

Banna v Merrill Lynch, Pierce, Fenner & Smith, Inc.
2008 NY Slip Op 31656(U)
June 12, 2008
Supreme Court, New York County
Docket Number: 0603111/2007
Judge: Richard B. Lowe
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: _____
Justice

PART 56

Index Number : 603111/2007
BANNA, GASTON
 vs.
MERRILL LYNCH
 SEQUENCE NUMBER : 003
 VACATE OR MODIFY AWARD

INDEX NO. _____
 MOTION DATE 3/19/08
 MOTION SEQ. NO. _____
 MOTION CAL. NO. _____

n 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

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
 147B).

HON. RICHARD B. LOWE, III

Dated: 6/12/08

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 CITY OF NEW YORK
COUNTY OF NEW YORK: PART 56

-----X
GASTON BANNA, JACQUELINE BANNA
and ALEPCO LTD.,
Petitioners,

Index No.: 603111/07

-against-
MERRILL LYNCH, PIERCE, FENNER
SMITH, INC.,
Respondents.

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 147B).

-----X
Hon. Richard B. Lowe, III

This is a special proceeding brought pursuant to CPLR 7511 (b) (1) (i)-(iv) to vacate an arbitral award issued by a panel of three arbitrators pursuant to a National Association of Securities Dealers, Inc. (NASD) arbitration agreement.¹

BACKGROUND

Petitioners are an elderly married couple who reside in Syria and a shell company created by respondent to manage the couple's trust account. Respondent is a registered domestic securities brokerage house that managed petitioners accounts from its regional office in Beirut, Lebanon.

Petitioners argue that the arbitration process prejudiced them on four separate grounds: one, by the arbitrators excluding allegedly pertinent expert testimony; two, by the partiality of two arbitrators who failed to disclose material background information about themselves; three, by the arbitration panel disregarding one of petitioners' claims regarding a breach of fiduciary

¹ As of July 30, 2007, the NASD became the Financial Industry Regulatory Authority (FINRA).

duty by respondents; and four, by the arbitrators failing to allow petitioners to present evidence in support of their claims.

Petitioners were contacted in 2000 by Frederic Hilel, respondent's employee, who is the son of a family friend of petitioners. Hilel convinced petitioners to open up a joint account with respondent. This joint account was subsequently changed to a trust account with petitioner Alepco Ltd. as settlor. The purpose for which the trust account was established was to provide petitioners' daughter with a greater portion of her parents' estate than she would be permitted under Syrian law because she is female. The trust account was classified as a non-discretionary account, meaning that petitioners were the ones to make investment decisions as opposed to a discretionary, or managed, account in which the securities broker makes such decisions.

Petitioners allege that respondents managed the trust account as though it were a discretionary account and invested petitioners' assets in high-risk securities, eventually costing them to lose \$4.6 million. Petitioners further assert that they were not sophisticated investors, that Hilel never informed them of the transactional costs of the trades he was making for their account, and that purchases were made without authorization.

Respondents maintain that petitioners were experienced and sophisticated investors, that they agreed with all the purchases, and that the risks involved were appropriate for them according to the information they provided to respondent.

After extensive hearings, the arbitration panel awarded petitioners \$30,000 for one unauthorized trade, plus \$6,412.80, representing the commission respondent made on that trade.

The specific factual allegations used to support this motion will be presented in conjunction with the discussion of each of the four grounds specified by petitioner as the bases to

vacate the arbitral award.

DISCUSSION

The grounds for vacating an arbitration award are limited and specifically enumerated in CPLR 7511 (b): one, corruption, fraud or misconduct in procuring the award; two, partiality of an arbitrator; three, an award that exceeds the arbitrator's power; and four, the arbitrator failing to follow the procedures of Article 75 of the CPLR.

The function of any court in a proceeding to vacate an arbitration award "is not to decide the appropriateness or wisdom of the award or whether the judges of a court would have rendered the same award had they acted as arbitrators but, rather, to ascertain whether the arbitrator who did make the award exceeded his powers or so imperfectly executed them as to require vacatur." (*In the Matter of the Arbitration between States Marine Lines, Inc. and Charles M. Crooks*, 13 NY2d 206, 212 [1963]). As a general rule, "[a]n arbitration award may not be vacated unless it violates a strong public policy, is irrational, or clearly exceeds a specifically enumerated limitation on the arbitrator's power." (*Board of Education of the Arlington Central School District v Arlington Teachers Association*, 78 NY2d 33, 37 [1991]). More simply stated, "[a] court ... may not set aside an arbitrator's decision merely because it may disagree with the merits or appropriateness of the arbitrator's findings and award." (*Board of Education of Central School District No. 1 of the Towns of Niagara, Wheatfield, Lewiston and Cambria v Niagara Wheatfield Teachers Association*, 54 AD2d 281, 284 [4th Dept 1976]).

