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

PRESENT: HON. RICHARD B. LOWE, III **PART** 56

Justice

Index Number : 113481/2007

SCHULMAN, STEVEN G.

VS

KALLAS, EDITH M.

Sequence Number : 001

COMPEL OR STAY ARBITRATION

INDEX NO. _____

MOTION DATE 10/17/07

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

his 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

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

Dated: 4/28/08

HON. RICHARD B. LOWE, III

J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 56

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In the Matter of the Application of
STEPHEN G. SCHULMAN,

Petitioner,

- against -

EDITH M. KALLAS, DEBORAH CLARK-WEINTRAUB, JOSEPH P. GUGLIELMO, and WHATLEY DRAKE & KALLAS, LLC,

Respondents.

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Index No. 113481/07

RICHARD B. LOWE, III, J:

Petitioner Steven G. Schulman petitions the court for an order (1) pursuant to CPLR 7503 (b), nullifying the demand for arbitration (Demand) served by respondents Edith M. Kallas, Deborah Clark-Weintraub, Joseph P. Guglielmo (collectively, Individual Claimants), and Whatley Drake & Kallas, LLC (Whatley Drake, or collectively with the Individual Claimants, Claimants), (2) permanently staying all proceedings related to the Demand on the grounds that there was no agreement to arbitrate between Schulman and any of the Claimants, and the claims of fraud in the inducement, breach of fiduciary duty, and unjust enrichment are predicated upon business decisions of the executive firm management which Shulman did not have authority to effect; and (3) assuming that Schulman is obligated to arbitrate against Claimants, joinder and consolidation of any arbitration against Schulman with arbitration against any other party would prejudice Schulman's substantial rights, and it should be severed from that arbitration.

Claimants cross-move, pursuant to CPLR 404 and CPLR 3211, for an order dismissing the petition.

According to the Statement of Claims accompanying the Demand, petitioner Steven G. Schulman became a non-equity partner of the Firm, effective January 1, 1989, and an equity partner, effective January 1, 1991. Schulman was appointed as one of the initial members of the Management Committee effective January 1, 1998. Effective January 1, 1999, Schulman became a member of the Firm's Executive Committee and remained in that position until his indictment in May 2006, at which time he took a leave of absence from the Firm.

Individual Claimant Kallas was a Firm partner (in varying partner capacities) from January 1, 1998 to June 1, 2006. Individual Claimant Clark-Weintraub was a Firm partner (in varying partner capacities) from January 1, 1996 to July 1, 2006. Individual Claimant Guglielmo was a Firm partner (also in varying partner capacities) from January 1, 2004 to June 1, 2006. As of the date of the petition, Kallas, Clark-Weintraub, and Guglielmo were partners/members of Whatley Drake, a limited liability company (law firm).

Through the Demand and Statement of Claims, dated August 13, 2007, Claimants seek arbitration pursuant to section 11.01 (Arbitration Clause) of the "Milberg Weiss LLP Partnership Agreement" (Partnership Agreement), which provides:

> "11.01 Arbitration. All disputes, disagreements and claims arising out of, under or in connection with this Agreement (including, without limitation, those relating to its construction or interpretation and/or payments or performance hereunder) shall be settled by arbitration held in the City of New York or such other place as the parties thereto may agree . . . ."

The Statement of Claims identifies four controversies: (1) breach of contract, including the failure to make various payments required under the Partnership Agreement; (2) fraudulent inducement to enter into the partnership; (3) breach of fiduciary duties arising out of the partnership; and (4) unjust enrichment based upon attorney's fees awarded in a class action

settlement.

The Statement of Claims names as "Respondents": (1) the Firm; (2) Melvyn I. Weiss, a founding partner of the Firm, an original Managing Partner, and a member of the Executive Committee; (3) David J. Bershad, a then senior partner of the Firm, and a member of its Executive Committee until July 2007, at which time he pleaded guilty to having conspired over a 30-year period with other senior partners of the Firm to violate federal law; and (4) Schulman (Weiss, Bershad, and Schulman, collectively, the Individual Respondents).

