

Business Law Monthly Practice Tip

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Virginia Supreme Court Affirms Circuit Court Decision Confirming Arbitration Award in Dispute Involving the Members of a Limited Liability Company

Cotton Creek Circles, LLC, et al. v. San Luis Valley Water Co., et al.,

689 S.E.2d 675, 2010 Va. LEXIS 31 (Va. 2010).

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Facts of the Case:

- Cotton Creek Circles, LLC (the "LLC") was formed to develop and sell water rights to certain Colorado municipalities (the "Project"). The LLC consisted of three (3) Members, one of which was co-owned by Gary Boyce (the "Boyce Member"), and the other two Members, James River Capital Corporation and Deepwater Development, LLC, are referred to collectively herein as the "Plaintiff Members."
- Under the Operating Agreement of the LLC, the Members' business activities within a certain geographic area (the "Protected Water Project Area") were limited by the following non-compete clause:
 - [I]f [the LLC] has not abandoned in writing the pursuit of the Project, then for such period of time as any of the [members] is involved in the potential or actual purchase, development or sale of any water project within [the Protected Water Project Area], in no event shall any [entity related to the Boyce Member] pursue the acquisition or development of water projects or any property relating thereto within the Protected Water Project Area without the prior written consent of [James River Capital Corporation].
- A dispute arose among the Members of the LLC as to whether the Boyce Member violated the non-compete clause by entering into a lease with an option to purchase (the "Option") certain property within the Protected Water Project Area (referred to herein as "Cherry Creek Ranch").
- The Plaintiff Members filed a demand for arbitration under the following provision of the Operating Agreement: "The Members agree that in the event of any dispute with respect to this Agreement, their respective obligations hereunder, or any other matter relating to [the LLC] whatsoever, such dispute shall be settled by arbitration ... in accordance with the Commercial Arbitration Rules of the American Arbitration Association."
- At a hearing before a panel of arbitrators (the "Panel"), the Boyce Member conceded that it intended to exercise the Option, but that it would provide a water rights easement to the LLC.



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- The Panel ruled that the Boyce Member owned the Option subject to an obligation to provide the LLC an easement for the water rights to the property.
- The Plaintiff Members filed a motion in the Circuit Court to vacate the arbitration award, arguing that the Panel exceeded its powers by disregarding the unambiguous terms of the non-compete clause contained in the Operating Agreement. The Circuit Court denied the motion to vacate and confirmed the arbitration award.

Analysis:

The Plaintiff Members argued, on appeal, that the Circuit Court should have vacated the Panel's award under Section 10(a)(4) of the Federal Arbitration Act, 9 U.S.C. §§ 1 through 16 (2006 & Supp. II 2008) (the "Act"), which permits a court to vacate an award if the arbitrators exceed their powers. The Plaintiff Members contended that the Panel's award ignored the plain language of the Operating Agreement by permitting the Boyce Member to acquire title to Cherry Creek Ranch under the Option without the prior written consent of James River Capital Corporation. As such, the Plaintiff Members claimed that the Panel exceeded its powers by fashioning a remedy that contravenes the unambiguous terms of the non-compete clause contained in the Operating Agreement.

In response, the Boyce Member argued that under the terms of the Operating Agreement, the task of interpreting the non-compete clause fell squarely within the Panel's authority. The Boyce Member argued further that the Panel did not ignore the terms of the non-compete clause, but rather applied a particular interpretation of the disputed language.

Under Section 10(a)(4) of the Act, a court may vacate an arbitration award if "the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4). Under the Act, arbitrators do not exceed their powers if they misinterpret a contract or make errors of law. *Apex Plumbing Supply, Inc. v. U.S. Supply Co., Inc.*, 142 F.3d 188, 191 n. 1 (4th Cir. 1998); *Richmond Fredericksburg & Potomac R.R. Co. v. Transportation Commc'ns Int'l Union*, 973 F.2d 276, 281 (4th Cir. 1992). For arbitrators to exceed their powers within the meaning of Section 10(a)(4) of the Act, the arbitrators must egregiously depart from the authority conferred by the parties in their arbitration contract. *Hall Street Assocs., LLC v. Mattel, Inc.*, 552 U.S. 576, 584, 128 S. Ct. 1396, 170 L. Ed. 2d 254 (2008).

Applying these principles, the Virginia Supreme Court concluded that the Operating Agreement granted the Panel the authority to settle the dispute. The provision of the Operating Agreement governing arbitration conferred upon the arbitrators the power to resolve "any dispute with respect to [the Operating Agreement]," necessarily including the authority to settle a dispute over proper application and interpretation of the non-compete clause. The Court determined that the Panel plainly applied the language of the non-compete clause by fashioning a remedy that prohibited the Boyce Member from retaining all water rights in Cherry Creek Ranch, located within the Protected Water Project Area, to the exclusion of the LLC. In reaching this conclusion, the Court emphasized that the grounds for vacatur provided in the Act do not permit courts to overturn an arbitration award based merely on a party's disagreement with the arbitrators' decision. *Remmey v. PaineWebber, Inc.* 32 F.3d 143, 146 (4th Cir. 1994). "[P]arties may not seek a 'second bite at the apple' simply because they desire a different outcome." *Id.*

Takeaway:

It is clear from the Court's decision and analysis that if an Operating Agreement contains an arbitration clause granting the arbitrators the power to resolve disputes among the members of the limited liability company, it is not likely that a decision of the arbitration panel will be overturned by the courts, barring an egregious departure from the panel's authority. Even if it is arguable that the arbitration panel misinterpreted the disputed provision(s) of the Operating Agreement, the panel has not exceeded its powers under the Act. Practitioners should exercise care in drafting arbitration provisions in Operating Agreements, remaining mindful of the fact that if arbitration panels are given broad authority to resolve disputes, the panels' decisions are afforded extreme deference by courts.
