

Scott-Dunne v Stewart
2007 NY Slip Op 30168(U)
March 12, 2007
Supreme Court, New County
Docket Number: 0107245
Judge: Joan A. Madden
Republished from New York State Unified Court System's E-Courts Service. Search E-Courts (http://www.nycourts.gov/ecourts) for any additional information on this case.
This opinion is uncorrected and not selected for official publication.

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

PRESENT: How Joan A. m. davis
Justice

PART 11

Ian Scott-Dunne

INDEX NO.

107245/06

MOTION DATE

1-18-07

MOTION SEQ. NO.

MOTION CAL. NO.

Joseph T J Stewart

- v -

The following papers, numbered 1 to _____ were read on this ^{application} motion to/for stay or bit

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~~ ^{application} is decided in accordance with the ~~concerned~~ ^{concerned} Memorandum, Decision, order + Judgment.

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 41B).

Dated: March 12, 2007

[Signature]
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
COUNTY OF NEW YORK: PART 11

-----X
IAN SCOTT-DUNNE,

Index No. 107245/06

-against-

JOSEPH T.J. STEWART,

Respondent.
-----X

JOAN A. MADDEN, J.:

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 41B).

Petitioner Ian Scott-Dunne (“Scott-Dunne”) moves, by order to show cause, for an order pursuant to CPLR 7503(b) permanently staying an arbitration proceeding commenced by respondent Joseph T.J. Stewart (“Stewart”) before the National Association of Securities Dealers, Inc. (“NASD”) on the grounds that (i) he did not agree to arbitrate and is not subject to arbitration under the NASD Code of Arbitration and Procedures, and (ii) the arbitrators do not have jurisdiction over claims decided against public policy. Scott-Dunne also seeks sanctions against Stewart for improperly joining him in the arbitration. Stewart opposes the petition, which is granted to the extent of permanently staying the arbitration against Scott-Dunne.

Background

Scott-Dunne is the majority owner, President and CEO of Stellar Financial, Inc., which provides software and other services to non-profit organizations, donor advised fund programs and charitable endowment programs. Stellar Financial is not a broker-dealer and is not registered with the NASD. Scott-Dunne is not registered with the NASD. Stellar Financial is a wholly-owned subsidiary of Stellar-McKim, LLC, which is a holding company. McKim Capital

("McKim"), which is a broker/dealer registered with the NASD, is also a wholly owned subsidiary of Stellar-McKim.¹ Scott-Dunne is a managing member of Stellar-McKim and owns a 31.4% interest in Stellar-McKim. At issue here is whether any relationship between Scott-Dunne and/or Stellar Financial and McKim is sufficient to provide a basis for requiring Scott-Dunne to submit to arbitration before the NASD.

Stewart began working at McKim's offices in Denver, Colorado in January 2004. According to the affidavit of McKim's Chief Compliance Officer, Jordan L. Loewer, Stewart's "duties at that time were to support the Denver Office by assisting with various operational duties," and that "beginning in September 2004, respondent began receiving a salary from Stellar Financial...." At the end of 2004, Stewart became registered with the NASD. After a dispute arose regarding the payment of commission to Stewart, Stewart was informed in October 2005, that his services were no longer needed at McKim's offices in Denver. While Stewart alleges that he was constructively terminated from employment at that time, Scott-Dunne and the principals of McKim maintain that Stewart's employment ended in December 2005, after Stewart refused an offer to relocate him to Stellar Financial's offices in Stroudsburg, Pennsylvania.

On January 26, 2006, Stewart filed a proceeding before the NASD against McKim and McKim's principals, James J. Cahill and Robert Taggart, seeking to recover damages arising out of McKim's alleged wrongful failure to pay him \$343,000 in commissions.

In March 2006, McKim filed a Uniform Termination Notice for Securities Industry Registration ("U-5") form in which it was stated that at the time of his termination Stewart was

¹Stellar-McKim is also the parent company of Stellar Advisors, which is a registered investment advisor.

under “internal review ...regarding [his] undisclosed trading of firm’s client company’s at outside broker/dealer against firm and regulatory policy and rule.”

On or about May 9, 2006, Stewart served a second amended statement of claim² alleging that the U-5 form contained false and defamatory statements and was filed in retaliation for his commencing an arbitration proceeding against McKim and its principals. The amended statement of claim added Scott-Dunne as a respondent and alleged that “U-5 was filed, upon information and belief, at the direction and with approval of the principals of McKim and its parent and affiliated companies,” and that “fines should be assessed against Taggart, Cahill, Scott-Dunne....”

