

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: RICHARD B. LOWE III
Justice

PART 56

J. Ezra Meekin

INDEX NO. 600617/09

MOTION DATE 8/17/09

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

- v -

The Calibre Fund, LLC

The following papers, numbered 1 to _____ were read on this motion to/for _____

PAPERS NUMBERED

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

RECEIVED
SEP 22 2009
TAS MOTION SUPPORT OFFICE
NYS SUPREME COURT - CIVIL

MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION

FILED
Sep 23 2009
NEW YORK
COUNTY CLERK'S OFFICE

CDJ

RICHARD B. LOWE III

Dated: _____

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE CITY OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56

-----X
Application of

J. EZRA MERKIN and GABRIEL CAPITAL
CORPORATION,

Petitioners,

Index No. 600617/2009

For an Order Pursuant to Article 75 of the CPLR
Staying Arbitration of a Certain Controversy

-against-

THE CALIBRE FUND, LLC

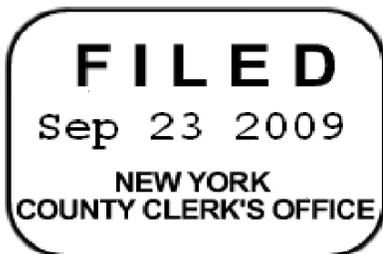
Respondent.

-----X
RICHARD B. LOWE III, J.:

Petitioners Gabriel Capital Corporation (“Gabriel Capital”) and J. Ezra Merkin (“Merkin”, and collectively “Petitioners”) seek an order, pursuant to CPLR § 7503(c), permanently staying the arbitration commenced by respondent The Calibre Fund, LLC (“Calibre”) with the American Arbitration Association.

BACKGROUND

Merkin has served as general and managing partner of the investment fund known as Ascot Partners, L.P. (“Ascot”). Calibre became a limited partner of Ascot as of January 1, 2008, when it invested approximately \$10 million into the fund. Calibre, like each investor who wished to become a limited partner of Ascot, was required to sign a Subscription Agreement that advised all limited partners that their investment was subject to the terms and conditions of the Partnership’s Confidential Offering Memorandum, as well as Ascot’s Amended and Restated



Limited Partnership Agreement.

At the time this dispute arose, the parties were signatories to the Third Amended and Restated Limited Partnership Agreement of Ascot Partner, L.P. (Mar 17, 2009 Affirmation of Arun Subramanian [“Subramanian Aff”] Ex D, “Partnership Agreement”). Section 11.06 of the Partnership Agreement states: “The Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.”

Section 11.09 of the Partnership Agreement states: “Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement or any breach or alleged breach hereof shall be submitted to, and determined and settled by, arbitration in New York, New York.”

According to the Petitioners, on December 11, 2008, Merkin learned that Bernard Madoff (“Madoff”) had admitted to orchestrating the now well-publicized multi-billion dollar fraud. After learning of the Madoff fraud, Merkin sent letters dated December 11, 2008, to the limited partners of Ascot informing them that substantially all of the fund’s assets were invested with Madoff. Calibre received the letter on December 12, 2008, and made an immediate request that Ascot, by the start of business on December 15, confirm that it (a) had frozen its accounts and would not distribute any funds in the next 30 days; (b) provide copies of the most recent audited and unaudited financial statements; (c) provide copies of bank statements, custodian statements, and other account records; and (d) confirm what ability Ascot has to satisfy outstanding redemption requests. Calibre received no response from Merkin.

On December 18, 2008, Merkin sent letters to all limited partners advising that dissolution of the partnership was the only practical option in light of the extent of the Madoff

losses.

Also on December 18, 2008, Calibre filed suit against Merkin in the United States District Court for the Southern District of New York seeking a temporary restraining order (“TRO”) and for a preliminary injunction. Calibre’s emergency application sought an order: (1) temporarily restraining Merkin from distributing remaining fund assets or from transferring any assets outside the ordinary course of business; (2) requiring Merkin to provide an accounting of Ascot’s and his own assets and liabilities; and (3) temporarily restraining Merkin from destroying or concealing documents. The complaint alleges causes of action for fraud, gross negligence, breach of fiduciary duty, and breach of the Partnership Agreement, all arising from the delegation of Ascot’s assets to Madoff (Subramanian Aff Ex C, the “Complaint”).

