

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

PRESENT: Lowe  
Justice

PART 56m

Noel M. Weederhorn

INDEX NO. 601265/10

- v -

MOTION DATE \_\_\_\_\_

MOTION SEQ. NO. 001

J. Ezra Merkin

MOTION CAL. NO. \_\_\_\_\_

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

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

Answering Affidavits — Exhibits \_\_\_\_\_

Replying Affidavits \_\_\_\_\_

PAPERS NUMBERED
_____
_____
_____

Cross-Motion:  Yes  No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION**

Dated: 8/6/10

  
RICHARD B. LOWE III  
J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST  REFERENCE

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

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

PRESENT: \_\_\_\_\_  
Justice

PART 56

Wiederhorn

INDEX NO.

601265/10

MOTION DATE

- v -

MOTION SEQ. NO.

002

Merkin

MOTION CAL. NO.

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

*Motion is decided in accordance with the memorandum decision accompanying motion sequence 001.*

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

Dated: 8/6/10

RICHARD B. LOWE III

J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST

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

-----X  
NOEL M. WIEDERHORN, MD o/b/o NOEL M.  
WIEDERHORN, MD IRA ROLLOVER  
ACCOUNT,

*Petitioner,*

Index No: 601265/2010

-against-

**DECISION AND ORDER**

J. EZRA MERKIN and GABRIEL CAPITAL  
CORPORATION

*Respondents.*

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

This matter comes before this Court on petitioner Noel M. Wiederhorn, MD o/b/o Noel M. Wiederhorn, MD IRA Rollover Account's ("Petitioner" or "Wiederhorn") petition, pursuant to 9 U.S.C. §§ 1-16 and CPLR § 7510, to confirm the arbitration award issued by a majority of the panel in *Noel M. Wiederhorn, MD o/b/o Noel M. Wiederhorn, MD IRA Rollover Account, Claimant, vs. J. Ezra Merkin and Gabriel Capital Corporation, Respondents* (Petitioner Ex A, American Arbitration Association Case # 13 148 Y 02937 08, the "Award") against respondent J. Ezra Merkin ("Merkin"). Merkin and Gabriel Capital Corporation ("GCC" and collectively, "Respondents") filed (1) an answer opposing the petition; (2) a cross-petition seeking to vacate the Award to the extent it granted the claims against Merkin for breach of fiduciary duty and violation of the New Jersey Securities Act, and to confirm the Award to the extent it denied all claims against GCC and all other claims against Merkin; and (3) a counterclaim seeking indemnification for Merkin for the full amount of the Award, to the extent any portion of the

Award is not vacated, and costs for Respondents for all of their expenses incurred in defending the claims in the underlying arbitration that were denied. Petitioner has also filed a motion to dismiss Respondents' counterclaim and a motion to unseal the entire record of the underlying arbitration. The petition and cross-petition, along with motion sequence numbers 001 and 002, are consolidated for disposition.

## **BACKGROUND**

Ascot Partners, L.P. ("Ascot") is a Delaware limited partnership that was formed in August 1992 to operate as a private investment partnership for U.S. investors. At all relevant times, Merkin served as the General and Managing Partner of Ascot. Merkin is also the sole shareholder of GCC, an investment management firm that managed assets in a number of Merkin's investment funds.

Petitioner is a pediatrician who resides in New Jersey, and has brought this petition on behalf his wholly-owned Delaware IRA. The IRA invested a total of \$1,492,040.47 in Ascot -- \$500,000 in April 2003 and \$962,040.47 in April 2004. Petitioner's last statement from Merkin stated that his entire investment in Ascot amounted to \$2,258,756.

Ascot had invested substantially all of its assets in an account with Bernard L. Madoff Investment Securities (together with Bernard L. Madoff, "Madoff"). Shortly after Madoff confessed to having operated a massive Ponzi scheme, which rendered the value of Ascot virtually worthless, Petitioner commenced the underlying arbitration against Merkin, GCC, and Ascot. Petitioner thereafter withdrew the claims against Ascot.

In the arbitration, Petitioner sought to recover the loss of the value of its investment in Ascot, as well as damages for lost investment opportunities, emotional suffering, punitive

damages, costs and attorneys' fees. The arbitration alleged seven claims for relief, including: (1) violations of the federal securities laws; (2) violation of the New Jersey Securities Act; (3) breach of fiduciary duty; (4) common law fraud and deceit; (5) negligence; (6) gross negligence; and (7) negligent misrepresentation.

