

Matter of Bershad v Kallas

2008 NY Slip Op 31299(U)

April 28, 2008

Supreme Court, New York County

Docket Number: 0603293/2007

Judge: Richard B. Lowe

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

PRESENT: HON. RICHARD B. LOWE, III

PART 56

Index Number : 603293/2007

BERSHAD, DAVID J.

vs

KALLAS, EDITH M.

Sequence Number : 001

COMPEL OR STAY ARBITRATION

INDEX NO. _____

MOTION DATE 10/17/07

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

s 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

FILED
MAY 06 2008
COUNTY CLERK'S OFFICE
NEW YORK

MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM DECISIONS

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

Dated: 4/28/08

HON. RICHARD B. LOWE, III

J.S.C.

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REFERENCE

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

----- X

In the Matter of the Application of
DAVID J. BERSHAD,

Index No. 603293/07

Petitioner,

- against -

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

Respondents.

RICHARD B. LOWE, III, J.:

FILED
MAY 06 2008
COUNTY CLERK'S OFFICE
NEW YORK

Petitioner David J. Bershada petitions the court for an order (1) staying all proceedings commenced by the Demand for Arbitration (Demand) made 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), or, in the alternative, (2) severing all claims asserted against Bershada by the Individual Claimants that are not time-barred.

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, Bershada was a senior partner of Milberg Weiss LLP (Firm) and a member of its Executive Committee until July 2007, at which time he pleaded guilty to having conspired over a 20-year period with other senior partners of the Firm to violate federal law. 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 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) Melyvn I. Weiss, a founding partner of the Firm, an original Managing Partner, and a member of the Executive Committee; (3) petitioner Bershada, and (4) Schulman, an equity partner of the Firm effective January 1, 1991, one of the initial members of the Management Committee, and a member of the Firm’s Executive Committee, a position that he held until his indictment in May 2006, at which time he took a leave of absence from the Firm (Weiss, Bershada, and Schulman, collectively, the Individual Respondents).

As alleged in the Statement of Claims, when Bershad 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 staying all proceedings commenced by the Demand, or, in the alternative, severing all claims asserted against Bershad by the Individual Claimants that are not time-barred, the Petition asserts that: (1) the Partnership Agreement provides no basis for the Claims against Bershad, (2) the statute of limitations bars the fraud claim, and (3) Whatley Drake is not a party to the Partnership Agreement.

Claims Subject to Arbitration

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, Deneufelize & 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 the 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 343, *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.

To achieve the result urged by Bershad, the agreement would have had to contain a narrow arbitration clause, not the broad one that the is present in the agreement. An example of a narrow agreement is found in *Gerling Global Reins. Corp. v Home Ins. Co.* (302 AD2d 118, 119 [1st Dept 2002]):

“Should an irreconcilable difference of opinion arise *as to the interpretation of this Contract*, it is hereby mutually agreed that, as a condition precedent to any right of action hereunder, such difference shall be submitted to arbitration.” (emphasis added).

In arguing that the second through fourth claims are not subject to arbitration, Bershad cites subsection 6.09 of the Partnership Agreement, which provides:

“Effect of Death, Withdrawal, Etc. Upon termination of a Partner’s interest in the Partnership for any reason whatsoever, whether as a result of death, voluntary or

compulsory withdrawal or otherwise, such Terminated Partner shall, without further action, be deemed to have assigned, transferred and released to the Partnership, effective as of his or her Termination Date, all of his or her rights, title and interest in and to the Partnership and its assets, and from and after such Termination Date he or she shall have no further rights in or claims against the Partnership except only with respect to the payments provided for in this Section 6 and, to the extent applicable, Section 7 below (disability). The foregoing notwithstanding, all payments made pursuant to Sections 6.05 and 6.06 are intended to qualify as guaranteed payments under Section 736 (a) of the Internal Revenue Code.”

6.09 is a subsection of Section 6 of the Partnership Agreement, entitled “Payments on Death and Withdrawal,” and it makes no reference to arbitration. Thus, to construe it as limiting the broad scope of arbitration contained in the Arbitration Clause would violate the contract principal of avoiding an interpretation that would leave a provision without force and effect (*Acme Supply Co., Ltd. v City of New York*, 39 AD3d 331 [1st Dept 2007]). If the parties intended to limit the scope of arbitration, they could have done so in the Arbitration Clause. But the language of the clause expresses an intent to not limit the matters subject to arbitration as long as they bear a “reasonable relationship” to the Partnership Agreement, which it does here, as discussed above.

Bershad also 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 Bershad, in an individual capacity. This argument 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. Bershad characterizes himself as a

“bystander to a battle over termination payments between former partners and the law firm for whom they all once worked” (Memorandum, at 1). This characterization is somewhat disingenuous in light of his guilty plea in July 2007 to a charge directly related to the issues raised here. The scope of the Arbitration Clause has been addressed above.