The Federal Complaint is captioned: “APPLICATION FOR TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE RE: PRELIMINARY INJUNCTION AND ORIGINAL COMPLAINT.” The Complaint’s introductory statement states that Calibre “brings this action against [Merkin] to prevent the unlawful dissipation of investment fund assets related to the Ponzi scheme orchestrated by [Madoff]” (Complaint at 1). The Complaint also states: “Calibre intends to pursue these claims in civil litigation or in arbitration, if required by a partnership agreement between Calibre and Ascot” (Complaint ¶ 2). Paragraph 3 states: “Pending presentation of Calibre’s claims before the appropriate tribunal, Calibre seeks a temporary restraining order and an order to show cause [for] a preliminary injunction” (Complaint ¶ 3). Additionally, paragraph 22 states: “The [Partnership Agreement] contains an arbitration provision The Partnership Agreement permits, and does not exclude, equitable or injunctive relief pending that arbitration” (Complaint ¶ 22).

Within the allegations for the various causes of action, the Complaint asserts that damages exist in an amount to be determined at trial (Complaint ¶¶ 27, 32, and 39). In the Prayer for Relief, Calibre sought only equitable and injunctive relief. In its memorandum of law submitted in the federal action, Calibre explained that it sought injunctive relief “to preserve the status quo so that Calibre may adjudicate its claims against Merkin via litigation or arbitration, as required.”

The Southern District heard oral argument regarding Calibre’s request for a temporary restraining order on December 18, 2008. The parties explain that the court indicated it was not inclined to grant the TRO in light of Calibre’s inability to demonstrate irreparable harm if the relief were not granted. The next day, December 19, 2008, Calibre’s counsel wrote a letter to court withdrawing its request for a temporary restraining order, yet “reserve[d] [Calibre’s] right to return to court” to seek further relief.

Calibre took no further action on its claims until January 7, 2009, when it voluntarily dismissed the federal action without prejudice. Approximately a month later, on February 6, 2009, Calibre sent a Demand for Arbitration to the American Arbitration Association, naming both Merkin and Gabriel Capital as respondents. The Demand includes no substantive allegations, other than to state that the dispute encompasses claims of fraud, negligence, misrepresentation, and violation of Connecticut General States SEC 36b-29 in connection with Calibre’s \$10 million investment in Ascot.

Petitioners now seek to stay the arbitration arguing that Calibre should not be permitted to arbitrate its claims because, by filing the federal action, it previously knowingly disregarded the arbitration provision and sought to resolve this dispute through litigation.

DISCUSSION

Petitioners argue that Calibre waived its right to arbitrate its claims arising from or related to the Partnership Agreement by (1) choosing to initiate a federal action, which included filing a complaint seeking damages, and (2) waiting until two months after the district court indicated that it would not grant the injunctive relief to file its demand for arbitration. Petitioners argue that such forum shopping should not be permitted. According to Petitioners, while New York law should apply, under all relevant standards, whether it be federal, New York or Delaware, Calibre waived its right to seek arbitration.

Calibre argues that it did not waive its contractual right to arbitrate by seeking limited injunctive relief in the wake of the Madoff scandal and Merkin's conduct. Calibre argues that its application to the federal court was for the sole purpose of preserving the status quo and never made any reference to litigating the merits of the dispute in court rather than arbitration. According to Calibre, the background of this dispute clearly reflects a willingness to resolve the merits of this dispute through arbitration and that it never acted in a manner inconsistent with such a position. Calibre argues that the arbitration clause is governed by the Federal Arbitration Act (the "FAA") and, thus, federal law should apply. Alternatively, Delaware law should apply because of the choice-of-law provision. Nonetheless, according to Calibre, even under New York's more liberal arbitration waiver standard it never waived its rights to arbitrate these claims.

Concerning the choice of law dispute, it is clear that federal law does not apply to the common-law waiver defense Petitioners assert. The express language of the FAA provides that common law defenses to enforcement of contract are applicable to arbitration agreements (9

USC § 2). The Supreme Court has interpreted this provision of the FAA to hold that state law contract defenses will apply in determining such defenses to enforceability of arbitration clauses (*Doctor's Assocs. v Casarotto*, 517 US 681, 687 [1996] [“the text of § 2 declares that state law may be applied ‘if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.’”]). Thus, state law waiver standards applies to this matter (*Accessory Corp. v Capco Wai Shing, LLC*, 39 AD3d 344 [1st Dept 2007] [suggesting that New York waiver law standards would apply to an arbitration governed by the FAA]; *Cap Gemini Ernst & Young, U.S., L.L.C. v Nackel*, 346 F3d 360, 364 [2d Cir 2003] [“Accordingly, while the FAA creates a ‘body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act,’ in evaluating whether the parties have entered into a valid arbitration agreement, the court must look to state law principles.”], *quoting Moses H. Cone Meml Hosp. v. Mercury Constr. Corp.*, 460 US 1, 24 [1983]).

