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SUPREME COURT OF ARIZONA

JEFFREY HAMBLEN and BARBARA YOUNGS, husband and wife,

Petitioners,

v.

HON. RALPH HATCH, JUDGE OF THE SUPERIOR COURT OF THE STATE OF ARIZONA, in and for the County of Navajo,

Respondent Judge,

and

WINSLOW MEMORIAL HOSPITAL INC d/b/a LITTLE COLORADO MEDICAL CENTER,

Real Party in Interest,

Arizona Supreme Court
No. CV-16-0260-PR

Court of Appeals
Division One
No. 1 CA-SA 16-0201

Navajo County
Superior Court
No. CV-2014-00311

PETITIONERS' SUPPLEMENTAL BRIEF

Scott W. Rodgers, AZ Bar No. 013082
Thomas L. Hudson, AZ Bar No. 014485
Joshua D. Bendor, AZ Bar No. 031908
OSBORN MALEDON, P.A.
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012
(602) 640-9000
srodgers@omlaw.com
thudson@omlaw.com
jbendor@omlaw.com
Attorneys for Petitioners

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INTRODUCTION[1]

Under the "separability doctrine" an arbitration provision included in a larger contract is considered a "severable" or "separate" agreement from the contract in which the arbitration provision is found. Consequently, an arbitrator's decision to rescind a contract containing an arbitration provision does not impact the validity of the arbitration provision itself. Thus if parties agree to arbitrate any and all disputes, the parties must arbitrate any and all disputes absent a successful attack on the arbitration provision itself that occurs before the arbitration. Once a trial court enforces an arbitration provision (and unless an appellate court reverses)—i.e., the trial court properly enforces the provision—the trial court may not permit further litigation between the parties with respect to any dispute that falls within the scope of the arbitration provision.

In this case, the superior court correctly enforced a broad arbitration provision that required the parties to arbitrate "[a]ny controversy or claim arising out of or relating to" Petitioner Jeffrey Hamblen's Employment Agreement and *all counterclaims*. (APPV1-0091.) Consequently, any counterclaims Respondent ("LCMC") had against Hamblen at the time of

[1] The supplemental brief cites to the Special Action appendix.

the Arbitration had to be pursued, if at all, in that Arbitration. Nevertheless, after the parties had completed the arbitration process, the superior court allowed LCMC to once again start litigating various counterclaims against Hamblen because the Arbitrator had rescinded the agreement containing the parties' arbitration provision. That ruling stands the separability doctrine on its head, and cannot be correct for myriad reasons. Most fundamentally, it permits the parties to litigate claims when they expressly agreed to arbitrate them instead.

PERTINENT BACKGROUND

I. Hamblen and LCMC's agreement to arbitrate their claims.

In 2013, LCMC hired Hamblen as its President and CEO. Hamblen's employment with LCMC ended in March 2014. Hamblen's employment agreement with LCMC ("the Employment Agreement") contained an arbitration provision (the "Arbitration Provision") that required arbitration of "[a]ny controversy or claim arising out of or relating to" the Employment Agreement. (APPV1-0091.) In addition, the Arbitration Provision required LCMC to arbitrate "[a]ll 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." (*Id.*)

II. Hamblen's initiation of arbitration.

In April 2014, Hamblen filed an arbitration demand against LCMC for severance compensation due under his Employment Agreement. (APPV1-0076–0079.) In May 2014, LCMC sued Hamblen in superior court asserting an unjust enrichment claim. (APPV4-0006.) Hamblen moved to compel arbitration, the superior court granted the motion, and that court stayed the case "until mandatory arbitration under the contract is completed." (APPV4-0073.) LCMC did not at that time pursue appellate review of the order compelling arbitration. *See S. Cal. Edison Co. v. Peabody W. Coal Co.*, 194 Ariz. 47, 53 ¶ 19 (1999) (outlining procedure for appellate review of an order to compel arbitration before the arbitration occurs).

Instead, the Parties proceeded to resolve their claims in arbitration ("the Arbitration")—a factually intensive, fiercely contested proceeding that involved hundreds of exhibits and multiple witnesses over several days. In that proceeding, LCMC asserted its unjust enrichment counterclaim and others. (APPV1-0105–0120.)

During the arbitration, LCMC sought rescission of Hamblen's Employment Agreement (the contract containing the Arbitration Provision) as one remedy. (APPV1-0116–0117.) Importantly, however, LCMC never sought—before, during, or after the arbitration—to separately invalidate the Arbitration Provision itself. Nevertheless, we now know that LCMC would later attempt to relitigate its counterclaims in superior court after the lengthy and expensive Arbitration proceeding.

