Kennilworth Partners L.P. v Bear Stearns Sec. Corp.
2005 NY Slip Op 30602(U)
January 14, 2005
Supreme Court, New York County
Docket Number: 107469/04
Judge: Marilyn Shafer
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 36

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KENNILWORTH PARTNERS L.P. and
KENNILWORTH PARTNERS II L.P.,

Petitioners

-against-

Index No.

BEAR STEARNS SECURITIES CORPORATION and
BEAR STEARNS & CO. INC.,

107469/04

Respondents.

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FILED
JAN 21 2005
COUNTY CLERK'S OFFICE
NEW YORK

MARILYN SHAFER, J. :

Petitioners move to vacate the award entered in the arbitration between petitioners and respondents. Respondents cross-move to confirm the award.

The issue concerns whether to confirm or vacate an award that was entered on February 17, 2004 in an arbitration proceeding of the National Association of Securities Dealers, Inc. (NASD), entitled In the Matter of the Arbitration between Kennilworth Partners L.P. and Kennilworth Partners II L.P, Claimants, and Bear Stearns Securities Corporation and Bear, Stearns & Co. Inc., Respondents, NASD Case No. 00-01232.

Petitioners (hereinafter called Kennilworth) were a securities trading hedge fund that principally traded convertible bonds and options on stocks. Between August 1997 and December 1999, Kennilworth entered into transactions with two separate units of respondent Bear Stearns. Bear Stearns Securities Corporation (BSSC) provided margin loans to Kennilworth to finance Kennilworth's purchase of securities and Bear Stearns & Co., Inc. (BSC) bought and sold options with Kennilworth.

The loans from BSSC to Kennilworth were governed by a Professional Account

Agreement that Kennilworth signed. The Agreement specified that BSSC's loans to Kennilworth were demand loans. Paragraph 20 of the Agreement provided that "[I]f any time Bear Stearns, in its sole discretion, deems it necessary for its protection, whether with or without prior demand, call or notice, Bear Stearns shall be entitled to exercise all rights and remedies," including the right to sell Kennilworth's securities. If Bear Stearns determined in its sole discretion that (i) the account had fallen" below the Bear Stearns Net Equity Requirements," or that (ii) "a maintenance margin call may be required,..." or that (iii) it faced "an unacceptable risk," then BSSC could cease to act as Kennilworth's prime broker or require Kennilworth to unwind all positions or transfer them to another firm.

Kennilworth sold 28 over the counter (OTC) option agreements to BSC. Under the express terms of each option agreement, Kennilworth had to deliver to and maintain with BSC collateral in the form of specific bonds. The option agreements incorporated requirements that any amendments must be made in writing.

According to Kennilworth, the parties realized that Kennilworth's bonds were not being margined. In November 1997, they moved the collateral from the BSC account to its clearing account with BSSC where the bonds were to be margined like all of Kennilworth's other bonds which were hedged by listed options. This constituted an amendment to the option agreements.

Kennilworth contends that on October 2, 1998, after the last of the 28 OTC agreements were executed, BSC directed BSSC to freeze $14.4 million of capital in Kennilworth's account. The freeze allegedly was a violation of the OTC agreements. Kennilworth was put in a margin deficit because of the freeze. Said deficit continued until October 22nd and Kennilworth sold off $205 million in bonds and related hedging securities.

Respondents deny that BSC directed BSSC to freeze $14.4 million of Kennilworth's capital. Up to October 1988, there was a collapse in the global bond market and Kennilworth was vulnerable. By October 9, 1988, Kennilworth's account lost more than $50 million, or 60 percent of its equity. Respondents contend that Kennilworth did not reduce the risk in its account. When Kennilworth failed to reduce risk or bring in new capital, BSSC issued a risk call. It called for Kennilworth to liquidate roughly $325 million of its bond positions. BSC asked for $14.4 million in collateral.

Respondents contend that for more than a year after the risk call, Kennilworth continued to trade with them. It was after Kennilworth liquidated all of its positions, in December 1999, that it decided to begin the arbitration against respondents.

The claims made against respondents included breach of contract, breach of the covenant of good faith and fair dealing and breach of fiduciary duty. Kennilworth sought lost profits, consequential damages and punitive damages. The panel of arbitrators conducted 59 hearing sessions and heard testimony from 18 witnesses. The sessions lasted almost 30 days.

After considering the pleadings, the testimony and the evidence presented, the panel unanimously issued an award denying Kennilworth's claims in their entirety. Kennilworth seeks a vacatur of the award, claiming that the award is in manifest disregard of the law and is irrational, and that a new arbitration should be held.

Kennilworth argues that the panel failed to acknowledge that the option agreements were orally modified. It maintains that even though the agreements required amendments to be in writing and contained anti-waiver clauses, the partial performance of the parties would validate an oral modification. Kennilworth also argues that by allowing it to transfer the bond collateral

to the BSSC account, respondents were estopped from enforcing the bar on oral modifications in the option agreements. According to Kennilworth, the arbitration panel failed to pick up on New York law when it came to exceptions to bars on oral modifications in contracts.

In opposition, respondents argue that Kennilworth did not mention an oral modification until after the arbitration hearings began, that the Master Agreement, which is incorporated in the option agreements bars any oral modification of those agreements, and that BSSC was not alleged to have been a party to the alleged oral modification. Respondents deny the establishment of an estoppel or justifiable reliance on the part of Kennilworth.

The court may vacate an arbitration award when it violates a strong public policy, is irrational, or clearly exceeds a specifically enumerated limitation of an arbitrator's statutory power. N.Y. State Correctional Officers and Police Benev. Ass'n, Inc. v State, 94 NY2d 321 (1999). The party seeking to vacate an award bears the burden of proving misconduct on the part of arbitrators by clear and convincing evidence. Janus v N.Y. State Div. Of Housing and Community Renewal, 271 AD2d 878 (3rd Dept 2000). Specifically, unless an award is completely irrational, the arbitrator is free to fashion an award without judicial interference. See Sweeney v Herman Management, Inc., 85 AD2d 34 (1st Dept 1982).

The court does not find the fact that the panel apparently found respondents' arguments more persuasive than Kennilworth's to be so irrational as to grant a vacatur of the award. Even in circumstances where an arbitrator makes errors of law or fact, courts will not assume the role of overseers to conform the award to their sense of justice. See Matter of United Federation of Teachers v Bd of Educ., 1 NY3d 72 (2003). Moreover, the panel did not have to issue a written opinion setting forth the reasons for the award. Arbitrators are under no

requirement to make detailed factual findings or specify formula relied upon to reach their conclusions. RRN Associates, Inc. v DAK Elec. Contracting Corp., 224 AD2d 250 (1st Dept 1996). The award was based upon all the relevant facts and law that was provided by the parties.

Accordingly, it is

ORDERED that the petition to vacate the award is denied; and it is further

ORDERED that the cross-petition to confirm the award is granted.

DATED: 1/14/05

ENTER:

J.S.C.

HON. MARILYN SHAFER, JSC

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JAN 21 2005
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