[* 1]

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

PRESENT: HERMAN CAHN PART 49

Index Number : 601065/2007

KATUGA ENTERPRISES INC

VS

KNZ LLC.

Sequence Number : 001

CONFIRM AWARD

INDEX NO. _____

MOTION DATE 5/30/07

MOTION SEQ. NO. 001

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 ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE .....

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

Dated: 10/11/07

J.S.C.

Check one: ☐ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 49
----------X

IN THE MATTER OF THE ARBITRATION OF
CERTAIN CONTROVERSIES BETWEEN:

KATUGA ENTERPRISES, INC., WILSON NUESA, MYRA NUESA, ROYLAND TAN, MA. CONSUELA TAN, RAMON ROSALES and MARILOU ROSALES,

Petitioners,

-and- Index No. 601065/2007

KNZ, LLC, and IMRAN ALI,

Respondents.

----------X

CAHN, J.:

Petitioners move to confirm a March 22, 2007 final arbitration award (the "Final Award") which resolved various disputes relating to the ownership of several Dunkin' Donuts franchises, CPLR 7510. Respondents cross-move to vacate the Final Award on the ground that it violates public policy and was made in excess of the arbitrator's authority, CPLR 7511. For the following reasons, the award is confirmed and the cross-motion is denied.

Background

The facts underlying this dispute were recounted at length in the Partial Award of the Arbitrator dated January 23, 2007 (the "Partial Award") and the Final Award, familiarity with which is presumed. As is relevant here, petitioner Katuga Enterprises, Inc. ("Katuga") is a New Jersey corporation and the individual petitioners are its members.

Respondent Imran Ali ("Ali") is the owner of respondent KNZ, LLC. When parties first met, Ali owned and operated a Dunkin' Donuts store, KNZ 110 Lexington, LLC ("KNZ 110") which was not available for sale.

On or about December 14, 2004, KNZ entered into a series of stock purchase agreements with petitioners. Pursuant to the agreements, petitioners agreed to buy 100% of the membership interests in three Dunkin' Donuts franchises which respondents intended to build: KNZ 161 Broadway Donut, LLC ("KNZ 161"); KNZ 149 Broadway Donut, LLC ("KNZ 149"); and KNZ 170 Grand Concourse Donut, LLC ("KNZ 170"). In 2005, Ali and petitioner Wilson Nuesa ("Nuesa") entered into a separate stock purchase agreement to buy the existing KNZ 110.

Each of the stock purchase agreements contained the following arbitration provision:

> 11.12 Arbitration. Any dispute, controversy or claim arising out of, connected with, or relating in any way to this Agreement, its formation, negotiation, performance, nonperformance, interpretation, termination or the relationship between the parties established by this Agreement shall be resolved by binding arbitration governed by the United States Federal Arbitration Act ("FAA") and conducted in accordance with the American Arbitration Association ("AAA") Commercial Arbitration Rules. Nothing herein shall, however, prohibit a party from seeking temporary or preliminary injunctive relief in a court of competent jurisdiction . . . Only damages allowed pursuant to this Agreement may be awarded and the arbitrator shall have no authority to award treble, exemplary, consequential, indirect or punitive damages of any kind regardless of whether such damages may be available at law under the FAA or AAA. Judgment upon any award granted in a proceeding brought pursuant hereto may be entered into any court of competent jurisdiction.

Pursuant to the stock purchase agreements, petitioners paid a total of $2.7 million for the four franchises. The closing was conditioned upon Dunkin' Donuts (the franchisor) written approval of the transactions, including the transfer of franchise rights from respondent to petitioners. However, in part because prior approval from Dunkin' Donuts had not been obtained, on January 30, 2005 the parties entered into a Joint Venture Agreement which, inter alia, "acknowledged" that petitioners were actually 49% rather than 100% owners of the three new stores subject to the transfer of the remaining 51% upon the franchisor's approval.

Respondent Ali amended the franchise agreement with Dunkin' Donuts to reflect that petitioners were "passive partners" in one of the stores.

The new stores opened between March and August 2005. Although Ali was the only franchisee recognized by Dunkin' Donuts, he withdrew from the day-to-day operations of the stores. Petitioners experienced difficulty in staffing and operating the stores and none of them showed a profit or broke even. Furthermore, none of petitioners ever qualified to be an authorized franchisee and neither the stock purchase agreements nor the joint venture agreement were disclosed to Dunkin' Donuts.

