ARIZONA COURT OF APPEALS

DIVISION ONE

JEFFREY HAMBLEN and BARBARA YOUNGS, husband and wife, Petitioners/Defendants, v. HONORABLE RALPH HATCH, Judge of the Superior Court of the State of Arizona, in and for the County of Navajo, Respondent, and WINSLOW MEMORIAL HOSPITAL INC d/b/a LITTLE COLORADO MEDICAL CENTER, Plaintiff-Real Party in Interest.	No. 1CA-SA 16-0201 Navajo County Superior Court No. S0900CV201400311

REPLY IN SUPPORT OF PETITION FOR SPECIAL ACTION

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INTRODUCTION

As the Petition demonstrated, the superior court abused its discretion by failing to treat as final the Arbitration Award issued by an arbitrator pursuant to a valid and binding arbitration provision. The Response does not dispute that the superior court correctly enforced the arbitration provision at the outset, and thus correctly compelled the parties to arbitration. Instead, the Response insists (at 2) that because the arbitrator rescinded the agreement containing the arbitration provision and ruled that the agreement was "undone from the beginning," the arbitration provision itself no longer has any force or effect.

This contention, however, fundamentally misconstrues the separability doctrine. That doctrine treats the arbitration provision as an agreement that is *separate* from (and severable from) the rest of the contract. That doctrine explains why a court may enforce an arbitration provision and permit the arbitrator to resolve a party's contention (like the one here) that the entire agreement (as opposed to the arbitration provision itself) was induced by fraud.

LCMC's position stands the concept of binding arbitration on its head. In this case, the parties went through the entire arbitration process,

the arbitrator entered a final Arbitration Award, and the superior court entered a Judgment confirming the Award. Nevertheless, LCMC convinced the superior court that LCMC could pursue in superior court the exact same issues and claims that were argued and decided in the arbitration. Stated differently, the superior court's order would permit a "do-over" or second bite at the apple on issues already resolved in binding arbitration. But that is not how arbitration works, and it is why this case cries out for special action relief from this Court.

JURISDICTION

The Petition demonstrated (at 10–13) that (1) Hamblen has no "adequate remedy by appeal" and the superior court's error will guarantee a remarkable unnecessary expenditure of judicial and party resources, (2) this case presents a pure legal issue of statewide importance (*i.e.*, the proper interpretation of Arizona's Revised Uniform Arbitration Action ("RUAA")), (3) the superior court's error "was without precedent or support in the law and could not be justified," *King v. Sup. Ct.*, 138 Ariz. 147, 150 (1983), and (4) this case raises issues of public significance given Arizona's deeply-rooted support of arbitration and the deference given to arbitrators.

LCMC does not dispute, disagree with, or even address these points. (Response at 4–5.) Instead, LCMC argues the Court should not accept jurisdiction because 1) special action relief is inappropriate in cases "involv[ing] the granting of a motion to amend a complaint" and 2) Hamblen has not filed a dispositive motion in the superior court. (*Id.*) These arguments miss the point, and do not fairly represent the proceedings below as set forth in Hamblen's Petition (at 13–28). For the reasons set forth therein, the Court should accept jurisdiction.

ARGUMENT

LCMC's <u>entire</u> defense to Hamblen's Petition rests on a flawed rescission theory that misconstrues the separability doctrine. Indeed, Hamblen has been unable to find a single case anywhere in which a party has attempted to do what LCMC has done here—undo an entire arbitration because the arbitrator rescinded the *contract* containing an arbitration provision.[1] Presumably that is because courts have uniformly held that, under the separability doctrine as it actually exists, efforts to invalidate a contract, including attempts at rescission, do not affect or rescind the

[1] The exception is one unpublished decision from the Southern District Court of Ohio. Hamblen can provide the citation to the case upon request by the Court.

arbitration provision set forth in the same contract. Moreover, the doctrine must work this way because to construe it as LCMC urges would lead to absurd results and undermine the principles of efficiency and finality that are at the heart of Arizona's long-standing policy favoring arbitration.

I. The separability doctrine is fatal to LCMC's Response and confirms that the superior court abused its discretion.

A. The separability doctrine treats the arbitration provision as a separate and distinct agreement from the entire contract.

