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.

DEFENDANT-APPELLANT SPX CORPORATION'S SECOND CORRECTED OPENING BRIEF

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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 of the working capital calculation used in determining the sale price. Garda demanded arbitration of the disagreement under the arbitration provisions of the SPA. Arbitration resulted in an award favorable to SPX. Dissatisfied with the arbitrator's determination, Garda sought to vacate the award in this action filed in the Court of Chancery. On cross motions for summary judgment, Master Abigail LeGrow issued a Final Report confirming the arbitration award. Garda filed exceptions to the Final Report. Vice Chancellor J. Travis Laster, pursuant to *de novo* review, did not adopt the Master's Final Report, granted Garda's motion for summary judgment and vacated the award. Pending before the Court is SPX's appeal of Vice Chancellor Laster's order vacating the award.

Summary of Argument

1. SPX respectfully submits the trial court erred in vacating the arbitrator's award which was well supported by the express language of the parties' agreement and the factual record. Garda disputed SPX's calculation of workers' compensation reserves in connection with the computation of working capital to arrive at the purchase price for Vance, a subsidiary of SPX. The dispute was submitted to Ernst & Young (referred to as "E&Y" or the "Arbitrator") as the Arbitrator under the provisions of the SPA. The dispute was decided by the Arbitrator in favor of SPX by not making any adjustment to the reserve amount, and correspondingly, to the purchase price. Consistent with the parties' agreement with E&Y, the Arbitrator rendered his determination in summary form, without specifying the reasoning or rationale underlying the determination.

2. On December 15, 2011, Garda filed a complaint in the Delaware Court of Chancery requesting the court vacate E&Y's Arbitration Award dated October 11, 2011 (the "Award") pursuant to 10 Del. C. § 5714 (a)(3), alleging E&Y acted in manifest disregard of the law. The parties' cross motions for summary judgment were initially reviewed by Master LeGrow, who issued a Final Report recommending affirmation of the Award. The Master determined that the Award drew support from the language of the SPA as well as the record and under the law was entitled to substantial deference. Vice Chancellor Laster issued an

oral and written opinion vacating the Award. In reaching the decision, the court below presumed how the Arbitrator interpreted the SPA in formulating the Award.

3. Based on that theory, the court concluded that the Arbitrator so misread the SPA that the Award had to be vacated. However, working capital reserve calculations are complex and can be determined by a variety of factors including, among many others, historical practices, the reserves carried by the relevant insurance provider, and the nature of the industry in which the parties operate. SPX calculated working capital reserves of $1.366 million as required by the terms of the SPA. SPX's calculation proved to be more than adequate to account for later incurred actual workers' compensation liabilities of $1.232 million, resulting in a windfall to Garda. Garda nevertheless disputed SPX's calculation and sought to have the Arbitrator double the reserve amount. SPX submitted materials during the Arbitration providing more than a sufficient basis to establish both the accuracy of the reserve calculation and the lack of basis under the SPA to increase the reserve amount. SPX introduced, *inter alia*:

a) the actual historical $1.4 million reserve balance its insurance carriers maintained prior to Garda submitting a bid to purchase Vance;

b) initial pre-bid correspondence wherein SPX advised Garda of the working capital calculations and, more particularly, specified the $1.4 million workers' compensation reserve component contained in that calculation;

c) Garda's purchase proposal in response acknowledging SPX's method of calculating working capital reserves;

d) the SPA, and specifically Section 1.3(c), of the Seller Disclosure Schedule, which required calculating "all" working capital reserves consistent with historical subjective methodologies, with the application of such methodologies reflecting changes in circumstances and events based on the most current information known to SPX;

e) Vance's Chief Financial Officer's post-closing correspondence confirming Vance's workers' compensation reserves were properly projected at $1.366 million, which reflected $34,000 in claim payments made since the pre-bid calculation of the reserve at $1.4 million; and

f) the actual workers' compensation expense proving that, upon termination of all claims arising prior to the Vance sale to Garda (i.e., all claims allocated to the reserve), Vance incurred only $1.232 million in workers' compensation liabilities.

4. Based on his accounting expertise, and having reviewed the parties' submissions, the Arbitrator resolved the dispute for which E&Y had been retained and denied Garda's request that the reserves be doubled. The Arbitrator issued the Award without providing any explanation, nor did he offer insight into his

analysis. Having reviewed the motion record, the Court therefore erred in vacating the Award as it drew support from the materials submitted at arbitration.

5. SPX respectfully submits Vice Chancellor Laster erred in substituting an alternative interpretation of the SPA, thereby vacating the Award. While the court's interpretation of the SPA may be viewed as plausible, it overrides the rational judgment and discretion of the Arbitrator to whom the parties jointly submitted the dispute for resolution. In the instant case, the evidence before the Arbitrator was uncontroverted that SPX calculated workers' compensation reserves in the same manner from when it acquired Vance to the sale to Garda and that Garda was well aware of the manner in which reserves would be calculated. Section 1.3(c) of the Seller Disclosure Schedule expressly required that all workers' compensation reserves be calculated according to historical practices. The law is clear that the court's review of arbitration awards requires substantial deference to an arbitrator's decision precisely because in such instances the parties have agreed to assign their dispute to the expertise of a mutually selected arbitrator. Therefore, absent a showing of bias or intentional disregard of the law such that prejudice results, the Arbitrator's interpretation cannot be set aside for an alternative view supplied by the courts, no matter how well-reasoned the substituted opinion.

6. In addition, SPX respectfully submits the trial court erred in reviewing the merits of the Award as the Arbitrator's determination was silent as to his methods of calculation. The Arbitrator simply chose to not alter the workers' compensation reserve amount. Neither the parties, nor the court below knows the basis of the Arbitrator's decision. They do not know whether the Award was based on a contractual interpretation of the SPA, whether it was based on a decision that the IBNR component of the reserve to be included was in fact $0, that the reserve amount was more than adequate to cover the actual workers' compensation expense, or something else. In sum, there was no basis to set aside the Award based on an assumption of how the Arbitrator reached the Award. This is especially true when the clear effect of the Award was to uphold a reserve calculation that events have shown was entirely accurate.

Statement of Facts

The record includes the following facts relevant to SPX's appeal.

A. SPX Consistently Calculated Workers' Compensation Liabilities in the Same Manner and made Garda Aware of its Methodology.

SPX acquired Vance as a wholly owned subsidiary in October of 2002. At that time, Vance carried a $1.1 million workers' compensation reserve which was then transferred to the consolidated SPX corporate reserve. The workers' compensation reserve was calculated as the sum of the reserve amounts carried by the relevant workers' compensation insurers for each reported and pending workers' compensation claim. A-0932-34.[1]

In October of 2005, SPX solicited offers for the sale of Vance. SPX specified that proposals for purchase of Vance should conform to certain guidelines including a purchase price "based on the peg working capital figure set forth in the schedule attached . . ." A-0954. The schedule amended the Vance September 30, 2005 interim financial statement to list the workers' compensation reserve at $1.4 million, "reflecting workers' compensation insurance policies."[2] A-0957. SPX further noted that "[b]ecause these reserves and the related policies will

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[1] A-___ indicates reference to Defendant's Appendix.

[2] During most of SPX's ownership, Vance's financial statements did not carry a workers' compensation reserve. Instead, SPX moved the $1.1 million workers' compensation reserve to the SPX corporate books and aggregated with the workers' compensation reserve for all other SPX business units. Thus, SPX amended the September 30, 2005 interim financial statements to specify the reserve applicable to Vance's workers' compensation liabilities.

be transferred to the business in connection with the transaction, the amount of the reserve will be included in the calculation of both the Working Capital Peg and the final working capital." *Id.*

On November 4, 2005, Garda submitted an offer to purchase the Vance capital stock. Garda acknowledged SPX's working capital calculations and noted that Garda's offered purchase price "will be subject to a price adjustment to the extent that [Vance's] net working capital at closing differs from an amount agreed upon in the definitive agreements." A-959-62. The parties then negotiated the purchase price, purchase price adjustments and working capital peg with the $1.4 million workers' compensation reserve balance included as the basis for the workers' compensation reserve liability on Vance's balance sheet in the September 30, 2005 financial statements. A-0959.

