IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

PROSPECT CAPITAL MANAGEMENT L.P.,	)	
	)	
Petitioner,	)	
	)	
v.	)	
	)	C.A. No. 22-mc-89-MN-CJB
STRATERA HOLDINGS, LLC and DESTRA CAPITAL MANAGERS LLC,	)	
	)	
Respondents.	)	

RESPONDENTS STRATERA HOLDINGS, LLC AND DESTRA CAPITAL MANAGERS LLC'S OBJECTIONS TO REPORT AND RECOMMENDATION

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Dated June 14, 2023

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Respondents, while in agreement with the Report and Recommendation's (D.I. 42) (the "Report") ultimate recommendation that the Panel's Final Award be enforced, object to the Report on the following grounds: (i) the Report replaces its conclusions for those of the Panel without the Panel having substituted its own form of justice or the Panel having acted with a manifest disregard of the law; (ii) the Interim Award of Arbitrators ("Interim Award") was not final, (iii) the doctrine of *functus officio* no longer exists and (iv) the Report fails to address and recommend that exception (2) to *functus officio* regarding the failure to fully adjudicate submitted issues applies. This Court applies *de novo* review to the Report's recommendations. Fed. R. Civ. P. 72(b)(3); D.I. 42 at 50.

I. The Report errs in failing to find the Panel acted within its authority under Section 10(a)(4) and that there was no manifest disregard of the law by the Panel when the Panel concluded that the Interim Award was not final and, therefore, that *functus officio* did not apply to the Interim Award[1]

The Report accurately describes the exacting standard courts must apply before rejecting conclusions in an arbitration award but then fails to apply that standard in rejecting the Panel's finding that *functus officio* did not apply. The Report acknowledges that to assert that arbitrators exceeded their powers under Section 10(a)(4), a party carries a heavy burden, and that the arbitrators' construction of their authority must stand even if in error "or even a serious error." D.I. at 15. Rather, it is necessary to show that the arbitrators acted outside their authority and did so by reflecting their "own notions of [economic] justice." *Id.* Further, the Report states that the Third Circuit "assume[d] without deciding" that an arbitration award under Section 10(a)(4) could be vacated for a "manifest disregard of the law." *Id.* But the Report disregards these heavy burdens in concluding, contrary to the Panel's findings, that the Interim Award was final as to all issues of liability, including the Provasi DRIP issue, and that *functus officio* applied (subject to an exception

[1] This legal issue was raised, *inter alia*, in D.I. 35 at 27-29.

appropriately found). D.I. 42 at 29-32.

The Panel, in detailed analysis in its Order #22 interpreted AAA Commercial Arbitration Rule 50 ("Rule 50") and *functus officio* as **not** preventing the clarifying of the Interim Award in the Final Award.[2] In construing its authority, the Panel notes that the AAA Commercial Arbitration Rules empowered the Panel to determine its own jurisdiction. D.I. 36, ex. 1-L at 1 n.1.[3] Thus, given Rule 7(a) and Rule 50, codifying *functus officio*,[4] the application of the doctrine is exclusively in the hands of the Panel, and Order #22 controls. Order #22 discusses, analyzes, and concludes that Rule 50, prohibiting redetermining "the merits of any claim already decided," did not prevent the Panel's clarification of the Interim Award because the Panel was not redetermining any claim already decided, distinguished *Verizon* and concluded that neither Rule 50 nor *functus officio* precluded clarification of the Interim Award.[5]

Notably, the Report states that Order #22 "suggests" that functus officio does not apply. D.I. 42 at 11-12. This is an underreading of Order #22 in light of the Panel's clear conclusion that Rule 50's redetermination prohibition did not apply to the Interim Award. D.I. 36, ex. 1-L at 1. The Report acknowledges that this language in Rule 50 codifies *functus officio*. D.I. 42 at 48.

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[2] S*ee* D.I. 35 at 11-15; D.I. 33, ex. 1-K at 1; D.I. 35 at 9-11; D.I. 36, ex. 1-L at 1.