As set forth in the Petition (35–38), under the "'doctrine of separability,' an arbitration provision is considered to be an independent and separate agreement between the parties to the underlying contract." *Stevens/Leinweber/Sullens, Inc. v. Holm Develop. & Mgmt., Inc.*, 165 Ariz. 25, 29 (App. 1990). In other words, there is the arbitration agreement on one hand, and the rest of the contract on the other, and these two agreements are treated as *separate* agreements for purposes of enforceability issues. This has been the law in Arizona for decades. *See U.S. Insulation, Inc. v. Hilro Const. Co., Inc.*, 146 Ariz. 250, 253 (App. 1985) (adopting the separability doctrine as set forth in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402–04 (1967)); *Smith v. Logan*, 166 Ariz. 1, 2 (App. 1990) (applying separability to claim of fraudulent inducement);

Stevens/Leinweber/Sullens, 165 Ariz. at 29; *WB, The Building Co., LLC v. El Destino*, 227 Ariz. 302, 306, ¶ 11 (App. 2011) (arbitration provisions "are severable from the rest of the contract"); *Falcone Brothers & Assocs., Inc. v. City of Tucson*, —P.3d—, No. 2 CA-CV 2015-0212, 2016 WL 4490486, at *5, ¶ 21 (Ariz. Ct. App. Aug. 25, 2016) (arbitration provision is "an independent agreement, separate from the underlying contract"). Therefore, there is no dispute that the arbitration provision found in Hamblen's Employment Agreement is an independent and separate agreement that is "severed" from the Employment Agreement itself.

B. A challenge to the validity of the entire contract does not affect the validity of the separable arbitration provision.

Because courts separately analyze the enforceability of the arbitration provision itself, an arbitration provision is not invalid even if the contract as a whole was induced by fraud. This issue frequently arises in the context of a motion to compel arbitration filed by one party, and in response to the motion, the responding party argues that the contract itself is invalid and should be rescinded. Courts uniformly agree that even if the contract should be rescinded, that does not (without more) invalidate the arbitration provision. The something more that is necessary—and what is

completely lacking here—is an independent challenge to the arbitration provision itself.

1. LCMC did not specifically and independently challenge the validity of the arbitration provision.

As set forth in the Petition (at 35), this Court has held that because "arbitration agreements are severable from the rest of the contract, . . . a court may only stay arbitration if there is a challenge to the arbitration clause itself." *WB*, 227 Ariz. at 306, ¶ 11; *id.* at 307, ¶ 12 (challenge must be "*separate* and *distinct* from any challenge to the underlying contract") (emphasis in original). Indeed, "where no claim is made that fraud was directed *to the arbitration clause itself*, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." *U.S. Insulation*, 146 Ariz. at 253 (citing *Prima Paint*, 388 U.S. at 402) (emphasis in original). Thus, a "party's challenge to another provision of the contract, or to the contract as a whole, does not prevent a court from enforcing a specific agreement to arbitrate." *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 70 (2010).

In this case, LCMC has *never* contended that the arbitration provision found in Hamblen's Employment Agreement—as opposed to the entire

Agreement itself—is invalid or procured by fraud. It has never "challenge[d] the validity of the arbitration agreement separately and distinctly from [its] challenge of the underlying contract." *WB*, 227 Ariz. at 307, ¶ 12. This is confirmed by LCMC's May 19, 2014 Complaint and its Response to Motion to Compel Arbitration in the superior court (where LCMC *could have* raised the separate challenge to the arbitration provision if one existed), its Counterclaims in the arbitration, all of its arbitration disclosure statements, pre- and post-arbitration memoranda, and its post-arbitration briefing to the superior court, none of which anywhere suggests that the arbitration provision itself is invalid.

In light of this record, the Response claims (at 2, 7) that the arbitrator "**determined that no arbitration contract existed** between the parties," and that the arbitrator determined "that there **was** no 'arbitration agreement.'" But these allegations are simply untrue and unsupported by anything in the record. The Arbitration Award makes no findings regarding the validity of the arbitration provision. Instead, the Award rescinds the Employment Agreement, not the arbitration provision. Indeed, the Award's complete silence as to the validity of the arbitration provision is understandable and appropriate because LCMC *made no attempt whatsoever*

to argue that the arbitration provision itself was invalid. Nor did LCMC ever argue in the superior court, before or after the arbitration, that the arbitration provision itself should be rescinded.

