Energy Savers, Inc. v. McKelvy, No. 192-4-04 Wrcv (Eaton, J., Nov. 18, 2008)

STATE OF VERMONT
WINDSOR COUNTY

ENERGY SAVERS, INC. d/b/a ENERGY SHIELD	)	Windsor Superior Court
	)	Docket No. 192-4-04 Wrcv
v.	)	
DOUG McKELVY and BARBARA McKELVY	)	

DECISION
Defendants' Motion to Vacate Arbitration Award
Plaintiff's Motion to Confirm Arbitration Award

This long-running dispute involves the construction of a new home in Norwich, Vermont. Contractor Energy Savers, Inc. filed a complaint in October 2004 alleging that homeowners Barbara and Doug McKelvy failed to pay invoices totaling more than $250,000. The McKelvys contend that the unpaid invoices represent cost overruns for which the contractor should bear responsibility. The McKelvys also filed counterclaims alleging, inter alia, misrepresentation and consumer fraud.

After discovery and summary-judgment litigation, the parties agreed to submit the matter to arbitration during the summer of 2007. The arbitration agreement provided in pertinent part as follows:

> Subject to the terms and conditions outlined herein, all of the factual and legal issues that may have been submitted to a jury in the above captioned matter may be submitted to the arbitrator hereafter described. The parties and their counsel may present all claims and legal theories to the arbitrator which they might otherwise have been permitted to submit to the jury.
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> * * * *
>
> There shall be an informal taping of procedures and testimony for use by Arbitrator Fead in rendering his

> decision. No transcription shall be made, although either party will be permitted to make a transcription at the end of the arbitration. The other party shall be supplied a copy of the transcription at the cost of copying. There shall be no court reporters during the hearing.
>
> Arbitrator Fead shall issue an award or decision, along with a reasoned explanation of the decision. He shall be permitted to utilize the tapes of the procedures and hearing for purposes of drafting his decision.

At the arbitration hearing, the parties presented evidence and testimony over the course of eight days. At the conclusion of the hearing, the arbitrator made preliminary determinations and offered a verbal explanation for his decision. He determined that the parties had agreed to construct a home on a time and materials basis, that the "budget price" specified in one document was subject to future design choices on the part of the homeowners, and that the actual cost overruns were, for the most part, caused by the homeowner's own choices. The arbitrator also determined that some amounts had been overbilled, and should be credited to the homeowners. On the whole, however, the arbitrator concluded that the homeowners breached the construction contract by failing to pay the invoices, and that the contractor's conduct did not rise to the level of misrepresentation or consumer fraud.

The preliminary arbitration award was issued in favor of Energy Savers three days later, on July 23, 2007. The arbitrator then issued a clarified explanation of his decision following a request by Energy Savers to do so, and made rulings on attorneys' fees and other post-trial matters. The final arbitration award was issued in favor of Energy Savers on February 29, 2008 in the following amounts:

Principal Amount	$ 245,182.94
Pre-Award Interest	$ 105,619.44
Penalty for Wrongful Withholding	$ 105,619.44
Attorney's Fees and Expenses	$ 124,907.11
Arbitrator's Costs	$ 12,881.50
Total:	**$ 594,210.43**

Homeowners now request that this court vacate the arbitration award under the Vermont Arbitration Act, 12 V.S.A. § 5677, and applicable case law. Homeowners contend primarily that the arbitrator deprived them of a reasoned explanation for the award by manifestly disregarding the law of contracts in his decision. Specifically, homeowners argue that the arbitrator improperly admitted evidence of oral agreements in alleged violation of the parol evidence rule, concluded that the parties waived a provision requiring change orders to be in writing, concluded that the budget price was not binding, and concluded that the homeowners waived reliance on any "budget price" by failing to account for the cost consequences of their choices. Homeowners also contend that the arbitrator manifestly disregarded the Vermont Prompt Payment Act by awarding a

penalty for wrongful withholding under 9 V.S.A. § 4007(b) and awarding attorney's fees to Energy Savers as the substantially prevailing party under 9 V.S.A. § 4007(c).

