

Arbitration Case Development

Emerald Aero LLC v. Kaplan, 4th District No. 0070579, Feb 28, 2017, 2017 WL 767004 – State appeals court overturns arbitrator’s \$30.8 million award finding that the lack of notice of the claimant’s increased punitive damages claim and the arbitrator’s decision to accept the last minute amendment to the damages claim fell outside the arbitrator’s scope of authority

This matter arose when several investors sued Stephen Kaplan for alleged breach of fiduciary duties pertaining to plaintiffs’ investment in a self-storage facility located in Texas. In the court proceedings, plaintiffs sought compensatory damages and declaratory relief, but not punitive damages. The trial court granted defendants’ unopposed motion to compel arbitration. About ten months later, in January 2014, plaintiffs submitted a request to the AAA to have a case opened and attached a “claim summary” form in which they stated that they were seeking \$1,000,000.00 in damages and that the basis for their claim was set forth in an attached copy of their state court complaint.

In November 2014, after the arbitrator was appointed, the matter was ordered stayed pending the outcome of Kaplan’s criminal prosecution. In terms of what happened next, it’s important to first look at Rule R-6 of the AAA Commercial Rules. Rule R-6(a) provides that at any time prior to the close of the evidentiary hearing or by a date established by the arbitrator, a party may increase or decrease the amount of its claim or counterclaim, provided that written notice of the change of claim amount must be provided to the AAA and all parties. Rule R-6(a) also provides that if the change of claim amount results in an increase in the amount of the administrative fee, the balance of the fee is due before the change of claim amount be accepted (and presumably acted upon) by the arbitrator. Additionally Rule R-6(b) provides that an arbitrator may only award remedies of which the parties had reasonable notice, and that at least 14 days’ notice must be given of “a]ny new or different claim or counterclaim.” Where a new or different claim or counterclaim are put forth after the arbitrator has been appointed, Rule R-6(b) provides that the arbitrator must consent to its submission.

In this case, the arbitration proceeding was reactivated after Kaplan pled guilty to wire fraud, but before his sentencing hearing. A number of proceedings were held, some it appears without notice to Kaplan or his attorney. In any event, given that plaintiffs’ stated claim amount was only \$1 million, it appears that whether Kaplan or his attorney received notice or not, Kaplan had opted to

devote his attention to other matters and let the chips fall where they might, viewing his maximum exposure as being \$1 million.

After numerous continuances, the arbitrator set the matter for a telephonic, default prove-up hearing and did so with only two and one-half week's notice. The day before the hearing, plaintiffs submitted briefing in which they requested over \$12 million in compensatory damages, *plus* punitive damages in the amount of three times their actual damages. The evidentiary hearing went forward as noticed, with no appearance or response by Kaplan. Two weeks later, the arbitrator issued an award in favor of plaintiffs in the amount of \$30.8 million and did so without specifying the grounds or nature of the award.

Plaintiffs then moved to confirm the award and Kaplan, not surprisingly, moved to vacate the award. Kaplan argued that the award lacked due process and exceeded the arbitrator's powers on various grounds, including that fact that it went beyond the submitted issues and provided for unauthorized remedies. Plaintiffs argued that the arbitrator's award was final and binding, and that the court had no authority to review the merits of the decision. The trial court ruled for plaintiffs, and entered judgment in the amount of the award.

On appeal to the Fourth District Court of Appeal, the judgment was overturned and the award vacated on the grounds that the arbitrator had exceeded his authority by including punitive damages in the award. The ruling, written by Justice Judith L. Haller and concurred with by Presiding Justice Judith McConnell and Justice Richard D. Huffman, said that the award of punitive damages violated the AAA Commercial Rules (discussed above), which were incorporated by reference into the parties' arbitration agreement. The appellate court rejected the argument that Kaplan was not prejudiced because he had already decided not to appear. Justice Haller reasoned that Kaplan might have retained counsel or appeared, at least to oppose the punitive damages request, given that the amount being sought substantially exceeded the \$1 million prayed for in the initial arbitration claim. Justice Haller went on to say that there were further procedural irregularities requiring that the award be vacated, including the lack of a showing that Kaplan had notice of prior hearings and orders, ambiguity as to how much the plaintiffs were claiming in compensatory damages, and the case manager's refusal to reassign the case when the arbitrator resigned and refused to hear or rule on Kaplan's motion seeking to set aside the award on the grounds that Kaplan had received no notice that plaintiffs would be seeking punitive damages. Justice Haller wrote that "the extraordinary large amount" of the arbitration award had heightened her concerns about the "numerous procedural shortcomings" in the arbitration. "On the record before us, plaintiffs' counsel

took unfair advantage of the situation by making a last-minute demand for more than \$30 million in punitive damages.... Given the lack of fair notice, the arbitrator's decision to accept this claimed amount fell outside the arbitrator's authority." Because the arbitrator did not specify how much of the award was punitive damages, the appellate court determined that the entire award must be vacated.



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