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STATE OF NORTH DAKOTA

IN THE SUPREME COURT

STATE OF NORTH DAKOTA

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| 26th Street Hospitality, LLP,<br><br>Plaintiffs-Appellants,<br><br>vs.<br><br>Real Builders, Inc.; Joel J. Feist, individually and as Managing Partners of 26th Street Hospitality, LLP,<br><br>Defendants-Appellees, | ) | Supreme Court No. 20150259<br>Burleigh County No. 08-2013-CV-02544 |

APPEAL

CIVIL NO. 08-2013-CV-02544

# REPLY BRIEF OF APPELLANT 26TH STREET HOSPITALITY, LLP

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## I. ARGUMENT

**(1.)** There is no dispute the Court reviews *de novo* the district court's ("court") orders compelling arbitration (App 307 & 398), as well as reviewing *de novo* the court's legal determination all of the litigation claims were subject to binding arbitration under the Partnership Agreement.

**(2.)** Appellees ("Feist") ignore the applicable legal standard and procedure to be applied without exception when the court is presented with undisputed evidence the arbitration agreement was procured through outright fraud. This is the very type of evidence or defense under state law that would invalidate a contract, and when presented with this type of evidence, the legal standard is clear: the court must conduct a summary jury trial on that very issue prior to and as a condition to ordering arbitration. This is true whether the controlling legal standard is the Federal Arbitration Act (FAA) or North Dakota's Uniform Arbitration Act (UAA). Yet, the court did not follow this procedure and instead sent all claims into arbitration, ignoring Partnership's unrefuted fraud evidence and the legal standard requiring a summary jury trial on the issue. In fact, the court never even mentioned in its orders the fraudulent AIA A103 – 2007, non-Guaranteed Maximum Price (non-GMP) construction agreement Joel Feist ("Joel") entered into with himself (App 028) ("fraudulent construction agreement"). Instead of focusing on these errors and the procedure required to be followed by the court, Feist focuses his brief on entirely irrelevant matters such as what allegedly occurred in the arbitration, and, on provisions of the Partnership Agreement, arguing the arbitrator's decision made after the fact proves there was no fraud. All of this turns the applicable legal standard on its head. Under the legal standard, courts are to determine the validity

of any particular arbitration agreement. The focus of this appeal is on what the court considered, failed to consider, and what is actually in its erroneous orders compelling arbitration, and not on what the arbitrator did long after the court's errors had been made. Feist is unwilling to confront these issues, as to do so places a spotlight on the court's errors. Instead Feist misstates the court's findings.

**(3.)** For example, Feist goes to great lengths to argue the FAA applies to this matter, but the court never made any express determination whether the UAA or FAA applied, and no appeal has been taken on this precise issue. Nevertheless and contrary to what Feist now argues, the court cited only to the UAA in its order compelling arbitration, holding, "[t]he court shall decide whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate." (App 307). This is verbatim language from the UAA. N.D.C.C. § 32-29.3-06(2). The order itself strongly suggests the court determined the UAA applied rather than the FAA, albeit incorrectly. Nevertheless, the UAA and the FAA provide identical remedies where an arbitration agreement is procured through outright fraud, as occurred in this case where Feist entered into the construction agreement with himself. The procedure is to hold a summary jury proceeding to determine the validity of the arbitration agreement. N.D.C.C. § 32-29.3-07; Title 9 U.S.C. § 4. Neither the UAA nor FAA state such a summary proceeding is to be held by the arbitrator, and this would make little sense, because if the arbitration agreement is invalid, there is nothing for an arbitrator to do. Only where there is a valid arbitration provision does arbitration occur, thereafter allowing the arbitrator the ability to determine the arbitrability of claims. When there is no valid arbitration provision, the inverse holds true: the court refuses to compel arbitration. The court did not follow this