Homeowners also raise arguments under the statutory grounds for vacatur set forth by 12 V.S.A. § 5677. They contend that the award was procured through "undue means" because Attorney Kolitch "blurted out" statements regarding the McKelvys' net worth, which must have biased the arbitrator against them. They also contend that the arbitrator exceeded his powers or otherwise erred by issuing a clarification of his decision, failing to record the testimony of a defense witness, failing to record various site visits, and including $20,000 in the award for sales tax. Finally, they contend that their constitutional rights to substantive due process were denied by the arbitrator's allegedly inconsistent and erroneous reasoning.

Energy Savers requests that the court confirm the arbitration award under 12 V.S.A. § 5676, which provides that, "[u]pon application of a party to confirm, modify or vacate an award, the court shall confirm the award unless it finds grounds for vacating or modifying the award."

Oral argument was heard on November 4, 2008. William Sahlman was present on behalf of Energy Savers, and was represented by attorney Lauren Kolitch. The McKelvys were both present and represented by attorney Peter Decato.

Standard of Review

At the hearing on November 4th, both parties presented well-reasoned explanations of their respective positions on the motions to vacate or confirm the arbitration award. The presentations were supported by the submission of expansive portions of the arbitration record, along with lengthy and detailed memoranda. For the most part, the presentations focused upon the factual determinations and legal conclusions drawn by the arbitrator, and the parties have asked the court to examine the record and determine whether the arbitrator's determinations were both legally correct and supported by the evidence presented during the arbitration hearing.

The parties' understanding of the standard of review appears to derive from the suggestion, first made in *Muzzy v. Chevrolet Div., Gen. Motors Corp.*, 153 Vt. 179, 185 (1989), that superior courts have the authority to review the arbitration award for legal error and order vacatur when the award demonstrates a "manifest disregard of the law." Cf. *Shahi v. Ascend Financial Services, Inc.*, 2006 VT 29, ¶ 14, 179 Vt. 434. In these cases, the Vermont Supreme Court appeared to review arbitration awards to determine whether the arbitrator made an "obvious error that can be instantly perceived," or whether the arbitrator ignored an "explicit legal principle clearly governing the matter." *Muzzy*, 153 Vt. at 185 (citation omitted). The parties were not alone in interpreting *Muzzy* and *Shahi* as authorizing judicial review of the arbitration award for legal error. See Albert G. Besser, *Arbitration Vacatur: The Supreme Court Bars One Route and Muddles the Other—Manifest Mistake is Dead!*, 34 Vt. B. J. 67, 68 (Fall 2008) (same). Nevertheless, recent decisions of the Supreme Court of the United States and the Vermont Supreme

Court have made clear that the superior court has no authority to review an arbitrator's decision for legal error. *Hall Street Assocs. v. Mattel, Inc.*, 128 S.Ct. 1396 (Mar. 25, 2008); *Vermont Built, Inc. v. Krolick*, 2008 VT 131 (Oct. 31, 2008).

Arbitration is designed to provide parties with a speedy and efficient method of alternative dispute resolution. *Springfield Teachers Ass'n v. Springfield School Directors*, 167 Vt. 180, 183 (1997). Arbitration offers parties the opportunity to "opt out" of the judicial system and obtain a private, binding ruling on the merits of their dispute in a quick, informal, and expeditious manner, without the expenses in time and cost associated with ordinary trial court proceedings. The efficiency of arbitration stems largely from its informality and the fact that the arbitrator may normally issue an award without providing an explanation for the decision. If the parties so request, the arbitrator may provide a reasoned explanation for the award, but need not make traditional findings of fact and conclusions of law of the type associated with judgments rendered by a trial court.

