

IN THE COURT OF APPEALS OF OHIO
TENTH APPELLATE DISTRICT

Fresh Eggs Manager, LLC, :
 :
 Plaintiff-Appellee, :
 :
 v. : No. 12AP-1074
 : (C.P.C. No. 12CVH-01-104)
 Ohio Fresh Eggs et al., : (REGULAR CALENDAR)
 :
 Defendants-Appellants. :

D E C I S I O N

Rendered on August 8, 2013

James E. Arnold & Associates, LPA, W. Evan Price, II, and Scott J. Stitt, for appellee.

Crabb Brown & James, LLP, and John C. Albert; Bradshaw Fowler Proctor & Fairgrave, PC, and Todd A. Strother, for appellants.

APPEAL from the Franklin County Court of Common Pleas.

SADLER, J.

{¶ 1} Appellants, Ohio Fresh Eggs ("OFE") and Austin J. DeCoster, appeal from a judgment of the Franklin County Court of Common Pleas denying their motion to vacate and confirming an arbitration award issued in favor of appellee, Fresh Eggs Manager, LLC ("FEM"). For the reasons that follow, we affirm the judgment of the trial court.

I. FACTUAL AND PROCEDURAL HISTORY

{¶ 2} The parties have not challenged the underlying facts as summarized in the arbitrator's award; therefore, like the trial court, we utilize those facts to form the basis of our factual summarization. This matter involves two large commercial egg-laying facilities located in Ohio that, prior to December 2003, were owned and operated by

Anton Pohlman through his company Buckeye Egg Farm, L.P. Pohlman was interested in selling the two facilities and DeCoster was interested in acquiring them. However, due to difficulties in DeCoster being able to obtain the necessary permits and licenses, DeCoster sought to accomplish this without noticeable and direct involvement. Accordingly, in December 2003, several agreements were entered into that, in essence, provided that OFE would finance the acquisition and operation of the two egg-laying facilities and FEM would provide management services to OFE. Under the agreements entered into by the parties, DeCoster personally guaranteed OFE's financial and other performances, and, in return, DeCoster, or entities controlled or owned by him, would receive all profits generated by OFE after payment of requisite expenses. One of the parties' agreements, the Consulting and Management Agreement ("CMA"), provided for FEM's base compensation and bonus compensation. The dispute herein involves only the calculation and payment of bonus compensation; therefore, we do not reproduce the provision of the CMA pertaining to base compensation. In relevant part, the provision in the CMA regarding bonus compensation provides:

(b) Bonus Compensation.

(i). OFE shall pay FEM bonus compensation to compensate it for its efforts on behalf of OFE (the "Bonus Compensation"). Such Bonus Compensation, computed on an annual basis (June 1 to May 31), shall be an amount equal to five percent (5%) of the Adjusted Net Income of Fresh Eggs for such year reduced to the extent of any prior year's net operating losses (computed similarly to the calculation of the Adjusted Net Income) that have not been offset by later years Adjusted Net Income. The Bonus Compensation shall be paid within thirty (30) days of the accountant's issuance of his/her Final Report.

(ii). For purposes of this calculation, Adjusted Net Income is defined as the Net Income of OFE computed in accordance with Generally Accepted Accounting Principles (GAAP) consistent with or subject to the following adjustments: (1) no provision or reduction for income taxes shall be made; (2) Depreciation (or amortization) on all capital assets and improvements shall be depreciated over a ten year straight life method. All expenditure for the initial required improvements shall be capitalized and treated as 10 year life assets. Thereafter, repairs of less than \$5,000.00 may be expensed

and items under \$5,000.00 may be expensed even if normally capitalized.

(iii). Interest paid or accruable on loans from commercial lenders shall be an expense for Adjusted Net Income hereunder under as determined under GAAP. Any loans by individual investors, Members or any other party otherwise having an interest in the profits or losses of OFE shall be computed at Wall Street Journal Prime Rate plus one percent (1%). In addition, for purposes of calculating Adjusted Net Income, a "deemed" interest expense on the initial capital investment of the Members equal to Wall Street Journal Prime Rate plus one percent shall be used.

