IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

INTERWAVE TECHNOLOGY, INC. & JONATHAN KALL, Plaintiffs	:	CIVIL ACTION
v.	:	
ROCKWELL AUTOMATION, INC. & RICHARD RYAN, Defendants	:	NO. 05-0398

MEMORANDUM AND ORDER

Gene E.K. Pratter, J. July 14, 2005

Defendants Rockwell Automation, Inc. ("Rockwell") and Richard Ryan filed a Motion to Stay Proceedings Pending the Outcome of Arbitration on June 7, 2005.[1] Defendants contend that a pending arbitration hearing between Plaintiff Jonathan Kall and Rockwell pursuant to an Employment Agreement may be dispositive of all of Interwave Technology, Inc.'s ("Interwave") and Mr. Kall's claims, so this matter should be suspended pending that arbitration.

For the reasons discussed below, the Court denies Defendants' Motion to Stay Proceedings.

I. SUMMARY OF FACTS

On January 29, 2003, Rockwell purchased substantially all of the assets of Interwave. Plaintiff Jonathan Kall was Interwave's president and sole shareholder at the time of sale. To effectuate the sale, Rockwell, Interwave, and Jonathan Kall signed an Asset Purchase Agreement

[1] This matter was previously suspended on March 2, 2005 pending the results of mediation. The parties sent a joint letter notifying the Court that the mediation was unsuccessful and the stay was lifted on June 2, 2005. The parties, with leave of the Court, stipulated to the filing of an Amended Complaint. The Amended Complaint was filed on June 24, 2005.

("APA"). Interwave then assigned its rights under the APA to Mr. Kall. (Pls.' Compl., at ¶ 1).

Pursuant to the terms of the APA, the purchase price for Interwave was a combination of $12 million, payable at closing, and an earn out amount of up to an additional $12 million to be calculated and paid in accordance with Article XIII of the APA. Article XIII allows for two earn outs, a year one earn-out, which "shall not exceed $2 million," of "$2.00 for every incremental dollar of Year One Revenue in excess of $11.9 million from sale of Software, Implementation Services and Interwave Consulting" and a year three earn-out, which "shall not exceed $10 million," "calculated by adding the sum of the Coordinator Earn-Out and the Implementation Service Earn-Out." APA, at Art. XII, § 13.1. Either earn out provision is reduced to zero dollars if Mr. Kall is terminated for cause or if he terminates his employment without good reason. APA, at Art. XII, § 13.1(c)(i).

Contemporaneous with the APA, Mr. Kall signed an employment agreement ("EA") with Rockwell in which Mr. Kall agreed to work for 39 months as Rockwell's Director, Manufacturing Business Solutions Americas. Mr. Kall was terminated by Rockwell, allegedly for cause, on June 22, 2004. The EA contains a mandatory arbitration clause, and Rockwell and Mr. Kall had executed a mutual agreement to arbitrate claims ("MAAC") (which is incorporated by reference in the EA). EA, at § 9.11. None of the claims excluded in the "Claims not Covered by this Agreement" section of the MAAC are being asserted in this litigation. On May 26, 2005, Mr. Kall served Rockwell with his Notice of Intention to Arbitrate issues, indicating that Mr. Kall is challenging the Rockwell contention that he was terminated for cause.

In Count One of the Complaint here, Plaintiffs allege that Rockwell breached the APA by not having procedures and infrastructure in place to satisfy all of its obligations under the APA.

In Count Two, Plaintiffs contend that Rockwell fraudulently induced Plaintiffs to agree to the earn out portion of Article XIII, while Rockwell did not have the capacity to reach the targets it claimed (resulting in smaller earn-out payments than Rockwell had asserted would be met). In Count Three, Plaintiffs argue that Defendant Ryan fraudulently induced Plaintiffs in the same manner as Rockwell. Finally, in Count Four, Plaintiffs assert that Rockwell breached the APA by failing to act in good faith to develop its business and various projects that affected the value of the earn-out payments.

II. LEGAL SUMMARY

Section 3 of the Federal Arbitration Act states:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C.A. § 3.

A federal court is limited to only considering "issues relating to the making and performance of the agreement to arbitrate" when determining whether to grant a stay pending arbitration. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 (1967). "When a contract involves 'commerce,'" the federal court applies federal substantive law, not state law. Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk, 585 F.2d 39, 43 (3d Cir. 1978). In other words, "'[o]nce a dispute is covered by the [Federal Arbitration] Act, federal law applies to all questions of [the arbitration agreement's] interpretation, construction, validity, revocability, and enforceability." Id.

"When confronted with a motion to stay proceedings pursuant to 9 U.S.C. § 3, the appropriate standard of review for the district court is that employed in evaluating motions for summary judgment under Federal Rule of Civil Procedure 56(c)." Choice v. Option One Mortgage Corp., No. 02-6626, 2003 WL 22097455, at *3 (E.D. Pa. May 13, 2003). Of course, a stay is "an extraordinary measure," and the movant must offer "compelling reasons for its issuance." United States v. Breyer, 41 F.3d 884, 893 (3d Cir. 1994).

