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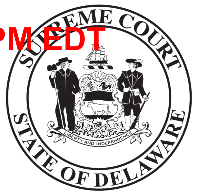

IN THE SUPREME COURT OF THE STATE OF DELAWARE

GARDA USA, INC., a Delaware Corporation, and GARDA WORLD SECURITY CORPORATION, a Corporation Organized Under the Laws of Canada, Plaintiffs-Appellee, v. SPX CORPORATION, a Delaware Corporation, Defendant-Appellant.	Case No. 332, 2013 Chancery Court of the State of Delaware Before: Hon. J. Travis Laster, Vice Chancellor.

<u>DEFENDANT-APPELLANT SPX CORPORATION'S REPLY BRIEF</u>

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INTRODUCTION

This matter arises out of the sale of the capital stock of Vance International ("Vance") from Defendant-Appellant, SPX Corporation ("SPX") to Plaintiff-Appellee, Garda USA, Inc. ("Garda") pursuant to an Amended Stock Purchase Agreement (the "SPA" or the "Agreement") effective December 31, 2005. Garda contested the calculation of the workers' compensation reserve component (the "WC Reserve") of the working capital calculation used in determining the sale price. In 2011, five years later, Garda demanded arbitration of the disagreement under the arbitration provisions of the SPA. The dispute was then submitted to arbitration in mid-2011. The Arbitration resulted in an award favorable to SPX.

REPLY ARGUMENT

I. GARDA SEEKS TO MISCHARACTERIZE AND UNDULY LIMIT THE NATURE OF THE DISPUTE PRESENTED TO THE ARBITRATOR.

Garda's Answering Brief demonstrates Garda's belief that, in order to prevail in this appeal, Garda must convince this Court that the dispute presented to the Arbitrator was limited to a mathematical computation, which the Arbitrator incorrectly performed. This characterization of the dispute, however, is expressly belied by the parties' written submissions to the Arbitrator articulating the nature of the dispute for the Arbitrator to resolve. As shown below, the parties' directed the Arbitrator to determine the "correctness" of the parties' respective positions concerning the Vance WC Reserve. In doing so, the parties did not limit the Arbitrator's latitude in making its determination, other than requiring the determination to be based on the parties' submissions and precluding the Arbitrator from making determinations of law. As such, the Arbitrator did not improperly exceed his authority by interpreting the Agreement and concluding that SPX's position that the WC Reserve amount of $1.366 million was the correct one, as Garda wrongly contends.

Based on the evidence presented to the Arbitrator, the Arbitration Award could clearly have been based on more than one basis, only one of which the Court

of Chancery considered. In its Answering Brief Garda attempts to characterize the task of the Arbitrator as being simply the application of an arithmetic formula to calculate the WC Reserve contained in the Effective Date Balance Sheet. The Court below agreed with this characterization and concluded that because the Arbitrator did not rule to increase the WC Reserve, the Arbitrator ignored an unambiguous provision in the Agreement that required the inclusion of incurred but not revealed claims ("IBNR") in the WC Reserve, essentially ruling that Arbitrator made a math error by failing to include a required element of the computation.

The dispute presented to the Arbitrator for decision was contained in two documents: the Arbitrators' Statement of Work dated March 15, 2011 ("SoW") and signed by SPX and Garda, and each party's List of Disputed Items submitted to the Arbitrator. A. 335-349; 362-363; 364-365. The SoW stated that E&Y would act as the "Independent Accountant to resolve certain disputes between the Parties arising under Section 1.3 of their SPA", based "solely on the presentations of the parties", and without "making any legal determinations or otherwise rul[ing] upon issues of law in rendering the Award." A. 337-338.

The parties List of Disputed Items are nearly as broad, identifying the dispute as the "correctness" of each other's positions.

> 1. **Workers Compensation Reserve –** Garda disputes the correctness of the $1.366 million recorded by SPX in the "accrued workers

> compensation expense" line item of Note 5. Garda asserts that SPX should have reserved an amount greater than the $1.366 million amount and, therefore, this amount should be increased in the Effective Date Balance Sheet

A. 362 (Garda's List of Disputed Items).

> 1. **Workers Compensation Reserve** – SPX disputes the correctness of Garda's claim that the accrued workers compensation expense line item Note 5 should be '$3,000,000,00' as set forth in Alan Dumont's May 19, 2006 letter to SPX.

A. 364 (SPX's List of Disputed Items). Given the broad scope of the dispute the parties presented to the Arbitrator, it is not at all surprising that the parties' submissions to the Arbitrator throughout the proceeding made various arguments seeking to have the Arbitrator interpret and apply the provisions of the Agreement.