Proceeding To Stay Arbitration

On May 30, 2006, Scott-Dunne commenced this proceeding seeking to stay the arbitration as to him, on the grounds that he is not subject to arbitration, and that statements in the U-5 form are absolutely privileged as a matter of public policy so that their alleged falsity cannot be arbitrated. Scott-Dunne also argued that as there is no basis for asserting claims against him in arbitration, sanctions and attorneys’ fees should be assessed against Stewart and his counsel.

By letter dated July 24, 2006, attorneys for Stewart sought to stay this proceeding so that limited discovery could be sought in the NASD arbitration regarding the propriety of Scott-Dunne’s joinder in the arbitration. Scott-Dunne objected to the stay. By interim order dated July 27, 2006, this court granted Stewart’s request for a stay “to the extent of permitting any submissions after completion of discovery in the arbitration,” denied Scott-Dunne’s request for

²It is unclear from the record whether a first amended statement of claim was filed.

sanctions, and provided a briefing schedule for submission of papers following discovery. The parties subsequently conducted discovery and made submissions based on such discovery.

There is no dispute that Scott-Dunne did not sign an agreement to arbitrate. Thus, the threshold issue in this proceeding is whether Scott-Dunne is required to arbitrate based on the NASD Code of Arbitration and Procedure and its By-Laws.

Rule 10101 of the NASD Code of Arbitration and Procedure provides, in relevant part:

10101. Matters Eligible for Submission

This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(iv) of the By-Laws of the Association for the arbitration of any dispute, claim or controversy arising out of or in connection with the business of any member of the Association, or arising out of the employment or termination of employment of associated person(s) with any member...

- (a) between or among members;
- (b) between or among members and associated persons;
- (c) between or among members or associated persons and public customers, or others....

Rule 10201(a) of the NASD Code of Arbitration and Procedure provides, in relevant part:

10201. Required Submission

(a)...a dispute, claim or controversy eligible for submission under the Rule 10100 Series between or among members and/or associated persons, and/or certain others, arising in connection with the business of such member(s) or in connection with the activities of such associated persons(s), or arising out of the employment or termination of employment of such associated person(s) with such member, shall be arbitrated under this Code, at the instance of:

- (1) a member against another member;
- (2) a member against a person associated with a member or a person associated with a member against a member; and
- (3) a person associated with a member against a person associated with a member.

Article I of the By-Laws of the NASD define an associated person as:

(dd) “person associated with a member” or “associated person of a member” means: (1) a natural person who is registered or has applied for registration under the Rules of Association; (2) a sole proprietor, partner, officer, director or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural persons engaged in investment banking or securities business who is directly or indirectly controlling or controlled by a member.

The verified petition alleges that Scott-Dunne is not obligated to arbitrate the dispute with Stewart under these provisions as Scott-Dunne is not an “associated person” of a member and in particular, McKim, and that Scott-Dunne has never been registered with the NASD. It is further alleged that while Scott-Dunne is the President and CEO of Stellar Financial, Stellar Financial is not a member of the NASD, and neither Scott-Dunne nor Stellar Financial is engaged in investment banking or the securities business. Moreover, it alleged that Scott-Dunne is not a controlling member of Stellar-McKim and exercises no control either directly or indirectly over McKim or its business. It is also alleged that Stellar Financial exercises no control, directly or indirectly, over McKim.

In opposition to the petition, Stewart argues that based on the discovery obtained in the NASD proceeding, including Scott-Dunne’s deposition testimony, that Scott-Dunne is required to arbitrate as “an associated person” as defined under Article I of the NASD By-Laws. Stewart also asserts that Stellar Financial and/or Stellar-McKim, acting through Scott-Dunne personally, so dominates and controls McKim, that the corporate veil should be pierced to require Scott-Dunne to arbitrate based on McKim’s status as an NASD member. Alternatively, Stewart argues that the issue of whether Scott-Dunne is amenable to arbitration should be

decided by the arbitrator.

In his supplemental reply, Scott-Dunne asserts that contrary to Stewart's characterization, the evidence does not provide a basis for finding that Scott-Dunne controlled McKim or engaged in investment banking such that he is a "person associated with a member," or that McKim is dominated or controlled by Scott-Dunne or Stellar Financial or Stellar McKim such that the corporate veil should be pierced. In support of his position, Scott-Dunne relies on his own affidavit and those of McKim's Chief Compliance Officer, Jordan L. Loewer, and McKim's managing member James Cahill.