III. DISCUSSION

Defendants here argue that the arbitration related to Mr. Kall's dispute over whether his termination truly was for cause may negate all of Plaintiffs' claims. Therefore, according to Defendants, the Court should stay this matter pending arbitration pursuant to 9 U.S.C.A. § 3 as these claims are "controvers[ies] arising out of or relating to" an arbitration agreement. Recognizing that this case as framed by Plaintiffs concerns more than the single agreement between Mr. Kall and Rockwell in which the arbitration clause appears, Defendants cite to Personal Security & Safety Sys., Inc. v. Motorola, Inc., 297 F.3d 388 (5th Cir. 2002). In that case the Court of Appeals for the Fifth Circuit found that two agreements signed contemporaneously, for the same purpose, and as part of the same transaction should be construed together and, therefore, the broad arbitration provision in the one agreement covered disputes in the other agreement, because the Court of Appeals for the Fifth Circuit presumed "that [the parties] intended the [arbitration] clause to reach all aspects of the transaction." Personal Security, 297 F.3d at 395. Defendants contend that here, as in Personal Security, the APA and EA were signed contemporaneously, they were part of the same transaction, and the APA mentions the EA, so it incorporates its terms by reference.

Defendants also dispute the Plaintiffs characterization in the complaint that Mr. Kall, as an individual, is not a plaintiff in this matter, but merely suing "in his capacity as the assignee of the rights of Interwave. (Pls.' Compl., at ¶ 2). Defendants argue that Mr. Kall was the recipient of the $12 million for the sale of Interwave to Rockwell. Even though Interwave and Richard Ryan would not be parties to the arbitration agreement, Plaintiffs have already agreed to a stay pending mediation that excluded a party, namely Richard Ryan, in this matter. Finally, Defendants argue that the "gist of the action doctrine" will bar Plaintiffs' tort claims if the arbitration panel determines that Rockwell released Mr. Kall for cause as Defendants apparently intend to argue in the arbitration.

In response, Plaintiffs argue that the Motion should be denied for six reasons: (1) Defendants have failed to meet the burden of proof required to stay the litigation of this matter; (2) Plaintiffs would suffer substantial prejudice as a result of the stay; (3) the outcome of the arbitration is not dispositive of Plaintiffs' claims in this case; (4) the causes of action set forth in Plaintiffs' Amended Complaint are not subject to the arbitration provision of the EA; (5) the relief sought by Defendants is contrary to express agreements made by Defendant Rockwell in the APA; and (6) Defendants' Memorandum of Law is premised on misstatements of fact integral to the issue and arguments raised by Defendants in their Motion.

Plaintiffs note that Defendants as the movants for a stay have the same burden as a movant in a summary judgment motion, and, when considering all of the non-movant's evidence and draw all reasonable inferences in the light most favorable to the non-moving party,[2]

[2] Neither party provides any evidence, other than the two agreements in this matter. Therefore, the Court will take the complaint and agreements at face value, because no evidence, at this time, has been proffered by Defendants to contradict them.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986), Defendants have failed to meet that burden. Further, according to Plaintiffs, Defendants' own arguments fail because, at best, they state the arbitration only "may" be dispositive and the claims only "may" be subject to the EA's arbitration provision. Plaintiffs argue that the lack of definitiveness by Defendants demonstrates that there is not the necessary evidence to meet their burden.

Plaintiffs further argue that delay will prejudice them by delaying discovery and resulting in the evidence to be discovered becoming more stale and make it more difficult for Plaintiffs to discover improper, post-termination actions by Rockwell. This is especially problematic, according to Plaintiffs, because arbitration only allows for very limited discovery. Plaintiffs argue the "clear possibility" exists that Plaintiffs will suffer prejudice by the stay, while Defendants have not demonstrated a "compelling reason" for the imposition of a stay.

Additionally, Plaintiffs contend that arbitration will not dispose of all the issues in dispute between them. Plaintiffs argue that, under Pennsylvania law, "arbitration agreements are strictly construed and not extended by implication." Highmark, Inc. v. Hospital Serv. Ass'n, 785 A.2d 93, 98 (Pa. Super. Ct. 2001). According to Plaintiffs, the calculation of the year one earn out, which ended prior to Mr. Kall's termination, will not be affected by whether he was terminated for cause or not, because the arbitration agreement is limited to questions related to the EA and not to interpreting the APA or valuing of the earn out payments. Additionally, the arbitration decision would not address any of the damages beyond whether Defendants are obligated to pay the year three earn out payment and the earn out damages are not the only damages being sought. Plaintiffs are also seeking all losses and expenses incurred as a proximate result of Defendants alleged fraud and the breach of contract claim would include damages unrelated to the earn out.

Plaintiffs partially base their argument on the theory that "one who materially breaches a contract first cannot demand subsequent adherence to the terms of that contract by the other party." Apple Corps. v. Button Master, 1998 WL 126935, at *14 (E.D. Pa. Mar. 19, 1998) (quoting Bohm v. Commercial Union Bank of Tennessee, 794 F. Supp. 158, 162 (W.D. Pa. 1992)). According to Plaintiffs, the arbitration panel's decision will not address whether an earlier breach (presumably by Defendants) occurred, so a stay would only delay discovery on the breach of contract claims and cannot be dispositive of them.