Garda agreed to purchase Vance for $67,250,000 plus Net Cash. A-0426. As the parties had agreed, the pre-closing balance sheet, including the working capital estimate (i.e., working capital peg) included the $1.4 million workers' compensation reserve liability that SPX had previously communicated to Garda in September of 2005. A-0948; A-0975.

Under Sections 1.3(a) and (c) of the SPA, SPX was required to produce a Pre-Closing Balance Sheet five days before closing and an Effective Date Balance Sheet within 60 days after closing. A-0436-37. Changes in the Effective Date

Balance Sheet that resulted in Working Capital changes as defined in the SPA falling above or below $12,750,000 would result in corresponding changes to the purchase price to be paid by Garda under the SPA. *Id.*

SPA Section 1.3(c) required that SPX 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 the Working Capital Schedule." A-0437. This required that SPX carry forward the same method of calculating the workers' compensation reserves as the aggregate total of the insurers' case reserves. In other words, the parties agreed that calculation of working capital liability reserves would occur according to historical practices. Within sixty days of the closing, SPX submitted the Effective Date Balance Sheet to Garda that contained a $1.366 million workers' compensation reserve liability, calculated according to SPA Section 1.3(c). A-0944-53.

1.3(c) of the Seller Disclosure Schedule corresponded to SPA Section 1.3(c) and provided:

> c) In preparing the Closing Date Statement of Working Capital, the respective amounts included in the Closing Date Statement of working Capital for all reserves (including, but not limited to, accounts receivable reserves and litigation reserves) and for asset valuation allowances (whether or not specified in this sentence) that were valued for the interim September 30, 2005 financial statements by subjective estimates shall be calculated using the same methodology in respect of such items on the interim September 30, 2005 financial

> statements but the application of the methodology shall reflect changes in circumstances or events occurring and based on the most current information known to SPX between the date of the interim September 30, 2005 financial statements and the Closing Date.
>
> [A-0556.]

On March 14, 2006, Andy Klemm, Chief Financial Officer of Vance, confirmed SPX's $1.366 million reserve calculation.[3] A-0975. By then Garda had owned and operated Vance for over two months. By 2011, all Vance workers' compensation claims arising prior to Vance's sales to Garda had reached closure. Vance's total liability for these claims (i.e., claims covered by the reserve) amounted to $1.232 million. A-935-36.

B. Garda Disputes the Working Capital Reserve Calculations.

SPA Section 1.3(d)(ii) allowed Garda the right to dispute the Effective Date Balance Sheet prepared by SPX post-closing only on the grounds that the Effective Date Balance Sheet was not prepared in accordance with the methods, procedures, assumptions and adjustments as set forth in Section 1.3 of the Seller Disclosure Schedule. A-0505. The SPA provided that any disputes would be resolved through a specifically defined fast track arbitration procedure which is the procedure the parties followed resulting in the Arbitration Award.

[3] This amount reflected the $1.4 million reserve amount less $34,000 in claim payments made between October 2005 and March 2006.

In May of 2006, Garda disputed the working capital reserve calculations as performed by SPX. After years of attempted resolution, Garda demanded the parties arbitrate the dispute as required under SPA Section 1.3(d) before an independent accountant.

In May 2011, the parties retained Ernst & Young, LLP to act as Arbitrator. A-0335. The parties and E&Y negotiated a Statement of Work ("SoW") which would govern E&Y's arbitration of the disputed issues. *Id.* In the SoW, E&Y confirmed the following: "You have jointly requested that we serve as Independent Accountant to resolve certain disputes between the parties arising under Section 1.3 of their [Agreement] . . . ." A-0337.

During the arbitration proceeding Garda alleged SPX failed to accurately calculate the workers' compensation liability reserves and presented the Arbitrator with briefs and materials in support of its allegations. A-0366. Garda asserted the workers' compensation reserves should have fallen between $3.5 and $3.9 million. A-0370. This amount, at the top end, was more than twice the amount communicated to Garda prior to the purchase, more than twice the amount of the amended September 30, 2005 financial statements that had been communicated to Garda in the pre-bid letter and, almost three times the amount confirmed by Vance's CFO in March of 2006.

Garda initially acknowledged that Section 1.3(c) of the Seller Disclosure Schedule controlled the workers' compensation reserve calculation but also contended that a certain report[4] received by SPX following the closing which estimated the Vance workers' compensation reserves at $ 2,782,077 constituted "the most current information" as referred to in 1.3(c) of the Seller Disclosure Schedule. A-0375. Garda also presented E&Y with its own actuarial analysis which indicated that the reserves should have been set at $3.5 to $3.9 million. A-0907.

In response, SPX presented E&Y with the following:

1) the method by which SPX had calculated workers' compensation reserves when it acquired Vance in 2002 – by adding the reserves carried by the workers' compensation insurers;

2) the amended September 30, 2005 financial statements calculated in the same manner for purposes of inviting offers of purchase;

[4] This is a report received by SPX from AON Risk Consultants, Inc., ("AON") dated January 6, 2005, (the "AON Report"). The AON Report is erroneously dated January 20, 2005, instead of January 20, 2006. The Report clearly states that it is a reserve analysis as of November 20, 2005 for the period ending December 31, 2005. SPX does not believe that there is any dispute by Garda that January 20, 2006, is the correct date of the report and that SPX did not receive the Aon Report until January 20, 2006, obviously after the December 31, 2005, Effective Date and the January 13, 2006, Closing Date. A-0631.

3) the pre-bid correspondence between SPX and Garda indicating the manner in which the reserves were calculated resulted in a reserve amount of approximately $1.4 million;

4) the SPA executed by the parties, including Section 1.3(c), which required that for closing date purposes the working capital would be calculated according to historical practices, in particular the methods employed preparing the September 30, 2005 financial statements;

5) the closing date workers' compensation reserve calculation of $1.366 million;

6) Vance's CFO's March 6, 2006 confirmation of the $1.366 reserve amount; and

7) the actual workers' compensation liabilities incurred by Garda amounting to $1.232 million which was $132,000 less than the reserve amount. A-0929-1012.

In its reply brief, Garda argued for the first time that SPX was required to calculate workers' compensation reserves by including a calculation for Incurred But Not Reported Claims ("IBNR"). Garda asserted that Section 1.3(a)(v) of the Seller Disclosure Schedule provided an alternative calculation of working capital liability reserves contrary to the terms of 1.3(c).

On October 11, 2011, E&Y issued the Award in the form of a determination letter denying Garda's claims. A-0350. No explanation or analysis of any kind was provided.

C. The Court Substitutes its Interpretation of the Agreement for that of the Arbitrator.

On December 15, 2011, Garda filed a complaint in the Delaware Court of Chancery requesting the court vacate the Award pursuant to 10 Del. C. § 5714 (a)(3), alleging E&Y acted in manifest disregard of the law. A-1173. The parties' summary judgment motions were initially reviewed by Master LeGrow, who issued a Final Report recommending affirmation of the Arbitrator's Award. A-0240. The Master determined that the Arbitration Award drew support from the language of the Agreement, as well as the record, and under the law was entitled to substantial deference. A-0255.

Vice Chancellor Laster issued an oral and written opinion vacating the Award. In reaching the decision, the court offered an alternative interpretation of the SPA, resulting in findings contrary to the determination of the Arbitrator. A-0001; A-0009.

During oral argument Vice Chancellor Laster expressed his reasoning in detail: "Master LeGrow concluded, based on excellent arguments that [SPX] advanced, that there is actually a colorable reading that says the [Arbitrator] could exercise its judgment not to include [INBR]. I don't get that. I think as I read

1.3(a), it is a clear and unambiguous formula. So because of that, I feel like I have to, in the exercise of *de novo* review, go the other way on this." A-0024.

In the order vacating the Arbitration Award, Vice Chancellor Laster articulated an irreconcilable interpretation of Sections 1.3(a)(v) and 1.3(c) of the Seller Disclosure Schedule. On the one hand, he stated that Section 1.3(a) "clearly and unambiguously requires the inclusion of IBNR related to workers' compensation liabilities." A-0006. On the other hand, he stated that 1.3(c) required the workers' compensation liabilities "to be 'calculated using the same methodology' used in the historical financial statements and not changed between signing and closing in a manner that could affect the price adjustment." A-0007. As noted above, the "methodology" used to calculate workers' compensation liability in historical financial statements did not include IBNR and doing so would dramatically affect the price adjustment. A-0437.