As long as any plausible basis exists for an arbitration award, the court cannot vacate it. (*Azrielant v Azrielant*, 301 AD2d 269, 275 [1st Dept 2002]). Consequently, the party seeking to vacate the arbitration award is imposed with a heavy burden to vacate that award. (*See Lehman*

Bros., Inc. v Cox, 10 NY3d 743 [2008]).

Each of petitioners' claims shall now be addressed, bearing in mind the above-referenced caveats.

1. The failure of the arbitration panel to hear expert testimony.

CPLR 7506 (c) states that the parties to an arbitration are entitled to be heard, to present evidence and to cross-examine witnesses. However, it is well-settled that in conducting an arbitration hearing the arbitrators are "not governed by the substantive or evidentiary rules which commonly prevail in courts of law; rather, the constraints on the arbitral authority are those measured by the bounds of rationality." (*Matter of the Arbitration Between Board of Education of Norwood-Norfolk Central School District and Frank F. Hess*, 49 NY2d 145, 152[(1979)]).

In the instant matter, the arbitration panel qualified petitioners' witness, Robert Conner, as an expert and permitted him to testify as to the computation of petitioners' damages, but refused to let him testify on respondent's research reports, the information a portfolio manager could be expected to derive from such reports, and the overlap between the individual equity securities and mutual funds held in petitioners' account. The panel concluded that it would make its own evaluations based on the documents themselves, the research reports and the portfolio, which were submitted into evidence. Petitioners claim that the proffered expert testimony is crucial to their case.

In *Credit Suisse First Boston Corporation v Crisanti* (289 AD2d 83, 83 [1st Dept 2001]), the court ruled that

“[t]he arbitrators’ refusal to hear the testimony of a particular proposed witness who would have presented a different version of events than that

provided by respondent was not fundamentally unfair, since the panel had been apprized of the contents of the proposed witness's testimony during several days of hearings and his testimony would have been cumulative."

Furthermore, in *Jones Hirsch Connors & Bull v Friedman, Carney & Wilson*, (166 AD2d 292, 292 [1st Dept 1990]), a case in which the court was asked to vacate an arbitration award because the arbitrators concluded that they did not require expert evidence, the court stated:

"we reject respondents' argument that the arbitrators committed misconduct in excluding the testimony. It is well established that 'an arbitrator is not bound by principles of substantive law or by rules of evidence He may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be. His award will 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 (citations omitted).'"

Just as arbitrators may limit the extent of cross-examination (*Medivix, Inc. v Shnayer*, (160 AD2d 911 [2d Dept 1990]), they may also limit the nature of testimony to be received.

In the instant matter, the documents forming the basis of the proposed expert testimony were in evidence, and the arbitrators, as required by the NASD, are all experienced in the financial industry. Therefore, the panel's conclusion that they could interpret the documents themselves is well within their power and authority. *See* the NASD Code of Arbitration Procedural Rule 10323.

Therefore, based on the foregoing, it is concluded that the arbitration award cannot be vacated based on the arbitration panel's exclusion of certain expert testimony.

2. The Partiality of the Arbitrators in not Disclosing Potential Conflicts.

Petitioners allege that two of the arbitrators selected by the NASD as “neutrals” failed to disclose pertinent information which indicates a bias on their part. It is noted that the chair of the panel was selected by the parties and is not subject to this claim.

The first arbitrator, Allan Johnson, had a complaint letter filed against him by an attorney representing a customer in an arbitration in which Mr. Johnson served as chair. The attorney complained of “extreme irregularities” in conjunction with Mr. Johnson’s conduct as chair of that panel. This complaint letter was sent after the instant arbitration had been seated but prior to any evidentiary hearings, and there is no indication that Mr. Johnson was aware of the existence of the letter at the time of the arbitration.