In other words, an arbitration agreement is a private contract to resolve a dispute. Judicial confirmation or vacatur of the resulting arbitration award is more like enforcement of the arbitration agreement than appellate review of a lower court decision. Thus, when courts review arbitration awards, the question is whether the arbitration agreement was violated in some fashion, rather than whether the arbitrator erred. This distinction was explained in the following terms by Judge Posner:

> It is tempting to think that courts are engaged in judicial review of arbitration awards under the Federal Arbitration Act, but they are not. When parties agree to arbitrate their disputes they opt out of the court system, and when one of them challenges the resulting arbitration award he perforce does so not on the ground that the arbitrators made a mistake but that they violated the agreement to arbitrate, as by corruption, evident partiality, exceeding their powers, etc.—conduct to which the parties did not consent when they included an arbitration clause in their contract. That is why in the typical arbitration . . . the issue for the court is not whether the contract interpretation is incorrect or even wacky but whether the arbitrators failed to interpret the contract at all, for only then were they exceeding the authority granted to them by the contract's arbitration clause.

Wise v. Wachovia Sec., LLC, 450 F.3d 265, 269 (7th Cir. 2006) (citations omitted).

The standard of review when deciding whether to confirm or vacate an arbitration award is extremely limited. It is not the role of the court to substitute its own judgment for that of the arbitrator, or otherwise to say whether it agrees or disagrees with the conclusions drawn by the arbitrator. *Matzen Constr., Inc. v. Leander Anderson Corp.*,

152 Vt. 174, 177 (1989). Neither is it the role of the court to review the award to determine whether the arbitrator's reasoning was supported by the evidence or correct as a matter of law. *Vermont Built, Inc.*, 2008 VT 131, ¶ 13; *Hall Street*, 128 S.Ct. at 1405. "Whether the arbitrators misconstrued a contract is not open to judicial review." *Stolt-Nielsen SA v. AnimalFeeds Intern. Corp.*, 2008 WL 4779582 at *5 (2d Cir. Nov. 4, 2008) (quoting *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 203 n.4 (1956)).

Instead, the role of the court is to enforce the arbitration agreement. The court determines whether the arbitration agreement has been violated (and whether the award should therefore be vacated) by determining whether any of the statutory grounds for vacatur have been met. These grounds are set forth in 12 V.S.A. § 5677,[1] which authorizes the court to vacate the award only where it finds that (1) the award was procured by corruption, fraud, or other undue means, (2) the arbitrator demonstrated evident partiality or engaged in misconduct prejudicing the rights of any party, (3) the arbitrator exceeded the powers set forth in the arbitration agreement, (4) the arbitrator refused to hear evidence material to the controversy, or (5) the court finds that there was no arbitration agreement. In other words, § 5677 defines five circumstances which courts may consider when deciding whether the terms of an arbitration agreement have been fulfilled. Cf. *Wise*, 450 F.3d at 269. If the court does not find that any of the five circumstances exist, the award must be confirmed. 12 V.S.A. § 5676. This procedure reflects Vermont's "strong tradition of upholding arbitration awards whenever possible," *R.E. Bean Constr. Co. v. Middlebury Assocs.*, 139 Vt. 200, 204 (1980), and is consistent with the national policy favoring arbitration. *Hall Street*, 128 S.Ct. at 1405.

As suggested above, however, various judicial decisions over the years have suggested that courts may intervene to correct an arbitrator's error of law "under extreme circumstances" constituting "manifest disregard of the law." *Muzzy*, 153 Vt. at 185. As described by federal courts, this supplemental ground for vacatur was judicially created, rather than rooted in the text of the Arbitration Act, and contemplated some review of the merits of the arbitrator's decision to determine whether the arbitrator "appreciate[d] the existence of a clearly governing legal principle but decide[d] to ignore or pay no attention to it" and whether the legal error was "obvious and capable of being readily and instantly perceived by the average person qualified to serve as arbitrator." *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933–34 (2d Cir. 1986) (citations omitted).

