

STATE OF NEW YORK
SUPREME COURT COUNTY OF MONROE

CONRAD R. HOFFMAN and
GEORGE B. FAZEKAS,

Plaintiff,

DECISION AND ORDER

v.

Index #2004-13572

FINGER LAKES INSTRUMENTATION, LLC,

Defendant.

Two disaffected members of an LLC, plaintiffs Conrad R. Hoffman and George B. Fazekas, move by Order to Show Cause for a preliminary injunction enjoining the LLC from making payments of money or other assets owned by it to any LLC Member until final determination of this action seeking dissolution. Defendant cross-moves to compel arbitration in accordance with the broad arbitration provision in the LLC's operating agreement.

The two disaffected plaintiffs allege that they began making specialized cameras in 1995, and then brought three other engineers into the business in March 2000. The five of them formed a LLC, with the two plaintiffs serving as President and Treasurer. All five signed the operating agreement. Under the terms of the operating agreement, each individual became a "Member" of the LLC upon formation, and acquired their respective shares of the 100 "Units" of the company. The LLC can "act" by a vote of the majority of all outstanding "units" present at a

member meeting, §7.4, except in respect to certain "major decisions," including "the taking of any action which would cause a termination, dissolution or liquidation of the Company."

§5.5(b). Concerning such "major decisions," the operating agreement provides that "[n]o authorization or action taken . . . shall be effective or binding on the Company unless approved by the unanimous vote or written consent of the members."

§5.5(preamble).

In May 2002, one of the three members brought in by plaintiffs, Robert Kolbet, offered to become President, promising the two plaintiffs that he could improve the business regimen and thereby free up the plaintiffs for creative work. According to the complaint, however, after Kolbet became President, he teamed up with the two other LLC members, James Mormski and Gregory Terrance, to freeze out the two plaintiffs. Things came to a head in the Fall of 2004, when plaintiffs demanded an accounting, and discovered that Kolbet and his faction were paying themselves considerable sums which plaintiffs contend were not authorized under the terms of the operating agreement or the Limited Liability Company Law. In addition, according to plaintiff Hoffman, who remains the LLC's treasurer, the payments were made to Kolbet's faction despite the terms of §10.8 of the operating agreement which vouchsafes the custody and disbursement of LLC funds to the treasurer. Ultimately, plaintiffs seek dissolution,

an accounting, and a declaratory judgment that the payments made were wrongful under the operating agreement and LLC law.

Instead of naming the individual Kolbet faction members as defendants, plaintiffs named the LLC itself, which is not a signatory to the operating agreement containing the arbitration clause.¹ The arbitration clause reads as follows:

Section 14.1 Alternative Dispute Resolution

(a) The Members have entered into this Agreement in good faith and in the belief that it is mutually advantageous to them. It is with that same spirit of cooperation that they pledge to attempt to resolve any dispute amicably and without litigation. Accordingly, the Members agree that if any dispute arises, they will utilize the procedure set forth in this Article XIV to resolve such dispute.

(b) The initiating Member shall give written notice to the other Member describing in general terms the nature of the dispute. The Members agree to promptly, and in no event later than 10 days from the date of the initiating Member's written notice, meet to discuss the resolution of the dispute.

(c) If the dispute has not been resolved within 15 days from the date of their initial meeting, then the Members agree that the dispute shall be settled by arbitration in accordance with the provisions of the Commercial Arbitration Rules of the American Arbitration Association....

¹ In view of the provisions of the operating agreement set forth above, it is a wonder how the lawsuit could proceed without the Kolbet faction members individually named as defendants. CPLR 1001. But defendant has not addressed this issue in it's motion papers, and the court, therefore, turns to what is presented.

Operating Agreement, Article XIV, §14.1 (emphasis supplied). The broad language of the arbitration clause reveals that the members intended that virtually all disputes pertaining to the LLC to be submitted to arbitration (there is in §14.2 an exception for determining fair value of the units, which is not an issue here). With that one exception, the parties "contract[ed] to submit every part of their disputes to arbitration," i.e., for "plenary alternative dispute resolution." Matter of Smith Barney Shearson Inc. v. Sacharow, 91 N.Y.2d 39, 48, 49 (1997).

