SCANNED ON 7/18/2005

[* 1]

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

PRESENT: SHIRLEY WERNER KORNREICH Justice J.S.C. PART 54

0107715/2004

POSTNIEKS, ERIK
VS
BERNER, RICHARD O.

INDEX NO. _____

MOTION DATE _____

SEQ 1

MOTION SEQ. NO. _____

VACATE OR MODIFY AWARD

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 ...	1,2,3,4
Answering Affidavits — Exhibits (x-petition)	5,6,7,8,9,10
Replying Affidavits	11,12,13

+ Transcript & papers annexed.

Cross-Motion: ☒ Yes ☐ No

Upon the foregoing papers, it is ordered that this ~~motion~~ petition & cross-petition is decided in accordance with the annexed decision/order.

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

Dated: 1/7/05

SHIRLEY WERNER KORNREICH J.S.C.

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 54
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In the Matter of the Arbitration of Certain
Controversies Between

ERIK POSTNIEKS, PARAMETRIC CAPITAL
MANAGMENT, LLC and DIVERSIFIED CAPITAL
MANAGEMENT, LTD.,

Petitioners,

DECISION & ORDER
INDEX NO.: 107715/04

-against-

RICHARD O. BERNER, on behalf of the Berners,
and AUNDYR TRUST CO., LTD.,

Respondents.

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SHIRLEY WERNER KORNREICH, J.:

Petitioners Eric Postnieks, Parametric Capital Managment, LLC ("Parametric"), and Diversified Capital Management ("DCM") bring this petition for a judgment, pursuant to CPLR 7511, vacating or modifying the interim and final arbitration awards against it. Respondents Richard O. Berner and Aundyr Trust Co., Ltd. ("Aundyr") cross-petition for a judgment confirming the interim and final awards.

Arbitration Proceeding

A. Background

The arbitration proceeding arose out of five agreements entered into between Postnieks and Berner and various entities controlled by each of them, in connection with investments in

and management of various hedge mutual funds ("Funds"). Those agreements were:

(1) A June 10, 1997 agreement between members of the Berner family ("Berners"), Postnieks and Postnieks Capital Management, LLC ("PCM"), a company through which Postnieks provided investment advisory services to the managers of the Funds, through which the Berners provided capital, introduced qualified investors to Postnieks and permitted the Berner name to be used in connection with the Funds. PCM is described as the owner of certain "Strategies," which are defined to encompass systematically implemented investment strategies, including aspects of Postnieks' mutual fund market timing technique. PCM and Postnieks (and Postnieks-controlled entities) are prohibited from using the Strategies "except for the benefit" of the Berner-controlled funds. Moreover, under paragraphs 12 and 14, Postnieks is prohibited from selling or transferring his interest without the Berners' consent. Postnieks was not permitted to add new members to DCM or PCM, liquidate or close the Funds, require the Berners to withdraw any funds or "make a material change in the nature of the existing business."

(2) A September 1, 1997 agreement between PCM and the Ronald Levinson Trust ("the Founder"), an offshore inter vivos trust in which certain members of the Berner family are primary beneficiaries. That agreement ("Founder's Agreement") provided that the Founder would pay the start-up cost of certain Funds and, in return, would receive a proportion of the fees paid by investors to Postnieks and PCM through a Postnieks-controlled management company, DCM (a tax vehicle through which Postnieks' compensation could be deferred) .

(3) Three agreements by which DCM and Aundyr, as trustee for the Founder, entered into

mirror image agreements with each of three master investment funds, known as Brig, Compass and Scoter ("the DCM/Trust Agreements"). Each of the master funds had a domestic feeder and an offshore feeder. In the case of Brig, the domestic feeder was known as Feniks, and the offshore fund was known as Eon.[1]

The various Agreements were to: (i) provide the Berners a favorable fee rate ("Fee Break"); (ii) exempt the first 10% of the Berners' annual increases in investment returns from performance fees ("Hurdle"); and (iii) provide the Berners with certain types of relevant information in connection with the Funds. In exchange for managing the Funds, Postnieks was to receive management fees, less any sum due to the Berners and Aundyr as their share of management or performance fees paid to Postnieks or his nominee companies; he also received the right to invest in the start-up hedge funds.

Between 1997 and 2000, the Postnieks' business grew from a single domestic hedge fund to ten different funds. The June 10, 1997 Agreement recites that, provided Posnieks is able to comply with certain performance guidelines, the Berners "intend" to commit an average balance of $10 million for a one-year period, to maintain a balance of $7 million for the second year, and $3 million in the third year and thereafter.