process, and instead incorrectly determined the arbitrator determines both the validity of the arbitration provision (in the fraudulent construction agreement) and arbitrability of the claims. This Court has in the past expressly upheld a court's correct application of the summary procedure set forth in the FAA where the party seeking to escape mandatory arbitration claims fraud in the inducement of the contract. David v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 440 N.W.2d 269, 270 (N.D. 1989). Although the David Court ultimately upheld the district court's summary judgment determination there was no fraud in the inducement of that contract, this case illustrates the correct procedure that should have been followed by the court. As in David, this Court should determine the district court is in error, and should determine and specify the court has jurisdiction (whether under the FAA or the UAA) to consider and address the Partnership's fraud claim that invalidates the arbitration agreement. Federal cases cited by Feist where courts force non-signatories into arbitration and cases concerning arbitrability are readily distinguishable and have no application to the summary proceeding required of the court. Only where that summary proceeding finds a valid arbitration agreement, would such matters be addressed. Had the court followed the legal standard, it would have become obvious the fraud and construction-related claims did not arise out of or relate to the Partnership Agreement. The court would have seen the construction related claims were not subject to arbitration (lacking an arbitration agreement), and those claims would have been stayed pending the arbitration of any Partnership related claims.

**(4.)** In this case, the court was presented by the Partnership with undisputed sworn affidavit testimony of fraud by Joel through two of its managing partners (App 047 & 050), and was presented with the per se fraudulent construction agreement (App 028)

where Joel admittedly signed on behalf of his own construction company and purportedly on behalf of Partnership, entering into that construction agreement with himself. As part of that fraudulent agreement, Joel unilaterally and in secret inserted a provision never agreed to by the Partnership that any and all claims arising out of the construction agreement were subject to mandatory arbitration. This provision is per se invalid. The only evidence before the court was that Partnership never agreed to the construction agreement or any of its terms, including its arbitration agreement. Although Joel points to his affidavit as supposed evidence (App 001-003), that affidavit makes no effort to deny the outright fraud or that he entered into the contract solely to enrich himself. Feist goes to great lengths to argue the Partnership Agreement allowed him to unilaterally "dummy up" and create a construction contract in secret, but the language clearly provides contracting authority to the partners, *plural*, which denotes joint decision and consensus that were entirely lacking and never denied. Appellee Brief at 4-5. No evidence whatsoever was provided to the court to refute the Partnership's fraud evidence. Notwithstanding this evidence, and being at least twice presented with the legal standard that requires a summary proceeding (by jury) in just such a situation, the court decided to send everything into arbitration. (App 307 & 398). Tellingly, neither of the court's orders even mentions the fraudulent construction agreement, which is also largely true of the briefing by Feist. In fact Feist never requested the court send any of the claims into arbitration based on the fraudulent construction agreement's arbitration provision, and the court never ordered arbitration on that basis. Rather Feist consistently requested the court order the claims into arbitration based solely on the Partnership Agreement, arguing the question of Joel's authority under the Partnership Agreement was the central focus of the

Complaint. Only now for the first time on appeal is Feist arguing the fraudulent construction contract is a basis for the arbitration that already took place. Feist states, "Although [Feist] did not raise the Construction Contract as a basis for compelling arbitration, the [] Contract's arbitration provision would be applicable once the arbitrator determined the enforceability of the [] Contract." Brief at 27. Feist cannot raise that argument only now on appeal.