The arbitration was brought pursuant to the arbitration provision contained in section 11.09 of Ascot's Amended and Restated Limited Partnership Agreement ("LPA"). As provided for in the LPA, the arbitration was conducted under the supervision of the American Arbitration Association ("AAA") by a three-member Panel. The Panel consisted of one appointment by the Petitioner, one appointment by the Respondents, and the Chairman of the Panel appointed by the AAA because the parties' appointed panel members could not agree upon a chair ("Panel"). The arbitration was tried over seven hearing days in December 2009 and January 2010, followed by extensive post-hearing briefing. On May 5, 2010, the Chair issued an opinion sanctioning Petitioner for misconduct during the course of the arbitration. On May 12, 2010, the Panel issued the Award, joined by the Chair and the Petitioner's appointment (the "Majority"), while Respondents' appointment issued a separate dissenting opinion.

The Award directed that Merkin make full restitution to the Petitioner for the amount that Petitioner invested in Ascot, the approximately \$1.5 million, and to pay pre-Award interest at the New Jersey statutory rate. The decision was based on the Majority's findings that Ascot was formed for a single, specific purpose -- that is, to transmit funds to Madoff -- and operated that way for more than 16 years. Despite issuing multiple offering memoranda during that time, Merkin never once disclosed that Madoff was the single manager of Ascot funds. Instead, Merkin falsely stated that he was Ascot's general manager, responsible for all management

decisions, and Ascot's "success depended to a great degree on the skill and experience of Mr. Merkin" (Award at 11, *quoting* Ascot Partners, L.P.'s Confidential Offering Memorandum).

The Majority found that Merkin expressly assumed contractual and fiduciary duties to perform independent evaluations of the performance of any "money managers" he might hire for Ascot. He also withdrew more than \$25 million in management fees annually, despite Madoff having complete discretion over managing the funds. Furthermore, Merkin failed to disclose that all the funds were in Madoff's custody, but rather told investors that clearing, settlement and custodial services were provided by Morgan Stanley and Madoff Securities. However, over 99.8% of Ascot assets were allegedly held by Madoff.

Based on Merkin's affirmative misstatements concerning the management of Ascot, as discussed in greater detail below, the Majority found for Petitioner on the claims of breach of fiduciary duty and violation of the New Jersey Securities Act. However, all three arbitrators concluded that GCC was not liable under any of Petitioner's claims, and the Award denied all claims against GCC. Similarly, all three arbitrators concluded that Merkin was not liable on the claims of common law fraud and gross negligence, and denied those claims against him (and also noted that any claims not specifically addressed were also denied, which includes the previously dismissed claims for violation of the federal securities laws, negligence and negligent misrepresentation).

In the dissent, Respondents' appointment explained that all of the claims should be rejected based on Petitioner's misrepresentation of its status as a "Qualified Purchaser", that the breach of fiduciary claim was preempted by the Martin Act, that the New Jersey Securities Act did not apply to Petitioner's investment because the offer to purchase was made in Delaware, and

that Petitioner, who had been expressly told about Madoff's role in Ascot, failed to carry its burden of proof on any of the claims.

This matter now comes before this Court on the parties' competing petitions which seek, *inter alia*, to confirm and vacate the Award.

## DISCUSSION

Respondents argue that the Award's finding in favor of Petitioner on the claims of breach of fiduciary duty and violation of New Jersey Securities Act should be vacated because those findings are "totally irrational" and were made in "manifest disregard" of the law. Specifically, Respondents argue that the Award (i) improperly added proof of scienter as a requirement of Respondents' contract-based indemnification defense, (ii) ignored the Martin Act preemption doctrine, (iii) eliminated the requirement that Petitioner prove its own lack of knowledge of Madoff's role in Ascot, (iv) disregarded the jurisdictional limitations of the New Jersey Securities Act, and (v) removed scienter as a requirement of Petitioner's New Jersey Securities Act claim (*see* Merkin's June 8, 2010 Memo in Opposition to Petition and in Support of Cross-Petition ["Merkin 06/08/10 Memo"] at 9).