The continued vitality of "manifest disregard of the law" as a supplemental ground for vacatur was recently called into question by the Supreme Court of the United States and the Vermont Supreme Court. In *Hall Street*, the U.S. Supreme Court held that parties may not provide in their arbitration agreement for more expansive appellate review of arbitration awards than is permitted by the relevant provisions of the Federal Arbitration Act (namely, the statutory grounds for vacatur described above). 128 S.Ct. at 1403–06. In the process, the Court strongly disapproved of judicial review of arbitration awards for "manifest disregard of the law." *Id*. at 1404–05. Writing for the majority, Justice Souter explained that independent appellate review of arbitration awards

[1] The statutory grounds for vacatur are substantively identical to the provisions of the Federal Arbitration Act. *Shahi*, 2006 VT 29, ¶¶ 5–9.

encourages the type of "full-bore legal and evidentiary appeals" that are inconsistent with both the text of the Arbitration Act and the "national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway." *Id*. at 1405.

The Vermont Supreme Court subsequently clarified its position that "manifest disregard of the law" is not a valid basis for vacatur of an arbitration award in Vermont:

> In *Muzzy*, we discussed but did not adopt another ground for vacating an arbitrator's decision—that the arbitrator manifestly disregarded the law. 153 Vt. at 185, 571 A.2d at 613. This ground was recognized in some federal circuits, and was perceived to be court-created and not based on the Federal Arbitration Act. *Hall Street Assocs. v. Mattel, Inc.*, 128 S.Ct. 1396, 1403 (2008). However, the United States Supreme Court has since held that under the Federal Arbitration Act, a court has no authority to review for an arbitrator's legal errors. *Id*. at 1404. While Contractor did not raise this ground, we take this opportunity to clarify that we do not recognize a court's right to review an arbitrator's decision for manifest disregard of the law.

Vermont Built, Inc. v. Krolick, 2008 VT 131, ¶ 13 n.2 (Oct. 31, 2008) (emphasis added). The Vermont Supreme Court went on to clarify in *Vermont Built* that the Vermont Arbitration Act does not authorize superior courts to engage in any review of the legal conclusions or factual determinations of the arbitrator. *Id*., ¶¶ 13–24.

Taken together, *Hall Street* and *Vermont Built* emphasize that it is not the role of the superior court to substitute its own judgment for that of the arbitrator, or otherwise to say whether it agrees or disagrees with the conclusions drawn by the arbitrator. It is also not the role of the superior court to evaluate the arbitrator's reasoning to determine whether it is correct or not. Rather, the role of the superior court is to determine whether any of the statutory grounds for vacatur exist, and if not, to enforce the arbitration agreement by confirming the award. 12 V.S.A. § 5676.

In undertaking this review in the present case, the court has carefully considered the arguments made by the parties in their written submissions and at the hearing, and has kept open the possibility that the arbitration award was so substantively wrong that it deprived the parties of a "reasoned" explanation or otherwise amounted to the arbitrator failing to interpret the construction contract at all. *Stolt-Nielsen SA*, 2008 WL 4779582 at *8. After reviewing the evidence, however, the court has concluded that the arbitrator considered the evidence presented by the parties, interpreted the documents which formed the parties' agreement, and analyzed the parties' obligations with respect to one another (including any obligations arising under the Vermont Prompt Payment Act). That is exactly what the parties asked the arbitrator to do when they submitted "all of the factual and legal issues" in this case to arbitration. The court must therefore conclude

that the substance of the arbitration award is consistent with the arbitration agreement. For the reasons discussed in more detail above, it is beyond the authority of this court to say whether it agrees or disagrees with the arbitrator's interpretations or analysis, whether the arbitrator's reasoning was consistent or not, or whether the arbitration award was correct.

The court now turns to a careful review of the arbitration award to determine whether any of the statutory grounds for vacatur have been demonstrated.