[3] The agreement between the parties specifically calls for the application of AAA Commercial Arbitration Rules. The Third Amended and Restated Limited Liability Company Agreement of Priority Senior Secured Income Management, LLC ("Third Agreement") provides that:

> "…the Asserting Parties agree to submit any persisting claim (whether or not permitted by this Agreement**) including but not limited to any issue regarding arbitrability, not to a court but only to binding arbitration** in Wilmington, Delaware in accordance with the Commercial Arbitration Rules of the American Arbitration Association…"

D.I. 33, ex. 1-A at 38-39 (emphasis added).

[4] The Report and Prospect agree Rule 50 codifies *functus officio*. D.I. 35 at 48 and D.I. 3 at 9-10.

[5] Order #22 goes on to discuss, in an abundance of caution, why, in any event, at least two exceptions to *functus officio* would nonetheless apply.

Thus, the Panel finding this language inapplicable also determines that *functus officio* does not apply. Further, Order #22 discusses the *Employers' Surplus Lines* case and the "common law doctrine of functus officio," and concluded liability and damages must be decided for an order to be final and such was not the case in the Interim Award and *functus officio* thus did not apply. D.I. 36, ex. 1-L at 3. Finally, Order #22 specifically discusses why the Interim Award was not final and distinguishes *Verizon* and discusses the exceptions to functus officio only if *Verizon* were "deemed applicable." The only fair reading of Order #22 is that the Panel found *functus officio* inapplicable.

In its Background section, the Report discusses in detail Order #22, entered by the Panel. D.I. 42 at 10-13. The Report then discusses the same main authorities as those the Panel considered, but the Report reaches a different conclusion: that the Interim Award was final as to the Provasi DRIP issue and that *functus officio* applied (subject to an exception). D.I. 42 at 17-28.

While the Report's conclusions in this regard are subject to vigorous legal debate, there is no debate that the Report substituted its conclusions for those of the Panel and did so without application of the standard of review the Report espouses. D.I. 42 at 15. The Report, at most, concludes that the Panel erred in deciding the Interim Award was not final but makes no mention as to how this purported error was the result of the arbitrators applying their "own notions of [economic] justice." *Id*. To the contrary, the record reflects the Panel's decision was based on applicable legal authorities and the Panel's legal conclusions regarding the same. The Report's different conclusion from Order #22 is not enough to support the Report's rejection of the Panel's finding that *functus officio* did not apply to the Interim Award and the Provasi DRIP issue.

Likewise, the Report makes no mention as to how the Panel engaged in a manifest disregard of the law. To make such a determination, the Report would need to establish that the arbitrators appreciated "the existence of a clearly governing legal principle but decides to ignore or pay no

attention to it." *Caputo v. Wells Fargo Advisors, LLC,* No. 20-3059, 2022 WL 1449176, *4 (3d Cir. May 9, 2022). Instead, the Panel considered, discussed and, at times, distinguished governing principles, thereby establishing that they did not ignore or fail to pay attention to such principles.

A court's obligation to adhere to this standard of review is particularly compelling where, as here, both sides petitioned to modify the award and therefore submitted the question of whether the award could be modified to the Panel. Where the parties intended for an issue to be decided by a panel, the panel does not exceed its authority in deciding such an issue, "irrespective of whether it decided the issue correctly." *T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 346 (2d Cir. 2010). Here, Stratera and Destra sought a modification through Rule 50, and Prospect requested that the Interim Award be modified to change its conclusion on who was the prevailing party entitled to attorneys' fees.[6] *See* D.I. 36, ex. 1-J. As such, the parties submitted the issue of the Panel's authority to modify the Interim Award to the Panel, and this Court may not revisit that determination absent a finding of manifest disregard of the law.

The Report substitutes its wisdom for that of the Panel and does so by ignoring the standard of review it announces. The Court, in applying such a standard of review, should confirm that the Panel did not substitute its own notion of justice and did not ignore or fail to pay attention to clearly governing principles. It should therefore confirm the Panel's conclusion that the Interim Award as to the issue of Provasi DRIP was not a final award for purposes of Rule 50 or *functus officio*.