As alleged in the Statement of Claims, when Schulman and the other Respondents named therein invited the Individual Claimants to become partners of the Firm, they affirmatively represented that the Firm and its individual partners were conducting the Firm's affairs in the partnership's best interests. The Statement of Claims further alleges that the indictment altered the nature of the Firm as a partnership that the Individual Claimants chose to join, and, due to the nature of their respective practices, and the Firm's equity structure, the indictment made it impossible for them to remain at the Firm.

During the years that the Individual Claimants practiced law at the Firm, they made capital and other contributions to the Firm that allowed the Firm to prosecute a number of cases. After Kallas left the Firm, the clients that she represented, and had brought to the Firm, in the class action *In re Managed Care Litig.*, No. 0001334, MDL No. 1334 [*In re Managed Care Litig.*], pending in the United States District Court for the Southern District of Florida, decided to change firms, and Whatley Drake replaced the Firm. Prior to the change in counsel, the court awarded attorney's fees and expenses, but did not decide the allocation among the various counsel who submitted fee applications. The Firm filed a motion seeking more than $15 million

of those fees and expenses. The fees and expenses were awarded to the individuals who served as class counsel, including Kallas and Guglielmo.

After Kallas and Clark-Weintraub became former partners of the Firm, they continued to own capital in the Firm, and the partners who remained at the Firm owed them a fiduciary duty. Under the Partnership Agreement, the Firm is required to make three categories of payments to former equity partners following their departure from the Firm, but failed to properly calculate these payments.

The first claim, for breach of contract, alleges that respondents violated the terms of the Partnership Agreement by failing to make the "Termination Year Payment," the "Capital Account Payments," and the "Base Amount Payments," all of which are required under the terms of the Partnership Agreement.

The second claim, for fraudulent inducement, alleges that the Individual Claimants were induced to join the Firm by false representations that the Firm and the individual partners were conducting the Firm's affairs in the best interests of the partnership. In actuality, they were conducting the Firm's affairs in a manner that invited a criminal investigation and indictment, and the Firm was eventually charged with conspiracy; obstruction of justice; the making of illegal payments to witnesses; the making of false declarations under oath; and engaging in mail fraud, wire fraud, and extortion, which threatened harm to the Firm, causing substantial monetary damages.

The third claim, for breach of fiduciary duty, alleges, among other things, that the Individual Respondents wrongfully (1) refused to agree to take leaves of absences even when federal prosecutors would not approve a non-prosecution agreement for the Firm as long as the

Individual Respondents controlled the Firm; (2) objected to the government's proposed admission of wrongdoing in exchange for a non-prosecution agreement; (3) permitted the continued payment of referral fees to repeat plaintiffs even after learning that the government was considering criminal charges for that very conduct; and (4) took action to benefit current partners to the detriment of former partners who continue to have capital invested in the Firm.

The fourth claim alleges that Respondents will be unjustly enriched if they receive the portion of the fee and expenses awards in *In re Managed Care Litig.* that is attributable to work performed by class counsel following the Firm's withdrawal as counsel, including work of Kallas, Guglielmo, and others at Whatley Drake.

In seeking an order nullifying the Demand, or staying the arbitration, the Petition asserts that: (1) the Arbitration Clause does not purport to constitute an agreement between the current and former partners of the Firm to arbitrate all disputes they may have against one another; and (2) Whatley Drake has never been a party to the Partnership Agreement.

In determining whether a claim is arbitrable, the court should determine at the outset whether the agreement is broad or narrow (*Louis Dreyfus Negoce S.A. v Blystad Shipping & Trading Inc.*, 252 F3d 218 [2nd Cir], *cert denied* 534 US 1020 [2001]). The Arbitration Clause at issue here – "[a]ll disputes, disagreements and claims arising out of, under or in connection with this Agreement" – is broad (*see Mineola Union Free School Dist. v Mineola Teachers Assn.*, 46 NY2d 568 [1979]; *Matter of Herrero [Tenth Ave. Fine Foods]*, 168 AD2d 343 [1st Dept 1990]; *Louis Dreyfus Negoce S.A. v Blystad Shipping & Trading Inc.*, 252 F3d at 225). A broad arbitration clause creates a presumption of arbitrability (*Matter of Domansky v Little*, 2 AD3d 132, 133 [1st Dept 2003]; *Louis Dreyfus Negoce S.A. v Blystad Shipping & Trading Inc.*, 252 F3d

at 224). In such instance, the "court merely determines whether there is 'a reasonable relationship between the subject matter of the dispute and the general subject matter of the underlying contract'" (*Matter of Domansky v Little*, 2 AD3d at 133 [citation omitted]; *Matter of Helmsley Enters. [Lepercq, Deneuflize & Co.]*, 168 AD2d 224 [1st Dept 1990]).