Whether the award was procured through undue means

Homeowners contend that Attorney Kolitch made impermissible references to both their net worth and the supposed value of their home during the arbitration hearing. For this reason, Homeowners argue that the award was procured through undue means, 12 V.S.A. § 5677(a)(1), and that the improper reference must have biased the arbitrator as a result, 12 V.S.A. § 5677(a)(2).

Section 5677(a)(1) provides for vacatur where "the award was procured by corruption, fraud or other undue means." Even assuming for the purposes of argument that the references made by Attorney Kolitch were improper, the term "procured" implies a causal link between the improper conduct and the resulting award, and there is no evidence in the present case that the arbitrator considered or relied on either reference when making his award. In his "Clarification of Decision," the arbitrator explained that both parties presented considerable admissible evidence indicating both the value of the home and the financial situation of the homeowners. He explained that he heard Ms. Kolitch's extraneous remark concerning the supposed value of the home, but that he "reprimanded" her for making the remark and "did not give her statement any consideration in making my decision." The arbitrator also explained that he did not recall the alleged statement regarding the McKelvys' net worth. There is no other evidence showing that the arbitrator relied on either piece of information in making his decision, or that the arbitrator secretly relied on these statements without saying so.

After considering the submissions of the parties, the court finds no evidence that the statements affected the outcome of the arbitration award or otherwise biased the arbitrator. To the extent that Homeowners base their claim of bias on the arbitrator's adverse rulings, it is well settled that "adverse rulings, no matter how erroneous or numerous," simply do not indicate bias. *Gallipo v. City of Rutland*, 163 Vt. 83, 96 (1994).

Whether the arbitrator exceeded his powers

Homeowners contend that the arbitrator exceeded his powers by failing to record the testimony of a defense witness, failing to make a record of various site visits, issuing a clarified decision after homeowners initially filed a premature motion to vacate in this court, and determining that Energy Savers had neglected to bill sales tax, and awarding

that expense to Energy Savers. See 12 V.S.A. § 5677(a)(3) (authorizing vacatur where "the arbitrators exceeded their powers").

The arbitration agreement called for "an informal taping of procedures and testimony for use by Arbitrator Fead in rendering his decision." In other words, the arbitration agreement contemplated the making of an informal record for use by the arbitrator in making his award. The agreement did not require the arbitrator to make a formal record for appeal, nor to make a record of any site visits. Moreover, there has been no showing that the "missing testimony" would have been relevant to any of the statutory grounds for vacatur (in light of the standard of review discussed above) or that the failure to record the testimony of a defense witness was anything other than inadvertent. For these reasons, the court concludes that the arbitrator did not exceed his powers by failing to make a complete record of the hearing and site visits.[2]

The next argument challenges the arbitrator's decision to issue a clarified explanation of his reasoning upon request from Energy Savers after the McKelvys filed a premature motion to vacate in this court based upon the preliminary award. See *Springfield Teachers Ass'n*, 167 Vt. at 184 (requiring finality to confirm an award). This was not beyond the authority of the arbitration agreement, which called for a "reasoned" explanation of the award. It was reasonable for the arbitrator to provide further reasoning upon request of one of the parties. The court does not construe the clarification decision as an improper attempt to influence appellate courts.

Finally, Homeowners contend that the arbitrator exceeded his powers by including a sales tax component in the award. To determine whether an arbitrator exceeded his powers, the court "focuses on whether the arbitrator had the power, based on the parties' submissions or the arbitration agreement, to reach a certain issue, not whether the arbitrator correctly decided the issue." *Vermont Built*, 2008 VT 131, ¶ 17 (quoting *DiRussa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 824 (2d Cir. 1997)). In this case, the parties broadly defined the issues to be submitted to arbitration as "all of the factual and legal issues that may have been submitted to a jury in the above captioned matter," and the issue of sales tax was raised during the hearing. For these reasons, the court concludes that the arbitrator did not exceed his powers by including sales tax as a component of the award.