DISCUSSION

The general rule applicable to the cross-motion is stated as follows: "It has long been the rule in this state that the parties to a commercial transaction 'will not be held to have chosen arbitration as the forum for the resolution of their disputes in the absence of an express, unequivocal agreement to that effect; absent such an explicit commitment neither party may be compelled to arbitrate.'" Matter of Marlene Industries Corp. v. Carnac Textiles, Inc., 45 N.Y.2d 327, 333-34 (1978) (quoting Matter of Acting Supt. Schools of Liverpool Central School Dist. (United Liverpool Faculty Ass'n), 42 N.Y.2d 509, 512 (1977)). See CPLR §7501 (requirement that agreement to arbitrate be in writing); County of Onondaga v. U.S. Sprint Communications Co., 192 A.D.2d 1108, 1109 (4th Dept. 1993) ("generally, the right to compel arbitration does not extend to a nonparty unless the

agreement itself so provides") (emphasis supplied). As the emphasized portion of the above passage from U.S. Sprint Communications suggests, however, this rule is not immutable. The Court of Appeals recognizes that "in certain limited circumstances the need to impute the intent to arbitrate to a nonsignatory" is appropriate. TNS Holdings, Inc. v. MKI Securities Corp., 92 N.Y.2d 335, 339 (1998). In this case, there is a need to impute an intent to arbitrate to defendant.

First, it must be observed that, unlike the submission of existing disputes to arbitration which require a writing signed by the party to be charged, in the context of an agreement to submit future disputes to arbitration, the statutory requirement of a writing does not include as a necessary component a signature. Helen Whiting, Inc. v. Trojan Textile Corp., 307 N.Y. 360, 370-71 (1954) ("while a contract to arbitrate future controversies must be in writing, it need not be signed so long as there is proof that the parties actually agreed on it"); Metropolitan Arts 7 Antiques Pavilion, LTD v. Rogers Marvel Architects, PLLC, 287 A.D.2d 372 (1st Dept. 2001) ("no requirement that a written agreement to arbitrate be signed . . . as long as there is an express, unequivocal agreement to arbitrate"); Getlan v. Josephthal & Co., Inc., 91 A.D.2d 971, 972 (2d Dept. 1983) ("no requirement that an agreement to arbitrate future disputes be signed"); Trafalgar Square, LTD v. Reeves Brothers, Inc., 35

A.D.2d 194, 196-97 (1st Dept. 1970) (CPLR 7501 "does not require that such an agreement be signed by the party to be bound"). Here, there is no question of the existence of a writing, which was subscribed by every person concerned with defendant FLI except the entity itself, and which contained a virtually plenary arbitration provision. The only question is whether the parties, including FLI, agreed to arbitrate future disputes. Crawford V. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 35 N.Y.2d 291, 299 (1974) ("no requirement that the writing be signed 'so long as there is other proof that the parties actually agreed on it'") (quoting Helen Whiting, Inc. v. Trojan Textile Corp., 307 N.Y. at 368).

In Crawford, the plaintiff signed an application for employment at Merrill, Lynch in 1967, which contained a provision by which plaintiff agreed to arbitrate disputes before the New York Stock Exchange. After working for Merrill Lynch for over three years, he left the firm and sued for commissions earned. When confronted by Merrill, Lynch with his signed agreement providing for arbitration of his claims, he asserted that Merrill, Lynch never signed the agreement, and that he was, therefore, entitled to arbitrate before a different tribunal. The Court of Appeals, recognizing that Merrill, Lynch was a nonsignatory, nevertheless held that the matter should be submitted to arbitration at Merrill, Lynch's behest, because the

evidence was that Merrill, Lynch agreed to arbitrate. Id. 35 N.Y.2d at 299-300.

Since Crawford, it has been held, in similar circumstances, that a signatory's effort to avoid an arbitration clause it drafted was "baseless." Rudolph & Beer, LLP v. Roberts, 260 A.D.2d 274, 275 (1st Dept. 1999). The court found an obvious inequity in the signatory's position, in that "plaintiff here seeks to deny defendant the benefit of an arbitration clause in an agreement which defendant did not sign, but which plaintiff always treated as governing the parties' relationship." Id. 260 A.D.2d at 275. The court observed: "Plaintiff's effort to avoid the arbitration clause is particularly disingenuous, in light of the fact that plaintiff is the one whose conduct most clearly shows an intent to be bound by the contract containing this clause." Id. 260 A.D.2d at 276. Similarly, in Ranieri v. Bell Atlantic Mobile, 304 A.D.2d 353 (1st Dept. 2003), the court held "that plaintiff's claim that the non-signatory defendants are not entitled to the benefit of the arbitration provision contained in the Agreements is inconsistent with his claim that they are liable to him under those Agreements for breaches of contract." Id. 304 A.D.2d at 354. That is the precise argument defendant FLI makes in this case, which sounds in equitable estoppel, and which is persuasive. The Crawford line of cases thus requires that defendant's cross-motion be granted.