While the arguments are addressed individually below, in general such arguments ask this Court to go beyond the limited scope of review the Court of Appeals has provided for on such motions to confirm and/or vacate arbitration awards. Specifically, in *Wien & Malkin LLP v Helmsley-Spear, Inc.* (6 NY3d 471 [2006]), the Court stated:

It is well settled that judicial review of arbitration awards is extremely limited. An arbitration award must be upheld when the arbitrator "*offer[s] even a barely colorable justification for the outcome reached*". Indeed, we have stated time and again that an arbitrator's award should not be vacated for errors of law and fact committed by the arbitrator and the courts should not assume the role of overseers

to mold the award to conform to their sense of justice  
(*Id.* at 480 [emphasis added], *citing and quoting Paperworkers v Misco, Inc.*, 484 US 29 [1987], *Matter of Sprinzen*, 46 NY2d 623, 629 [1979]; *Matter of Andros Cia Maritima, S.A.*, 579 F.2d 691, 704 [2d Cir 1978], *Matter of New York State Correctional Officers & Police Benevolent Assn. v State of New York*, 94 NY2d 321, 326 [1999] [“A court cannot examine the merits of an arbitration award and substitute its judgment for that of the arbitrator simply because it believes its interpretation would be the better one”]).

Respondents’ arguments seek to vacate the Award based on the line of statutory and case law that provides for vacatur when the basis of the arbitrators’ award is in manifest disregard of the law or the arbitrator completely ignored applicable law. On this point, the Court of Appeals added:

[In addition to the Federal Arbitration Act (“FAA”)], an award may be vacated under federal law if it exhibits a “manifest disregard of law”. But manifest disregard of law is a “severely limited” doctrine. It is a doctrine of last resort limited to the rare occurrences of apparent “egregious impropriety” on the part of the arbitrators, “where none of the provisions of the FAA apply”. The doctrine of manifest disregard, therefore, “gives extreme deference to arbitrators”. The Second Circuit has also indicated that the doctrine requires “more than a simple error in law or a failure by the arbitrators to understand or apply it; and, it is more than an erroneous interpretation of the law”. We agree with that premise. To modify or vacate an award on the ground of manifest disregard of the law, a court must find “both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case”.

(*Wien & Malkin*, 6 NY3d at 480-481 [citations omitted]). Thereafter, in *Cheng v Oxford Health Plans, Inc.* (45 AD3d 356 [1st Dept 2007]), the First Department stated:

A court may find an award to be in manifest disregard of the law if the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and that legal principle was well defined, explicit and clearly applicable to the

case. But the “manifest disregard” standard rarely results in vacatur because it is limited to those “rare occurrences of apparent ‘egregious impropriety’ on the part of the arbitrators”, which requires “more than a simple error in law or failure by the arbitrators to understand or apply it;” in other words, it must be “more than an erroneous interpretation of the law”

(*Id.* at 357, quoting *Wien & Malkin LLP v Helmsley-Spear, Inc.*, 6 NY3d 471, 480 [2006], *Duferco Intl. Steel Trading v T. Klaveness Shipping A/S*, 333 F3d 383, 389 [2d Cir 2003]). More recently, in *U.S. Electronics, Inc. v Sirius Satellite Radio, Inc.* (73 AD3d 497 [1st Dept 2010]), the First Department reiterated its position, stating:

It is axiomatic, however, that judicial review of arbitration awards, whether under state law or the Federal Arbitration Act (9 USC § 9), is extremely limited, and such an award will be upheld when there is even colorable justification for the result, regardless of errors of law or fact committed by the arbitrators. Therefore, the “showing required to avoid summary confirmation of an arbitration award is high,” and a party moving to vacate the award has the burden of proof

(*Id.* at 498 [emphasis added], citing and quoting *Wien & Malkin*, 6 NY3d at 479-480, *Willemijn Houdstermaatschappij, BV v Standard Microsystems Corp.*, 103 F3d 9, 12 [2d Cir 1997]; see also *McLaughlin, Piven, Vogel Sec., Inc. v Ferrucci*, 67 AD3d 405, 406 [1st Dept 2009]; *Elul Diamonds Co. Ltd. v Z Kor Diamonds, Inc.*, 50 AD3d 293 [1st Dept 2008] [“An arbitration award will be upheld so long as the arbitrator offers barely colorable justification for the outcome reached and will be vacated only where it is totally irrational or exceeds a specifically enumerated limitation on the arbitrator’s power.”]; *Cheng*, 45 AD3d at 357; *Matter of Merrill Lynch, Pierce, Fenner & Smith Inc. v Graef*, 34 AD3d 220, 221 [1st Det 2006]).