Due Process

Homeowners' final argument is that their right to substantive due process was violated because the arbitrator exhibited "inconsistency in thought" and "knew the law and chose to ignore it." To the extent that these arguments seek judicial review of the merits of the arbitration award for legal error or "manifest disregard of the law," the court has already determined that it lacks authority to conduct such a review. *Vermont Built*, 2008 VT 131, ¶ 13 n.2.

[2] For these reasons as well, the court finds that there was no procedural due process violation with respect to the making of the record.

The court is mindful, however, that the Vermont Arbitration Act does not require courts to confirm unconstitutional awards. See *Brinckerhoff v. Brinckerhoff*, 2005 VT 75, ¶ 5, 179 Vt. 532 (mem.) (explaining that trial courts must confirm an arbitration award "unless there exist statutory grounds for vacating or modifying it, or the parties were denied due process"). One example of this principle is the Windham Superior Court's decision in *MBNA America Bank v. Wallace*, Docket No. 588–12–06 Wmcv (Wesley, J., July 26, 2007), available at http://www.vermontjudiciary.org/tcdecisionscvl/2007-7-27-1.pdf, in which the court refused to confirm an arbitration award under due process principles where the creditor obtained a default arbitration award, but could not demonstrate to the court's satisfaction that an arbitration agreement existed or that the debtor had been provided with adequate notice of the arbitration hearing. Cf. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950).

Accordingly, this court has reviewed the record to determine whether the arbitration award was so "out of bounds" as to amount to an error of constitutional magnitude. After reviewing the record, the court has determined that the arbitration award was based on the evidence presented at the hearing and was within the bounds of the presentations made by the parties. Even though the claim is constitutional in nature, mere inconsistencies or errors in the arbitrator's reasoning (if any) are beyond the authority of this court to review or correct. *Brinckerhoff*, 2005 VT 75, ¶ 14. For these reasons, the court finds no constitutional basis for vacatur.

Other Grounds

To the extent that Homeowners have raised other grounds for vacatur, either in their legal memoranda or at the hearing on November 4th (such as that the arbitrator erred when evaluating the credibility of certain witnesses), the court has considered the arguments and found no grounds for vacating the arbitration award.

Conclusion

For the foregoing reasons, the court finds no grounds to vacate the arbitration award. The award is accordingly confirmed. 12 V.S.A. § 5676. This disposition makes it unnecessary to consider the evidentiary objections raised by Energy Savers both before and during the hearing, and Plaintiff's Motion to Exclude (MPR #41) is denied as moot.

Although this case originated in 2004 as a foreclosure action, it was necessary first to determine whether or not there had been a breach of contract, and to hear and decide the counterclaims. The confirmation of the arbitration award finally resolves all of the legal claims in this case, and it would appear to be appropriate at this time to reduce the award to a final judgment under V.R.C.P. 54(b), even though there are other issues remaining in the case, including the writ of attachment and the possibility of foreclosure. Entering final judgment on the arbitration award will preserve the ability of the Defendants to appeal from the confirmation of the arbitration award and clarify the time for filing any notice of appeal. 10 Wright, Miller & Kane, Federal Practice and Procedure: Civil 3d § 2654. There does not appear to be any just reason for delaying the

entry of final judgment on this component of the action. V.R.C.P. 54(b). Plaintiff is accordingly directed to submit a form of judgment within 10 days. V.R.C.P. 58. Defendant shall file any objections to the form of judgment within 10 days thereafter.

The court will schedule a status conference in thirty days to address the remaining issues in the case.

ORDER

(1) Defendant's Motion to Vacate Arbitration Award (MPR #36) is ***denied***;

(2) Plaintiff's Motion to Confirm Arbitration (MPR #31) is ***granted***;

(3) Plaintiff's Motion to Exclude (MPR #41) is ***moot***;

(4) Plaintiff shall submit a form of final judgment within 10 days; and

(5) the Court shall schedule a status conference in 30 days.

Dated at Woodstock, Vermont this ____ day of November, 2008.

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Hon. Harold E. Eaton, Jr.
Superior Court Judge