SPX filed a notice of appeal of the court's decision on June 25, 2013.

Argument

I. THE TRIAL COURT ERRED IN REVIEWING THE MERITS OF THE ARBITRATOR'S AWARD WHICH IS WELL SUPPORTED BY THE TERMS OF THE AGREEMENT AND THE FACTUAL RECORD.

A. Question Presented

Whether the trial court may review the merits of an arbitrator's award that is well supported by the terms of the agreement and the factual record. Tr. 11-15 (A -0019-0021); A-0303-0315).

B. Scope of Review

Questions of law, such as those addressed pursuant to summary judgment proceedings, are subject to *de novo* review. *See Worldwide Ins. Group v. Klopp*, 603 A.2d 788, 790 (Del. 1992). A motion for summary judgment is the "common [method] for [] courts to determine whether to vacate or confirm an arbitration award," *Beebe Med. Ctr., Inc. v. InSight Health Servs. Corp.*, 751 A.2d 426, 431 (Del.Ch.1999), especially for claims brought pursuant to the Delaware Uniform Arbitration Act. *See TD Ameritrade, Inc. v. McLaughlin, Piven, Vogel Sec., Inc.*, 953 A.2d 726, 730 (Del. Ch. 2008) (confirming arbitration award and granting summary judgment dismissing claims seeking to overturn same). *See also, Blank Rome LLP v. Vendel, C.A. No.* 19355, 2003 WL 21801179, at *3 (Del.Ch. Aug. 5, 2003) ("[s]ummary judgment is an appropriate vehicle to review an arbitration award, because the complete arbitration record is before the Court . . .").

C. Merits of Argument

Garda challenged the Arbitrator's determination under Section 5714(a)(3) of the Delaware Uniform Arbitration Act. Section 5714(a)(3) specifies a court may only vacate an arbitration award where the arbitrator acts "in manifest disregard of the law." The statutory standard must be applied in a manner consistent with Delaware's public policy favoring arbitration and the finality of arbitration awards. *See, e.g., Pettinaro Const. Co. v. Harry C. Partridge, Etc.*, 408 A.2d 957 (Del. Ch. 1979); *Falcon Steel Co.*, 1991 Del. Ch. LEXIS 69, 1991 WL at *2 (stating that it is "well settled that the resolution of disputes by arbitration is strongly favored in this State"). *Metromedia Energy, Inc. v. Enserch Energy Servs., Inc.*, 409 F.3d 574, 580 (3d Cir. 2005) (quoting *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 301 (3d Cir. 2001), and reversing trial court's order vacating arbitrator's award interpreting method of valuation set forth in parties' contract provisions).

For these reasons, arbitration awards are not lightly disturbed and courts are encouraged to "resolve all doubts in favor of the arbitrator." *TD Ameritrade*, 953 A.2d at 733 (citing *Executone Info. Sys., Inc. v. Davis*, 26 F.3d 1314, 1320 (5th Cir. 1994). When "an arbitration award rationally can be derived from either the agreement of the parties or the parties' submission to the arbitrator, it will be enforced." *Brennan v. CIGNA Corp.*, Nos. 06-5027, 06-5124, 2008 WL 2441049, at *4 (3d Cir. June 18, 2008). Moreover, there is a presumption that an arbitrator

acted within the scope of its authority and "this presumption may not be rebutted by an ambiguity in a written opinion." *Metromedia Energy, Inc. v. Enserch Energy Servs., Inc.*, 409 F.3d 574, 580 (3d Cir. 2005). *See also Major League Umpires Assoc. v. Am. League of Prof. Baseball Clubs*, 357 F.3d 272, 279-80 (3d Cir. 2004) (holding that an arbitrator's "improvident, even silly, fact finding does not provide a basis for a reviewing court to refuse to enforce the award.").

To successfully convince the court to vacate the Award, Garda bore the heavy burden to show "something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law." *TD Ameritrade*, 953 A.2d at 733. Plaintiff fell far short of the mark.

Resolving "all doubts in favor of the Arbitrator", *TD Ameritrade*, 953 A.2d at 733, the record reveals the following: E&Y was tasked with resolving the dispute regarding the calculation of workers' compensation reserves. The Arbitrator did exactly that based on the record before him as submitted by the parties. Moreover, the Award is consistent with the terms of the SPA, the historical practices of the parties, the calculation methods performed in preparation of the sale, Vance's CFO's confirmation of the reserve calculations in March of 2006, and the actual liabilities incurred by Vance.

1. The Arbitrator's Award Draws Substantial Support from the Terms of the Agreement and the Factual Record.

When SPX first solicited offers for the purchase of Vance, SPX made Garda aware of the workers' compensation liability calculations resulting in a reserve amount of $1.4 million. A-0957. These calculations were performed according to historical practices employed since 2002: by adding the claim case reserves carried by the relevant insurance carriers. A-0932-34. Garda's offer to purchase acknowledged the $1.4 million reserve throughout the life-cycle of the transaction as well as the method of calculation according to Section 1.3(c) of the SPA. A-0959-62; A-0643; A-0948; A-0975. When the sale of Vance was consummated, SPX carried forward the existing workers' compensation reserves of $1.366 million ($1.4 million less $34,000 in claim payments made during the interim period) into the Effective Date Balance Sheet applying the same method of calculation as SPX had historically. A-0944-53.

Thereafter Garda incurred $1.232 million in workers' compensation liability payments, $130,000 below the projected amount.[5] A-935-936. The projected

[5] On October 19, 2010, SPX filed a Superior Court Complaint against Garda seeking, *inter alia*, reimbursement for post closing workers' compensation liabilities in the amount of $1,198,623 due from Garda to SPX under the SPA. This amount increased to $1,232,000 after the remaining claims were settled. This action remains pending. Under Section 8.3(c) of the SPA, Garda was responsible for workers' compensation payments for Vance employees after the Effective Date. These payments are essentially the actual payment of the amount reserved in

reserves were therefore accurate. The benefit of historical practices yielded accurate results with the exception of a $130,000 windfall to Garda. During the arbitration proceedings, Garda initially agreed Section 1.3(c) of the Seller Disclosure Schedule required calculation of workers' compensation reserves according to the parties' historical practices, but argued that later information as reflected in the AON Report required the upward adjustment of the reserves. A-0375.

By issuing the Award denying an adjustment to the workers' compensation reserves, the Arbitrator applied the terms of the SPA and Seller Disclosure Schedule in the manner in which the parties intended. That is, the Arbitrator confirmed the actual workers' compensation liabilities of $1.232 million had been properly accounted for by the $1.366 million workers' compensation reserve. The Arbitrator's determination is therefore entirely in accord with the SPA negotiated by the parties and draws substantial support from the record. Equity requires the Arbitrator's ruling remain intact and not be subjected to an alternative interpretation leading to vacatur. *See Brennan v. CIGNA Corp.*, Nos. 06-5027, 06-5124, 2008 WL 2441049, at *4 (3d Cir. June 18, 2008). The trial court therefore erred in ruling the Award resulted in a "manifest disregard of the law."

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the Effective Date Balance Sheet which SPX reserved at $1,344,000 and Garda asserts should have been between $3.5 to $3.9 million.

II. THE TRIAL COURT ERRED IN SUBSITUTING AN ALTERNATIVE INTERPRETATION OF THE AGREEMENT WHERE THE ARBITRATOR DID NOT DISCLOSE HIS CALCULATION METHODS.

A. Question Presented

Whether the trial court erred by substituting an alternative interpretation of the agreement where the arbitrator did not disclose his calculation methods. Tr. 11-15 (A. -0019-0021); A-0303-0315.