On October 6, 2015, the arbitrator issued the arbitration award ("the Arbitration Award"). (APPV1-0016.) The Arbitrator Award found that LCMC "had grounds to rescind, and did rescind" the Employment Agreement, which "abrogates the agreement and undoes it from the beginning," thereby "eliminating" Hamblen's claim for severance payments, fees, and costs. (APPV1-0025.) But the Arbitrator Award did not hold that the Arbitration Provision itself was rescinded or otherwise invalid, presumably in part because that issue had never been raised. (*See id.*) Indeed, the Arbitration Award presupposed that the Arbitration Provision remained valid because it declared that "[t]his Final Award is in full settlement of all claims and counterclaims submitted to this

Arbitration. All claims not expressly granted herein are hereby denied." (APPV1-0026.)

III. Confirmation of the Arbitration Award.

Following the Arbitration process, LCMC moved to confirm the Arbitration Award. (APPV1-0009.) During that process, it did not challenge the enforceability of the Arbitration Provision, thereby conceding its validity. Hamblen did not oppose the confirmation request, but explained that the "judgment entered should be a simple judgment in LCMC's favor, with no monetary award for any party, consistent with the language of the [Arbitration] Award." (APPV4-0074.)

LCMC, however, disagreed with Hamblen's straightforward request. Although LCMC had asked for confirmation of the Arbitration Award, it also asked the court to "dissolv[e] the stay pursuant to the August 8, 2014, order now that the AAA hearing is complete," and "allow[] LCMC's claims against Mr. Hamblen to proceed." (APPV1-0009.) Hamblen opposed this request on various grounds, including that all of these issues had been arbitrated, and were subject to the Arbitration Provision. (*See* APPV4-0074–0078, 0119–0138.)

Over Hamblen's objections, the superior court entered a judgment confirming the Arbitration Award, but then also lifted the stay due to the arbitrator's rescission of the Employment Agreement. (APPV4-00139–0140.) The superior court found that because the Arbitration Award "undid" the Employment Agreement "from its very beginning," Hamblen's request "to deny the Plaintiffs their right to a jury trial to prove damages . . . is unreasonable." (APPV-0140.) LCMC then filed an amended complaint in superior court asserting the same issues and claims that were "denied" in the Arbitration Award.[2]

Following the superior court's denial of Hamblen's Rule 59(a) motion, Hamblen timely appealed the superior court's rulings. (APPV4-0166–0169.) The Court of Appeals dismissed the appeal for lack of jurisdiction. (APPV4-0220.) Hamblen then filed a special action petition and the Court of Appeals denied jurisdiction. This Court granted Hamblen's petition for review.

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[2] The Petition for Special Action (at 17–18, 23-28) includes a detailed discussion showing the extensive overlap between the issues and claims in the arbitration proceeding and those LCMC sought to relitigate in the superior court. Although overlap is not required because the Arbitration Provision governs all counterclaims, LCMC was not asserting new claims.

LCMC did not appeal from the confirmation ruling. Consequently, the superior court's ruling at the outset that LCMC's counterclaims fell within the scope of the Arbitration Provision will remain law of the case.

ARGUMENT

I. The "separability doctrine" generally precludes further litigation after an arbitrator rescinds the contract containing the arbitration provision.

A. Under the separability doctrine, which is now part of Arizona law, an arbitration provision included in a larger contract is considered a "severable" or "separate" agreement from the contract in which the arbitration provision is found.

Fifty years ago, the United States Supreme Court adopted what came to be known as the "separability doctrine" in the arbitration context. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). *Prima Paint* considered whether the court or the arbitrator should decide a claim of fraud in the inducement of the entire contract. Applying the Federal Arbitration Act, the Supreme Court held that "if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Id.* at 403-404. 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). Therefore, without a separate and distinct challenge to the enforceability of the arbitration provision as a stand-alone agreement, a party's effort to have the entire contract rescinded does not impact the enforceability of the arbitration provision itself. *Id.* at 71. (Courts "require the basis of challenge to be directed specifically to the agreement to arbitrate before the court will intervene").

In other words, absent a challenge to the enforceability of the arbitration provision itself, courts will enforce the arbitration provision as written, and allow the arbitrator to decide whether to rescind the entire contract. Furthermore, whether or not the arbitrator decides to rescind the contract containing the provision has no impact on the "separate" arbitration provision. Significantly, "[t]he 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." Martin Domke, Gabriel Wilner & Larry E. Edmonson, *Law and Practice of Commercial Arbitrations* § 11:5, p. 22 (3d ed.