KNZ filed a Demand for Arbitration in July 2006, seeking a declaration that petitioners were "beneficial owners" of 100% of the stores thereby required to "assume all rights and responsibilities that naturally flow from such ownership." Petitioners counterclaimed against both KNZ and Ali, demanding the return of either 100% or 51% of the purchase price paid for each of the stores. By order dated September 14, 2006 the arbitrator, John F. Byrne, Esq., directed that the proceedings be bifurcated on the issues of liability and damages.

The arbitrator issued a Partial Award on January 23, 2007 (the "Partial Award"). He found that it would be "impossible" to enforce the agreements to declare petitioners to be the owners of the store without the consent of Dunkin' Donuts, but that under the circumstances petitioners were not entitled to rescission of the agreements and repayment of the full purchase price. Finding that parties might be entitled to equitable reformation of the agreements, the arbitrator directed a hearing on damages to consider additional evidence regarding the reasonableness of the purchase price, of the post-agreement conduct of the parties, and of their efforts to mitigate the damages caused by their performance (or non-performance) under the agreements.

The damages hearing was scheduled for March 6, 2007. By letter dated February 23, 2007, respondents' counsel requested that further proceedings be cancelled on the ground that the Partial Award effectively found that the parties had entered into an "illegal contract" that was unenforceable in arbitration or otherwise. The arbitrator denied this request, as well as a March 1, 2007 e-mailed request from Ali for a 60-day adjournment.

The March 22, 2007 Final Award directed various forms of relief, including the sale of the stores; the repayment of $400,000 by Ali to the petitioners; the nullification of the stock purchase agreement for KNZ 110 and the repayment to petitioner Nuesa; and an allocation of the outstanding debt owed by the parties for third-party financing. This proceeding followed.

Discussion

The motion to confirm is granted and the motion to vacate is denied. "Judicial authority to vacate an arbitration award is limited . . . [u]nless the arbitration agreement provides otherwise, an arbitrator is not bound by principles of substantive law or by rules of evidence but may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be" (Azrielant v Azrielant, 301 AD2d 269, 275 NYS2d 19 [1st Dept 2002], lv denied 99 NY2d 509 [2003][internal quotations and citations omitted]). Accordingly, an award may not be vacated "unless it is violative of a strong public policy, or is totally irrational, or exceeds a specifically enumerated limitation on his power" (Matter of Silverman [Benmor Coats], 61 NY2d 299, 308 [1984]). Moreover, "[a] court is bound by an arbitrator' s factual findings, interpretation of the contract and judgment concerning remedies, and 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" (Azrielant, 301 AD2d at 275) (internal quotations and citations omitted).

Respondents' challenge to the Final Award falls far short of the stringent standards for a vacatur. Their contention that the award violated public policy because it granted relief relating to allegedly "illegal" agreements intended to violate a contact with a third party, i.e., the franchise agreement with Dunkin' Donuts, is misguided. The public policy exception is "extremely narrow" and cannot be invoked except where the subject matter is obviously non-arbitrable in an "absolute sense" or the award itself "violate[s] a well-defined constitutional, statutory or common law of this State" (Matter of United Fed. of Teachers, Local 2, AFT, AFL-CIO v. Board of Educ., 1 NY3d 72, 80 [2003][internal quotations and citations omitted]; see, Matter of Crosstown Operating Corp., 191 AD2d 384 [1st Dept 1993][vacating arbitration award to the extent it included breach of contract damages for revenues derived from illegal gambling device]).

In addressing the question of illegality, the arbitrator properly concluded that "[w]hile the respective agreements are more than flawed, they are nonetheless enforceable as among the parties over whom I have jurisdiction" (Final Award at 2). Whether the parties may have originally attempted to circumvent some the notice and approval provisions of the franchise agreement is irrelevant because the Final Award itself did not condone or facilitate that conduct. "It is only where an arbitrator seeks to enforce a contract that is against public policy or otherwise illegal that a court will interfere with the arbitrator's powers" (Matter of Heilman [Casella], 188 AD2d 294, 294 [1st Dept 1992][emphasis added]). In this case, the arbitrator did not seek to enforce the parties' agreements in any manner that would violate Dunkin' Donuts contractual rights by forcing it to accept an unqualified franchisee.