2. Because LCMC never separately challenged the arbitration provision, rescinding the Employment Agreement did not affect the arbitration provision.

In light of the arbitrator's actual ruling—that the Employment Agreement was rescinded—the ongoing enforceability of the arbitration provision remains unaffected under the separability doctrine because it is, as a matter of law, severed from the rescinded agreement. *See, e.g.*, *Smith*, 166 Ariz. at 2 (applying separability doctrine to fraudulent inducement claim). In other words, the separability "doctrine serves to save an arbitration clause from being rescinded when a claimant attempts to rescind an entire contract." *Wilharm v. M.J. Constr. Co.*, 693 N.E.2d 830, 832 (Ohio Ct. App. 1997). Thus, "even if the contract was ultimately determined to be invalid, the arbitration clause, now severed, would nevertheless be valid." *A.T. Cross Co. v. Royal Selangor(s) PTE, Ltd.*, 217 F. Supp. 2d 229, 233 (D. R.I. 2002); *see also Unionmutual Stock Life Ins. Co. of Am. v. Beneficial Life Ins. Co.*, 774 F.2d 524, 528–29 (1st Cir. 1985) (the "arbitration clause is separable from the contract and is not rescinded by

Beneficial's attempt to rescind the entire contract" because "Beneficial never argued below that the arbitration clause itself was invalid").

Ignoring these settled principles, LCMC incorrectly contends the rescission of the Employment Agreement automatically rescinded the arbitration provision and revoked the arbitrator's authority:

> Once the arbitrator had determined that LCMC had properly rescinded the **entire** contract, therefore, and that it had been "undone from the beginning" . . . the arbitrator no longer had any power to decide any other claims that were or could have been asserted by LCMC against Hamblen. The "arbitration agreement" that was the basis for the arbitrator's subject-matter jurisdiction was determined not to exist, and so his powers ended with the arbitration award addressing the rescission issue . . . .

(Response at 6–7) (emphasis in original).

But this argument reflects a fundamental misunderstanding of the separability doctrine. Indeed, treating the arbitration provision as separate from the rest of the contract is what makes it legally possible for an arbitrator to rescind an agreement which contains an arbitration provision:

> The traditional argument against having the arbitrator decide on the rescission of the contract is that rescission, if awarded by the arbitrator vitiates the entire contract, including the arbitration agreement, thus removing the basis for the arbitrator's authority. Courts, however, have dealt with this theoretical problem by adopting the doctrine of separability,

> whereby the arbitration clause is treated as an independent contract which is severable from the principal agreement.

Martin Domke, Gabriel Wilner and Larry E. Edmond, *Law and Practice of Commercial Arbitration* § 11:5, p. 11-22 (3d ed. 2003–2015) (prior edition cited approvingly by *U.S. Insulation*, 146 Ariz. at 253). Indeed, separability "will defeat the argument that when the arbitrator is permitted to decide on the validity of the contract he is, in fact, deciding on the existence of the contract from which his jurisdiction stems." *Id.* § 11.1, at pp. 11-4–5.

C. LCMC's construction of the separability doctrine makes no sense and would lead to absurd results.

In this case, as the above discussion demonstrates, the separability doctrine has two important implications. First, the arbitration provision itself was not rescinded, meaning that LCMC was obligated to arbitrate all of its claims against Hamblen in the arbitration (as it did). Second, the arbitrator retained the authority to issue the Arbitration Award, and the superior court had the obligation to enforce it and had no authority to do anything else.

LCMC's suggestion otherwise—that it gets a complete do-over even though the parties had already completed binding arbitration—makes no sense. For starters, if the arbitration provision itself were not separately

enforceable, then the arbitrator had no authority to rescind anything and that issue should have been resolved by the trial court at the outset. *See, e.g.*, *Stevens/Leinweber/Sullens*, 165 Ariz. at 30 (only when the "arbitration provision is enforceable will the court compel arbitration"). As LCMC would have it, however, arbitration is no longer "a speedy and affordable means of resolving disputes," *RS Indus., Inc. v. Candrian*, 240 Ariz. 132, 377 P.3d 329, 332, ¶ 7 (App. 2016), because a party can avoid abiding by an arbitration provision even after completing the entire arbitration process for reasons nowhere found in RUAA.