2016). The separability doctrine solves "this theoretical problem" by treating the arbitration clause "as an independent contract which is severable from the principal agreement." *Id*.

Although the rule could be different, any other rule would run contrary to the underlying policies favoring arbitration as well as controlling United States Supreme Court precedent. In particular, in 1984 the United States Supreme Court held that the separability doctrine is "federal substantive law" and applies in both federal and state courts to the full reach of the Commerce Clause. *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006) (reaffirming that "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator"). And, of course, "[t]he FAA preempts state law and governs all written arbitration agreements involving interstate commerce, making such agreements enforceable in both federal and state courts." *S. Cal. Edison*, 194 Ariz. at 51 ¶ 13.

Unsurprisingly, then, state courts across the country now recognize the separability doctrine. *See Uniform Arbitration Act - 2000*, 3 Pepp. Disp.

Resol. L.J. 323, 347 (2003) ("A majority of States recognize some form of the separability doctrine under their state arbitration laws."). Indeed, the Arizona Court of Appeals has applied the doctrine for more than 25 years. *U.S. Insulation, Inc. v. Hilro Const. Co., Inc.*, 146 Ariz. 250, 253 (App. 1985) (holding that the separability doctrine announced in *Prima Paint* is embodied in the Arizona Uniform Arbitration Act); *Stevens/Leinweber/Sullens, Inc. v. Holm Dev. & Mgmt., Inc.*, 165 Ariz. 25, 29 (App. 1990) (applying the separability doctrine and confirming that challenges to the validity of the arbitration provision are decided by the court under Arizona's Uniform Arbitration Act); *WB, The Building Co. v. El Destino, LP*, 227 Ariz. 302, 306-07 ¶¶ 11-12 (App. 2011) (discussing what qualifies as an appropriate challenge to an arbitration provision in applying the doctrine).

Many states, including Arizona, have also adopted versions of the Uniform Arbitration Act. Arizona, for example, first adopted the Uniform Arbitration Act in 1962. *See* A.R.S. §§ 12-1501-1518 (1962). Arizona then adopted the Revised Uniform Arbitration Act ("RUAA") in 2010. *See* A.R.S. §§ 12-3001-3029 (2010). Importantly, because of the critical role the separability doctrine plays in the arbitration context, Section 6(c) of RUAA

incorporated the separability doctrine. *See Uniform Arbitration Act - 2000*, *supra*, at 347 ("The language in Section 6(c), 'whether a contract containing a valid agreement to arbitrate is enforceable,' is intended to follow the 'separability' doctrine outlined in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967)."); *see also Canon Sch. Dist. No. 50 v. W.E.S. Co.*, 180 Ariz. 148, 153-54 (1994) (citing the prefatory comments to the 1954 draft of the Uniform Arbitration Act). Arizona adopted Section 6(c)'s separability language verbatim in A.R.S. § 12-3006(C) ("An arbitrator shall decide . . . whether a contract containing a valid agreement to arbitrate is enforceable."). Arizona also directed its courts, when "applying and construing" RUAA, to consider "the need to promote uniformity of the law with respect to its subject matter among states that enact it." A.R.S. § 12-3028. Therefore, although this Court has neither discussed the separability doctrine nor RUAA, both the United States Supreme Court and A.R.S. § 12-3006(C) make clear that the separability doctrine is part of Arizona law.

This Court has also lauded arbitration as "prompt, efficient, and inexpensive dispute resolution," *S. Cal. Edison Co.*, 194 Ariz. at 52, and has discouraged "nonmeritorious protracted confirmation challenges," *Canon*

School Dist., 180 Ariz. at 154. This prompt and efficient resolution is possible because arbitration permits parties to "select judges of their own choice and by consent submit their controversy to such judges for determination, in the place of the tribunals provided by the ordinary processes of law." *Gates v. Ariz. Brewing Co.*, 54 Ariz. 266, 269 (1939). The separability doctrine ensures that parties may "select judges of their own choice," *id.*, to resolve a controversy concerning the enforceability of the contract containing the arbitration provision.

B. The separability doctrine requires that once a trial court properly compels arbitration, the parties may not later litigate claims subject to the governing arbitration provision.