B. Scope of Review

Questions of law, such as those addressed pursuant to summary judgment proceedings, are subject to *de novo* review. *See Worldwide Ins. Group v. Klopp*, 603 A.2d 788, 790 (Del. 1992). A motion for summary judgment is the "common [method] for [] courts to determine whether to vacate or confirm an arbitration award," *Beebe Med. Ctr., Inc. v. InSight Health Servs. Corp.*, 751 A.2d 426, 431 (Del.Ch.1999), especially for claims brought pursuant to the Delaware Uniform Arbitration Act. *See TD Ameritrade, Inc. v. McLaughlin, Piven, Vogel Sec., Inc.*, 953 A.2d 726, 730 (Del. Ch. 2008) (confirming arbitration award and granting summary judgment dismissing claims seeking to overturn same). *See also, Blank Rome LLP v. Vendel, C.A. No.* 19355, 2003 WL 21801179, at *3 (Del.Ch. Aug. 5, 2003) ("[s]ummary judgment is an appropriate vehicle to review an arbitration award, because the complete arbitration record is before the Court . . .").

C. Merits of Argument

When tasked with reviewing an arbitration award, courts must refrain from imposing a review of the merits of the method by which the contract was interpreted. This is because a "[m]ere error of law or fact is ... not sufficient grounds to vacate an award," and "[i]t is recognized that inaccuracies as to the law or facts are possible and their existence is accepted implicitly by an agreement to submit the dispute to arbitration." *Falcon Steel Co. v. HCB Contractors, Inc.*, C.A. No. 11557, 1991 WL 50139, at *2 (Del.Ch. Apr. 4, 1991). In sum, "the [c]ourt is not to pass an independent judgment on the evidence or applicable law," and "[i]f any grounds for the award can be inferred from the facts on the record, the [c]ourt must presume that the arbitrator did not exceed his authority and the award must be upheld." *Audio Jam, Inc. v. Fazelli*, C.A. No. 14368, 1997 WL 153814, at *1 (Del.Ch. Mar. 20, 1997).

Furthermore, where an arbitration award is silent as to the grounds for relief, the reviewing court is limited to inspection of the record to confirm the arbitrator did not act outside of his or her authority. *Malekzadeh v. Wyshock*, 611 A.2d 18, 22 (Del. Ch. 1992). In such circumstances, though a court may not agree with the manner in which an arbitrator interpreted an agreement, a court cannot "conclude simply by looking at the arbitrator's award that he had completely ignored the contract." *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1181 (D.C. Cir.

1991). It follows that a party is not entitled to vacatur simply because a court would have interpreted an agreement in an alternative manner. *World-Win Mktg., Inc. v. Ganley Mgmt. Co.*, 2009 Del. Ch. LEXIS 151, 2009 WL 2534874 (Del. Ch. Aug. 18, 2009).

1. The Trial Court Erred in Substituting an Alternative Interpretation Where the Arbitrator Did Not Disclose His Calculation Methods.

In this instance, the court below erred in analyzing the SPA executed by the parties and substituting its own assumption on how the Arbitrator interpreted the SPA to arrive at the Award. Case law cautions against review of arbitration awards based on the merits. Even if a potential ambiguity is perceived to exist within an agreement, all inferences must be resolved in favor of the arbitrator's award in accordance with binding legal precepts and supporting public policy. *Metromedia Energy, Inc. v. Enserch Energy Servs., Inc.*, 409 F.3d 574, 580 (3d Cir. 2005).

The court below chose to reconcile the two apparently competing provisions by ignoring that SPX could not both include IBNR and utilize the same historical methodology in calculating the Vance workers' compensation liability. The court thus eliminated Section 1.3(c) from the Seller Disclosure Schedule as it related to the calculation of workers' compensation reserves, despite the fact that Section 1.3(c) expressly applies to "all reserves." A-0556.

While Vice Chancellor Laster's means of interpreting Seller Disclosure Schedule Sections 1.3(a) and 1.3(c) provides one possible view of the interaction between these provisions, it is not the only rational interpretation available. The two provisions can be interpreted harmoniously as requiring the inclusion of IBNR in the calculation of workers' compensation liability (Section 1.3(a)(v)), except to the extent that IBNR previously was not included in the working capital calculation (Section 1.3(c)). This is not only a rational interpretation, but the preferred one as it gives effect to both 1.3(a)(v) and 1.3(c).

In any event, because the Arbitrator did not disclose the analysis he employed resulting in the Award, the parties and the trial court are left to guess as to how the Arbitrator reached his determination. Without the benefit of the Arbitrator's reasoning, the court below assumed the Arbitrator erred in not assigning Sections 1.3(c) and 1.3 (a)(v) of the Seller Disclosure Schedule the same meaning the court derived from these terms. In addition, in applying his understanding of the method in which Sections 1.3(a)(v) and 1.3(c) interact, the Vice Chancellor created an interpretation of the SPA which he presumed was different from that of the Arbitrator in making the Award. This determination was made without knowing how or on what basis the Arbitrator formulated the Award.

Because the Arbitrator did not disclose his analysis, we have no way of knowing in what manner he interpreted the SPA. For example, based on his

expertise, the Arbitrator may have concluded working capital liabilities were correctly calculated pursuant to the historical practices of the parties based on the language of Section 1.3(c) such that no adjustment to the Vance purchase price was necessary. This is especially plausible given the fact the projections proved to be accurate, with the exception of a windfall to Garda.

Alternatively, the Arbitrator may have reached his determination by harmonizing Sections 1.3(c) and 1.3(a)(v) in a manner that did not require adjustment to the purchase price. The Arbitrator may also have concluded the parties were required to list IBNR, but that based on his analysis and calculations, considering the full and proper factual context, and the full arbitration record, the amount of IBNR particular to the transaction at issue did not require any adjustment to the workers' compensation reserves or to the purchase price. Or, the Arbitrator's determination could have resulted from other grounds entirely. Because the Award is silent as to the Arbitrator's reasoning, we are left to speculate.

Under those circumstances, though a court may not agree with the interpretation of a contract it cannot "conclude simply by looking at the arbitrator's award that he had completely ignored the contract." *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1181 (D.C. Cir. 1991). *And see Malekzadeh v. Wyshock*, 611 A.2d 18, 22 (Del. Ch. 1992). Certainly the liability reserve

provisions as set forth in the Agreement are prone to generate questions as to their interpretation regarding the SPA and Seller Disclosure Schedule as a whole. For example, reasonable minds can disagree as to whether Sections 1.3(c) and 1.3(a)(v) are in direct conflict or can be harmonized. In addition, reasonable minds can disagree as to which section provides the more specific instruction such that in the event of conflict, it will trump the more general. However, courts do "not sit as an appellate authority reviewing the arbitrator's substantive findings." *Kuhn v. Hess*, 2000 Del. Ch. LEXIS 110, 2000 WL 1336780, at *1 (Del. Ch. Aug.16, 2000). Courts are prohibited from engaging in such a review because "parties electing to arbitrate generally waive their right to judicial review of the case's substantive merits." *Id.*

What we do know for certain is that the purpose of the Agreement was to provide adequate provision for future workers' compensation liability Vance might incur. What we also know for certain is that the Agreement (specifically, the workers' compensation calculation provisions) provided for proper calculation and served the parties' intended purpose by allocating reserves of up to $1.336 million to cover liabilities Vance incurred of $1.232 million. Finally, what we also know for certain is that the determination of the Arbitrator ensured the application of the terms of the SPA to achieve the fair and equitable end result.

In sum, because the Arbitrator's determination is well supported by the record and the terms of the SPA, because the Award is silent as to grounds for relief, and because the law of Delaware prohibits a court from assuming an arbitration award resulted in legal error where the court perceives a potential alternative interpretation of an agreement, the Arbitrator's Award must be reinstated.

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.