Indeed in this case, the superior court's ruling means that Hamblen faces the prospect of an entire trial, from scratch, on the very same issues and claims LCMC asserted in the arbitration. Under LCMC's worldview, then, an arbitrator's decision simply is no longer "final and binding as to both issues of fact and law." *Atreus Cmtys. Grp. of Ariz. v. Stardust Develop., Inc.*, 229 Ariz. 503, 506, ¶ 13 (App. 2012). Instead, the superior court, as it did here, could substitute its own judgment and ignore completely the scope and impact of the validly-issued Arbitration Award.

Tellingly, this Court previously warned about the dangers and consequences of a superior court interjecting itself into a case the parties agreed to resolve through arbitration:

> If the conclusions of the arbitrators were to be subjected to the full range of ordinary judicial review, then the function of the substituted arbitration [t]ribunal would be largely defeated—the objectives of an inexpensive and speedy final disposition of the controversy would become illusory and the arbitration tribunal would in fact become merely a lower rung in the ascending ladder of judicial review. In addition to defeating the specific intent of the parties, this would add further to the time-consuming and expensive role required by a court adjudication—a result which is antithetical to the objectives inherent in the arbitration concept.

Smitty's Super-Valu, Inc. v. Pasqualetti, 22 Ariz. App. 178, 182 (1974).

That the superior therefore court abused its discretion is readily apparent, and this Court should exercise its discretionary special action jurisdiction and grant relief to Hamblen.

II. LCMC's Response confirms that the superior court abused its discretion by allowing LCMC to relitigate claims against Hamblen that LCMC should have—and indeed did—assert against Hamblen in the arbitration.

Because the Arbitration Award is valid and enforceable (and was enforced), the superior court abused its discretion by: violating the provisions of RUAA; violating the express terms of the arbitration

provision; substituting its judgment for that of the arbitrator whose Award encompassed all of LCMC's claims; and allowing LCMC to assert claims that are barred by res judicata. LCMC does not address or dispute any of these arguments in its Response. Its silence is compelling—LCMC did not respond because it has no response.

A. LCMC does not dispute that RUAA governs and prohibits <u>any</u> action taken after confirmation of an arbitration award.

RUAA governs the parties' arbitration and states that following an arbitration hearing, the superior court "**shall** enter a judgment in conformity with the order" confirming the Arbitration Award, and this judgment is enforceable like "any other judgment in a civil action." A.R.S. § 12-3025 (A) (emphasis added). After the superior court has entered this mandatory judgment, any "further determination by the trial court" of *any issue* is "in excess of the trial court's jurisdiction." *Ariz. Pub. Serv. Co. v. Mountain States Telephone & Telegraph Co.*, 149 Ariz. 239, 244 (App. 1985). Therefore, when the superior court lifted the stay and allowed LCMC to file an Amended Complaint asserting claims against Hamblen—all of which occurred <u>after</u> the superior court entered the mandatory judgment confirming the Arbitration Award—its actions were "in excess of the trial

court's jurisdiction" and constitute an abuse of discretion in violation of RUAA.[2] LCMC provides no response to, and therefore concedes, this argument.

B. LCMC does not dispute that the arbitration provision required LCMC to submit all compulsory and permissive counterclaims in the arbitration.

The superior court violated the basic tenant of contract law that a court must not interpret a contract in any way that renders any portion of it meaningless. *First Credit Union v. Courtney*, 233 Ariz. 105, 110–11, ¶ 23 (App. 2013). The Petition sets forth (at 15) the broad scope of the arbitration provision:

> Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration . . . and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.
>
> All counterclaims that would be compulsory or permissive under Federal Rule of Civil Procedure 13(a) and (b) if the claim were filed in court shall be asserted in the arbitration and not otherwise.

