IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

PATRICK E. MEYERS, et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	C.A. No. 9878-VCL
	)	
QUIZ-DIA LLC, et al.,	)	
	)	
Defendants.	)	
	)	
	)	
QUIZ-DIA LLC, et al.,	)	
	)	
Third-Party Plaintiffs,	)	
	)	
v.	)	
	)	
ROCKFORD MANAGER LLC, et al.,	)	
	)	
Third-Party Defendants.	)	

MEMORANDUM OPINION

Date Submitted: November 21, 2016
Date Decided: December 2, 2016

John T. Dorsey, Richard J. Thomas, Emily V. Burton, YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware; Bruce S. Bennett, Christopher Lovrien, Nathaniel P. Garrett, Sarah G. Conway, JONES DAY, Los Angeles, California; *Counsel for Plaintiffs*.

Brock E. Czeschin, Blake Rohrbacher, Susan M. Hannigan, Elizabeth A. DeFelice, Brian F. Morris, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; *Counsel for Defendants and Third-Party Plaintiffs*.

LASTER, Vice Chancellor.

Twelve plaintiffs previously affiliated with the Quiznos family of companies have sued three Quiznos entities for indemnification and advancement under multiple agreements. The defendants have moved to dismiss the claims for indemnification that two former officers brought under their employment agreements, contending that those claims are subject to arbitration. The plaintiffs contend in response that the defendants have waived their right to arbitrate. This decision stays the officers' claims under their employment agreements pending a determination by the arbitrator of the arbitrability of the claims.

I. FACTUAL BACKGROUND

The pertinent facts are undisputed. The Quiznos sandwich shop empire has operated through a complex and changing web of entities. One constant has been the principal operating entity, called QCE LLC ("OpCo").

Plaintiffs Greg MacDonald and Dennis Smythe were officers of OpCo. They also say they were officers of all of the other entities in the Quiznos family of companies.

In 2006, under their watch, a Quiznos affiliate issued a substantial amount of debt to various investment funds. In 2012, to avoid defaulting on the debt, Quiznos entered into a restructuring. As part of the restructuring, ownership over OpCo and its subsidiaries passed to a group of the investors who owned the debt (the "Funds"). MacDonald and Smythe left Quiznos after the restructuring.

In summer 2013, MacDonald and Smythe began to suspect that the Funds might sue them for their role in the restructuring. The Funds asked each of them to attend meetings at which Fund representatives expressed frustration with the restructuring and Quiznos'

continuing financial decline. In advance of the meetings, MacDonald and Smythe retained the law firm of Jones Day to investigate potential claims that the Funds might pursue.

On March 14, 2014, OpCo and numerous other Quiznos entities filed a petition for bankruptcy. Their filings disclosed that "[t]he Reorganized Debtors [and the Funds] w[ould] enter into [a] Specified Litigation Agreement" to pursue "Specified Litigation Claims" against various individuals, including MacDonald and Smythe.

On July 1, 2014, Jones Day demanded indemnification and advancement on behalf of MacDonald and Smythe for "all expenses incurred in connection with the threatened claims." Jones Day asked the defendants to "respond within 10 days of this letter indicating whether [they] agree[d] to indemnify the [plaintiffs] and advance costs." On July 10, just before the ten-day period expired, the plaintiffs filed this lawsuit. In their original complaint, they sought indemnification and advancement under a range of agreements, but not under MacDonald's and Smythe's employment agreements.

Less than two weeks later, on July 22, 2014, the Funds sued MacDonald, Smythe, and other individuals in the United States District Court for the District of Colorado. The complaint alleged that MacDonald and Smythe induced the Funds to participate in the restructuring by creating financial projections "that made it appear that the debt burden and capital structure that would remain in place post-[restructuring] would be sustainable . . . ." The Funds asserted claims for violations of the federal securities laws and common law fraud.

On May 16, 2016, after nearly two years of litigation, the plaintiffs in this action amended their complaint. In the amended pleading, MacDonald and Smythe added claims

for indemnification under their employment agreements. The agreements contain broad arbitration clauses.

On June 22, 2016, the defendants moved to dismiss MacDonald and Smythe's new claims in favor of arbitration. The defendants argued that MacDonald and Smythe's other claims should be stayed pending the outcome of arbitration. The plaintiffs opposed the motion, arguing that the defendants waived their right to arbitrate.

II. LEGAL ANALYSIS

"Delaware courts lack subject matter jurisdiction to resolve disputes that litigants have contractually agreed to arbitrate." *NAMA Hldgs., LLC v. Related World Mkt. Ctr., LLC*, 922 A.2d 417, 429 (Del. Ch. 2007). When a party invokes an arbitration provision, the court must decide the threshold question of "substantive arbitrability," or "whether the issue of arbitrability should be decided by the court or the arbitrator." *McLaughlin v. McCann*, 942 A.2d 616, 620–21 (Del. Ch. 2008) (Strine, V.C.).

"When deciding whether the parties agreed to arbitrate a certain matter (including arbitrability), courts generally . . . should apply ordinary state-law principles . . . ." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). Colorado law governs the employment agreements and therefore the question of whether and to what extent the parties have agreed to arbitrate. *Maloney-Refaie v. Bridge at Sch., Inc.*, 958 A.2d 871, 882 (Del. Ch. 2008) (interpreting arbitration provision under Maryland law where that state law's governed contract).