After the funds were well established, Postnieks sent notices to the Berners purporting to redeem their interests in Brig, Compass and Scoter as of December 31, 2000. At about the same time, Postnieks notified the Founder that its investments in the Funds were also being redeemed. Postnieks subsequently rescinded these redemption notices. However, thereafter, Postnieks sent

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[1] In this decision, where reference is made to all the agreements, they are referred to as the Agreements.

letters terminating the June 10 Agreement, the Founder's Agreement and the agreements with Brig, Compass and Scoter. After the terminations, the Founder did not receive its contractual proportion of investor fees paid to Postnieks, and neither the Berners nor the Founder received the Fee Break, the benefit of the Hurdle or the information concerning the Funds, which was required under the Agreements.

Respondents subsequently served a Demand For Arbitration, claiming that the terminations constituted a breach of contract. The case was heard by a panel of three arbitrators -- Walter Schackman, Richard Mattiaccio and John Wilkinson, the chairman.

B. Arbitration Proceedings

During the course of the arbitration proceedings, petitioners were represented by three different counsel. Central to this action is his second counsel, Michael Lacher and his law firm, Lacher & Lovell-Taylor. Lacher resigned in the midst of arbitration as a result of a fee dispute. After Lacher resigned, the Panel convened on June 9, 2003 and directed Lacher to attend. Lacher neither responded nor attended further hearings. However, Postnieks wrote an ex parte letter to the Panel, requesting a brief adjournment to retain new counsel. He disclosed the basis for his dispute with Lacher. Subsequently, Postnieks appeared at the hearing accompanied by Robert Sentner of Nixon Peabody LLP. Mr. Sentner stated that he was not representing Postnieks on the merits but was present to insure that Postnieks, PCM and DCM had a fair opportunity to obtain counsel for the remainder of the proceeding. With Sentner at his side, Postnieks asserted to the Panel that, due to what he described as abusive billing by Lacher, he could not proceed with Lacher as counsel. Sentner asked for an ex parte conference with the Panel, excluding claimants.

On this hearing date, David Harris, a director of Aundyr, had flown in from the Isle of

Man and was due to testify. The Panel gave Postnieks several options -- he could pay Lacher's disputed bill and proceed with Lacher as counsel, he could proceed "pro se" with Sentner at his side, or he could proceed with new counsel. The panel also told Postnieks that he could pay $15,000, costs, and postpone Harris' testimony. Postnieks chose to proceed.

Postnieks maintains that the arbitrators improperly discussed the Lacher matter with him and improperly urged him to "make a deal" with Lacher for payment of $43,000 of the disputed bills. He also contends that the Chairman of the Panel improperly inquired of him as to whether he would be willing to pay the Berners and/or Founder the sum of $15,000 to compensate them for the adjournment. This very same motion was made to the Panel, and the Panel denied the motion which requested a new hearing. The Panel pointed out that the discussion with Postnieks was at Sentner's request, that Sentner, his attorney, was present, that nothing privileged was revealed, that what was revealed was done so by a letter written to the Panel by Postnieks and that Postnieks agreed to the taking of Harris' testimony.

On June 11, 2003, Engel & McCarney entered an appearance for Postnieks, PCM and DCM in the arbitration. By that time, the arbitration hearings were rescheduled for various dates in July 2003. Engel told the Panel that he anticipated an application to adjourn some or all of the July dates. Nonetheless, Engel agreed to permit the Berners' damages expert, David Williams, to testify on direct. The Panel adjourned cross-examination and cancelled the remainder of the week's testimony, going over to July 17.

The motion for a new hearing was made and denied on July 17, 2003, and an adjournment into October was also denied. The Panel pointed out that the case would be two years old by that time and that most of the delay was attributable to defendants. The Panel,

however, gave Engel six days to prepare for Postnieks' cross-examination and ordered Postnieks to appear the following week to conclude his testimony.

On July 23, the hearing continued with testimony of Postnieks, and the deposition testimony of the president and director of DCM, which was introduced into evidence. Claimants, then, rested. Finally, on August 28, defendants presented their case and rested. They chose not to recall Harris or Williams. Trial briefs were subsequently submitted in November, and the case decided in a lengthy 40 page opinion.

C. Arbitrators' Findings

The major issue in the arbitration was whether defendants had the right to terminate the Agreements in December 2000. PCM and Postnieks argued that, since there was no duration or termination provision in either of the Agreements, the Agreements were either terminable at will or terminable after a "reasonable" period of time. They characterized the relationship between claimants and defendants as one of employer-employee. Claimants, on the other hand, argued that the termination here violated three specific contractual provisions and that the relationship between the parties was a joint venture.