{¶ 3} The parties made subsequent amendments to their agreements; however, none made any substantive changes to either the CMA's bonus compensation provision or DeCoster's personal guaranty obligations. In accordance with the CMA's bonus compensation provision, FEM received a bonus from OFE for part of the year ending in 2004. After that time, the egg market declined and did not show improvement until 2006. Because of the decline in the egg market, in fiscal years ending in 2005 and 2006, OFE incurred significant losses which ultimately threatened OFE's grain license, the loss of which would further harm the company's finances. To remedy the problem of OFE's falling net worth, DeCoster agreed to write off \$25.5 million of debt on the company's financial statement. This debt was owed to Ohio Investments Co., LLC, an entity owned and managed by DeCoster. The write-off occurred in two separate transactions, specifically, \$20.5 million on September 15, 2006 and \$5 million on May 30, 2007. According to the arbitrator's award, general accounting and tax principles provide that, when an entity writes off a debt obligation on a balance sheet, such benefit must be reflected in its income statement as "gain on debt forgiveness" and consequently creates income for tax purposes.

{¶ 4} Pertaining to fiscal years ending in 2006 to 2008, OFE's accountant, Frost PLLC ("Frost"), prepared several financial statements. As is relevant here, Frost prepared an auditor's report for the Ohio Department of Agriculture related to fiscal year 2006. This report applied the Generally Accepted Accounting Principles ("GAAP") and showed

the \$20.5 million gain arising from debt forgiveness. Frost's auditor's report for fiscal year 2007 showed the full \$25.5 million gain on debt forgiveness.

{¶ 5} In May 2008, Frost prepared the initial bonus compensation calculation. In accordance with the CMA, Frost calculated the adjusted net income, including making adjustments for depreciation and deemed interest under the bonus compensation formula. However, Frost further reduced the adjusted net income for fiscal year 2007 by the \$25.5 million gain on debt forgiveness "based on management's interpretation of the agreement," resulting in an adjusted net income for purposes of calculating bonus compensation of negative \$6,337,375 and no bonus being due. Donald Hershey, sole owner of FEM, objected to the bonus calculation pursuant to the CMA.

{¶ 6} In March 2009, Frost prepared a second bonus calculation. This calculation for 2007 repeated the calculation set forth in the May 2008 report and again showed the exclusion of the gain on debt forgiveness and no bonus being due. Frost then offset 2008's adjusted net income with the calculated loss for 2007. This resulted in an adjusted net income for purposes of 2008 bonus compensation of negative \$2.36 million and no bonus being due for 2008. Had Frost not added back the debt in 2007, the loss carryover to 2008 would have been less and, when carried forward, would have resulted in an adjusted net income for purposes of 2008 bonus compensation of over \$23.1 million and a resulting bonus of over \$1.15 million. Hershey again objected to the bonus calculation pursuant to the CMA.

{¶ 7} In August 2010, FEM filed a demand for arbitration in accordance with the parties' arbitration agreement. The sole claim remaining when the matter proceeded to arbitration was FEM's claim for breach of contract based on OFE's failure to pay the proper bonus for fiscal year ending in 2008 as required by the CMA. FEM argued that, in fiscal year ending in 2008, for purposes of calculating bonus compensation, OFE had an adjusted net income of \$44,834,775, resulting in a five percent bonus of approximately \$1,156,786. However, because OFE erroneously reduced 2008's adjusted net income by the \$25.5 million gain on debt forgiveness and then further offset the erroneous loss of \$47 million for fiscal year 2007 against 2008 profits, an incorrect negative adjusted net income arose for fiscal year ending in 2008.

