

[37] A.B. 33.

beneficiary of the contract requiring arbitration – the Bailment Agreement, a contract which it also sued upon. "[W]hether seeking to avoid or compel arbitration, a third party beneficiary has been bound by contract terms where its claim arises out of the underlying contract to which it was an intended third party beneficiary."[38] The Court of Chancery simply got it wrong when it ruled that IDB's claims did not arise out of a contract requiring arbitration.

As to the agency argument, IDB makes only a one-paragraph rebuttal supported solely by a citation to the post-trial opinion.[39] As previously noted, IDB's reliance on the post-trial opinion to support it arguments is improper given the standard the Court must apply on a challenge to subject matter jurisdiction.

[38] *E.I. Dupont*, 239 F.3d at 195.

[39] A.B. 34.

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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