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[2] To the extent that LCMC now argues that the arbitrator lacked authority to issue—or exceeded his power by issuing—the Arbitration Award, LCMC's claims are further barred by § 12-3023 of RUAA which requires LCMC to file a motion to vacate the Arbitration Award if an "arbitrator exceeded the arbitrator's power" within 90 days of receiving notice of the Award, which LCMC undisputedly did not do. A.R.S. § 12-3023 (A)(4), (B).

LCMC was obligated to arbitrate "any claim [LCMC] may have against [Hamblen]." *See* Wright, Miller & Kane, Federal Practice & Procedure § 1420 at 184 (discussing combined scope of Fed. R. Civ. P. 13(a) and (b)). Moreover, LCMC was obligated to do so in "**the arbitration**"—the parties agreed they would participate in arbitration and that was LCMC's sole opportunity to assert its claims. And, of course, LCMC does not dispute that the issues and claims in LCMC's Amended Complaint and in the arbitration are identical. (Petition at 16–18, 23–28.)

In addition, LCMC does not dispute the broad scope of the arbitration provision. In fact, Hamblen argued in the Petition that LCMC "has never addressed the 'compulsory or permissive' counterclaim portion of the arbitration provision in **any** of its post-arbitration filings with the superior court, despite Hamblen's repeated reliance on this language below." (*Id.* at 42.) The same now holds true for LCMC's Response to the Petition, which is silent on this issue.

Curiously, LCMC argues in a footnote that its claims for conversion, destruction of property, racketeering and abuse of process "cannot reasonable be argued" to fall within the scope of an "employment contract arbitration clause." (Response at 7.) It makes this claim—without

addressing the "all counterclaims" language found in the arbitration provision—by relying on *Doe v. Princess Cruise Lines, Ltd.*, 657 F.3d 1204 (11th Cir. 2011).

This is not the first time that LCMC has erroneously relied on *Princess Cruise Lines*. In its response to Hamblen's Rule 59(a) motion in the superior court, LCMC cited the case for the proposition that if "the [employer] had wanted a broader arbitration provision, it should have left the scope of it at 'any and all disputes, claims, or controversies whatsoever,'" rather than including a limited "relating to" provision. (APPV4-0150.) LCMC's reliance on *Princess Cruise Lines* in its Response before this Court is as flawed as it was in the superior court below. The arbitration provision here could not be broader—it required LCMC to submit to the arbitration every claim it had against Hamblen in the arbitration, including permissive counterclaims, which means all claims.

The superior court abused its discretion by ignoring the plain terms of the valid and binding arbitration provision and allowing LCMC to assert its claims (again) against Hamblen below.

C. LCMC does not dispute that the claims it asserts in its Amended Complaint are encompassed by and merged with the Arbitration Award.

It is well-established that the superior court's authority to review the Arbitration Award is "substantially limited by statute." *Candrian*, 240 Ariz. 132, 377 P.3d at 332, ¶ 7. The superior court may not substitute its judgment for the arbitrator's "decisions . . . as to both issues of fact and law." *Atreus*, 229 Ariz. at 506, ¶ 13. Thus, the "rulings made by the arbitrators are binding unless they result in extending the arbitration beyond the scope of the submission." *Pasqualetti*, 22 Ariz. at 181.

LCMC does not dispute that an arbitrator's authority is determined by the scope of the arbitration provision. (Petition at 45). Nor does it dispute that when an arbitration provision requires a party to submit "all claims" to arbitration, an arbitration award resolving "all claims submitted to this arbitration" encompasses claims a party could have, but did not, raise during the arbitration. *Creative Builders, Inc. v. Avenue Develops., Inc.*, 148 Ariz. 452, 456 (App. 1986). LCMC also does not dispute that it was required to submit every claim it had against Hamblen in the arbitration, that the Arbitration Award is in "full settlement of all claims and

counterclaims submitted to this Arbitration," and that the Award held that "all claims not expressly granted herein are denied." (APPV1-0026.)