ARCHER & GREINER

/s/ John V. Fiorella

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EXHIBIT "A"

EFiled: Jun 04 2013 11:27AM EDT
Transaction ID 52596943
Case No. 7115-VCL

IN THE COURT OF CHANCERY 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,	)	
v.	)	C.A. No. 7115-VCL
SPX CORPORATION, a Delaware corporation,	)	
Defendant.	)	

ORDER VACATING ABRITRATION AWARD

WHEREAS, Garda World Security Corporation and Garda USA, Inc. (collectively, "Garda") agreed to acquire all of the outstanding shares of Vance International ("Vance"), a wholly-owned subsidiary of SPX Corporation ("SPX"), pursuant to an amended stock purchase agreement (the "Stock Purchase Agreement") on January 13, 2006;

WHEREAS, Garda challenged SPX's calculation of Vance's working capital under Section 1.3 of the supplemental disclosure schedule (the "Supplemental Schedule") to the Stock Purchase Agreement;

WHEREAS, in May 2011, Garda and SPX agreed to have Ernst & Young (the "Arbitrator") arbitrate the dispute pursuant to Section 1.3(d)(ii) of the Stock Purchase Agreement;

WHEREAS, the Arbitrator issued a determination agreeing with SPX's calculation of working capital (the "Arbitration Award") on October 11, 2011;

WHEREAS, Garda commenced this action to vacate the Arbitration Award pursuant to 10 *Del. C.* § 5714(a)(3) on December 15, 2011;

WHEREAS, Garda and SPX cross-moved for summary judgment on June 8, 2012;

WHEREAS, the Master issued her Final Report recommending this Court grant SPX's motion for summary judgment and dismiss Garda's claims on February 7, 2013;

WHEREAS, Garda filed its Notice of Exception to the Master's Final Report pursuant to Ct. Ch. R. 144 on February 14, 2013;

WHEREAS, the Court considered the parties' briefing and held argument on June 4, 2013;

NOW THEREFORE, this 4th day of June, 2013, IT IS HEREBY ORDERED:

1. A "master's rulings, findings of fact, conclusions of law, and recommended disposition have no effect until they are adopted by a judge after a 'meaningful review.'" *DiGiacobbe v. Sestak*, 743 A.2d 180, 183 (Del. 1999) (quoting *Redden v. McGill*, 549 A.2d 695, 698 (Del. 1988)). "If the parties do not except to any of the master's factual findings . . . the trial judge may review the

record *de novo* accepting the master's facts in the same way that the judge would resolve a dispute presented on a stipulated set of facts." *Id.* at 184.

2. Section 1.3 of the Supplemental Schedule to the Stock Purchase Agreement prescribes the calculation for Vance's working capital. Under Section 1.3(a),

> [t]he calculation of current assets and current liabilities shall exclude the following accounts and balances:
>
> . . .
>
> v. Incurred but not reported and reported claims related to risk management programs, with the exception of those claims related to workers' compensation liabilities, which shall be included in the calculation of current liabilities . . . .

Jt. App. Vol. 1 at A-000296. Under Section 1.3(c),

> In preparing the Effective Date Statement of Working Capital, the respective amounts included in the Effective Date Statement of Working Capital for all reserves (including, but not limited to, accounts receivable reserves and litigation reserves) . . . that were valued for the interim September 30, 2005 financial statements by subjective estimates shall be calculated using the same methodology in respect of such items on the interim September 30, 2005 financial statements but the application of the methodology shall reflect changes in circumstances or events occurring and based on the most current information known to SPX, between the date of the interim September 30, 2005 financial statements and the Effective Date.

Id. Garda contends that Section 1.3(a) required the inclusion of incurred but not

reported ("IBNR") claims in Vance's workers' compensation liability, one of the liabilities on Vance's balance sheet. SPX contends that Section 1.3(c) overrides Section 1.3(a) because historically SPX did not include IBNR in its workers' compensation liability. The Arbitrator agreed with SPX's construction but provided no explanation.

3. Arbitration awards are not lightly disturbed, and "Courts must accord substantial deference to the decisions of arbitrators." *TD Ameritrade, Inc. v. McLaughlin, Piven, Vogel Sec., Inc.*, 953 A.2d 726, 732 (Del. Ch. 2008) (internal quotation marks omitted). "When an arbitration award rationally can be derived from either the agreement of the parties or the parties' submission to the arbitrator, it will be enforced." *Id.* (internal quotation marks omitted). The Court "will not substitute its judgment for that of an arbitrator," but will "refuse to enforce an award if [the Court] finds no rational construction of the contract that can support it." *RBC Capital Mkts. Corp. v. Thomas Weisel P'rs, LLC*, 2010 WL 681669, at *8 (Del. Ch. Feb. 25, 2010).

4. Section 5714 of Title 10 permits a Court to vacate an award in only narrow circumstances. Section 5714(a)(3) authorizes *vacatur* where "[t]he arbitrators exceeded their powers, or so imperfectly executed them that a final and definite award upon the subject matter submitted was not made . . . ." 10 *Del. C.* §

5714(a)(3). This provision has been construed to apply where an arbitrator acts with "manifest disregard" of controlling law or contractual language.

> An award must be vacated . . . if the arbitrators, in "manifest disregard" of the law, were cognizant of the controlling law but clearly chose to ignore it in reaching their decision. Only such serious violations of authority by an arbitration panel permit this Court to vacate an award under Section 5714(a)(3)'s narrow exception. A broader reading of Section 5714 would undermine the purpose of arbitration.

Wier v. Manerchia, 1997 WL 74651, at *4 (Del. Ch. Jan. 28, 1997) (Allen, C.) (citation omitted), *aff'd*, 700 A.2d 736 (Del. 1997). *See also Mansoory v. SC & A Const., Inc.*, 2009 WL 2140030, at *2 (Del. Ch. July 9, 2009) ("The court [may vacate] . . . if the arbitrator's actions are in direct contradiction to the express terms of the agreement of the parties . . . ." (internal quotation marks omitted)), *aff'd*, 988 A.2d 937 (Del. 2010); *Pryor v. IAC/InterActiveCorp*, 2012 WL 2046827, at *6 n. 61 (Del. Ch. June 7, 2012) ("[I]t is only when the arbitrator acts in direct contradiction to the express terms of the agreement that a court may properly find grounds to vacate . . . .").

5. The Court "may infer the required knowledge of the law and intentionality on the part of the arbitrator" for purposes of *vacatur* where the Court finds "an error that is so obvious that it would instantly be perceived as such by the average person qualified to serve as an arbitrator.'" *Travelers Ins. Co. v. Nationwide Mut. Ins. Co.*, 886 A.2d 46, 49 (Del. Ch. 2005) (internal quotation

marks omitted). "Because [Section] § 5714(a)(3) is modeled after the Federal Arbitration Act, . . . federal cases interpreting this section are most helpful." *Id.*

6. The manifest disregard standard involves three inquiries: (i) a clear contract or law, (ii) an erroneous application, and (iii) knowledge of the clear contract or law. *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389-90 (2d Cir. 2003). Those three requirements are met here, warranting *vacatur*.

7. First, the Supplemental Schedule is clear and controlling. Section 1.3(a) clearly and unambiguously requires the inclusion of IBNR reserves related to workers' compensation liabilities. Under Section 1.3(a), "[t]he calculation of current assets and current liabilities *shall exclude* . . . [i]ncurred but not reported and reported claims related to risk management programs," except for "those claims related to workers' compensation liabilities, *which shall be included* in the calculation of current liabilities." Jt. App. Vol. 1 at A-000296 (emphases added). This is simply formulaic. Working capital is the net of current assets less current liabilities. According to this formula, all current liabilities shall exclude IBNR, except for the liability for workers' compensation claims which shall include IBNR. Section 1.3(c) does not alter or inject ambiguity into the formula. All that Section 1.3(c) requires is that the various accounts underlying working capital are to be "calculated using the same methodology" used in the historical financial

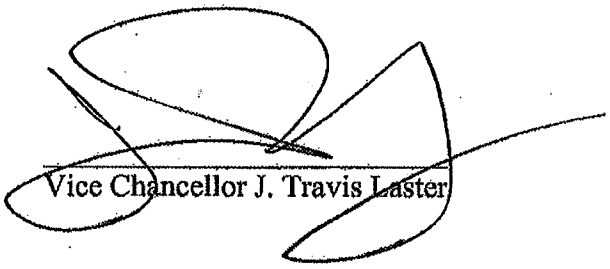
statements. That means, for example, that the workers' compensation liability, including its subcomponents, was to be "calculated using the same methodology" used in the historical financial statements and not changed between signing and closing in a manner that could affect the price adjustment. It does not alter the formula for determining working capital.