In its submission, consistent with the disclosures that SPX had made to Garda in soliciting an offer from Garda to purchase Vance and as provided throughout the Agreement, SPX advised the Arbitrator that SPX computed the WC Reserve in the same manner and using the same subjective methodology it used in the September 30, 2005, Balance Sheet. SPX referred to SPA Section 1.3(a) as requiring SPX to prepare the Pre-Closing Balance Sheet "consistent with and using the same methods, procedures, assumptions and adjustments employed on the September 30 Balance Sheet as set forth on Section 1.3 of the Seller Disclosure Schedule (the "Working Capital Schedule")." A. 501. Section 1.3(c) of the SPA contained the same language requiring SPX to prepare the Effective Date Balance

Sheet "consistent with and using the same methods, procedures, assumptions and adjustments employed on the September 30 Balance Sheet as set forth on Section 1.3 of the Working Capital Schedule." A. 501-502. Virtually the same language was carried forward in Seller Disclosure Section 1.3(c). A. 556.

SPX also submitted evidence that, in the almost six year period between the Vance sale closing and the Arbitration, all the actual workers' compensation claims had been resolved and the actual claims paid out were less than the amount of the $1,366,000 WC Reserve. A. 935. SPX proved that the total value of the actual workers' compensation liabilities arising or incurred before December 31, 2005 was $1,232,758, resulting in a WC Reserve surplus of $133,242 and that as a factual matter, there were no additional IBNR claims to be accrued. A. 976-999.

In its initial Arbitration submission, Garda argued that based on a report received by SPX from its consultants after the Effective Date of the SPA and Garda's own actuarial report, the WC Reserve should have been at least $2.1 to 2.5 million higher. Garda contended that this increase was mandated based on a provision in the Agreement that required SPX to include information received between the date of the September 30 Balance Sheet and the Effective Date. Garda also submitted its interpretation of various sections of Section 1.3 of the Seller Disclosure Schedule including Section 1.3(c), concerning the use of the same "subjective methodology" as used in preparation of the September 30 interim

balance sheet. A 366-393. In its Arbitration Rebuttal Brief, Garda raised for the first time its contention that Seller's Disclosure Schedule section 1.3(a)(v) required the inclusion of an IBNR component in the WC Reserve.[1] A. 1016.

At no point during the Arbitration did Garda ever contend that SPX did not calculate the WC Reserve in the Pre-Closing Day or Effective Date Balance Sheets using the same methodology it used to create the WC Reserve in the September 30 Balance Sheet. Nor has Garda ever disputed that the amount of the workers compensation claims actually paid on all Vance workers' compensation claims during the almost six years between the closing and the Arbitration was less than the WC Reserve.

Following the parties submissions to the Arbitrator, the Arbitrator issued a set of questions to the parties. A. 353-356. Included in these questions was a question to SPX to further verify the Vance workers' compensation claims that were paid and the amount. A. 335. The Arbitrator requested from Garda the basis for its assertion in its Arbitration Rebuttal Brief that the amount of the actual workers' compensation claims paid during the six year period should not be considered in determining whether the WC Reserve was properly calculated. A.

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[1] In its Answering Brief Garda asserts that SPX never argued that Seller Disclosure Statement section 1.3(c) trumps section 1.3(a)(v). Answering Brief, p.10. Garda itself never contended that Section 1.3(a)(v) was implicated in the dispute until its Arbitration Rebuttal Brief to which SPX had no opportunity to respond.

335. Both parties responded to the questions and the Arbitration record was then closed. A. 1075-1121 and 1122-1172.

By letter dated October 11, 2011, E&Y issued its decision in a summary form as the parties had agreed (the "Arbitration Award" or the "Award"). A. 350 - 352. As pertains to the WC Reserve, the Letter simply states that no adjustment to the Closing Date Working Capital is warranted. The Court of Chancery determined that the Arbitrator in making this determination erroneously excluded IBNR from the WC Reserve which the Court of Chancery found was a manifest disregard of the contractual language.

SPX submits that, contrary to Garda's arguments and the Court of Chancery's decision, based on the Arbitration record, the Arbitration Award could clearly have been based on several different bases, only one of which the Court of Chancery considered and then used to substitute its view for that of the Arbitrator. The Arbitrator could certainly have concluded that the language of SPA sections 1.3(a) and (c) and repeated in Seller Disclosure Schedule section 1.3(c), simply required that SPX not change its methodology in calculating the WC Reserve, despite the language of Seller Disclosure Schedule 1.3(a)(v).[2] This is the reading of the Agreement that the Court of Chancery rejected on the basis that the Agreement was susceptible to only one possible reading.

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[2] SPX contends that the language of the SPA clearly allows SPX to continue use its historical basis to compute the Reserve which did not include an IBNR component.

The Arbitrator also could have decided that the undisputed facts that all Vance workers' compensation claims incurred prior to the Vance sale had been resolved by the time of the 2011 Arbitration and the actual amount of the claims was less than the WC Reserve by more than $133,242 made any adjustment to the WC Reserve inappropriate under the Agreement.

The Arbitrator could also have interpreted the Agreement exactly as the Court of Chancery determined was the only possible reading of the Agreement. The Arbitration record provided the Arbitrator with the ability to review and evaluate both parties' evidence including Garda's extensive actuarial submissions that the WC Reserve should be increased by between $2.1 and 2.5 million against SPX's unchallenged evidence on the actual amount of the workers' compensation claims paid. Based upon this review, the Arbitrator had the right to reject Garda's actuarial evidence (particularly in light of the dramatic variance between Garda's claims for $2 million or more in IBNR and the factual showing of $0 IBNR that actually resulted) and determine that any required increase to the WC Reserve for an IBNR component should have been $0 instead of the between $2.1 to 2.5 million that Garda was demanding.