This limited scope of review, even in the face of errors of law, is significant in this matter considering that the Respondents do not attack the basic premise from which the Majority based many of its rulings. The Majority ruled that “an arbitration of a forum of equity . . . [and] an

arbitrator's paramount responsibility is to reach an equitable result" (Award at 16, *citing Sprinzen v Nomberg*, 46 NY2d 623 [1979]; *Silverman v Benmor Coats, Inc.*, 61 NY2d 299 [1984]). The Majority relies on such equitable principles throughout the Award, and even quotes the Court of Appeals decision in *Silverman* for the following statement on the law:

Moreover, absent provision in the arbitration clause itself, an arbitrator is not bound by principles of substantive law or by rules of evidence. *He may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be and making an award reflecting the spirit rather than the letter of the agreement*, even though the award exceeds the remedy requested by the parties. His award will not be vacated even though the court concludes that his interpretation of the agreement misconstrues or disregards its plain meaning *or misapplies substantive rules of law*, unless it is violative of a strong public policy, or is totally irrational, or exceeds a specifically enumerated limitation on his power. Nor will an arbitration award be vacated on "the mere possibility" that it violates an express limitation on the arbitrator's power.

(61 NY2d at 308-309 [emphasis added] [citations omitted]). The Majority is very clear that many of its rulings were based on principles of equity, which an arbitrator is free to use absent some limitation in the arbitration agreement (*see Fitzgerald v Fahnestock & Co., Inc.*, 48 AD3d 246, 247 [1st Dept 2008]; *Matter of Chawki v New York City Dept. of Educ., Manhattan High Schools, Dist. 71*, 39 AD3d 321, 324 [1st Dept 2007] [explaining this State's "strong public policy of encouraging, by judicial noninterference, an unfettered, voluntary arbitration system, where equity should be done"] [citation omitted]). It is in that vein that the Award holds that Merkin must repay the amounts the Petitioner invested in Ascot -- nothing more, nothing less. Consistent with their interest in finding an equitable result, the Award denies Petitioner's claims for emotional suffering, punitive damages and even attorneys' fees. This power of equity does not give an arbitrator the power to manifestly disregard "well defined, explicit," and controlling law (*Wien & Malkin*, 6 NY3d at 480-481); however, in interpreting the Award as an attempt to

find an equitable result -- expressly relying on their equitable powers, not attacked by the Respondents -- that this Court must confirm the Award and judge Respondents' arguments (*Chaindom Enters. v Furgang & Adwar, L.L.P.*, 10 AD3d 495, 497 [1st Dept 2004]).

*Qualified Investor*

Respondents argue that the Majority's refusal to bar all claims based on Wiederhorn's misrepresentation of his financial qualifications to invest in Ascot was totally irrational and was made in manifest disregard of the law. To become a limited partner of Ascot, Petitioner completed a Subscription Agreement for Ascot. The Subscription Agreement required Petitioner to certify that it was a Qualified Purchaser -- which in the case of an individual or an investment vehicle owned by an individual required that the individual own at least \$5 million in investments. Wiederhorn did not have \$5 million in qualified investments, but represented that he was a Qualified Purchaser on the Subscription Agreement. At the arbitration hearing, he testified that he believed his home and other assets (such as jewelry) could be considered when determining his Qualified Purchaser status.

Respondents' provide no legal authority for the proposition that a general partner may keep the investment of a limited partner after it is determined that the limited partner falsely represented that it maintained a certain amount of assets. The Majority clearly discussed this issue over pages 15 and 16 of the Award, cited no legal authority on this Qualified Investor issue, examined the facts carefully, and expressly looked to find an equitable result. In determining such an equitable result, the Majority examined whether the Respondents made any effort to explain the significance of the Qualified Investor requirement or whether Respondents undertook any due diligence to determine whether Wiederhorn had sufficient assets to become a limited

partner. As Merkin made no effort to enforce this provision at the time of the investment, or to ensure that there was no misunderstanding on how to compute qualified investments, the Majority found it would be inequitable to bar Wiederhorn's claims based on this issue. Considering that Wiederhorn would not have made any investments in Ascot (and subsequently lost his investment) if Respondents had ensured compliance with this provision at the outset (Merkin 06/08/10 Memo at 12), the Majority found Respondents' argument that they would have "never been brought to arbitration" unavailing (*id.*). In resolving this issue, the Majority expressly sought to do equity -- a basis of power that Respondents do not contest arbitrators possess -- and did not come to a "totally irrational" conclusion.