This result is consistent with what would be ordered under the Federal Arbitration Act. Inasmuch as the federal statute "is almost identical to, and is derived from our own arbitration statute," Matter of Weinrott (Carp), 32 N.Y.2d 190, 198-99 (1973), the Court of Appeals has announced a policy of "consistency" where that can be accomplished without violating either statute. Id. 32 N.Y.2d at 199-200 n.2 ("bothersome to have different rules applied in interstate commerce cases from those applied in intrastate commerce cases") ("it is a rather technical distinction to apply one law or another depending on whether interstate commerce is involved"). This policy of consistency has especial application when it comes to consideration of "commercial matters where reliance, definiteness and predictability are such important goals of the law itself." Matter of Southeast Banking Corporation (Chemical Bank), 93 N.Y.2d 178, 184 (1999). So it is worthwhile to examine whether the result reached here is consistent with the federal cases.

As implicitly acknowledged in CDC Capital Inc. v. Gershon, 282 A.D.2d 217 (1st Dept. 2001), the most complete catalog "of the recognized common-law grounds for enforcing an arbitration agreement against a non-signatory" (id. 82 A.D.2d at 218) appears in Tomson-CSF, S.A. v. American Arbitration Association, 64 F.3d 773, 776-80 (2d Cir. 1995). The exception at issue here, equitable estoppel, is itself separated into two classes of cases

which often are, but should not be, confused. Merrill Lynch Inv. Managers v. Optibase, LTD, 337 F.3d 125, 131-32 (2d Cir. 2003) ("it matters whether the party resisting arbitration is a signatory or not"); E.I. DuPont De Nemours & Co. v. Rhone Poulenc Fiber and Resin Intermediates, S.A.S., 269 F.3d 187, 201-02 (3d Cir. 2001) (the argument that "these cases [which] bind a signatory [but] not a non-signatory to arbitration" involves a "distinction without a difference" is "wrong"). The distinction was recognized in Rudolph & Beer, LLP v. Roberts, 260 A.D.2d at 275 ("it is even clearer that it is unnecessary that it be signed by the party seeking enforcement" of the agreement to arbitrate).

The doctrine of estoppel, as applied to cases like this one, will bind "a signatory . . . to arbitrate with a non-signatory at the non-signatory's insistence because of 'the close relationship between the . . . [protagonists] involved, as well as the relationship of the alleged wrongs to the non-signatory's obligations and duties in the contract . . . and [the fact that] the claims were "intimately founded in and intertwined with the underlying contract obligations.'" " Thomson-CSF, S.A., 64 F.3d at 779 (quoting Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc., 10 F.3d 753, 757 (11th Cir. 1993), cert. denied, 513 U.S. 869 (1994)) (quoting McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342, 344 (7th Cir. 1984)). Thus, courts "are willing to estop a signatory from avoiding arbitration with

a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed." Thomson-CSF, S.A., 64 F.3d at 779 (emphasis in original).

Put another way, equitable estoppel applies (1) "[w]hen each of a signatory's claims against a nonsignatory makes reference to or presumes the existence of the written agreement, the signatory's claims arise out of and relate directly to the written agreement, and arbitration is appropriate," or (2) "when the signatory to the contract containing the arbitration clause raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract." Grigson v. Creative Artists Agency, L.L.C., 210 F.3d 524, 527 (5th Cir. 2000). Both conditions are easily met on the facts of this case. Indeed, plaintiffs make no serious argument that their claims do not presume the existence of the operating agreement, that their claims arise out of and directly implicate that agreement, that arbitration would not otherwise be appropriate, and that they, as signatories, are raising claims of substantially interdependent and concerted misconduct by both the individual Kolbet faction signatories and the LLC itself. Either of the two conditions for application of equitable estoppel quoted above would be enough, yet both apply here.

"In short, although arbitration is a matter of contract and cannot, in general, be required for a matter involving an arbitration agreement non-signatory, a signatory to that agreement cannot, . . . 'have it both ways,'" that is, he "cannot, on the one hand, seek to hold the non-signatory liable pursuant to duties imposed by the agreement, which contains the arbitration provision, but, on the other hand, deny the arbitration's applicability because the defendant is a non-signatory." Id. 210 F.3d at 528 (emphasis in original). See also, JLM Industries, Inc. v. Stolt-Neilson S.A., 387 F.3d 163, 177-78 (2d Cir. 2004) (collecting cases in which the signatory who resists arbitration was estopped by the non-signatory); Choctaw Generation LTD Partnership v. American Home Assurance Co., 271 F.3d 403, 404, 406 (2d Cir. 2001). It matters not that the plaintiff signatory seeks dissolution, if the claims are based, as they are here, on the operating agreement. Dassero v. Edwards, 190 F.Supp.2d 544, 549-50 (W.D.N.Y. 2002) (claim of rescission cannot escape arbitration in this context, because "[i]t would be virtually impossible to litigate or resolve this case without extensive reference to the Agreement"). If "[a] signatory to a contract providing for arbitration may not elude his obligation by masking himself under a corporate identity," Glasser v. Price, 35 A.D.2d 98, 101 (2d Dept. 1970), neither may he elude his obligation to submit to arbitration by masking his opponents in