{¶ 8} The arbitrator held that, while other agreements were executed by the parties, the CMA is the governing document for purposes of calculating bonus compensation. After a detailed discussion of the calculations, the arbitrator concluded that Frost's \$25.5 million adjustments for calculating bonus compensation were not in accordance with the formula set forth in the CMA, thus creating an improper adjusted net income figure for fiscal year ending in 2007. According to the arbitrator, the proper adjusted net income for fiscal year ending in 2007 should have been \$19,162,625 and carrying that number forward results in a 2008 adjusted net income for purposes of bonus compensation calculation in the amount of \$23,135,724. This in turn results in a five percent bonus of \$1,156,786.20 for fiscal year ending in 2008, plus pre-judgment interest in the amount of \$177,163.56. Because DeCoster individually and personally guaranteed all payments by OFE to FEM, the arbitrator entered the award jointly and severally against appellants.

{¶ 9} On January 4, 2012, FEM filed in the trial court an application to confirm the arbitration award pursuant to R.C. 2711.09. In response, OFE filed a motion to vacate the arbitration award arguing that the arbitrator exceeded his authority and the arbitrator's award was illogical and demonstrated a disregard for the law. After briefing, a magistrate rendered a decision finding that the arbitrator correctly applied the appropriate law. Therefore, the magistrate recommended that appellants' motion to vacate the arbitration award be denied and that the arbitration award be confirmed.

{¶ 10} Appellants timely filed objections to the magistrate's decision. The primary contention asserted in their objections was that the magistrate erred in finding the arbitrator did not exceed his authority when interpreting the applicable contracts in this case. The trial court reviewed the matter and concluded both the magistrate and the arbitrator applied the correct law and correctly applied the law to the facts set forth in the arbitrator's decision. Accordingly, the trial court overruled appellants' objections to the magistrate's decision and adopted the magistrate's decision as its own. As set forth in the decision, appellants' motion to vacate the arbitrator's award was denied, and appellee's application to confirm the arbitrator's award was granted.

II. ASSIGNMENTS OF ERROR

{¶ 11} This appeal followed, and appellants bring the following four assignments of error for our review:

I. The trial court erred when it found the arbitrator did not exceed his authority by adding a requirement to the bonus provision, thereby improperly modifying the parties' contract.

II. The trial court erred when it found the arbitrator did not exceed his authority by ignoring the provision in the bonus agreement that required the net income used in the calculation be reduced to the extent of prior years' net operating losses.

III. The trial court erred when it found the arbitrator did not exceed his authority and did not manifestly disregard the law when the arbitrator refused to consider all of the inter-related contracts to interpret the parties' agreement and intent.

IV. The trial court erred when it confirmed the arbitrator decision to award the plaintiff a \$1 million bonus on fictional income that was required to be booked due to massive losses incurred under plaintiff's management, despite plaintiff's admission that he did not object to the removal of that income from the bonus calculation.

III. DISCUSSION

{¶ 12} Though this case presents a somewhat convoluted factual history, the issue before this court, as it was before the trial court and arbitrator, is relatively narrow. The issue here is whether the \$25.5 million gain on debt forgiveness should be treated as income for purposes of calculating bonus compensation under the CMA. While FEM contends the CMA unambiguously requires this, appellants contend otherwise.

A. Standard of Review

{¶ 13} "[I]t is the policy of the law to favor and encourage arbitration and every reasonable intendment will be indulged to give effect to such proceedings and to favor the regularity and integrity of the arbitrator's acts." *Lake Cty. Bd. of Mental Retardation Dev. Disabilities v. Professional Assn. for the Teaching of the Mentally Retarded*, 71 Ohio St.3d 15, 17 (1994). As such, a reviewing court has a very limited role in reviewing a binding arbitration award. *Madison Local School Dist. Bd. of Edn. v. OAPSE/AFSCME*