In January 2004, the arbitrators issued an Interim Partial Arbitration Award, which determined that the Agreements were not terminable at will. The arbitrators looked to paragraph 27 of the June 10 Agreement, which provided :

> Anything to the contrary notwithstanding, if the minimum acceptable returns to Postnieks as set forth in Exhibit H are not met, Postnieks should have the right to offer his interest in PCM to the Berners for one times (sic) the last full fiscal years' incentive compensation to PCM. If the Berners do not accept this offer within 45 days, then Postnieks shall have the right to liquidate Feniks, Eon, Brig or PCM without Berners consent (sic). If the

> Berners do accept the offer, Postnieks shall turn over to them everything he has that they will need to operate these entities and he will educate them in the use of the models and operation of these entities. In either event, thereafter, Postnieks shall have no obligation hereunder and this agreement shall become null and void except that in the event the Berners accept his offer, Postnieks shall keep the Strategies confidential.

The arbitrators also looked to Section 4 of the Founders' Agreement, which gave PCM and Postnieks the right to offer to sell PCM to the Founder in the event that PCM and Postnieks did not achieve the minimum acceptable returns as defined in Exhibit D of the Founders' Agreement.[2]

The arbitrators concluded that paragraph 27 of the June 10 Agreement and Paragraph 4 of the Founder's Agreement, which sets forth the circumstances under which Postnieks and PCM may terminate involvement in the venture with the Berners or the Founder, would be superfluous if Postnieks had an unlimited right to terminate the Agreements at any time. The arbitrators also noted that paragraph 19 of the June 10 Agreement and paragraph 14(a) of the Founder's Agreement provided that the parties would be entitled to an injunction to prevent breaches of the Agreement. Moreover, the arbitrators noted that paragraph 14 of the June 10 Agreement and paragraph 15 of the Founder's Agreement required Postnieks and PCM to obtain the Berners' or Founder's consent before implementing certain changes in the nature of Postnieks' business, including the sale or transfer of Postnieks' interest in PCM, the admission of any new members to PCM, or any other "material change in the nature of the existing business." The arbitrators found that the termination of two of the agreements on which the business was founded, would constitute a "material change in the nature of the existing business."

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[2] Defendants had made more than $40 million during the three year relationship.

The arbitrators further noted that the Agreements permitted Postnieks to terminate under certain circumstances, i.e., the failure to achieve "minimum acceptable returns." The arbitrators construed this to mean that Postnieks and PCM could not terminate the Agreement unless there was a failure to achieve the "minimum acceptable returns." It is undisputed that the Funds were earning many times the minimum acceptable returns for Postnieks and PCM.

In addition, the arbitrators found that Postnieks was not an employee, but rather a business collaborator. They supported their determination with Postnieks' past statements: Postnieks, on several occasions during the hearings, acknowledged the Founder as having a "stake in my business"; Postnieks wrote in a November 11, 1997 memorandum that "we structured the Berner-Postnieks agreement to give the [Berner] family a 20-30% stake in the business to align our incentives and avoid parochial distractions"; in a February 9, 1997 e-mail, Postnieks wrote to Berner that "the Founder will make about $1 million this year in fee rebates and from their stake in my business." Similarly, the arbitrators rejected Postnieks' argument that the Agreements contained restrictive covenants which were unenforceable as a matter of public policy. They, instead, found that the Berners were not seeking to enforce a post-employment, non-compete clause but were simply attempting to hold Postnieks and PCM to the terms of the Agreements, which manifested a collaboration.

Postnieks, additionally, argued that the June 10 Agreement, providing that the Berners "intended" to commit a specified investment, was not a binding commitment. However, the arbitrators found that the "intend to commit" language was taken from a May 30, 1997 Memorandum of Understanding between Berner and Postnieks, that the language was not changed, and that the Berners had actually made the "intended" investments. Also, in answer to

Postnieks' claim that the contract lacked mutuality on the Berners' side, the arbitrators pointed out that the Berners had always met the minimum investment levels. The arbitrators ruled that the June 10 Agreement was an offer for a unilateral contract which the Berners had accepted by performance.