#### *Martin Act Preemption*

Respondents argue that the Majority acted in manifest disregard of the law by refusing to apply the Martin Act preemption doctrine. According to Respondents, the doctrine of Martin Act preemption was a governing legal principle that mandated preclusion of Petitioner's breach of fiduciary duty claim and the Majority improperly held that Petitioner's claim for fiduciary duty was not preempted because Merkin's breach was intentional.

Petitioner concedes that the issue of Martin Act preemption of common-law claims is well-settled in the First Department. However, Petitioner argues that the issue has not been determined by the Court of Appeals and there is currently a split of opinion among various Appellate Divisions.

As this Court recently highlighted in *People v Merkin* (2010 NY Slip Op 50430U, 10 [NY Sup Ct, NY Cty Feb 8, 2010] [J Lowe]), there is a dispute of authority as to whether common-law claims brought by private parties are preempted by the Martin Act (*see Horn v 440*

*East 57th Co.*, 151 AD2d 112, 120 [1st Dept 1989]; *In re Bayou Hedge Fund Litig.*, 534 F Supp 2d 405 [SD NY 2007]; *Kassover v UBS AG*, 619 F Supp 2d 28 [SD NY 2008] [explaining that the Attorney General has exclusive jurisdiction to enforce the Martin Act]; *but see Caboara v Babylon Cove Dev., LLC*, 54 AD3d 79 [2d Dept 2008] [holding that individual's common-law fraud claim, resting on same facts as Martin Act, not preempted, so long as the fraud claim satisfies the pleading standards]; *Scalp & Blade, Inc. v Advest, Inc.*, 281 AD2d 882, 883 [4th Dept 2001] [holding that a breach of fiduciary duty claim not preempted by Martin Act]). While this Court may not rule in the same manner if presented with the issue (*see CRT Investments v Merkin*, Index No 601052/2009 [Sup Ct, NY Cty May 5, 2010] [J Lowe]), there was no settled, governing legal principle the Panel ignored or manifestly disregarded.

Here, the Majority did not deliberately ignore controlling law, but instead, after analyzing case law offered by both sides (including *Aris Multi-Strategy Offshore Fund, Ltd. v Devaney* (2009 NY Slip Op 52738U, 11 [NY Sup Ct NY Cty 2009]), *Barron v Igolnikov* (09-Civ-4471, 2010 US Dist LEXIS 22267, at 15-16 [SD NY Mar 10, 2010]), and *Pension Comm. of the Univ. of Montreal Pension Plan v Banc of Am. Sec., LLC* (592 F Supp 2d 608, 640 [SD NY 2009]), concluded that Petitioner's breach of fiduciary duty claim was not preempted by the Martin Act (Award at 18). Given the conflicting case law, as discussed above, the Majority's holding regarding Martin Act preemption was not made in manifest disregard of the law (*see Cheng*, 45 AD3d at 358; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Bobker*, 808 F2d 930, 934 [2d Cir 1986] ["We are not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it."]; *see also Park v First Union Brokerage*, 926 F Supp. 1085, 1089 [MD Fla 1996] [finding that when an arbitration

award is challenged for manifest disregard of state law, the mere fact that two inferior courts decided the issue in opposite ways “totally vitiates any potential ‘manifest disregard’ or ‘wholesale departure’ from the law.”]).

*New Jersey Securities Act*

The New Jersey Securities Act applies to investments where “(1) *an offer to sell is made in this State*, or (2) an offer to buy is made or accepted in this State” (N.J. Stat. § 49:3-51(a) [emphasis added]). N.J. Stat. § 49:3-71(a)(2) states:

Any person who . . . [o]ffers, sells or purchases a security by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission) .