Moreover, there was nothing facially illegal about the agreements insofar as they all made Dunkin' Donuts' consent a condition precedent to any transfer of a franchise. And even if

the agreements somehow encouraged the parties to conceal their purported ownership interests from Dunkin' Donuts, as noted above, the Final Award did not validate those interests. To the contrary, the award recognized that petitioners could not assert any claims to ownership contrary to Dunkin' Donuts' rights and sought to adjust the equities in a manner consistent with that fact. Even where some aspects of a contract are illegal, an arbitrator is not required to avoid it altogether but may enforce it to the extent that lawful objectives are served (see, e.g., Crosstown Operating Corp., 191 AD2d at 384 [remanding to arbitrator to recalculate damages to exclude those attributable to illegal gambling]).

Respondents also err in their related argument that the arbitrator exceeded his jurisdiction in granting reformation of the contracts once he found them unenforceable in some respects. "[T]he laudatory value of arbitration lies in the arbitrator's power to construct a remedy best suited to the situation without regard to the restrictions on traditional relief in a court of law . . . [m]erely because the computation of damages may be so speculative as to be unsupportable if awarded by a court does not make the award infirm, for, as we have firmly stated, arbitrators are not bound by rules of substantive law or, indeed, rules of evidence" (Bd. of Educ. of Cent. School Dist. No. 1 of Towns of Niagara, Wheatfield, Lewiston & Cambria v Niagara-Wheatfield Teachers Assn., 46 NY2d 553, 557 [1979]). The arbitration clause gave the arbitrator broad authority to award damages in connection with any dispute relating to the "formation, negotiation, performance, nonperformance, interpretation, termination or the relationship between the parties," and his decision to direct repayment of some of the purchase money fell well within this grant. The award did not, as respondents suggest, include impermissible punitive damages, but merely compensated petitioners for what they had lost in their unsuccessful bid for ownership of the stores.

Ali' s objection to the award as against him individually cannot be reviewed by this court. Although the corporate veil may not ordinarily be pierced to compel arbitration against a party who has not signed or otherwise been made a party to an arbitration agreement (see, Metamorphosis Construction Corp. v Glekel, 247 AD2d 231 [1st Dept 1998]), the objection is waived where no timely motion to stay arbitration is made and the party instead elects participates in the proceedings (Matter of RRN Assocs. [DAK Elec. Contr. Corp.], 224 AD2d 250 [1st Dept 1996]). Although counsel avers that some oral objection to the joinder of Ali individually as a counterclaim respondent was made during a September 2006 telephone conference, the matter proceeded to hearing without a stay being sought to seek judicial review.

Respondents' final objection regarding the arbitrator's refusal to grant an adjournment of the damage hearing is without merit. "Whether to grant or refuse an adjournment is generally within the discretion of the arbitrator, and it is only if that discretion is abused that misconduct results" (Harwyn Luggage v Henry Rosenfeld, Inc., 90 AD2d 747, 747-48 [1982], aff'd 58 NY2d [1983]). In this connection, "a refusal to grant an adjournment constitutes 'misconduct' within the meaning of CPLR 7511[b][1][I] only when it results in the failure to hear pertinent and material evidence and in the effective exclusion of an entire issue" (Matter of Campbell v New York City Tr. Auth., 32 AD3d 350, 352 [1st Dept 2006]; see, Henneberry v ING Capital Advisors, LLC, 37 AD3d [1st Dept 2007]). The objecting party must make a showing that the presentation of material evidence was foreclosed or that relevant testimony was curtailed (Harwyn Luggage, 90 AD2d at 747-48). Here, respondents appeared at the hearing with counsel (Woodco Mfg. Corp. v GR&R Mfg., Inc., 51 AD2d 631 [3d Dept 1976]) and although they note a second year associate was sent on short notice they do not allege that any necessary evidence was excluded. Given that counsel did attend the hearing, the further complaint regarding the

existence of a fee dispute is irrelevant, especially where respondents have not set forth what steps were taken to resolve it during the month after the law firm purported to withdraw (see, Harwyn Luggage, 90 AD2d at 747-48).

Finally, the court notes receipt of a letter from petitioners' counsel indicating that due to the closure of the stores some of the relief directed by the Final Award may be moot. No response has been received from respondents. Because only the motions resolved above are properly before the court, the award will be confirmed in its entirety, subject to further proceedings before the court or the arbitrators as necessary.

Settle order on notice.

Dated: October 11, 2007

ENTER:

J.S.C.