Local 4, 11th Dist. No. 2008-L-086, 2009-Ohio-1315, ¶ 9. The arbitrator is the final judge of both the law and the facts, and a court may not substitute its judgment for that of the arbitrator. *Id.* When a provision in an arbitration agreement is subject to more than one reasonable interpretation, an arbitrator's interpretation, rather than that of the reviewing court, governs the rights of the parties. *Id.*

{¶ 14} Arbitration awards are presumed valid, and a reviewing court may not merely substitute its judgment for that of the arbitrator. *Findlay City School Dist. Bd. of Edn. v. Findlay Edn. Assn.*, 49 Ohio St.3d 129 (1990), reversed on other grounds, *Cincinnati v. Ohio Council 8, AFSCME*, 61 Ohio St.3d 658 (1991). Judicial review of arbitration awards is narrowly limited by R.C. 2711.10 and 2711.11. *Reynoldsburg City School Dist. Bd. of Edn. v. Licking Heights Local School Dist. Bd. of Edn.*, 10th Dist. No. 11AP-173, 2011-Ohio-5063; *Arrow Uniform Rental, LP v. The K & D Group, Inc.*, 11th Dist. No. 2010-L-152, 2011-Ohio-6203. The Supreme Court of Ohio has held that "the vacation, modification or correction of an award may only be made on the grounds listed in R.C. 2711.10 and 2711.11 * * *. The jurisdiction of the courts to review arbitration awards is thus statutorily restricted; it is narrow and it is limited." *Warren Edn. Assn. v. Warren City Bd. of Edn.*, 18 Ohio St.3d 170, 173 (1985).

{¶ 15} R.C. 2711.11 provides limited instances in which an arbitration award can be judicially modified, and R.C. 2711.10 provides for instances in which an arbitration award can be judicially vacated. R.C. 2711.10 states, in relevant part:

In any of the following cases, the court of common pleas shall make an order vacating the award upon the application of any party to the arbitration if:

(A) The award was procured by corruption, fraud, or undue means.

(B) Evident partiality or corruption on the part of the arbitrators, or any of them.

(C) The arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(D) 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.

{¶ 16} In the present case, appellants' motion to vacate the arbitrator's award was based on the allegation that the arbitrator exceeded his powers. The essence of all four assigned errors on appeal is that the arbitrator exceeded his authority by modifying and ignoring the parties' agreements.

{¶ 17} When determining whether the arbitrator exceeded his powers, the reviewing court must confirm the arbitration award if it finds that the arbitrator's award draws its essence from the underlying contractual agreement. *Prosper Business Dev. Corp. v. Intervenor*, 10th Dist. No. 11AP-855, 2012-Ohio-2992, ¶ 22, citing *Reynoldsburg City School Dist. Bd. of Edn.* at ¶ 22, citing *Miami Twp. Bd. of Trustees v. Fraternal Order of Police, Ohio Labor Council, Inc.*, 81 Ohio St.3d 269 (1998), syllabus. An arbitrator's award will be found to "draw its essence" from the parties' agreement where "there is a rational nexus between the agreement and the award, and where the award is not arbitrary, capricious or unlawful." *Mahoning Cty. Bd. of Mental Retardation v. Mahoning Cty. TMR Edn. Assn.*, 22 Ohio St.3d 80 (1986), paragraph one of the syllabus. Stated another way, an arbitrator's award will be found to depart from the essence of the parties' agreement only when: "(1) the award conflicts with the express terms of the agreement, and/or (2) the award is without rational support or cannot be rationally derived from the terms of the agreement." *Ohio Office of Collective Bargaining v. Ohio Civ. Serv. Emp. Assn., Local 11, AFSCME, AFL-CIO*, 59 Ohio St.3d 177, 179 (1991), syllabus.