the suit in a corporate or LLC identity.²

CONCLUSION

Defendant's motion to compel arbitration and for a stay is granted. "[N]o claim is advanced that . . . [defendant] failed to give notice." In re Trump, 303 A.D.2d at 288. See CPLR 7503(c).

Plaintiffs' motion for a preliminary injunction is denied. "CPLR 7502(c) governs provisional remedies in arbitration cases,

² Defendant also relies on a line of cases in New York which follow the rule "that employees or disclosed agents of an entity that is a party to an arbitration agreement are protected by that agreement." Roby v. Corporation of Lloyd's, 996 F.2d 1353, 1360 (2d Cir. 1993), cert. denied, 510 U.S. 945 (1993). See Hirschfeld Productions, Inc. v. Mirvish, 88 N.Y.2d 1054 (1996); In re Trump, 303 A.D.2d 287 (1st Dept. 2003). In these cases, it is held "that the parties fully intended to protect the individual . . . employees or agents of the entity] to the extent they are charged with misconduct within the scope of the agreemen[t]." Roby, 996 F.2d at 1360 (adding: "If it were otherwise, it would be too easy to circumvent the agreements by naming individuals as defendants instead of the entity Agents themselves.") Defendant contends that this case is a "mirror image" of the scenario in these cases, and that therefore they are authority for compelling arbitration here. Because of the disposition above, it is unnecessary to reach this question. No case is cited, nor has one been found, in which this "mirror image" argument was embraced.

Defendant also relies on In re Lane (Abel-Bey), 70 A.D.2d 838 (1st Dept. 1979), aff'd on other gr., 50 N.Y.2d 864 (1980), which held that a close corporation could not resist arbitration when all of the stockholders sign a stockholder's agreement containing a broad arbitration clause. Plaintiff contends that this holding, not embraced by the Court of Appeals, was based on two sections of the Business Corporation Law (§615[b] and §620[a]) that have no counterpart in the LLC Law, which is true enough, but that is quite beside the point. The entity party in Lane resisted arbitration, and here the entity defendant seeks to bind the signatories to the agreement. As set forth above, the distinction makes a difference.

and provides the courts with limited power to 'entertain an application for an order of attachment or for a preliminary injunction in connection with an arbitrable controversy, but only upon the ground that an award to which the applicant may be entitled may be rendered ineffectual without such provisional relief.'" H.I.G. Capital Management, Inc. v. Ligator, 233 A.D.2d 270, 271 (1st Dept. 1996) (quoting CPLR 7502(c)). Plaintiff must show, in addition, "a likelihood of success on the merits, irreparable injury [and] that the equities balance in their favor." Cullman Ventures, Inc. v. Conk, 252 A.D.2d 222, 230 (1st Dept. 1998). Plaintiffs have established that defendant is disbursing large sums to three individual members for services plaintiffs believe can be rendered by others for much less. "The uncontrolled disposal of respondent's assets, which might render an award ineffectual, presents a risk of irreparable harm." Id. But plaintiffs do not establish by that accusation alone that any award they might receive in arbitration would be rendered ineffectual, nor do they "establish that defendants were hiding or dissipating assets." Spatz v. Ridge Lea Associates, LLC, 309 A.D.2d 1248, 1250 (4th Dept. 2003). Plaintiffs concede that the conduct they complain of was fully revealed in the discovery they were given in response to the demand for an accounting. Furthermore, although it is the rule as plaintiffs contend that "preservation of the status quo with respect to the subject

corporation's governance and assets is necessary to assure its orderly dissolution, the relief . . . [plaintiff presumably will] see[k] in arbitration," Matter of Guarini (Severini), 233 A.D.2d 196 (1st Dept. 1996), here plaintiffs allege that they were frozen out "soon" after Kolbet assumed became President in May 2002, over two years before plaintiffs demanded an accounting and filed suit. Accordingly, the motion is denied.

SO ORDERED.

KENNETH R. FISHER
JUSTICE SUPREME COURT

DATED: January 26, 2005
Rochester, New York