8. Second, "once it is determined that the contract provision is clear and plainly applicable," the Arbitrator must have "improperly applied [it], leading to an erroneous outcome." *Duferco*, 333 F.3d at 390. Here, the Arbitrator erroneously found that IBNR for workers' compensation should be excluded, despite the clear controlling contract language.

9. Third, the Arbitrator must have knowledge of the clear controlling contract language. "In order to intentionally disregard the law, the arbitrator must have known of its existence, and its applicability to the problem before him." *Duferco*, 333 F.3d at 390. Here, the parties directed the Arbitrator to perform the working capital calculation pursuant to Section 1.3 of the Supplemental Schedule. Thus, the Arbitrator had knowledge of Section 1.3(a) and its mandate.

10. On the facts of this case, the Court finds that the Arbitrator manifestly disregarded controlling contractual language and "so imperfectly executed" its powers that "a final and definite award upon the subject matter submitted was not made . . . ." 10 *Del. C.* § 5714(a)(3). *Vacatur* is appropriate.

11. The plaintiffs' motion for summary judgment is GRANTED, the defendant's motion for summary judgment is DENIED, and the Arbitration Award is VACATED.



Vice Chancellor J. Travis Laster

EXHIBIT "B"

IN THE COURT OF CHANCERY 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,	:	
v.	:	Civil Action No. 7115-VCL
SPX CORPORATION, a Delaware corporation,	:	
Defendant.	:	

- - -

Chancery Courtroom No. 12C
New Castle County Courthouse
500 North King Street
Wilmington, Delaware
Tuesday, June 4, 2013
10:00 a.m.

- - -

BEFORE: HON. J. TRAVIS LASTER, Vice Chancellor.

- - -

HEARING
MOTION TO VACATE ACCOUNTING ARBITRATION AWARD
AND THE COURT'S RULING

CHANCERY COURT REPORTERS
500 North King Street
Wilmington, Delaware 19801
(302) 255-0521

APPEARANCES:

PETER B. LADIG, ESQ.
Morris James LLP
-and-
JEFFREY A. SIMES, ESQ.
of the New York Bar
Goodwin Procter LLP
for Plaintiffs

JOHN V. FIORELLA, ESQ.
Archer & Greiner, P.C.
for Defendant

- - -

THE COURT: Good morning, everyone.

MR. SIMES: Good morning, Your Honor.

MR. FIORELLA: Good morning.

THE COURT: Mr. Ladig, how are you?

MR. LADIG: Very well, Your Honor. Thank you.

This is the time set for oral argument in the exceptions to Master LeGrow's report in the Garda versus SPX matter. I'd like to introduce Jeffrey Simes from Goodwin Proctor.

THE COURT: Welcome.

MR. SIMES: Good morning.

MR. LADIG: He has been admitted pro hac vice and will be making the plaintiffs' arguments this morning.

THE COURT: All right. Great.

Good morning.

MR. FIORELLA: Good morning, Your Honor. John Fiorella of Archer & Greiner appearing on behalf of the defendant SPX Corporation.

THE COURT: Thank you.

Mr. Simes.

MR. SIMES: Thank you, Your Honor.

As Your Honor is aware, this case

involves a working capital dispute arising from the sale of Vance from SPX, the defendant, to Garda, the plaintiff.

The specific issue before the Court today is whether the accounting arbitration award should be vacated. And the sole ground that we're presenting is that the accounting arbitrator did not include in calculating Vance a Workers' Compensation reserve, a very significant liability for that company, this concept of incurred but not reported losses or IBNR. IBNR, as the Court is aware, includes this notion of loss development, the idea that Workers' Comp claims grow over time.

This was such an important item in this deal, it was a multimillion dollar component of the liabilities, and it was so important that when the parties set forth their working capital schedule, the document that said how working capital will be calculated, they included a specific line item that said that IBNR would not be included except for Workers' Compensation reserves, which must be included.

It is undisputed that SPX did not include IBNR in its calculation of the reserve. It's

undisputed that Ernst & Young, the accounting arbitrator, also did not include it.

Now, Master LeGrow agreed with Garda's reading of the agreement that IBNR had to be included but she nonetheless concluded that it was the prerogative of E&Y to do otherwise. And while her report was thoughtful and thorough, we respectfully suggest there were three ways in which she erred.

First, Master LeGrow operated under the assumption, an incorrect assumption, that the competing contractual interpretations had been put before Ernst & Young, and that was not the case. SPX's submission to the accounting arbitrators make no mention of IBNR. They make no mention of Section 1.3(a)(v) of the working capital schedule, which required the inclusion of IBNR.

In fact, the parties made simultaneous briefing to the arbitrator. It wasn't until Garda received SPX's opening brief that it understood that IBNR had not been included. And it was only then, in the simultaneous reply briefs, that Garda said to the arbitrator, "IBNR needs to be included." There was no argument before E&Y because nobody disputed the question of whether IBNR should be included or not.

The record before the arbitrator was not one of arguing the issue but was one simply of Garda noting the existence of a contractual provision and Ernst & Young then disregarding it.

So we submit it was erroneous for Master LeGrow to conclude that the issue was submitted to the arbitrator because, in fact, it wasn't. It wasn't until we got to Master LeGrow that SPX developed the argument that a separate section of the working capital schedule, 1.3(c), somehow interrelated with 1.3(a) in a way that allowed them to disregard IBNR.

But, Your Honor, even if it had been the case that these issues were put before Ernst & Young, there was only one possible reading of this agreement that is reasonable here, and that is that IBNR must be included. 1.3(a)(v) says it shall be included. Nobody says that that is an ambiguous provision, SPX never argued otherwise, and Master LeGrow never found otherwise.

It was only later in the proceedings before the Master that SPX argued that Section 1.3(c), which makes a reference to historical methods of accounting, allowed it to disregard the IBNR

provision. We submit that there are three reasons why SPX's contention that 1.3(c) trumps 1.3(a) is unreasonable.

First, you would have to disregard the IBNR provision. You would literally have to write it out of the agreement. You would have to pretend that sophisticated parties got together, negotiated the language specifically concerning IBNR, but knew, somehow, because they were talking about historical methodologies, that all of that was a waste of time. And this Court does not infer that sophisticated parties put language into a contract that has no meaning.

Second, the specific must govern over the general. There was a line item about a specific subcomponent of a line item of a particular liability, IBNR, and that must govern over a very generic provision that speaks generally about accounting methodologies without any particular line item or issue or item included in it.

And finally to get to where SPX wants to be, to find that there could be a reading where 1.3(c) controls, you'd have to not read the agreement as a whole. You would have to essentially conclude

that we're not going to harmonize the provisions that are reaching different sets of issues.

Your Honor's decision in the Brinckerhoff case, I think that is a very relevant decision. That was a case in which there was a partnership agreement, and as I understand it, the general partner was given wide authority to run the affairs of the partnership, but there was a specific provision as to how property could be disposed of. And Your Honor, as I recall, concluded that that specific provision could be harmonized with the general provision by concluding that it governed as to property and the general provision governed as to all other matters. We think that's directly on point here. You've got an IBNR provision that governs as to that issue and then historical methodologies as to all other issues.

And Master LeGrow got the principle correct that if the agreement is not ambiguous, if it's not reasonably capable of two readings, then it was error for Ernst & Young to disregard the provision concerning IBNR. We submit to the Court there is no ambiguity here. It's never been argued by SPX. There is no reasonable reading of the agreement that gets us

to exclude IBNR when the parties said to include it, and, therefore, the award should be vacated.

Finally, Your Honor, even if the agreement were ambiguous, and we submit it was not, Ernst & Young did not have the authority to interpret or resolve any ambiguity. This was not a general arbitrator. It was very specific accounting arbitrator, a specialist. And the agreement between the parties and Ernst & Young specifically said that Ernst & Young could not make any legal determinations. They were prohibited from doing so.

Now, in this case, the agreement was not ambiguous. Nobody argued these issues to Ernst & Young. And Ernst & Young agreed and the parties agreed that Ernst & Young could not engage in any kind of legal determination or construction of the contract. And, therefore, to the extent that Ernst & Young did attempt to resolve an ambiguity -- and, again, we submit that none existed -- it erred and it exceeded its authority.