II. The Report errs in determining that the Interim Award was a final award

The Report incorrectly determines that the Interim Award is a final award by applying the incorrect standard in determining whether an award is final and by failing to apply the correct

[6] The prevailing party issue had been decided in the Interim Award, and, more than just discussing the amount of attorney's fees to be awarded, Prospect sought to have itself declared the prevailing party. *See* D.I. 36, ex. 1-J at 3 and 13.

standard of review to the arbitrators' decision that the Interim Award was not final. *See* D.I. 35 at 13-19. The Report reads *Verizon* to dictate that any award that determines all liability issues without determining damages issues is a final award. D.I. 42 at 22. This ignores, though, that the only issue before the *Verizon* court was whether an arbitrator's award addressing liability but not damages was final when only liability issues had been submitted to the arbitrator. *Verizon,* 13 F.4th at 305, 309. The *Verizon* court, understandably, found that since all submitted issues had been decided, the award was final despite not resolving the unsubmitted damages issue. *Id.* at 309. While Prospect argues some language in *Verizon* can be read to suggest that awards that address all liability issues but not damages are final, such reading is inconsistent with Third Circuit precedent and constitutes *dicta* given that damages issues were not submitted to the arbitrator before its merits award. *See La Vale Plaza, Inc. v. R. S. Noonan, Inc.,* 378 F.2d 569, 573 (3d Cir. 1967) (holding that finality depends upon whether all submitted issues are decided). Here, of course, both liability and damages were submitted to the Panel, such that the Panel's award only as to liability did not determine the submitted issues and was therefore not final.

This is also consistent with Third Circuit precedent on the finality of arbitration awards. The Report incorrectly concludes that "finality" means something different in the context of the complete arbitration rule versus *functus officio.* In both circumstances, the question is whether submitted issues have been decided. *See PG Publ'g, Inc. v. Newspaper Guild of Pittsburgh*, 19 F.4th 308, 322 (3d Cir. 2021); *La Vale,* 378 F.2d at 573. It would be counterintuitive to have separate finality standards, using the same word, to evaluate whether an arbitrator has resolved submitted issues so that they can be reviewed by a court and whether the arbitrator has resolved submitted issues so the arbitrator may not complete its award to address all submitted issues.

Moreover, the Third Circuit looks to the intent of the arbitrator, as expressed in the award at issue, to determine whether the award is final. *PG Publ'g, Inc.*, 19 F.4th at 321-22. Even were the Panel's conclusions in Order #22 not dispositive of its intent, the Panel made clear in the Interim Award that only after the Panel had reviewed the additional submissions by the parties, asked any questions it had, or scheduled a hearing does the Panel state that "the Panel will issue a final award." D.I. 36, ex. 1-F at 18. The Report notes other language by the Panel that vaguely and conclusorily states that all arguments had been considered (D.I. 42 at 31), but the fact remains that the Panel failed in its Interim Award not only to fully address the issue of Provasi-sold DRIP shares but also did not address the issue of damages, which, unlike in *Verizon*, was an issue submitted to the Panel at the time of the Interim Award. As to that latter issue, the Panel made clear its intention that the Interim Award not be final when it said in Order #21 that both liability and damages were to be submitted to the Panel with attorney's fees to be decided later, and then, in the Interim Award, ordered further briefing on damages. D.I. 36, ex. 1-E.

In any event, the issue of whether the Panel's award was final has already been decided by the Panel. In Order #22, the Panel concluded, "our analysis could stop here, as the Interim Award was labeled as such and clearly did not decide all issues including damages." D.I. 36, ex. 1-L at 3. The Panel went further, in its analysis of the exceptions to *functus officio*, prefacing its conclusion that exceptions apply with the phrase, "Even if the Panel's Interim Award were not considered 'interim', despite its title and effect . . . ." *Id.* This language makes clear that the Panel found that the Interim Award was not a final award, such that *functus officio* does not apply. As discussed in Section I, *supra*, a court may not second-guess a panel's decision on such issues unless the Panel acted outside its authority under Section 10(a)(4) or manifestly disregarded the law, which Prospect has not shown.

III. The Report errs by limiting the breadth of *Morgan v. Sundance, Inc.* and not recognizing its applicability to the judge-made doctrine of *functus officio*[7]

The Report restricts the breadth and application of the U.S. Supreme Court's recent holding in *Morgan v. Sundance, Inc.*, 142 S. Ct. 1708 (2022) by finding it does not apply to the judge-made *functus officio* doctrine. *See* D.I. 42 at 29, n.11. *Morgan* considered only a single issue responsive to the Courts of Appeals' predominant analysis:

> [whether courts] may create arbitration-specific variants of federal procedural rules, like those concerning waiver, based on the FAA's 'policy favoring arbitration.' They cannot. For that reason, the Eighth Circuit was wrong to condition a waiver of the right to arbitrate on a showing of prejudice.