To Hamblen's knowledge, only one published decision has explicitly addressed the separability doctrine in the post-arbitration context.[3] *See Visiting Nurse Ass'n v. Jupiter Med. Ctr., Inc.*, 154 So.3d 1115 (Fla. 2014). In that case, a hospital moved to vacate an arbitration award on the ground that the arbitration panel's construction of the contract at issue meant that the contract violated state and federal laws prohibiting kickbacks for

[3] Hamblen has located one 2008 unpublished decision from the United States District Court for the Southern District of Ohio that addresses the doctrine in this context. Hamblen can provide the citation to the case upon request by the Court.

referrals of Medicare patients. *Id.* at 1118. The Florida Supreme Court held that the motion to vacate was properly denied, because, under *Prima Paint* and its progeny, a challenge to the validity of a contract as a whole must go to the arbitrator, and is not a proper ground for vacatur or modification of the award. *Id.* at 1118, 1125-27, 1132, 1134.

Thus, the doctrine of separability has as much force on the back end as on the front end. An argument that there is some defect in the contract as a whole does not prevent a court from compelling arbitration or confirming an arbitral award. Thus, once a trial court properly compels arbitration, and the arbitration disposes of certain claims, those claims may not be relitigated, even if the award undermines the validity of the contract as a whole. As explained in Argument § I.A., such a ruling as to the entire contract has no impact on the "separate" arbitration provision, which remains valid and enforceable. This means that if a party could not litigate a claim before the arbitration, it may not do so afterwards. Any other conclusion would run contrary to the separability doctrine.

Moreover, construing the separability doctrine in this manner—that once a trial court properly compels arbitration, the parties may not later litigate claims subject to the governing arbitration provision—fits squarely

with RUAA. RUAA requires that challenges to the enforceability of an arbitration agreement must be made "not later than the beginning of the arbitration hearing." A.R.S. § 12-3023(A)(5). If no challenge is made before the arbitration hearing commences, a party waives the right to later challenge the enforceability of the arbitration agreement. *See id.* (authorizing courts to vacate an arbitration award where "there was no agreement to arbitrate, unless the person participated in the arbitration hearing without raising the objection under § 12-3015, subsection C not later than the beginning of the arbitration hearing."); *Uniform Arbitration Act - 2000*, *supra*, at 399 (explaining the purpose of this provision). These rules presuppose—consistent with the separability doctrine—that if an arbitration occurs under a properly enforced arbitration provision, the arbitration will control the outcome of all claims that fall within the scope of the enforced arbitration provision.

Indeed, RUAA strictly limits the superior court's options after the arbitration process is complete: the superior court "**shall** issue a confirming order unless the award is modified or corrected . . . or is vacated." A.R.S. § 12-3022 (emphasis added). The limited options available do not include permitting a party to litigate claims subject to the

originally enforced arbitration provision. Moreover, a court may only modify, correct, or vacate an arbitration award in limited circumstances that are unrelated to whether the arbitration award found the contract containing the arbitration provision unenforceable. *See id.* at § 12-3023 (A) (allowing vacatur for arbitrator partiality, corruption, or misconduct), § 12-3024(A) (correcting ministerial mistakes or where the arbitrator ruled on a claim not submitted to the arbitrator).

Lastly, if a trial court could permit parties to relitigate claims that were properly compelled to arbitration merely because the arbitrator rescinds the contract containing the (enforceable) arbitration provision, it would result in tremendous waste and discourage parties from entering into arbitration agreements. Such a rule would run contrary to the long-standing policies designed to encourage arbitration and respect parties' choices to arbitrate disputes, including disputes over the enforceability of the contract containing their arbitration agreement.

II. In this matter, the separability doctrine precluded the superior court from permitting further litigation between the parties.

In this case, the Arbitration Provision required LCMC to arbitrate all of its counterclaims, both compulsory and permissive as those terms are

used in the Federal Rules of Civil Procedure. (APPV1-0091); *see also* Fed. R. Civ. P. 13(b) (defining a permissive counterclaim as a "claim that is not compulsory"). In other words, the Arbitration Provision governed any and all claims that LCMC had against Mr. Hamblen.

In light of this and RUAA,[4] the superior court properly required LCMC to arbitrate any claims it had against Hamblen, including the unjust enrichment claim it had asserted in superior court. LCMC then in fact did assert all of its counterclaims against Hamblen in the arbitration proceeding. The arbitration hearing lasted several days and at the end of the process, the arbitrator entered a final Arbitration Award, which settled "all claims and counterclaims submitted." (APPV1-0026.)