**(5.)** The court ignored the fact almost all of the claims made by the Partnership were not subject to the Partnership Agreement and not brought against parties to that agreement, instead being focused almost exclusively on the shoddy and incomplete construction work and Feist's and Solid's use of the construction project to commit outright fraud. These claims had nothing to do with the formation of the Partnership Agreement, and the Partnership's claims against Real Builders ("RBI") and Solid did not implicate the Partnership Agreement in any way. The court erroneously considered only the Partnership Agreement, basing its decision entirely on that document, although the court mentioned the fraudulent construction agreement in passing. (App 311). Had the court given the fraudulent construction agreement any consideration, the court would have quickly ascertained it was signed by one person, which should have been regarded as highly suspicious, and the agreement did not have a guaranteed maximum price, which is unheard of in the construction industry. This agreement, on its face demonstrably fraudulent, coupled with the Partnership's sworn affidavit testimony, should have led the court to question whether the construction claims were subject to arbitration as any arbitration provision in that agreement would be invalid. The court never addressed those questions. Instead the court did exactly as requested by Feist: it swept all claims into

arbitration per the Partnership Agreement's arbitration provision. (App 310, 311). Both the UAA and FAA required the Court to fully evaluate the fraudulent construction agreement, and to hold a jury trial on the issue if one has been requested. 9 U.S.C. § 4 ("If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed."); N.D.C.C. § 32-29.3-07(1)(b) (providing similar summary proceeding). The applicable legal standards required the court and a jury to address the fraudulent construction agreement prior to arbitration of any claims.

**(6.)** Feist further attempts a slight of hand, stating the Partnership's fraud claims and defenses are the types of claims and defenses the FAA has held cannot invalidate an arbitration provision. This too is false. North Dakota's remedies for fraud were specifically enacted to "govern issues concerning the validity, revocability, and enforceability of contracts generally" Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 686-87 (1996) (citation omitted); Superpumper, Inc. v. Nerland Oil, Inc., 1998 ND 144, 582 N.W.2d 647, 651("states cannot invalidate arbitration agreements with laws applicable *only* to arbitration provisions."). Feist's argument the Partnership's state law fraud claims and defenses are invalidated by the FAA is simply wrong, and cases cited for that proposition have no bearing here.

**(7.)** Another fundamental mistake of the court was to order all lawsuit claims into arbitration on the basis those claims arose out of or related to the Partnership Agreement. This type of reasoning makes little sense where the actual construction process was not at all governed by that agreement. The partners had an oral agreement for the construction of the hotel, and the fraudulent construction agreement was created solely by Joel in

secret in order to enrich himself. (App 047 & 050). Joel enriched himself through his construction company RBI, a non-party to the Partnership Agreement. It makes as much sense to allow non-party RBI to demand arbitration under the Partnership Agreement as it does to allow, for example, the electrical contractor (another non-party) to do likewise. Any hypothetical claims by and between the electrical contractor on the project would have arisen out of and related to the Partnership in precisely the same way as they do to the general contractor RBI, which is they do not relate at all. This illustrates the fallacy and illogic in sending all claims into arbitration pursuant to the Partnership Agreement.

## II. CONCLUSION

**(8.)** Partnership respectfully requests the Court remand this case for summary proceedings pursuant to the FAA and/or the UAA concerning Partnership's claims of fraud in the formation of the construction contract's arbitration agreement. Partnership further requests the Court declare the claims for fraud, contract breach, construction defects, equitable claims, and judicial determination are not subject to arbitration, whether under the construction agreement or the Partnership Agreement. Alternatively, Partnership respectfully requests the Court reverse the court's order awarding 18% post-judgment interest.

Dated this 7th day of December, 2015.

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## CERTIFICATE OF COMPLIANCE

**(9.)** The undersigned, as attorneys for the Plaintiffs/Appellants in the above matter, and as the authors of the above brief, hereby certify, in compliance with Rule 32(a) of the North Dakota Rules of Appellate Procedure, that the above brief was prepared with proportional type face and that the total number of words in the above brief, excluding words in the table of contents, table of authorities, signature block, certificate of service and certificate of compliance totals 2,000.

Dated this 7th day of December, 2015.

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## CERTIFICATE OF SERVICE

**(10.)** I hereby certify that a true and correct copy of the foregoing **REPLY BRIEF OF APPELLANT 26TH STREET HOSPITALITY, LLP** was on the 7th day of December, 2015, emailed to the following:

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