The business relationship of the partners amongst themselves is set forth in the Partnership Agreement. It declares, on page one:

> "The parties desire to make arrangements, among other things, for the continuation, management and operation and the sharing of profits and losses of and the admission of new partners to the Partnership and as to matters relating to death, withdrawal or disability of partners."

Hence, all four arbitration claims bear a "reasonable relationship" to the Partnership Agreement in that they arise out of the relationship of the parties in carrying out the purpose of the partnership (*Hirschfeld Prods. v Mirvish*, 218 AD2d 567 [1st Dept 1995], *affd* 88 NY2d 1054 [1996]). The Arbitration Clause is sufficiently broad to reach the present controversy which arises in connection with the Partnership Agreement (*Matter of Herrero [Tenth Ave. Fine Foods]*, 168 AD2d 344, *supra*). The claim of breach of fiduciary duty arises out of the relationship of the parties in carrying out the purpose of their partnership, a matter that is subject to the broad Arbitration Clause (*Hirschfeld Prod. v Mivirsh*, 218 AD2d at 568). The same is true for the fraudulent inducement and unjust enrichment claims.

Schulman argues that the Arbitration Clause does not purport to constitute an agreement among the current and former partners of the Firm to arbitrate all disputes that they may have against one another. Rather, it is expressly limited to disputes "arising out of, under or in connection with this Agreement," and that the Firm is alone responsible, if at all, for financial distributions under the Partnership Agreement, not Schulman, in an individual capacity. The

argument that the claims against Schulman are not subject to arbitration is without merit. The Partnership Agreement is an agreement among the individual partners, including "Managing Partners," "Equity Partners," and "Non-Equity Partners" and the Firm, as a separate entity, is not a party to that agreement. The scope of the Arbitration Clause has been addressed above.

Schulman's argument that he signed the Partnership Agreement only as a limited partner is also without merit. The Partnership Agreement categorizes the partners as "Managing Partners," "Equity Partners," "Non-Equity Partners," "Original Partners, and "New Partners," and makes no mention of limited partners. Moreover, although in the petition Schulman describes himself only as a former equity partner of the Firm, he does not controvert the assertion in the Statement of Claims, that Schulman was appointed as one of the initial members of the Management Committee, became a member of the Firm's Executive Committee, and he remained in that position until his indictment in May 2006, at which time he took a leave of absence. Thus, the attempt to minimize his role in the Firm's operations is not persuasive.

As for Whatley Drake, unless a party has entered into an agreement to arbitrate, and the agreement expressly covers the subject matter of the particular dispute, that party will not be compelled to forego its right to seek judicial relief (*Bowmer v Bowmer*, 50 NY2d 288 [1980]; *Matter of Eastern Mins. Intl. v Cane Tenn.*, 274 AD2d 262 [1st Dept 2000], *lv denied* 96 NY2d 702 [2001]).

Thus, Whatley Drake, which is not a party to the Partnership Agreement, cannot compel Schulman to arbitrate its claims against him. The right to compel arbitration does not extend to a party that has not signed the agreement pursuant to which arbitration is sought unless the right of the nonsignatory as expressly provided for in the agreement (*Greater New York Mut. Ins. Co. v*

Rankin, 298 AD2d 263 [1st Dept 2002]).

Finally, Schulman requests that, assuming that he is obligated to arbitrate against Claimants, that the court make a ruling as to consolidation or severance of the arbitrations involving the other respondents. The request is denied for the reasons stated on the record at oral argument held on December 11, 2007.

Accordingly, it is

ORDERED that the motion is granted to the extent of staying the arbitration as to Whatley Drake and is otherwise denied; and it is further

ORDERED that the parties are directed to proceed to arbitration; and it further

ORDERED that the cross motion to dismiss the petition is denied.

This constitutes the decision and order of the court.

Dated: April 28, 2008

ENTER:

HON. HOWARD B. LOWE, III
J.S.C.

FILED
MAY 06 2008
COUNTY CLERK'S OFFICE
NEW YORK