Discussion

On this petition to stay arbitration, the initial inquiry for the court is whether there was an agreement to arbitrate. CPLR 7503; TNS Holdings, Inc. v MKI Sec. Corp., 92 NY2d 335, 339 (1998); Smith Barney Shearson, Inc. v Sacharow, 91 NY2d 39, 45 (1997). As arbitration is contractual by nature, a party cannot be required to arbitrate any dispute that he has not agreed to arbitrate. Waldron v Goddess, 61 NY2d 181, 183 (1984); see also, Thomson-CSF, S.A. v American Arbitration Ass'n., 64 F3d 773, 776 (2d Cir 1995); Clarendon Natl. Ins. Co. v Lan, 152 F Supp2d 506, 519 (SD NY 2001). An agreement to arbitrate must be clear, explicit, and unequivocal and must not depend upon implication or subtlety. Waldron v Goddess, 61 NY2d at 183-184; The Harriman Group, Inc. v. Napolitano, 213 AD2d 159, 163 (1st Dept 1995).

The first issue to be addressed concerns whether Scott-Dunne is person associated with McKim, such that he would be required to arbitrate under the relevant NASD provisions. Stewart contends that under the NASD By-Laws, Scott-Dunne is an "associated person" as the record shows that Scott-Dunne controls McKim both directly and indirectly, and that Scott-Dunne

“engaged in investment banking” by arranging a bridge loan with Vantage Funds, a mutual fund, for Kortec, Inc., a company for which McKim was raising capital in an investment banking transaction.

In support of its argument that Scott-Dunne controls McKim, Stewart relies on a BD Form which discloses that Scott-Dunne as an indirect owner of McKim based on his ownership interest in Stellar-McKim, his position as a managing member of Stellar-McKim and a statement in Loewer’s affidavit that Scott-Dunne was required to write a letter to the NASD to verify that he was not involved in the investment banking business. It also points to Scott-Dunne’s deposition testimony that McKim was established to perform investment banking deals for Stellar Financial, that Stellar-McKim and Stellar Financial paid McKim’s debts,³ and that while Stewart was employed by Stellar Financial he performed work at McKim’s offices.

Although the evidence relied on by Stewart demonstrates the existence of a mutually beneficial business relationship among Stellar Financial and McKim, as affiliated companies, and their parent Stellar-McKim, such evidence does not establish Scott-Dunne’s control over McKim. Notably, while the BD Form discloses Scott-Dunne’s ownership interest in McKim’s parent, Stellar-McKim, it also discloses that Scott-Dunne is not a controlling person at McKim. Furthermore, it has been held that a non-member will not be required to arbitrate based solely on its corporate affiliation with an NASD member or an ownership interest in a member. See CDC Capital Inc. v. Gershon, 282 AD2d 217 (1st Dept 2001)(staying arbitration as to entities which are not members of the NASD despite their corporate affiliation with a NASD member); Cantor-

³Although Stewart argues that Stellar Financial paid the debts of McKim, the only evidence of this payment is Scott-Dunne’s testimony that it might have been true “in the early days.”

Fitzgerald, L.P. v. Prebon Securities (USA), Inc., 731 A2d 823 (Del. Ch. 1999)(limited partnership not required to submit claims to NASD arbitration based on its 99.5% ownership interest of a general partnership that was an NASD member) .

Furthermore, while Scott-Dunne testified that McKim was not profitable in 2005 and that its debts were paid by Stellar-McKim, in his affidavit, McKim's President, James Cahill, states that this testimony is incorrect as McKim realized a small profit in 2005, and in support of this statement, submits McKim's audited financial statement for 2005. In any event, even if Stellar-McKim and/or Stellar-Financial had paid the debts of McKim, this fact is insufficient to establish Scott-Dunne's control over McKim, particularly given the absence of any evidence that Scott-Dunne used his personal funds to pay McKim's debts or intermingled his money with that of Stellar-Financial, McKim, or Stellar-McKim. See American Fuel Corp. v Utah Energy Development Co., Inc., 122 F3d 130 (2d Cir 1997)(holding that evidence was insufficient to show President of corporation dominated or controlled the corporation where there was no evidence that the President used the corporation's funds for personal matters or intermingled corporate funds with his own).

In addition, nothing in the record establishes that Scott-Dunne or Stellar Financial were engaged in the investment banking or securities business. First, Scott-Dunne wrote a letter to the NASD stating that he did not engage in either such activity as managing member of McKim's parent. Second, evidence that Scott-Dunne arranged for a bridge loan to obtained by Kortec through a third party, Vantage Funds, to use in its deal with McKim does not require a conclusion to the contrary. Notably, while arranging the bridge loan facilitated an investment banking transaction, Scott-Dunne acted as an intermediary and was not directly involved in

loaning the money or in the underlying transaction. See Slade v. Metropolitan Life Ins. Co., 231 AD2d 467, 469 (1st Dept 1996)(noting that “engaged in the investment banking or securities business” as defined under the NASD by-laws “connotes some actual participation in the securities business and not just some tangential connection.”).