Under Colorado law, when "the parties explicitly incorporate rules that empower the arbitrator to determine issues of arbitrability, that incorporation constitutes clear and

unmistakable evidence of intent to delegate" the issue of arbitrability to the arbitrator. *Ahluwalia v. QFA Royalties, LLC*, 226 P.3d 1093, 1098–99 (Colo. App. 2009). The arbitration provisions in Macdonald's and Smythe's employment agreements are substantively identical. MacDonald's employment agreement is illustrative and provides as follows:

> Subject to the provisions of Section 8.6 hereof [permitting the Company to seek injunctive or equitable relief to prevent or curtail a breach of the agreement], any controversies or claims arising out of or relating to this Agreement shall be fully and finally settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association (or any successor thereto) then in effect . . . .

Dkt. 154, Ex. 13, § 25.

Rule R-7(a) of the Commercial Arbitration Rules of the American Arbitration Association provides that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction . . . ." The employment agreements thus explicitly incorporate a set of rules that empowers the arbitrator to decide arbitrability.

Because authority to decide arbitrability has been conferred on the arbitrator, this court must await the arbitrator's decision. The ensuing question is what to do with this action in the meantime. Whether to stay or dismiss this action pending the arbitrator's decision is a procedural matter governed by the law of the forum. *See Parker v. K & L Gates, LLP*, 76 A.3d 859, 870 (D.C. 2013); *see also Maloney-Refaie*, 958 A.2d at 879. Because the matter concerns arbitration, the Delaware Uniform Arbitration Act provides the pertinent law of the forum. That act incorporates the terms of the Federal Arbitration Act unless the agreement at issue explicitly references the Delaware Uniform Arbitration

Act. 10 *Del. C.* §§ 5702(a) & (c). The employment agreements do not explicitly reference the Delaware Uniform Arbitration Act, so the terms of the Federal Arbitration Act apply.

Section 3 of the Federal Arbitration Act provides for a stay of proceedings when "the issue involved in . . . [a] proceeding is referable to arbitration." 9 U.S.C. § 3. The issue of arbitrability is referable to arbitration, so MacDonald and Smythe's claims under their employment agreements are stayed pending the arbitrator's decision. If the arbitrator determines that their claims are arbitrable, then those claims will be dismissed in this action for lack of jurisdiction. *Julian v. Julian*, 2009 WL 2937121, at *3 (Del. Ch. Sept. 9, 2009) ("If a claim is arbitrable, *i.e.*, properly committed to arbitration, this Court lacks jurisdiction because arbitration provides an adequate legal remedy."). *Cf.* 10 *Del. C.* § 342 ("The Court of Chancery shall not have jurisdiction to determine any matter wherein sufficient remedy may be had by common law, or statute, before any other court or jurisdiction of this State.").

MacDonald and Smythe do not contest this analysis. Instead they argue that the defendants waived their right to arbitrate. According to the plaintiffs, they asserted claims in their first complaint that were "root[ed] in the employment relationship." Br. at 53. Thus, even though they did not invoke their employment agreements sooner, MacDonald and Smythe argue it was incumbent upon the defendants to demand arbitration by making the aggressive argument that the provisions in those agreements extended to claims for indemnification and advancement arising under separate and distinct agreements. *But see Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 583-84 (2006) (Strine, V.C.).

"[A] party may waive its right to arbitration by expressly waiving that right, actively participating in litigation as to an arbitrable claim, or otherwise taking action inconsistent with the right to arbitration." *Parfi Hldg. AB v. Mirror Image Internet, Inc.*, 842 A.2d 1245, 1260 n.39 (Del. Ch. 2004) (Strine, V.C.) (citations omitted). In general, however, "once arbitrability of the underlying dispute is determined, procedural defenses . . . also fall within the scope of arbitration." *SBC Interactive, Inc. v. Corp. Media P'rs*, 714 A.2d 758, 761–62 (Del. 1998). Therefore, if a claim is arbitrable, "resolution of procedural questions, including whether the invocation of arbitration was proper or timely, commonly referred to as 'procedural arbitrability,' is left to the arbitrator." *Id.* at 762. In this case, the issue of arbitrability has been assigned to the arbitrator. If the arbitrator determines that the claims are subject to arbitration, then this court will defer to the arbitrator as to whether the defendants waived their right to arbitrate.

The defendants have argued that all of the claims that MacDonald and Smythe have asserted, including those seeking advancement or indemnification under other agreements, should be stayed pending the outcome of the arbitration. According to the defendants, a stay is necessary to "avoid inefficient and potentially conflicting results." *Salzman v. Canaan Capital P'rs, L.P.*, 1996 WL 422341, at *6 (Del. Ch. July 23, 1996). The *Salzman* decision involved identical claims for dissolution asserted against three partnerships, one of which was governed by a partnership agreement that mandated arbitration of the dissolution claim. The claims asserted for dissolution were so intertwined that arbitration of one claim would produce factual findings that would be "dispositive of the . . . claims [asserted] against the other two . . . [p]artnerships." *Id.* at *1.

MacDonald and Smythe's claims under their employment agreements are not sufficiently intertwined with the other agreements at issue in this action. The indemnification provisions in the employment agreements are materially different from the provisions at issue in the other agreements. Most notably, the employment agreements provide clearly that the parties that must provide indemnification include OpCo's parent and all of its subsidiaries, including OpCo and all of OpCo's subsidiaries. The central issue being litigated under the other agreements is whether any entities other than OpCo must provide advancement or indemnification. Although there is potential for some overlap on factual issues, that risk is not sufficient to warrant a broader stay.

III. CONCLUSION

Proceedings are stayed as to MacDonald and Smythe's claims under their employment agreements pending a determination by an arbitrator as to whether the dispute is arbitrable. If the arbitrator determines that the claims are subject to arbitration, then those claims will be dismissed for lack of jurisdiction.