Calibre argues that Delaware law should apply because section 11.06 of the Partnership Agreement states: “The Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.” However, while “New York courts generally defer to the choice of law made by the parties to a contract[,] . . . New York law allows a court to disregard the parties’ choice when ‘the most significant contacts’ with the matter in dispute are in another state” (*Cap Gemini Ernst & Young, U.S., L.L.C. v Nackel*, 346 F3d 360, 365 [2d Cir 2003, *quoting Cargill, Inc. v Charles Kowsky Res., Inc.*, 949 F2d 51, 55 [2d Cir. 1991]). Petitioners argue that New York has the most significant contacts concerning this dispute. Notwithstanding, the determination of whether New York or Delaware law applies is only necessary if “a real conflict exists” as a result of applying New York and Delaware law (*Cap Gemini*, 346 F3d at

366; see also *Rosenberg & Rosenberg, P.C. v Hoffman*, 195 AD2d 343, 344 [1st Dept 1993]).

Delaware law recognizes a strong public policy in favor of arbitration (*Pettinaro Construction Co., Inc. v Harry C. Partridge, Jr. & Sons, Inc.*, 408 A.2d 957 [Del Ch 1979]). Delaware courts require two elements to be satisfied before they find waiver: (1) clear and convincing evidence of waiver (*Zaret v Warners Moving & Storage*, 1995 WL 56708, at *1 [Del Ch Feb 3, 1995]; *Carcich v Rederi A/B Nordie*, 389 F2d 692, 696 [2d Cir 1968]), and (2) the party asserting waiver must demonstrate prejudice (*Rush v Oppenheimer & Co.*, 779 F2d 885 [2d Cir 1985]). “Waiver of arbitration is a matter of intention and to constitute waiver there must be an intentional relinquishment of a right with both knowledge of its existence and intention to relinquish it” (*James Julian, Inc. v Raytheon Serv. Co.*, 424 A2d 665, 668 [Del Ch 1980]). While mere delay is not enough to sustain a claim of waiver (*Carcich*, 389 F2d at 696), active participation in a lawsuit shows an intent to relinquish its right to arbitration (*Zaret*, 1995 WL 56708, at *1; *Price v Drexel Burnham Lambert, Inc.*, 791 F2d 1156 [5th Cir 1986]). Litigation may be prejudicial because of the unnecessary expense incurred before the demand for arbitration, or because the party seeking arbitration has obtained discovery that would have been unavailable in arbitration (*E. C. Ernst, Inc. v Manhattan Construction Co. of Texas*, 559 F2d 268 [5th Cir 1977]; *McDonnell v Dean Witter Reynolds, Inc.*, 620 F Supp 152 [D Conn 1985]; *Anadarko Petroleum Corp. v Panhandle Eastern Corp.*, 1987 WL 13520, * 8 [Del Ch 1987]).

New York law also recognizes a strong public policy in favor of arbitration (*Stark v Molod Spitz DeSantis & Stark, P.C.*, 9 NY3d 59, 66-67 [2007]). However, “[l]ike contract rights generally, a right to arbitration may be modified, waived or abandoned” (*id.*). Accordingly, a litigant may not compel arbitration when its use of the courts is “clearly inconsistent with [its]

later claim that the parties were obligated to settle their differences by arbitration” (*id.*). The Court of Appeals explained:

The crucial question . . . is what degree of participation by the defendant in the action will create a waiver of a right to stay the action. In the absence of unreasonable delay, so long as the defendant’s actions are consistent with an assertion of the right to arbitrate, there is no waiver. However, where the defendant’s participation in the lawsuit manifests an affirmative acceptance of the judicial forum, with whatever advantages it may offer in the particular case, his actions are then inconsistent with a later claim that only the arbitral forum is satisfactory.