Although the Award rescinded the Employment Agreement (the contract containing the Arbitration Provision), it did not separately rescind the Arbitration Provision and instead presupposed its continued validity by settling all claims. Under the separability doctrine, that means the "separate" Arbitration Provision remained enforceable. Although LCMC

[4] RUAA "governs an agreement to arbitrate made on or after January 1, 2011." A.R.S. § 12-3003(A)(1). Although LCMC has sometimes below cited the Uniform Arbitration Act, RUAA applies because the parties executed the Employment Agreement in 2013, (APPV1-0095).

also decided to "withdraw" its unjust enrichment counterclaim in its arbitration closing memorandum (as it was free to do), that could not somehow make the counterclaim subject to future judicial litigation. To the contrary, the separability doctrine requires that once the superior court properly compelled arbitration, LCMC could never litigate any claims (permissive or compulsory) against Hamblen that existed at that time.

Notwithstanding this, the superior court authorized LCMC to start the litigation over by permitting LCMC to amend the complaint it filed before the arbitration to add various counterclaims, including a claim for unjust enrichment. (APPV4-0170–0183.) The superior court did so because the Arbitrator rescinded Hamblen's Employment Agreement. But under the separability doctrine, that rescission had no impact on the Arbitration Provision. Moreover, RUAA drastically limited the superior court's authority after completion of the Arbitration, and LCMC did not timely move to vacate, modify, or correct the Arbitration Award.

Note too that the superior court's legally incorrect ruling also completely undermines the policies the Court has cited in favor of arbitration. In effect, the superior court adopted a rule that says parties must first go to arbitration and arbitrate any and all claims, but if the

arbitrator rescinds the contract containing the arbitration provision, the parties must start over in superior court. Indeed, the superior court's order would permit LCMC to litigate again the exact same issues and claims that the arbitrator already ruled upon. This ruling cannot be squared with the separability doctrine, and instead transformed the arbitration hearing into a meaningless and costly process.

III. LCMC's arguments in its petition for review response lack merit.

LCMC's response to the petition for review attempts to sidestep the separability doctrine. LCMC primarily argues about procedural issues, contending that somehow the superior court could have proceeded as it did, or that Hamblen must file a different motion before any appellate review may occur. (Response to Petition for Review at 3-5.) But these arguments go nowhere.

The superior court was presented with a motion to confirm the Arbitration Award following a complete arbitration process. Under the separability doctrine and RUAA, it had extraordinarily limited options and could not restart the litigation. It should have simply confirmed the Arbitration Award. Instead, the superior court granted LCMC's request to amend its complaint and allowed LCMC to litigate in superior court claims

that fell squarely within the enforceable Arbitration Provision—the same claims submitted to arbitration. It erred, and badly so, and LCMC cannot defend the error it asked the superior court to make.

To the contrary, although LCMC has never expressly said so, it is, at bottom, arguing that the separability doctrine does not exist or somehow does not apply in this case. Its position—that its claims should proceed against Hamblen in superior court—ignores that those claims were required to be arbitrated and were arbitrated. Its position also ignores that LCMC never lodged any separate attack on the Arbitration Provision itself, and thus the Arbitrator's rescission of the contract containing the Arbitration Provision had no impact on the Provision's enforceability.

Moreover, LCMC has never disputed in its appellate briefing that (a) the Arbitration Provision in Hamblen's Employment Agreement required LCMC to submit to arbitration all compulsory and permissive counterclaims; (b) the Arbitration Award disposed of the claims that LCMC reasserted in superior court; (c) LCMC's claims in the superior court amended complaint are the same claims and issues it asserted and disputed in the arbitration hearing, and are barred by res judicata; and (d) it never made a separate challenge to the enforceability of the

arbitration provision, as opposed to the entire Employment Agreement. (*See* Hamblen's September 27, 2016 Reply in Support of Petition for Special Action at 12, 17-25.)

ATTORNEYS' FEES REQUEST

Hamblen seeks his attorneys' fees and costs for all confirmation proceedings under A.R.S. §§ 12-341.01 and 12-3025(B), (C). *See also Steer v. Eggleston*, 202 Ariz. 523, 528, ¶¶ 23–25 (App. 2002) (awarding appeal fees under a similar Uniform Arbitration Act provision, A.R.S. § 12-1514).

CONCLUSION

The Court should reverse the superior court's order granting LCMC leave to amend, and vacate the superior court's February 10, 2016 Judgment and all rulings thereafter. The Court should remand with instructions for the superior court to enter, nunc pro tunc, the final judgment confirming the Arbitration Award with the requisite Rule 54(c) certification, thereby bringing this case to an end.

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RESPECTFULLY SUBMITTED this 3rd day of April, 2017.

OSBORN MALEDON, P.A.

By /s/ Scott W. Rodgers

Scott W. Rodgers
Thomas L. Hudson
Joshua D. Bendor
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012

Attorneys for Petitioners/Defendants