{¶ 18} As long as the arbitrator is arguably construing the contract, the trial court is obliged to affirm its decision. *Arrow Uniform Rental* at ¶ 47, citing *Summit Cty. Bd. of Mental Retardation & Dev. Disabilities v. Am. Fedn. of State, Cty. & Mun. Emp.*, 39 Ohio App.3d 175, 176 (9th Dist.1988). This court has recognized that a trial court's judgment confirming an arbitration award is subject to review using an abuse of discretion standard. *Prosper Business Dev. Corp.* at ¶ 24, citing *Telle v. Estate of Soroka*, 10th Dist. No. 08AP-272, 2008-Ohio-4902, ¶ 11.

B. First Assignment of Error

{¶ 19} In their first assignment of error, appellants contend the arbitrator exceeded his authority in this case because, while the CMA provides that the adjusted net income for purposes of bonus calculation be determined in accordance with GAAP, this does not require that the adjusted net income used for bonus calculation purposes be the same adjusted net income as used in the audited financial statements. According to appellants, GAAP principles allow debt forgiveness transactions to be treated either as debt forgiveness creating fictional income or as a conversion of debt to equity thereby removing the fictional income for bonus calculation purposes. Appellants assert they chose the latter method when calculating bonus compensation because a bonus should not result from fictional income. Because of this, appellants assert the arbitrator's award cannot be rationally derived from the agreement's terms, and, thus, the arbitrator exceeded his authority in fashioning the award as he did.

{¶ 20} As set forth in the CMA, for purposes of calculating bonus compensation, adjusted net income is defined as the net income of OFE computed in accordance with GAAP subject to certain adjustments. Appellee's expert, Michael Stevenson, testified that GAAP's purpose is to "make financial statements look consistent across several entities." (Tr. 198.) In Stevenson's opinion, to be calculated in accordance with GAAP, as the CMA required, excluding the \$25.5 million of debt forgiveness, as OFE did for purposes of calculating bonus compensation for 2008, was incorrect and not in accordance with GAAP. Specifically, Stevenson testified that the first step in calculating the bonus under the CMA was to ascertain the net income from the statement of operations, which was calculated according to GAAP. After making the adjustments expressly permitted by the CMA, Stevenson testified those amounts should not have been further reduced by the \$25.5 million gain on debt forgiveness because it was "part of net income calculated in accordance with [GAAP] in 2007." (Tr. 234.) According to Stevenson, deducting the \$25.5 million for calculating bonus compensation "has no GAAP relevance." (Tr. 235.) Further, on cross-examination, Stevenson testified that he disagreed with the deposition testimony of appellants' experts who opined that, in this circumstance, the \$25.5 million could have been treated either as gain on debt forgiveness or conversion of debt to equity in calculating bonuses. Stevenson also explained that Frost's treatment of the \$25.5

million for purposes of bonus calculation did not comply with GAAP because GAAP would require that the net income being utilized by OFE to be uniform and not different depending on the purpose, unless the parties otherwise agreed to the same.

{¶ 21} We recognize appellants provided expert testimony to the contrary. However, in adopting appellee's position that, in this instance, GAAP, as used in the bonus provision of the CMA, required the \$25.5 million to be included as gain on debt forgiveness, the arbitrator performed his function as the ultimate arbiter of the parties' dispute. The arbitrator could have rejected appellee's position if he disagreed with appellee regarding what the CMA required. After review of the applicable contract language, we cannot conclude the award conflicts with the express terms of the parties' agreement or that the award is without rational support or cannot be rationally derived from the terms of the agreements. *Ohio Office of Collective Bargaining* at 179. Therefore, we find the trial court did not err in determining the arbitrator did not exceed his authority in this instance. So long as the arbitrator is arguably construing the contract, the trial court is obliged to affirm its decision. *Arrow Uniform Rental* at ¶ 47, citing *Summit Cty. Bd. of Mental Retardation & Dev. Disabilities* at 176.

{¶ 22} Accordingly, appellants' first assignment of error is overruled.