Morgan, 142 S. Ct. at 1712 (omitting cited cases). The Court stated that "the FAA's 'policy favoring arbitration' does not authorize federal courts to invent special, arbitration-preferring procedural rules." *Id.* at 1713 (citation omitted). Put another way, "a court may not devise novel rules to favor arbitration over litigation." *Id*. (internal citations omitted). The Court held "the text of the FAA makes clear that courts are not to create arbitration-specific procedural rules, like the one we address [in *Morgan*]." *Id.* at 1714. Thus, to state it "conversely, it is a bar on using custom-made rules, to tilt the playing field in favor of (or against) arbitration." *Id.*

The Supreme Court's holding in *Morgan* is clearly irreconcilable with Third Circuit precedent requiring the application of the *functus officio* doctrine, which is an arbitration-specific procedural rule. *See Verizon Pennsylvania, LLC v. Communications Workers of Am., AFL-CIO, Local 13000*, 13 F.4th 300, 305-306 (3d Cir. 2021). The *functus officio* doctrine "is judge-made; it can be judge-unmade." *Glass, Molders, Pottery, Plastics and Allied Workers International Union, AFL-CIO, CLC, Local 182B, v. Excelsior Foundry Company,* 56 F.3d, 844, 847 (7th Cir.

[7] Respondents raise their argument in D.I. 38 and D.I. 39 at 1, 2-3, 15.

1995). Just as the rule struck down in *Morgan* was based upon the federal policy favoring arbitration, the *functus officio* doctrine originated "in the bad old days when judges were hostile to arbitration and ingenious in hamstringing it." *Id.* at 846. As in *Morgan,* the doctrine creates a unique judge-made rule applicable only to arbitrations, treating arbitrations differently than contract cases outside of arbitration. Prospect and Respondents agreed in ¶11.15 (b) of the Third Agreement to submit their disagreements to binding arbitration using the AAA Commercial Rules of Arbitration.[8] By their agreement to such rules, the Parties agreed that the arbitrators, not the court, would decide *functus officio,* which doctrine is embodied in Rule 50. The Panel decided all Rule 50 and *functus officio* issues, and the Court is without authority under the Third Agreement to overturn their decision. *See also* Section I, *supra*.

When a Supreme Court decision "undercut[s] the theory or reasoning underlying the prior circuit precedent in such a way that the cases are clearly irreconcilable," the circuit precedent is effectively overruled, and a district court should follow the Supreme Court decision. *Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, No. CV 04-1371-LPS, 2018 WL 4804685, at *1 n.1 (D. Del. Oct. 4, 2018) (internal quotations omitted). The Report argues that in the year since *Morgan,* "no court has concluded that *Morgan* put an end to the *functus officio* doctrine…, [and courts] have continued to apply [it]. D.I. 42 at 30, n.11 (citations omitted). In none of the three exemplar cases issued after *Morgan* cited by the Report did any of the parties raise any argument that *functus officio* was precluded by *Morgan,* meaning the issue was not before any of those courts.[9] *See id.*, citing *Smarter Tools Inc. v. Chongqing SENCI Import & Export Trade Co.,*

[8] In addition to their objection that *functus officio* is clearly irreconcilable with *Morgan,* Respondents independently object that the United States Supreme Court or a Third Circuit *en banc* panel should abolish *functus officio* for the reasons explained at D.I. 35 at 29-30.

[9] Notably, all briefing in these cases was concluded before *Morgan's* issuance, and none addressed the issue presented here.

Ltd., 57 F.4th 372 (2d Cir. 2023); *Cornfeld Grp., LLC v. Certain Underwriters at Lloyds's, London,* Case Number: 21-62510-CIV-MORENO, 2022 WL 17480934 (S.D. Fla. Dec. 6, 2022); *Sapp v. Indus. Action Servs., LLC,* Civil Action No. 19-912-RGA, 2022 WL 1690938 (D. Del. May 26, 2022). Respondents are not aware of any post-*Morgan* filing in in which a party asserted *Morgan* ended judicially created *functus officio,* and no court has therefore addressed the issue.