N.J. Stat. § 49:3-71(b) states:

(1) If any claim is brought for violation of paragraph (2), (3), (4) or (5) of subsection (a) of this section, the person who bought the security or received the investment advice shall sustain the burden of proof that the seller or giver of investment advice knew of the untruth or omission *and intended to deceive the buyer or recipient of investment advice* and that the buyer or recipient of investment advice has suffered a financial detriment;

(2) If any claim is brought for violation of paragraph (2), (3), (4) or (5) of subsection (a) of this section involving a purchase of securities by others or investment advice as to the selling of securities, the person who sold the security or who received the investment advice to sell the security shall sustain the burden of proof that that person suffered a net loss with respect to that sale or investment advice taking into account all transactions by that person in the same security or any security convertible into that security within one year before or after the sale or advice which is the basis of the claim;

(*Id.* [emphasis added]). N.J. Stat. § 49:3-71(c) states:

(c) Any person who offered, sold or purchased a security or engaged in the business of giving investment advice to a person in violation of paragraph (1), (2), (3), (4) or (5) of subsection (a) of this section is liable to that person, who may bring an action either at law or in equity to recover the consideration paid for the

security or the investment advice and any loss due to the advice, together with interest set at the rate established for interest on judgments for the same period by the Rules Governing the Courts of the State of New Jersey from the date of payment of the consideration for the investment advice or security, and costs, less the amount of any income received on the security, upon the tender of the security and any income received from the investment advice or on the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at the rate established for interest on judgments for the same period by the Rules Governing the Courts of the State of New Jersey from the date of disposition;

Concerning Wiederhorn's knowledge of Madoff's involvement with Ascot, the Respondents argue that the evidence shows that the Ascot investment was recommended to Wiederhorn by Leon Meyers ("Meyers"), a successful investor and fund-of-funds manager whose daughter is married to Wiederhorn's son. At Meyers' recommendation, Wiederhorn contacted Merkin to discuss a potential investment in Ascot. Merkin and Wiederhorn discussed the tax inefficiencies of Ascot, and Wiederhorn thereafter decided to invest in Ascot through his IRA. Thus, in approximately March 2003, Wiederhorn instructed the administrator of his IRA to execute the Subscription Agreement for Ascot on behalf of the IRA and to transfer \$500,000 of the IRA's assets to Ascot. The administrator followed Wiederhorn's instructions in early April 2003. The IRA made the subsequent investment in April 2004.

On this issue, "the panel's majority did not state certain law as controlling and then deliberately ignore it" (*Cheng*, 45 AD3d at 357). In fact, Respondents do not argue that they provided any case law on this issue to the Panel. Respondents provide no citation to the arbitration record or its post-hearing brief that states the law on this issue was clear and explicit. The language of N.J. Stat. § 49:3-71(a)(2) does not explicitly support Respondents' position. Without further authority on this issue, this Court with out guidance to hold that notice from a

third party defeats a claim under the New Jersey Securities Act is a “well defined, explicit,” and “governing legal principle” (*Acciardo v Millennium Secs. Corp.*, 83 F Supp 2d 413, 420 [SD NY 2000]).

Regarding the factual issue, the Panel was presented with conflicting evidence concerning the scope of Merkin’s disclosures to Wiederhorn as to the extent of Madoff’s involvement in Ascot. A significant portion of the Award is given to the Majority’s finding that Merkin did not ever affirmatively disclose the full extent of Madoff’s role in managing Ascot funds, which goes beyond the scope of Meyer’s testimony. In fact, as Petitioner points out, none of the witnesses testified that Merkin disclosed the fee arrangement he had with Madoff. In addition to the legal interpretation issue noted above, Respondents are asking this Court to revisit factual issue decided by the arbitrator. To do so would be beyond the power of this Court (*Acciardo*, 83 F Supp 2d at 417 [“the Court is not empowered to second-guess the arbitrators’ fact-finding or assessment of credibility. . . . A district court must accept findings of fact if they are not clearly erroneous.”], citing *International Bhd. of Elec. Workers v Niagara Mohawk Power Corp.*, 143 F3d 704, 706 [2d Cir 1998] [holding that arbitrators’ fact-finding cannot be reviewed de novo by district court]).

Concerning the applicability of the New Jersey statute, the Award recites N.J. Stat. § 49:3-51 (excerpt above) and stated:

New Jersey’s securities law . . . is steadfast in the protection of its residents from misconduct related to the offer and sale of securities. When Mr. Merkin agreed to permit Dr. Wiederhorn to become a limited partner in Ascot, he knew the pediatrician was a resident of New Jersey and the *necessary documents were sent to Claimant in New Jersey*. Section 11.06 of the Amendment and Restated Limited Partnership Agreement of December 2002 states that it is to be governed by and construed with the laws of the state of Delaware. Much of the

misconduct of Mr. Merkin occurred in New York, where he purportedly managed the Ascot portfolio. The misconduct with regard to the 2002 OM and LPA could be construed to have taken place in New Jersey because it is that state where those documents were sent to Claimant and read by him before he invested. When Dr. Wiederhorn and Mr. Merkin had their initial discussion about Ascot in 2003, they were each in their respective states.