In this case, Your Honor, we've got sophisticated parties that had a very pointed view about IBNR. Ernst & Young effectively rewrote the deal and undid the bargain that the parties struck.

If the parties in cases before you are to be encouraged to arbitrate, they need to know that their instructions and their limitations on arbitrators will be followed and if they're not followed, the awards that erroneously deviate from those instructions will be vacated.

We submit that this is an example of a situation where the arbitrator disregarded clear instructions, and we ask that the award be vacated.

THE COURT: I thought you were going to tell me about the waiver issue when you were talking to me about the submission of legal issues to the arbitrator.

MR. SIMES: Well, there was no waiver, Your Honor. I think Master LeGrow would probably be correct that had it been the case that the parties submitted the issue to Ernst & Young, even though they previously agreed not to, that by their conduct, they waived that agreement. In other words, they had voluntarily relinquished that.

THE COURT: Even if they briefed the contract interpretation point or argued the contract interpretation point?

MR. SIMES: Right. In other words, if

the parties had briefed that issue and put it before Ernst & Young, then I think the Court could probably conclude that by their conduct, they elected to arbitrate notwithstanding their prior agreement that they did not want Ernst & Young to do so.

What I'm suggesting to the Court is, in fact, that did not happen. Master LeGrow, it looks like, erroneously believed that because we were arguing to her these contractual interpretation points, that those issues must also have been argued before Ernst & Young, but that was not the case. That did not happen.

THE COURT: Mr. Fiorella.

MR. FIORELLA: Good morning, Your Honor. May it please the Court.

I think that the issue of what this arbitration was has sort of been diverted. This was an accounting arbitration. The parties submitted to an accountant the issue of how do you calculate disputes under the working capital calculation under the SPA. They provided the accountant with the SPA and the related documents to make this determination. To say that the issue of what SPX could view the operative provision to be is incorrect.

As early as 2006, in a letter from SPX to Garda, SPX advised Garda how it viewed the basis for calculating the Workers' Compensation reserve. Your Honor, that matter, that was contained in a letter dated June 29, 2006 from SPX to Garda appearing in the arbitration record or in the appendix as Document A-524, when the issue of the Workers' Compensation reserve first came up from Garda's perspective. And SPX pretty clearly advised Garda exactly the provision that it believed was operative in determining whether or not and how it calculated the Workers' Compensation reserve. None of this was or should have been a surprise to Garda.

In SPX's submissions to the arbitrator, SPX essentially provided its justification under the SPA as to why the Workers' Compensation reserve should be calculated as a loss. The parties argued calculation. They didn't argue the legal principles of contract interpretation. But of necessity, the accountant has to look at a document and decide what the document requires on how the calculation should be conducted. And that's what happened.

Your Honor, this case began with a

complaint that alleged a manifest disregard of the law. The issue of disregard of the law wasn't something that SPX created. This was an allegation by Garda. Only later did the issue morph into that the arbitrator didn't have the authority to make a legal determination. And we submit, Your Honor, that's not what the arbitrator did.

The arbitrator made a decision within the expertise and the experience of the arbitrator as an accountant, which is exactly what the parties negotiated would be the dispute resolution procedure in the SPA. They didn't negotiate an arbitration with AAA rules. They didn't negotiate an arbitration for someone to make a legal determination. They negotiated an accountant's determination, and that's what they got.

And, Your Honor, we submit that Master LeGrow's report should be affirmed on the basis that from a legal perspective, maybe lawyers would have interpreted the agreement differently, but the accountant had a legitimate basis and a clear basis under the agreement to make the decision that the accountant made, and that's precisely what the parties negotiated.

THE COURT: Thank you.

Reply?

MR. SIMES: Thank you, Your Honor.

Very briefly, the issue is not whether Garda was surprised by the arguments that SPX is now making, although we contend that it was. The issue is whether the parties submitted that dispute to the arbitrators. And there is no record in the evidence to show that it happened because, in fact, it did not.

Secondly, this was not a decision that was within Ernst & Young's expertise. There is an agreement here that says very specifically what must be and must not be included in the calculation of working capital. The agreement could not be clearer that IBNR must be included.

The only argument that has ever been offered as to why IBNR might not be included in the face of an agreement that says it must be is SPX's belated argument based on reading of 1.3(c) that the contractual principle from the generic historical methodology provision controls. That is not a provision that Ernst & Young indicated it was relying on. It is not a provision that anyone cited to Ernst & Young. There is no basis for this Court to conclude

either that Ernst & Young relied on it or that it is reasonable to read the contract in the way that SPX suggests.

As a result, it is not sufficient for SPX to say Ernst & Young is an accountant. This was in their expertise. That expertise was taken away when the parties said, "Regardless of what you may think, IBNR must be included."

THE COURT: Thank you both for being direct and to the point. I appreciate that.

Today's hearing asks me to consider the notice of exceptions to the Master's final report dated February 7, 2013 in the case captioned Garda USA, Inc. versus SPX Corp., C.A. No. 7115-VCL. The final report affirmed the decision of Ernst & Young, which served as an accounting arbitrator for a post-closing adjustment.

Some brief factual background. Actually, let me go ahead and give you my answer up front and then I'll explain my answer. That way, you all will know where I'm coming out and can listen. To the extent you want to go ahead and anticipate an appeal or the arguments that the other side may make on appeal, it will allow you to listen with a point of

view.

I think the Master wrote an opinion that provides an excellent analysis of the applicable legal principles right up until the point where she applies them. I think the contract is clear and unambiguous. It's a formula. It's a formula that says include X, exclude Y, include Z. The accountant, for whatever reason, didn't include Z. The accountant can use its judgment as to what Z is. There is another provision of the agreement that says calculate Z according to how it has been calculated historically. But when push comes to shove, there is a specific provision, 1.3(a), that says you must include Z.

Master LeGrow concluded, based on excellent arguments that SPX has advanced, that there is actually a colorable reading that says the accountant could exercise its judgment not to include Z. I don't get that. I think as I read 1.3(a), it is a clear and unambiguous formula. So because of that, I feel like I have to, in the exercise of de novo review, go the other way on this.

To give you some factual background: On January 13, 2006, the parties executed an amended

stock purchase agreement whereby Garda agreed to acquire 100 percent of the outstanding stock of Vance from SPX for a total purchase price of $67.25 million. The agreement, as is common with private company agreements, required Vance to have a specified amount of working capital at the closing date, and it provided for a corresponding adjustment to the purchase price if Vance's working capital was more or less than the targeted amount. Again, as is common in these agreements, the agreement specified a method of calculating working capital. That calculation included the reserve for Workers' Compensation liabilities.

Now, calculating a reserve for Workers' Compensation liabilities can take into account claims that are incurred but not reported, referred to as IBNR. IBNR is an accounting concept which recognizes that there are claims outstanding as of a valuation date that are anticipated liabilities and, therefore, appropriately accounted for, even though the actual amounts of those liabilities only will be learned over time, as claims are asserted and resolved. In an acquisition, if the reserve for IBNR turns out to be too low, then the buyer is saddled

with the extra liability and paid too much. If the reserve turns out to be too high, then the buyer gets a windfall and paid too little.

Calculating IBNR is an art that lies at the intersection of mathematics, statistics and actuarial science. It requires making educated projections about claims rates, amounts and recoveries based on historical data, and then rolling those forward using complex formulae. These educated projections are effectively informed assumptions. Between signing and closing, a seller could affect the IBNR calculation, and hence the purchase price because of the IBNR adjustment by changing its assumptions.

As I'm about to explain, the Workers' Compensation schedule said two things. It said, one, include IBNR. That's 1.3(a). It then said under 1.3(c), don't change your assumptions for doing it, because if you change your projections and things like that, you could affect the methodology. And 1.3(c) doesn't single out IBNR. 1.3(c) says to the extent you've been doing these things historically, do it the same way. Don't try and jigger your numbers between signing and closing to change the result. Then 1.3(a) is the formula that you then put those numbers into.

The key language from 1.3(a) says that the calculation for working capital was to "exclude IBNR related to risk management programs with the exception of those claims related to Workers' Compensation liabilities, which shall be included in the calculation of current liabilities."