Finally, Postnieks contended that the Founders failed in their obligation under the Founder's Agreement to pay up to $30,000 in organizational fees and, therefore, sought rescission of the Founder's Agreement. In response, the arbitrators pointed to testimony from Richard Berner to the effect that the Founder had paid the organizational expenses, that Thomas Davis (president of DCM) acknowledged that there was never an amount due from the Founder and unpaid, and that Postnieks wrote an e-mail stating that "as either Tom or Richard will tell you, the Trusts paid the upfront legal costs of the structures in exchange for a revenue stream for the remainder of the Postnieks-Berner relationship."

D. Damages

The arbitrators then turned to damages. One aspect was the "cover" damages, arising out of the amounts that the Berners withdrew after the Postnieks' attempted termination of the Agreements in December 2000. Upon receipt of these funds, the Berners placed a portion of them in investments during the period of December 31, 2000 through June 30, 2002; some of these funds performed less well than the PCM-advised funds. The cover damages consisted of this performance differential. The arbitrators found that the Berners' attempt to cover was reasonable, and that there was no credible evidence that the Berners were motivated by anything other than self-interest in obtaining maximum performance from comparable investments. Accordingly, the Panel awarded the Berners $526,357 in cover damages.

The largest single portion of the arbitration award involved the Grindelwald Fund, a Postnieks fund advised by PCM and managed by Gotthard Management Ltd. ("Gotthard"). Gotthard committed money to insurance policies whose funds were then invested in Grindelwald. The Panel found that, without PCM to advise the Grindelwald Fund, it had to be shut down and approximately $46 million had to be placed under different management. The Panel awarded the Berners $5,222,176 by reason of PCM's termination of an agreement to provide advisory services to Grindelwald.

Ultimately, in the Interim Final Award, the Panel awarded the Berners the total sum of $6,793,091, plus interest, as against Postnieks, PCM and DCM and awarded the Founder $4,649,446, plus interest, as against Postnieks, PCM and DCM. The Final Award added $1,497,000 in costs and attorneys' fees, plus the administrative fees of the American Arbitration Association and the fees of the arbitrators themselves.

Conclusions of Law

A. Conduct of Panel

Postnieks moves to vacate the arbitration award, contending the arbitrators engaged in misconduct. CPLR 7511 (court may vacate arbitration where arbitrators engaged in misconduct). This Court finds that there was nothing improper in the arbitrators' discussions with Postnieks regarding his conflict with Lacher. As remarked by the Panel, Postnieks, attended by counsel, requested the discussion, and any matter discussed, if possibly privileged, was revealed voluntarily and with counsel present. Moreover, the existence of ex parte communications might be ground for vacatur of the award had such communications been between the arbitrators and the Berners (see Goldfinger v. Lisker, 68 N.Y.2d 225 [1986]), but in the instant case, the

communications were with Postnieks himself.

CPLR 7506 (d) provides a party the right to be represented by counsel and prohibits compelled waiver of counsel. Alexander, Practice Commentaries, McKinney's Cons. Laws of N.Y. Book 7B, CPLR C7506:4. Postnieks contends that the Panel should have given him, PCM and DCM more time to prepare the case, in light of the situation with Lacher. It is clear that Postnieks, PCM and DCM encountered difficulties during the arbitration as a result of their representation, and then virtual desertion, by their attorney Michael Lacher and his law firm, Lacher & Lovell-Taylor. Nonetheless, the Panel acted reasonably in terms of adjournments and scheduling. Whale Securities Co. v. Godfrey, 271 A.D.2d 226 (1st Dept 2000), lv. denied 96 N.Y.2d 729 (2001)(decision as to whether to grant or refuse adjournment within discretion of arbitrators).

Although Postnieks was represented only by Sentner, who was not there to represent him on the merits, when David Harris was examined, he was given the opportunity to adjourn the proceeding by paying costs. He declined to do so and, with Sentner present, voluntarily agreed to go forward with the direct testimony of Harris. Further, he was later offered the opportunity to recall Harris and decided not to do so. In addition, although Engel's request to adjourn Williams' direct testimony was denied, the Panel gave Engel several weeks to prepare for cross-examination of Williams. Likewise, it granted Engel a six day adjournment to prepare for Postnieks' cross-examination. Consequently, this Court finds that the scheduling of the case by the arbitrators did not constitute a violation of law. In light of the above, the Court rejects the contention that the award should be vacated by reason of arbitrator misconduct.