If Mr. Merkin was willing to do business with a New Jersey resident; send the Offering Memorandum and Partnership Agreement to Dr. Wiederhorn at his home in New Jersey; and, speak with Dr. Wiederhorn while the latter was in his home state, Mr. Merkin should be bound by that state's securities statute, including its statutory rate of interest.

(Award at 19-20 [emphasis added]).

Respondents argue that all of Wiederhorn's actions were taken on behalf of a Delaware entity and there was no intent to be bound by the laws of New Jersey. However, Respondents do not provide this Court with any controlling authority that would require a different outcome, and did not cite any clear, explicit authority in its post-hearing brief. The statute itself states that it applies to investments where "an offer to sell is made in this State"(N.J. Stat. § 49:3-51[a][1]), which can apply to the portion of the Award cited above. Furthermore, Respondents do not dispute the Majority interpretation's that the New Jersey securities law is given liberal and broad application in order to protect "its residents from misconduct related to the offer and sale of securities" (Award at 19). As such, as illustrated by the excerpts above, there is "colorable justification for the [Majority's] result, regardless of errors of law or fact committed by the arbitrators" (*U.S. Electronics*, 73 AD3d at 498 ).

Concerning the scienter requirement under the New Jersey statute, the Majority explained:

Mr. Merkin's "Don't ask, Don't tell" policy of selective disclosure breached his fiduciary duties. A fiduciary is more than a gatekeeper. With the

acceptance of millions of dollars in management fees comes important responsibilities at point-of-sale and thereafter. Did Mr. Merkin intend to deceive Dr. Wiederhorn? It is difficult to get into Mr. Merkin's mind, but deception was the effect. What Mr. Merkin did do was to intentionally, recklessly or with gross negligence misrepresent what he had been doing and would continue to do as the Managing Partner of Ascot. Dr. Wiederhorn relied on what he read in the 2002 OM and LPA, what he was told by Mr. Merkin and Mr. Autera and what he learned from Leon Meyers (Tr. 1126-1132), the last of whom had no legal duty to Dr. Wiederhorn.

(Award at 10). At other points in the Award, the Majority speaks more directly to the deliberateness of Merkin's acts and of his scienter. At page 8, the Majority found:

By deliberately failing to clearly and unmistakably disclose that he was not "managing" *any* trades and that he was making no investment decisions, Mr. Merkin misled Dr. Wiederhorn into investing and maintaining his IRA investments in Ascot.

(Award at 8 [emphasis in original]). On page 18, the Majority found:

The Martin Act . . . is no bar to Dr. Wiederhorn's claims because he was able to show *requisite intent* through the manner in which Mr. Merkin described his "management" of Ascot . . . ; the manner in which Mr. Merkin deliberately failed to disclose, in those offering documents, Ascot's integral association with Bernard Madoff; and, the manner in which Mr. Merkin *intentionally breached his fiduciary duty* to Dr. Wiederhorn.

(Award at 18 [emphasis added]). As such, the Majority examined both sides of the issue, determined factual and credibility issues that went directly to the issue of Merkin's intent, and found him liable under the New Jersey Securities Act. It must be repeated, the Majority provided more than "colorable justification", and the result must be confirmed "regardless of errors of law or fact committed by the arbitrators" (*U.S. Electronics*, 73 AD3d at 498 ).

Therefore, the thorough and reasoned 23-page Award presents a "colorable justification for the result, regardless of errors of law or fact committed by the arbitrators" and must be confirmed (*U.S. Electronics*, 73 AD3d at 498).

### *Cross-Petition's Counterclaim*

Upon confirming the Award, Respondents argue that they are entitled to judgment on their counterclaims awarding them indemnification under both prongs of the indemnification provision in the Subscription Agreement. Respondents argue that the Second Circuit decision in *Pike v Freeman* (266 F3d 78 [2d Cir 2001]) provides that a party to an arbitration may bring a subsequent, independent action in court against the other party for indemnification claims arising upon issuance of the arbitration award.