As set forth in the Petition (at 48), given the broad scope of the arbitration provision and of the Arbitration Award, any claim LCMC had—including those it did not make—against Hamblen "must be deemed to have merged in the arbitration award." *Creative Builders*, 148 Ariz. at 456 (finding that superior court's post-arbitration award of pre-award interest was improper because arbitration resolved all claims, including the claim for pre-award interest). Therefore, the superior court's decision to allow LCMC to assert claims for damages against Hamblen—based on the incorrect assertion by LCMC that it did not seek damages in the arbitration (Petition at 21, 24–27)—is an abuse of discretion.

D. LCMC does not dispute that its claims in the Amended Complaint are barred by res judicata.

As with nearly every other issue raised in the Petition, LCMC does not dispute that the issues and claims set forth in its Amended Complaint in the superior court are identical to the issues and claims LCMC asserted in the arbitration. (Petition at 16–18, 23–28.) In addition, LCMC does not dispute that the superior court entered a Judgment confirming the

Arbitration Award. (Petition at 49.) As a result, LCMC does not, and indeed cannot, dispute that its claims are barred by res judicata in two ways.

First, the arbitration provision and Arizona law required LCMC to submit its compulsory counterclaims against Hamblen in the arbitration—if such "claims are not pled . . . they are waived and barred in any subsequent action under the doctrine of claim preclusion [res judicata]." *Mirchandani v. BMO Harris Bank, N.A.*, 235 Ariz. 68, 70, ¶ 8 (App. 2014). Compulsory counterclaims "arise from the same transaction or occurrence that was the subject matter of the opposing party's claim." *Id.* LCMC does not dispute that its claims against Hamblen in the superior court meet this standard. (Petition at 53–54.)

Second, when a court issues a valid, final judgment after an arbitration, under principles of res judicata, the judgment is "conclusive as to every issue decided and every issue raised by the record that could have been decided." *Heinig v. Hudman*, 177 Ariz. 66, 72 (App. 1993). Here, the superior court issued a judgment confirming the Arbitration Award. While Hamblen argues that the superior court erred by allowing further actions to occur in the superior court, there is no dispute that the superior

court confirmed the Arbitration Award and entered a Judgment on the Award. Therefore, the Judgment is conclusive as to **every issue** which was or could have been decided during the arbitration, and the superior court abused its discretion by allowing LCMC to bring claims which are barred (twice) by principles of res judicata.

ATTORNEYS' FEES REQUEST

In the Petition (at 56–57), Hamblen requested his attorneys' fees and costs incurred in connection with the disputed post-arbitration confirmation proceedings, including this appeal. LCMC Response is completely silent as to Hamblen's request for attorneys' fees. Under the separability doctrine, the arbitration provision remains a separate and stand-alone agreement, and therefore an award of fees and costs is appropriate under § 12-341.01. In addition, RUAA provides for attorneys' fees and costs to the successful party in a judicial proceeding following an arbitration. A.R.S. §§ 12-3025(B), (C). *See also Steer v. Eggleston*, 202 Ariz. 523, 528, ¶¶ 23–24 (App. 2002) (awarding fees on appeal under a similar provision in the Uniform Arbitration Act, A.R.S. § 12-1514).

CONCLUSION

Hamblen's Petition stands almost entirely unopposed by LCMC, and any argument in opposition is either irrelevant or unsupported by any legal authority whatsoever. This Court should accept jurisdiction, grant relief, and remand to the superior court to take the following actions. First, the superior court must vacate the following judgments, orders, minute entries, and filings: February 10, 2016 Judgment; April 14, 2016 Judgment denying Hamblen's Motion 59(a) Motion for a New Trial or, Alternatively, Rule 59(l) Motion to Alter or Amend Judgment; April 14, 2016 Judgment granting LCMC's Motion to Amend the Complaint; LCMC's Amended Complaint; and Hamblen's Answer to Plaintiff's Amended Complaint.

Second, the superior court must issue a judgment confirming the Arbitration Award, and certify the judgment under Rule 54(c). Simply put, LCMC should not be able to take any action in the superior court beyond seeking an order and judgment confirming the Arbitration Award. Because Hamblen is without an adequate remedy by appeal for any of the issues presented, and given the issues of public importance and legal

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questions presented, the Court should accept special action jurisdiction and grant relief.

RESPECTFULLY SUBMITTED this 27th day of September, 2016.

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