In any event, even if it could be argued that the arranging for the bridge loan constituted engaging in investment banking, in the absence of evidence that Scott-Dunne controlled McKim, Scott-Dunne would not be required to arbitrate under the NASD definition of an “associated person” contained in Article I (dd) of its By-Laws.⁴

Stewart also argues that Scott-Dunne is an associated person since he “is a sole proprietor, partner, officer, director or branch manager of a member [i.e. McKim], or other natural person occupying a similar status or performing similar functions.” This argument is without merit as the record is devoid of any evidence that Scott-Dunne held any position at McKim.

Accordingly, Scott-Dunne is not an associated person as defined under the NASD by-laws and cannot be compelled to arbitrate.

Equally unavailing is Stewart’s argument that Stellar Financial and Stellar-McKim,

⁴ Stewart belated submits a 2004 SEC filing for Vantage Funds, the third party that loaned the funds to Kortec to facilitate its deal with McKim. The filing indicates that Stellar Financial serves as the distributor of shares for Vantage Funds, that McKim receives a fee based on the total assets of Vantage Fund, and that Stellar Financial provides administrative services for Vantage Funds and receives a fee based on the total assets of Vantage Fund. The filing also indicates that McKim shares an office address with Stellar Financial in Stroudsburg, PA.

The court will not consider the 2004 filing, which should have been available to Stewart when the proceeding was submitted in January 2007. In any event, the information in the filing does not demonstrate that Scott-Dunne controlled McKim but, rather, further evidences the mutually beneficial relationship between Stellar Financial and McKim.

through Scott-Dunne, so dominated and controlled McKim that the corporate veil should be pierced, and Scott-Dunne required to arbitrate based on McKim's status as a member of the NASD. "Those seeking to pierce the corporate veil ... bear a heavy burden of showing that the corporation was dominated as to the transaction attacked and that such domination was the instrument of fraud or otherwise resulted in wrongful or equitable consequences." TNS Holdings, Inc. v MKI Sec. Corp., 92 NY2d at 339, citing Morris v New York State Dept. of Taxation and Fin., 82 NY2d 135, 143-144 (1993).

In this case, evidence that Stewart worked at McKim's offices while employed by Stellar Financial, that Stellar-McKim guaranteed payment of McKim's debts, and agreed to pay certain of McKim's expenses is insufficient to satisfy this heavy burden. see American Fuel Corp. v Utah Energy Dev. Co., Inc., 122 F3d at 135 (evidence that President of corporation personally paid the corporation's expenses and guaranteed its loans was insufficient to justify piercing the corporate veil) . Notably, there is no evidence that the three corporations at issue ignored corporate formalities. Instead, the record shows that the corporations maintained their distinct identities and that McKim and Stellar Financial had different managing members. Furthermore, evidence showing that Scott-Dunne was involved, along with McKim's principals, in decisions regarding Stewart's employment is inadequate to demonstrate that Scott-Dunne controlled or dominated McKim, particularly as Stewart was paid by Stellar Financial.

Finally, contrary to Stewart's alternative argument, as the issue of whether Scott-Dunne is subject to arbitration can be determined as a matter of law, it is for the court and not the arbitrator to decide. See CDC Capital Inc. v. Gershon, 282 AD2d 217; compare Schenkers Intern'l Forwarders, Inc. v. Meyer, 164 AD2d 541 (1st Dept 1991)(factual issue regarding

whether arbitration agreement was terminated is for the arbitrator to decide).

As Scott-Dunne is not subject to arbitration, the court need not reach Scott-Dunne's argument that the claims against him are not arbitrable since the statements in U-5 are absolutely privileged under New York's public policy.⁵

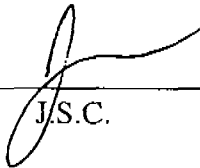
Thus, pursuant to CPLR 7503 (b), Scott-Dunne is entitled to an order permanently staying the arbitration that Stewart has demanded against him.

Accordingly, it is hereby

ORDERED that the petition is granted; and it is further

ORDERED and ADJUDGED that the arbitration proceeding that respondent Joseph T.J. Stewart II commenced with the National Association of Securities Dealers, Inc. in New York, New York is permanently stayed as against petitioner Ian Scott-Dunne.

Date: March 2, 2007



J.S.C.

UNFILED JUDGMENT

his judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the assignment Clerk's Desk (Room 41B).

⁵The court notes, however, Justice Kibbie Payne rejected this argument when it was made by McKim and its principals in an application to stay the arbitration brought against them by Stewart. See McKim Capital, Inc. v. Stewart, 14 Misc3d 1209(A), 2006 WL 3833659 (Sup Ct. NY Co., Sept. 27, 2006).