Petitioner moves, pursuant to CPLR §§ 3211(a)(1), (2), (5), (6), and (7), to dismiss the Respondents' counterclaim on the grounds that: (1) the Award was a final resolution of all claims between the parties and the Respondents are collaterally estopped from raising this claim now; (2) the Court does have subject matter jurisdiction to hear these claims as they are governed by an arbitration agreement; and (3) the counterclaim is impermissible and fails to state a cause of action.

The instant matter is distinguishable from the facts underlying the dispute in *Pike* because in that case "the parties agree that [the respondent] did not assert his indemnification claims in the arbitration" (266 F3d at 91). Here, Respondents' indemnification arguments were raised thoroughly at the arbitration proceeding. Specifically, on page 2 of Respondents' Post-Hearing Brief, they stated:

Claimant agreed in his Subscription Agreement to indemnify *Respondents* against any claim or loss resulting from, *inter alia*, any false representation or warranty made by him. Thus, even if Claimant were awarded damages against Respondents on any of his claims, Respondents would be entitled to indemnification from Claimant for the amount of damages awarded.

(June 15, 2010 Affirmation of David Bamberger ["06/15/10 Bamberger Aff"] Ex D, at 2

[emphasis added]). On pages 3 through 6 of the Post-Hearing Brief, Respondents further argued that under the Subscription Agreement that they are entitled to indemnification for any damages (*id.* at 6). Respondents further argued specific provisions of the Subscription Agreement's indemnification clause in their Post-Hearing Reply Brief (06/15/10 Bamberger Aff Ex E, at 4-6), and raised it in their Proposed Form of Final Award (06/15/10 Bamberger Aff Ex F, at 2-3). Respondents also sought forum costs in the arbitration (06/15/10 Bamberger Aff Ex F at 7), and the Panel necessarily decided this issue (Award at 22 ["This Award is in full satisfaction of all claims and counterclaims submitted in this Arbitration. All claims not expressly granted herein are denied"]). In fact, Respondents affirmatively represented that they were not seeking attorney's fees (06/15/10 Bamberger Aff Ex G).

While the Subscription Agreement may not have mandated arbitration of the indemnification claims, Respondents clearly raised their claim for indemnification under the Subscription Agreement in the arbitration. As stated in Respondents' Post-Hearing Brief:

For the same reason, under the explicit terms of the Subscription Agreement, *Respondents* are entitled to indemnification for any damages that would otherwise be awarded to Claimant (Ex. 3 (Subscription Agreement) at III(A)).

(06/15/10 Bamberger Aff , at 6 [emphasis added]). Additionally, the basis of the counterclaim is the Qualified Investor issue was necessarily decided in the arbitration (*see* Award at 15-16). And the dissenting opinion, in the first paragraph, raised the issue of whether the Claimant agreed to indemnify and hold harmless the Respondents under the Subscription Agreement. Any argument that the issue of the applicability of the Subscription Agreement's indemnification clause was not properly before the arbitrators is clearly without merit. Furthermore, it is clear that the Panel had the opportunity to rule on this issue, and did so.

*Petitioner's Motion to Unseal the Arbitration Record*

Petitioner's motion to unseal the entire record in of the underlying arbitration is denied. Petitioner fails to note under what authority this Court possesses the power to unseal the record. Petitioner has waived the opportunity to argue the unsealing of the arbitration record by consistently agreeing in the arbitration, without reservation, to maintain the arbitration record confidential. Furthermore, "confidentiality is a paradigmatic aspect of arbitration" (*Guyden v Aetna, Inc.*, 544 F3d 376, 385 [2d Cir 2008] ["confidentiality clauses are so common in the arbitration context that [petitioner's] 'attack on the confidentiality provision is, in part, an attack on the character of arbitration itself'"], quoting *Iberia Credit Bureau, Inc. v Cingular Wireless LLC*, 379 F3d 159, 175 [5th Cir 2004]).

The court has considered the parties' remaining arguments and finds them to be unavailing.

**CONCLUSION**

Accordingly, it is

ORDERED that the petition to confirm the arbitration award is granted; and it is further

ORDERED that the cross-petition to vacate the arbitration award is denied; and it is

further

ORDERED that the motion for sanctions on the cross-petition is denied; and it is further

ORDERED that the motion to dismiss the counterclaim is granted; and it is further

ORDERED that the motion to unseal the arbitration record is denied.

SETTLE JUDGMENT

This constitutes the decision and order of the Court.

**Dated: August 06, 2010**

**ENTER:**



RICHARD D. LOWE III

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J.S.C.