Finally, the Report argues that *Morgan* need not extend to *functus officio* because it does not prohibit every legal rule that only applies in the arbitration context. D.I. 42 at 30, n.11. But *Morgan* is not limited to waiver and extends to all rules superimposed upon arbitration agreements, stating "federal policy is about treating arbitration contracts like all others, not about fostering arbitration." *Morgan,* 142 S. Ct. at 1713. Given that court-made *functus officio* doctrine treats arbitration contracts differently from those outside the context of arbitration, and, specifically in this case, the agreement to apply the AAA Commercial Arbitration Rules and Rule 50, the court-made *functus officio* doctrine vitiates the parties' contract, and *Morgan* requires it come to an end.

IV. The Report errs in failing to address and conclude that, even should *functus officio* apply to the Interim Award, exception (2) regarding the failure to fully adjudicate submitted issues applied[10]

In Order #22, the Panel concludes that, even were *functus officio* applicable to the Interim Award and the Provasi DRIP issue, exception (2) to *functus officio*, as discussed in *Verizon*, applied because "by failing to address adequately in the Panel's holding the effect of its determination of the issue of entitlement to inclusion of the DRIP shares in the calculation of [Stratera and Destra's] fees, the Panel failed to adjudicate the issue completely." D.I. 36, ex. 1-L at 4. Order #22 contains the Panel's interpretation of the Interim Award, including that it failed to

[10] This legal issue was raised, *inter alia*, in D.I. 35 at 26-27 and D.I. 41, pp. 11-15. The Report concluded that, "Given the Court's decision, it need not and will not address Respondents' arguments as to the second exception." D.I. 42 at 34, n. 14.

adjudicate all issues presented and failed to fully adjudicate "the issue of entitlement to inclusion of the DRIP shares in the calculation of Claimants' fees." *Id.* The Panel notes:

> The essence of the Panel's ruling on the merits is that Schedule 11.18 requires the inclusion of *all* DRIP shares, and not just those issued on shares issued through DCI acting as sub-wholesaler, in the calculation of Destra and Stratera Fee party Percentages.

D.I. 36, ex. 1-L at 2 (italics in original). But the Panel then notes that the Interim Award would be subject to clarification because it did not decide all issues submitted:

> That exception presumably includes cases in which the award does not *completely* adjudicate an issue that has been submitted. Here, by failing to address adequately in the Panel's holding the effect of its determination of the issue of entitlement to inclusion of the DRIP shares in the calculation of [Stratera and Destra's] fees, the Panel failed to [adequately] adjudicate the issue completely.

D.I. 36, ex. 1-L at 4 (italics in original).[11]

To ignore this finding of the Panel regarding its own authority, the conclusion would need to be not that the Panel was wrong or "even seriously wrong" but rather that the arbitrators acted outside their authority and did so by reflecting their "own notions of [economic] justice." D.I. 42 at 15. Or, that the Panel's "manifest disregard of law" was such that it understood controlling authorities and chose to ignore them. *Caputo,* 2022 WL 1449176, at *4. To the contrary, the Panel examined the same legal authorities discussed in the Report and why, under such controlling authority, exception (2) to *functus officio* applied.[12] The Report errs by not accepting, based on the above standard of review, the Panel's conclusion that exception (2) applied. The Court, therefore, should uphold the Panel's conclusion that exception (2) applied.

[11] Prospect argued that the Panel's failing to adequately address its determination regarding DRIP could be interpreted as some kind of baby-splitting compromise. D.I. 3 at 5. Of course, this Court need not, and cannot, accept Prospect's wild speculation, where, as here, the Panel has explained what it meant and such explanation is a rational one subject to deference. *Verizon*, 13 F.4th at 309.
[12] *See, e.g.,* D.I. 36, ex. 1-L at 4 discussing *Verizon* and exception (2).

Respectfully submitted,

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CERTIFICATION PURSUANT TO STANDING ORDER FOR OBJECTIONS FILED UNDER FED. R. CIV. P. 2

Pursuant to the District of Delaware Standing Order for Objections Filed Under Fed. R. Civ. P. 72, Respondents Stratera Holdings, LLC and Destra Capital Managers LLC hereby certify that their Objections to the Report and Recommendation (D.I. 42) do not raise new legal or factual arguments.

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