The task presented to the Arbitrator was not simply limited to the exercise of plugging numbers into an arithmetic formula. The Arbitrator was given the task of deciding a dispute under the Agreement based on the evidence the parties'

presented, including the evidence as to the interpretation and application of various provisions of the agreement, as well IBNR projections versus actual results. Based on the evidence that the parties chose to submit, the Arbitrator made a decision. This Court should affirm the Arbitration Award and reject the decision to vacate the Award simply on the basis that the Court below disagreed with one assumed basis for the Award.

II. THE PARTIES EXPLICITLY GRANTED THE ARBITRATOR AUTHORITY TO INTERPRET THE AGREEMENT.

Garda began to argue late in these proceedings that there was no dispute that the Arbitrator had no authority to interpret any provisions of the Agreement, as Garda and SPX expressly declined to grant him such authority. In Garda's Answering Brief, Garda repeats this argument that the Arbitrator has no authority to interpret the Agreement. Answering Brief, pp 25- 28. This position directly conflicts with Garda's allegations in its Complaint, its conduct during the Arbitration and its submissions to the Arbitrator.

The record confirms that the Arbitrator was tasked with determining the WC Reserve according to the dispute resolution provision: Section 1.3(d) of the SPA which provided that "the parties shall submit the items remaining in dispute for resolution to the Independent Accountant." A. 502-503. Consequently, the SoW recites that the parties retained E&Y to "act as independent accountant to resolve certain disputes between the Parties arising under Section 1.3 of their SPA Agreement." A. 337. Both parties extensively argued the bases for their respective positions under the SPA. SPX argued that various provisions of Agreement required it to use its historical methodology to compute the WC Reserve and Garda argued that Section 1.3(a)(v) required that IBNR be included. Neither party made legal arguments to the Arbitrator, but they did rely on certain provisions of Agreement to support their position.

In its Complaint, Garda asserted that the Arbitrator in making its determination acted in manifest disregard of the law, alleging that "Ernst & Young was aware of contractual legal authority" and disregarded "controlling legal requirements." A. 52-53. Garda further alleged that the Arbitrator, having been made aware of relevant legal principals, failed to properly interpret the Agreement. These same contentions were repeated in Garda's briefing in support of its Cross-Motion for Summary Judgment. A. 157- 160. Nowhere did Garda plead or allege that the Arbitrator exceeded his authority by interpreting the Agreement.

Garda failed to raise the issue of the Arbitrator's lack of authority to interpret the Agreement with any court prior to or during the Arbitration and failed to assert this claim in its Complaint. Garda was well aware throughout the Arbitration what SPX contended was the basis under the Agreement for SPX's calculation of the WC Reserve. Garda argued to the Arbitrator the import of Section 1.3(a)(v) and never sought to direct the issue of interpretation of the Agreement to the courts, where Garda now contends this issue should have been decided. Garda is therefore barred from now challenging the authority of the Arbitrator. See, *ITT Hartford Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 1999 Del. Ch. LEXIS 225, 8 n.8, (Del. Ch. Dec. 8, 1999) (By not objecting to the authority or jurisdiction of the arbitrator and arguing the issue to the arbitrator, a party waived such an argument); *Audio Jam, Inc. v. Fazelli*, 1997 Del Ch. Lexis 40 (Del Ch.

Mar. 20 1997) (Party submitting issues to arbitrator cannot show by clear and convincing evidence that the arbitrator exceeded his authority in deciding them). Garda is therefore precluded from asserting this argument at this stage in the proceeding.

Garda has pled and consistently argued that the Arbitrator did not interpret the Agreement correctly, not that the Arbitrator had no authority to interpret the Agreement. As a result, Garda's current argument is not only lacks support in the record, but also undercuts Garda's previous submissions, prompting Master LeGrow to note in the Final Report the following:

> The argument, however, ignores the history of the arbitration proceedings. Whatever the Statement of Work provided, it is undisputed that the parties submitted to the Independent Accountant the issue of whether Section 1.3 required SPX to include IBNR worker's compensation claims in the Vance Reserve. . . Neither party argued to the Independent Accountant that the interpretation of Section 1.3 was a legal question that he could not decide, or that required resolution in a court of law. Instead, the parties knowingly submitted their dispute to the Independent Accountant, and therefore waived any claim that he exceeded his authority in deciding that dispute. Had Garda prevailed on the issue, it likely would not now be contending that the arbitrator exceeded the scope of his authority.

A. 255-256.

CONCLUSION

For the foregoing reasons, Defendant-Appellant, SPX Corporation, respectfully submits that the court below erred in vacating the Arbitration Award and requests that this Court reverse the trial court's order and enter judgment affirming the Arbitration Award.

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