C. Second Assignment of Error

{¶ 23} Based on the same premise as that in their first assignment of error, in their second assignment of error, appellants contend the arbitrator also exceeded his authority by ignoring the CMA's bonus provision requiring that the net income be reduced by prior years' net operating losses. According to appellants, though appellee's expert accounted for OFE's losses, since DeCoster actually accrued the losses, DeCoster was entitled to recoup prior years' losses before FEM could receive a bonus. In essence, appellants seek to reword the CMA so that, instead of deducting for OFE's losses, one would deduct the losses of DeCoster and his other entities. As the arbitrator found, the CMA does not provide for the "shifted focus off of OFE and onto DeCoster to determine the financial impact of the debt write-off." (Award, 20.) Further, as the arbitrator concluded, DeCoster consciously decided to forgive the debt rather than covert it to equity in order that his indirect legal ownership of OFE could remain undisclosed. Appellants cannot now change the reality of what happened by arguing that the debt write-off could have been

handled differently, specifically as debt to equity conversion rather than gain on debt forgiveness. Upon review, we conclude the arbitrator did not exceed his authority by ignoring the CMA but, instead, performed bonus compensation calculations in accordance therewith.

{¶ 24} Accordingly, appellants' second assignment of error is overruled.

D. Third Assignment of Error

{¶ 25} In their third assignment of error, appellants contend the arbitrator disregarded the law and exceeded his authority by refusing to consider all of the contracts involved. Contrary to appellants' position that the arbitrator refused to consider their agreements, the arbitrator expressly concluded the CMA was the operative agreement and provided sound reasoning to support his conclusions, i.e., that the CMA was the only document that referred to the calculation of bonus compensation. Upon review, we find no merit to appellants' argument that the arbitrator disregarded the law or exceeded his authority by ignoring the parties' agreements.

{¶ 26} Accordingly, appellants' third assignment of error is overruled.

E. Fourth Assignment of Error

{¶ 27} In their final assignment of error, appellants contend the trial court erred in affirming an award that provides a bonus "for doing a job that lost OFE millions of dollars, and forced Defendant DeCoster to step in and save OFE by writing off \$25.5 million of his own money." (Brief, 36.) The challenge appellants face here is the same as that underlying their previous assignments of error, specifically their position is contrary to the express language of the CMA's provisions pertaining to bonuses. While appellants clearly disagree with the arbitrator's conclusions, that is not a valid basis for vacating an arbitration award.

{¶ 28} The arbitrator interpreted the contract rather than adding to, subtracting from or altering the language of the contract and, hence, did not exceed his authority under the terms of the contract. "[T]he arbitrator's interpretation of the contract is what the parties bargained for in agreeing to submit their disputes to final and binding arbitration. The arbitrator's interpretation must prevail regardless of whether his or her interpretation is the most reasonable under the circumstances." *Hillsboro v. Fraternal Order of Police, Ohio Labor Council, Inc.*, 52 Ohio St.3d 174, 177-78 (1990). Appellants

assert the magistrate merely rubber-stamped the arbitrator's award, and the trial court issued a cursory decision overruling their objections to and adopting the magistrate's decision. We reject appellants' characterization and recall the instruction from the Supreme Court of Ohio:

The continued vitality of the arbitration system of dispute resolution can only be ensured through judicial restraint. Not only must a reviewing court limit its inquiry for purposes of vacating an arbitrator's award in accordance with the requirements in [*Findlay City School Dist. Bd. of Edn. v. Findlay Edn. Assn.*, 49 Ohio St.3d 129 (1990)], but a reviewing court also must be sensitive to upholding an arbitrator's award whenever it is possible to do so.

Id. at 178.

{¶ 29} Accordingly, appellants' fourth assignment of error is overruled.

IV. CONCLUSION

{¶ 30} For the foregoing reasons, we overrule appellants' four assignments of error and hereby affirm the judgment of the Franklin County Court of Common Pleas.

Judgment affirmed.

CONNOR and McCORMAC, JJ., concur.

McCORMAC, J., retired, formerly of the Tenth Appellate District, assigned to active duty under authority of the Ohio Constitution, Article IV, Section 6(C).