This is what I meant when I said at the outset that you subtract Y but add back Z. So they're saying exclude IBNR related to risk management programs. That's the Y. But then add back those claims related to Workers' Comp liabilities. That's the Z. And it specifically says, "which shall" -- mandatory -- "be included in the calculation of current liabilities."

1.3(c) is the part where I said, or already adverted, that the instruction was do it the way you've always done it so we know you're not messing with the numbers. I will quote that language. "In preparing the Effective Date Statement of Working Capital, the respective amounts included in the Closing Date Statement of Working Capital for all reserves (including, but not limited to, accounts receivable reserves and litigation reserves) ... shall be calculated using the same methodology in respect of

such items on the interim September 30, 2005 financial statements but the application of the methodology shall reflect changes in circumstances or events occurring and based on the most current information known to SPX between the date of the interim September 30, 2005 financial statements and the Effective Date."

What that provision means is don't suddenly change your accounting methodologies. Do them the way you've always done them, unless something that we all agree has happened would necessarily cause you to change your methodology because of the circumstance or event occurring afterwards. In other words, don't change from LIFO to FIFO or vice versa just to change the calculation.

As is common, the parties agreed to have an accountant serve as the arbitrator to resolve disputes over the closing balance sheet calculation. In May 2011, the parties selected the arbitrator and negotiated a statement of work. They each submitted calculations. On October 11, 2011, the arbitrator agreed with SPX's calculation of working capital. In December 2011, Garda commenced this action to set aside the arbitration award. There were cross-motions for summary judgment. And on February 7, 2013, the

Master issued her final report.

Under DiGiacobbe v. Sestak, the Master's rulings, findings of fact, conclusions of law, and recommended disposition have no effect until they are adopted by a judge after meaningful review. I'm obligated under DiGiacobbe to review the record de novo to determine whether I would come out the same way.

As I've said, I think the Master's analysis of the applicable legal principles is right on. It all comes down to whether the agreement itself is clear and unambiguous. This is because under Delaware's version of the Uniform Arbitration Act, an arbitration award can be vacated if the arbitrator acted in manifest disregard of the law and controlling contractual provisions.

It is true that arbitration awards are not lightly disturbed. It is true that Courts accord substantial deference to arbitrators. It is also true that when considering whether an arbitrator exceeded its authority, the Court must resolve all doubts in favor of the arbitrator. These are all paraphrases of the TD Ameritrade case.

Nevertheless, an award must be vacated

if the arbitrator failed to follow the plain language, the clear and unambiguous language, of the contract. To state that in the language of the RBC Capital Markets versus Thomas Weisel Partners case, and I'm quoting, "Although a Court will not substitute its judgment for that of an arbitrator, it may conclude that the arbitrator exceeded his powers and will therefore refuse to enforce an award if [the Court]" -- and I'm inserting "the Court -- "finds no rational construction of the contract that can support it."

Here, the determination of the arbitrator warrants vacatur. Section 1.3(a), read within the context of the document, unambiguously requires the inclusion of the Workers' Compensation IBNR. Under Section 1.3(a), "the calculation of current assets and current liabilities shall exclude the following accounts and balances." So you are to exclude incurred but not reported and recorded claims related to risk management programs. You're taking those out, with the exception of those claims relating to Workers' Compensation liabilities. You add that in.

Expressed as a formula, working capital equals current assets minus current

liabilities. Current liabilities equals reserves minus total IBNR plus adding back in Workers' Compensation IBNR.

Since my son just finished baseball season and I know Mr. Ladig is a baseball fan, I will reframe this in a baseball analogy. There is a difference between plate appearances and at-bats. To determine at-bats, you take plate appearances and you subtract bases on balls, times the batter is hit by a pitch, sacrifice hits, and interference.

Let's assume you wanted to figure out, because perhaps you were acquiring a player, how many at-bats they had. In the language of this contract, you would say, for example, "We want you to calculate all these numbers historically, the base on balls, the hit by pitch, the sacrifices, interference, et cetera, the way you historically did." But then let's say, for whatever reason, you think sacrifices shouldn't be excluded because that's actually a time when the guy makes contact with the ball, so you would ask the seller to add back in sacrifices. That's exactly what these guys did by saying add back in Workers' Compensation liabilities.

Now, what you're not doing by that is

saying, "Calculate sacrifices differently than you've always done it." You still want to calculate sacrifices the same way. You just want them added back into the formula. That's what should have happened here. It's math. And for whatever reason, the accountant didn't do it.

SPX's argument that "It's because it historically did not include Workers' Compensation IBNR" doesn't carry the day because, again, the contract specifically asked them for this purpose to add it back in. The fact that you historically excluded sacrifices from your calculation of at-bats doesn't mean you get to exclude it when I specifically contract that you are going to add it back in for the purposes of the calculation we're doing on this one player.

This, in my view, is also not part of the accountant's ken to which one would give a measure of discretion. If the issue were whether IBNR had been calculated appropriately, that would be the type of accountant's judgment where the reading might be arguably more colorable. You'd give deference to the colorable reading, and the idea that the accountant could exercise its judgment and experience, as I think

Mr. Fiorella said in his argument. This isn't that type of question. This is a question of "Do you add back in the variable Z? Do you add back sacrifice hits?" That's not a judgment call. That's not an accountant call. That's a specific aspect of the formula under this agreement.

So once it's determined that the law in terms of the contract was clear and plainly applicable, I can only vacate if I find that the law, in fact, was improperly applied, leading to an erroneous outcome. That clearly was true. The arbitrator reached his result excluding IBNR from Workers' Compensation reserve, directly opposite to the calculation required by 1.3(a).

And finally, to set aside the award, I have to determine whether the arbitrator actually had knowledge of the error. That means that the arbitrator must have actually known what the law was. This is really most applicable when there is some statute or regulation or something like that and some question about whether it was known to the arbitrator.

Here, there is no question that the arbitrator had the contract provision and the formula before him. The arbitrator had the supplemental

schedule. The point was to apply the supplemental schedule. For whatever reason, the arbitrator didn't follow the formula set out in 1.3(a) and didn't add back in Workers' Comp IBNR, as, in my view, the plain language of the document clearly requires.

Consequently, on the facts of this case, I find that the arbitrator manifestly disregarded controlling contractual language and, consequently, so imperfectly executed its powers that a final and definite award on the subject matter submitted was not made. In reaching that holding, I am paraphrasing the language of Title 10, Section 5714(a)(3), which is the requisite provision for vacating an arbitration award.

Consequently, the plaintiffs' motion for summary judgment is granted. The defendant's motion for summary judgment is denied. The arbitration award is vacated.

Mr. Ladig.

MR. LADIG: Yes, Your Honor.

THE COURT: Would you please draft up a form of order, submit it to Mr. Fiorella so he can take a look at it, and then submit it to me once it's been agreed on as to form. Then you all can decide

what to do going forth.

MR. LADIG: Will do, Your Honor. I have one question.

THE COURT: Yes, sir.

MR. LADIG: Should the order reference reversing the Master's final report or should it just say what Your Honor recited?

THE COURT: You know what? I'm going to veto that.

MR. LADIG: That's fine. I just wanted to make sure, procedurally, we're doing the right thing.

THE COURT: No, no. I'm going to do the order for you.

MR. LADIG: Oh. Thank you, Your Honor.

THE COURT: I'm feeling generous.

MR. LADIG: It's always appreciated.

THE COURT: That will save you having to debate the language to be used.

Any other questions from your side?

MR. LADIG: None, Your Honor.

THE COURT: Mr. Fiorella, questions from you?

MR. FIORELLA: None, Your Honor.

THE COURT: Thank you, everyone, for being direct and to the point. You can look for the order on the docket.

We stand in recess.

(Court adjourned at 10:32 a.m.)

CERTIFICATE

I, JEANNE CAHILL, Official Court Reporter for the Court of Chancery of the State of Delaware, do hereby certify that the foregoing pages numbered 3 through 28 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I have hereunto set my hand this 12th day of June, 2013.

/s/ Jeanne Cahill

Official Court Reporter
of the Chancery Court
State of Delaware

Certificate Number: 160-PS
Expiration: Permanent