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 Bershad 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 is expressly provided for in the agreement (*Greater New York Mut. Ins. Co. v Rankin*, 298 AD2d 263 [1st Dept 2002]).

Fraudulent Inducement

Bershad argues persuasively that the fraudulent inducement claim, as asserted by Kallas and Clark-Weintraub, is time-barred because it was brought more than either six years from when the Individual Claimants became partners of the Firm, or more than two years from the time that they could have, with reasonable diligence, discovered the alleged fraud; Kallas first became a partner on January 1, 1998, and Clark-Weintraub first became a partner on January 1, 1996. Bershad argues further that both were on inquiry notice of the alleged fraud more than two years prior to the date of the Demand. The petition does not assert that the fraudulent

inducement claim is time-barred as to the third Individual Claimant, Guglielmo, who first became a Firm partner in January 2004.

An action alleging a cause of action for fraud must be commenced within six years from the time of the fraud or within two years from the time the fraud was discovered, or with reasonable diligence, could have been discovered (CPLR 213 [8]; CPLR 203 [g]; *Saphir Intl., SA v UBS PaineWebber Inc.*, 25 AD3d 315 [1st Dept 2006]). When a plaintiff becomes aware of sufficient facts or assertions pertaining to the alleged fraud, that plaintiff is under a “duty of inquiry.” During the course of that inquiry, the two-year limitations period for the fraud action will then be measured from the time of the discovery of facts constituting the fraud or from the time such facts could have been discovered (*TMG-II v PriceWaterhouse & Co.*, 175 AD2d 21, 22 [1st Dept 1991], *appeal denied* 79 NY2d 752 [1992]). The inquiry “turns upon whether a person of ordinary intelligence possessed knowledge of facts from which the fraud could be reasonably inferred” (*Rite Aid Corp. v Grass*, 48 AD3d 363, 364 [1st Dept 2008] [citation omitted]).

Claimants made the Demand on Bershad on August 13, 2007. Thus, August 13, 2005 is the measuring date for the two-year limitations period (*see TMG-II v PriceWaterhouse & Co.*, 175 AD2d at 23). The question then becomes whether the Claimants had sufficient knowledge of the alleged fraud prior to August 13, 2005, so as to have imposed upon them the obligation to have asserted the fraudulent inducement claim by then. The record conclusively establishes that they did.

There were numerous news articles dating as far back as 2002 reporting in detail the then ongoing investigation into the kickback scheme involving the Firm and various plaintiffs not parties to the arbitration. That these articles mentioned that federal prosecutors were

investigating the Firm was sufficient, by itself, to have created a duty of inquiry (*TMG-II v PriceWaterhouse & Co.*, 175 AD2d at 23). Moreover, according to the Statement of Claims:

“On June 23, 2005, the government unsealed an indictment handed up by a federal grand jury in the Central District of California against Seymour M. Lazar and Paul T. Selzer. The indictment alleged, among other things, that the defendants had been involved in a scheme to receive and conceal illegal kickbacks, and that the kickbacks had been paid by members of an unnamed New York law firm. The unnamed New York law firm was Milberg Weiss. Following the Lazar indictment, the government sent letters to the firm and the individual Respondents notifying them they were targets of the ongoing grand jury investigation.”

Contrary to Claimants’ assertion, that Bershad pleaded guilty in July 2007 did not mark the commencement of the two-year period because of evidence existing prior thereto (*TMG-II v PriceWaterhouse & Co.*, 175 AD2d at 23). That the Claimants were themselves partners of the Firm placed them in a greater position to obtain information about the charges than would otherwise have been the case if they had not been partners of the Firm. Furthermore, the contention that the Individual Claimants were unable to obtain information because the Individual Respondents controlled all access to Firm information militates in favor of a finding that they had a sufficient basis to have doubted their public denials of the charges. Indeed, the Claimants had ample evidence, and a reasonable basis to suspect wrongdoing (*Prestandrea v Stein*, 262 AD2d 621 [2d Dept 1999]).

Claimants’ equitable estoppel argument is unavailing because, as discussed above, the Individual Claimants had sufficient information to ascertain the relevant facts prior to the expiration of the applicable statute of limitations period (*Rite Aid Corp. v Grass*, 48 AD3d at 364-65). Furthermore, the mere failure of the Individual Respondents to disclose the wrongdoing is insufficient to trigger the application of this doctrine (*Rose v Louise Wise Servs., Inc.*, 8 NY3d 478, 491 [2007]).

Finally, the cross motion for consolidation 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, except as to Joseph Guglielmo, dismissing the fraudulent inducement Claim from the Demands, 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. RICHARD B. LOWE, III
J.S.C.

FILED
MAY 06 2008
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