(*Id.* at 67, quoting *De Sapio v Kohlmeyer*, 35 NY2d 402, 405 [1974]). The Court further explained that “[n]ot every foray into the courthouse effects a waiver of the right to arbitrate. . . . [W]here urgent need to preserve the status quo requires some immediate action which cannot await the appointment of arbitrators, waiver will not occur” (*id.*).

In *Stark*, the Court of Appeals summarized what the totality of the allegations that were raised concerning waiver. In that case:

[The defendant law firm] opposed plaintiff’s June 2003 application and cross-moved for affirmative relief related solely to its fees and disbursements in enumerated personal injury lawsuits that plaintiff sought to retain. In June 2003, the firm entered into a stipulation resolving disputes over substitution of counsel in these lawsuits, the transfer of files, and the timing of its reimbursement for disbursements. The firm specifically reserved its right to attorneys’ fees, and later moved in the trial courts to recover attorneys’ fees and disbursements in lawsuits covered by the stipulation and litigated to conclusion by plaintiff. Additionally, the firm at one point moved to enforce the stipulation.

(*Stark*, 9 NY3d at 67). The Court of Appeals held that these “‘foray[s] into the courthouse’, cumulatively, do not as a matter of law ‘manifest[] an affirmative acceptance of the judicial forum’ such that the firm’s ‘actions [were] then inconsistent with [its] later claim that only the arbitral forum [was] satisfactory’ for resolving the employment-related claims subsequently advanced by plaintiff” (*id.*).

In the instant matter, the extent of the litigation in federal court includes filing an application for a TRO and injunctive relief, which included filing of a complaint that clearly reserved a right to arbitrate the claims. That same day, the parties participated in oral argument. The following day, Calibre sent the court a letter withdrawing its petition for injunctive relief. While Calibre did not formally withdraw the Complaint for another month, the federal litigation essentially lasted two days. As the Court of Appeals stated in *Stark*, “there is no waiver of arbitration where urgent need justifies resort to the courts” (9 NY3d at 67-68).

Under either Delaware or New York law, Calibre did not waive its right to arbitrate its claims that arise from or relate to the Partnership Agreement. There is no evidence that by seeking limited injunctive relief in the federal court, Calibre “intentionally relinquished” its right to arbitrate (*Smyrna v Kent County Levy Court*, 2004 Del Ch LEXIS 163, * 12 [Del Ch Nov 9, 2004]), or even acted in a manner “clearly inconsistent” with its stated claim to arbitrate (*Stark*, 9 NY3d at 66). Calibre’s submissions in the federal action reflected its willingness to arbitrate and only sought injunctive relief in an attempt to maintain the status quo immediately after the Madoff fraud was revealed (*id.* At 67).

Petitioners have not argued that they have been prejudiced by Calibre application for injunctive relief in federal court (*Smyrna*, 2004 Del Ch LEXIS 163, * 12). Furthermore, there are no facts that support Petitioners’ claim that Calibre sought to litigate the merits of this matter in federal court. Rather, the fact that Calibre only sought injunctive relief in the Complaint’s Prayer for Relief is consistent with its expressed intention stated in the opening paragraphs of the Complaint.

Calibre took steps to protect its investment after its requests to Petitioners were met with

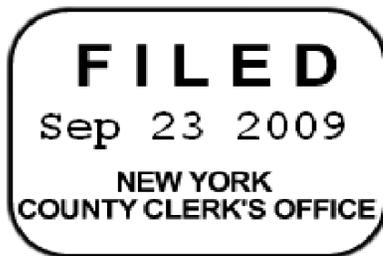
silence. It was not necessary, nor even possible, to raise its immediate concerns through arbitration (*Stark*, 9 NY3d at 67). Further, Calibre repeatedly reserved its right to pursue arbitration and never exhibited an intention of pursuing the case in court (*id.* at 68 [explaining that the parties included a mutual reservation-of-rights provision in their stipulation that preserved the defendant's right to demand arbitration]). The TRO application and Complaint did not demonstrate, contrary to Petitioners' argument, Calibre's intention to select litigation rather than arbitration.

There is no need to determine whether Delaware or New York law applies to the matter because there is no real conflict whereas, under either standard, Calibre did not waive its right to pursue arbitration. As such, Petitioners' motion to stay the arbitration is denied.

CONCLUSION

Accordingly, the petition is denied and the proceeding is dismissed.

Dated: September 18, 2009



ENTER: 
RICHARD SWEIN

J.S.C.