Finally, Plaintiffs argue that the EA's arbitration clause does not even apply to these claims because Plaintiffs are not parties to the EA, the APA does not incorporate by reference the EA, and Plaintiffs' earlier willingness to submit to contractually required mediation, as required under the APA, has no bearing on whether a stay should be enacted now. According to Plaintiffs, neither Interwave nor Mr. Kall, as the assignee of Interwave's rights, are actually parties to the EA. Plaintiffs concede that Mr. Kall as an individual was a party to the EA, but not Mr. Kall, as the subsequent assignee of Interwave's rights given that Interwave had not been a signatory to the arbitration agreement or the EA.[3] Further, Plaintiffs distinguish Personal Security, the Fifth Circuit Court of Appeals case relied upon by Defendants, by noting that the signatories of the two contracts in that case were identical, but in this case there are different signatories to the agreements.[4] Plaintiffs also argue that, although arbitration agreements are

[3] Plaintiffs cite to Medtronic Ave, Inc. v. Advanced Cardiovascular Systems, Inc., 247 F.3d 44 (3d Cir. 2001), which states "assignment of a contract results in the assignee stepping into the shoes of the assignor with regard to the rights that the assignor held and not in an expansion of those rights to include those held by the assignee." Medtronic, 247 F.3d at 60.

[4] Interwave is a signatory to the APA but not the EA. Mr. Kall and Rockwell were signatories to both agreements, and Mr. Ryan is not a signatory to either.

highly favored, there must be an expression by the parties to be bound by arbitration before arbitration can be so favored. In this case, according to Plaintiffs, the arbitration agreement in the EA specifically only applies to the EA, while the APA specifically precludes commencing "any Action relating thereto except in" this court. APA, at § 14.13.

As to the argument that the arbitration clause in the EA is incorporated by reference in the APA, Plaintiff points out that the only reference to the EA in the APA is: "Defined terms used herein shall have the same meaning as defined in the Employment Agreement of Jonathan Kall and [Rockwell]." APA, at § 13.1(c). Plaintiffs argue this reference is not an incorporation of the entire EA, but a mere incorporation of the definition section. Thus, Plaintiffs contend that only the provisions in the APA which required mediation of disputes is relevant. Plaintiffs assert that they have abided by this requirement of the APA, that mediation was unsuccessful, and further delay is unnecessary and prejudicial.

The Court finds that the a stay is not proper in this case because the Federal Arbitration Act does not control this dispute as framed in the complaint and further delays in this matter would not serve the interests of justice nor the parties. Admittedly, arbitration is favored. However, the Court finds the dispute here is not over the EA, but rather is related to the APA, which does not include an arbitration obligation. The language in the two agreements make it clear that disputes related to the APA were treated differently than disputes related to the EA. Further, although the agreements were signed contemporaneously and are part of a related transaction, they are clearly not for the same purpose, so the reasoning in Personal Security is not applicable. Therefore, the EA's arbitration provisions do not extend to the APA, and the requirements of 9 U.S.C.A. § 3 do not apply because this is not an issue "referable to arbitration

under such an agreement."

Further, the Court finds that, while the arbitration panel's decision may affect the ultimate calculations of damages in this case, the panel's decision, either way, would not preclude pursuit of this matter. The damages sought by Plaintiffs include damages entirely unrelated to the earn out payments which are tangentially at issue in the EA arbitration matter, namely the fraud claim damages. Further, even if the arbitration panel were to find Mr. Kall was terminated for cause, the instant case would need to proceed, because the claims in this matter address issues beyond the dispute over Mr. Kall's termination. Specifically, the questions of whether the sale of Interwave was fraudulently induced, if Defendants breached the APA and whether that breach vitiates Plaintiffs' alleged breach, and the value of the Year One earn out payment. Delays of this matter likely would make these issues harder to resolve.

IV. CONCLUSION

For the foregoing reasons, the Court denies the Defendants' Motion to Stay Proceedings Pending the Outcome of Arbitration. An appropriate Order consistent with this Memorandum follows.

BY THE COURT:

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GENE E.K. PRATTER
UNITED STATES DISTRICT JUDGE

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O R D E R

Gene E.K. Pratter, J. July 14, 2005

AND NOW, this 14th day of July, 2005, upon consideration of the Defendants Rockwell Automation, Inc.'s and Richard Ryan's Motion to Stay Proceedings Pending the Outcome of Arbitration (Docket No. 9) and the responses thereto (Docket Nos. 11, 12, & 15), it is hereby ORDERED that the Motion to Stay is DENIED.

It is further ORDERED that, pursuant to the stipulation of the parties, Defendants shall file their answer or other response to the Amended Complaint within 10 days of the date of this Order.

BY THE COURT:

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GENE E.K. PRATTER
UNITED STATES DISTRICT JUDGE