B. Vacatur

In terms of the merits, since the case affects interstate commerce, the Federal Arbitration Act ("FAA") governs. 9 U.S.C. §§1 et seq.; Wien & Malkin LLP v. Helmsley-Spear, Inc., ___ A.D.2d ____, 783 N.Y.S.2d 339, 340 (1st Dept 2004)(FAA applies to any transaction affecting commerce). The FAA, which strongly favors arbitration, provides for only limited judicial review of arbitration awards. Sawtelle v. Waddell & Reed, Inc., 304 A.D.2d 103, 108 (1st Dept. 2003). To avoid summary confirmation of an arbitration award, the party seeking vacatur bears the burden of proof and the showing required "is high." Id. Accord Roffler v. Spear, Leeds & Kellogg, ___ A.D.2d ___, 2004 N.Y. App. Div. LEXIS 15635 (1st Dept. 2004).

Under the FAA, an arbitration award may be vacated either on grounds set forth in the statute (inapplicable here) or on judicially recognized grounds such as irrationality, manifest disregard for applicable law or public policy concerns. Wien & Malkin LLP, supra at 343; Sawtelle, supra. See United Federation of Teacher v. Bd. Of Ed., 1 N.Y.3d 72, 79 (2003)(arbitration award may be vacated on three narrow grounds – it is irrational, violates public policy or exceeds limitation on arbitrator's power). To find manifest disregard for the applicable law, the record must demonstrate 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 LLP, id. at 343-4; Morgan Stanley DW, Inc. v. Afridi, ___ A.D.2d ____, 2004 N.Y. App.Div. LEXIS 15485 (1st Dept.)(manifest disregard applies only where arbitrator knew of legal principle, appreciated that principle controlled and nonetheless flouted governing law by refusing to apply it); Sawtelle, supra. This standard requires more than a mere mistake of law or an error in fact finding. Wien & Malkin LLP, id. at 343; Goldman v. Architectural Iron Co., 306 F3d 1214 (2d Cir 2002). " 'If

there is "even a barely colorable justification for the outcome reached," the court must confirm the arbitration award' " [citations omitted]. Sawtelle, supra. See N.Y.S. Correctional Officers & Police Benevolent Assoc., Inc. v. State, 94 N.Y.2d 321, 326 (1999)(court cannot examine merits of arbitration award and substitute its judgment for that of arbitrator simply because it believes its interpretation better); Roffler v. Spear, Leeds & Kellogg, supra(manifest disregard doctrine limited to exceedingly rare instances where arbitrators commit egregious impropriety).

Here, petitioners have failed to carry their burden of proving manifest disregard of the law by the arbitration panel. The arbitrators made clear findings of fact and substantiated them by citing to New York law. The panel ignored no explicit, governing legal principle. Rather, petitioners argue that the panel mistakenly applied the applicable case. This is not sufficient ground to vacate the arbitration award. See Wien & Malkin LLP, supra; Sawtelle, supra; Goldman v. Architectural Iron Co., supra.

Nor is the award irrational or in contravention of public policy. The forty page opinion of the arbitration panel extensively cited to the record – thirty volumes of exhibits and thirteen days of testimony – and case law in support of its decision. The Court does not find this thought-out decision, based on the extensive record and case law, irrational.

Similarly, the Court of Appeals in N.Y.C. Transit Auth. v. Transp. Workers Union of Am., 99 N.Y.2d 1, 6-7 (2002), has remarked on New York's policy favoring arbitration, "discouraging judicial interference with either the process or its outcome" and the narrowness of the public policy exception invoking judicial intervention. The Court articulated the public policy exception as applying in:

> "cases in which public policy considerations, embodied in

> statute or decisional law, prohibit, *in an absolute sense*, particular matters being decided or certain relief being granted by an arbitrator. Stated another way, the courts must be able to examine an arbitration agreement or an award *on its face* without engaging in extended factfinding or legal analysis, and conclude that public policy precludes its enforcement. [citation omitted].

Id. at 7.

The public policy considerations invoked here by defendants are the claimed "rewriting" of the parties' agreements and the contention that the Panel determined that Postnieks could not terminate his employment contracts with claimants. The Panel, however, based its decision on specific clauses of the parties' agreements, testimony of the parties as to their intent in contracting and its finding that the relationship between the parties was a joint venture. New York's decisional law does not "prohibit, *in an absolute sense*," represented parties from negotiating and executing business agreements with restrictive termination clauses. Public policy does not require vacatur here. Accordingly, it is

ORDERED that petitioners' application to vacate the arbitration award is denied; and it is further

ORDERED that respondents' cross-petition to confirm the arbitration awards is granted; and it is further

ORDERED that respondents are to settle order.

DATED: January 7, 2005

SHIRLEY WERNER KORNREICH, J.S.C.