Prior to the hearings, petitioners sent Mr. Johnson a questionnaire to discover information that might create the appearance of partiality or bias. One of the questions asked whether Mr. Johnson’s conduct has been an issue in any securities litigation or arbitration. Mr. Johnson answered “no.” However, petitioners correctly assert, Mr. Johnson had a continuing duty to disclose any new information that comes to his attention that might effect his partiality or bias.

Petitioners have indicated no specific act on the part of Mr. Johnson indicating any partiality or bias. A “mere inference” of impartiality is insufficient to warrant the disturbance of an arbitration award. (*Saldana v State Farm and Casualty Company*, 39 AD3d 416, 416[1st Dept 2007]). Not only have petitioners failed to demonstrate that Mr. Johnson was biased, but they have not evidenced that they sustained prejudice attributable to any such bias. (*Hughes Contracting Industries, Ltd. v A & N Restoration, Inc.*, 39 AD3d 378 [1st Dept 2007]).

Furthermore, the complaint letter did not put Mr. Johnson’s conduct in issue in a litigation or arbitration, any more than a complaint letter to a bar association places an attorney’s

conduct in issue in a litigation or arbitration. To be an “issue” in such a venue, there must be an actual lawsuit or arbitration that concerns the person’s conduct, not a complaint which eventually may be found groundless.

The second arbitrator, John Morgan, is employed with a securities firm that may have been actively working with respondents in connection with a Securities and Exchange Commission (SEC) investigation involving a third party’s alleged price manipulation scheme. Mr. Morgan had been named as a witness in the SEC’s case shortly after the instant hearings began. Mr. Morgan failed to disclose this relationship, although the questionnaire provided by petitioners asked whether he was involved in any securities litigation. It is noted that there is no allegation that Mr. Morgan had any direct or indirect business relationship with respondents, merely that his company and respondents were both part of an SEC investigation of a non-related third party. Furthermore, petitioners themselves state that there is nothing improper with Mr. Morgan’s co-operation with respondents in the SEC investigation.

In *J.P. Stevens & Co. v Rytex Corporation* (34 NY2d 123 [1974]), the court vacated an arbitration award in which two of the arbitrators failed to disclose that they had substantial business relationships with one of the parties, a relationship that netted their business several million dollars annually. The court granted vacatur because the relationship was demonstrably substantial; however, the court went on to say that not every kind of business relationship would disqualify an arbitrator.

In the instant case, petitioners have not proffered an argument that Mr. Morgan had any type of business relationship with respondent, and the SEC investigation for which Mr. Morgan was named as a witness does not involve respondent or Mr. Morgan’s company as parties.

Furthermore, petitioners have not indicated any specific act of bias or partiality on the part of Mr. Morgan.

There is no “per se rule requiring vacatur of an award whenever an undisclosed relationship is discovered.” (*Merrill Lynch, Pierce, Fenner & Smith Incorporated v Graef*, 34 AD3d 220, 221 [2006], citing *Matter of Weinrott (Carp)*, 320 NY2d 190 [1973]). Further, not all undisclosed relationships automatically result in the disqualification of an arbitrator or provide the basis to vacate an arbitral award. (*Wagner Stott Clearing Corp. and J.A. Celentano Securities Corp.*, 225 AD2d 367 [1st Dept 1996]).

Although Mr. Morgan’s decision not to disclose the fact that he had been named as a witness in a securities litigation cannot be condoned, neither can it form the basis, without some specific indication of bias or partiality, for vacating the arbitration award. This is especially so since the litigation for which he was named as a witness has absolutely no relationship to the instant arbitration, and there is no business relationship between Mr. Morgan and respondent.

Therefore, based on the foregoing, it is concluded that the arbitration award cannot be vacated on the grounds of arbitrator bias or partiality.

3. The Allegation that the Arbitrators Disregarded Petitioners’ Claim of Breach of a Fiduciary Relationship.

Petitioners allege that Hilel, who acted as petitioners’ broker, exercised de facto control over petitioners’ trust account, thereby engendering a fiduciary duty to petitioners that goes beyond that of ordinary care. Petitioners further assert that when the panel limited their expert’s testimony the panel was, in fact, disregarding petitioners’ theory of de facto management of the trust.

In reading the transcript of the hearing in which petitioners' expert, Mr. Conner, was ruled to be allowed to testify as to damages only, the panel indicated that they saw no relevance in the expert's other opinions "at this time," because they viewed this portion of the claim to be based on purchase suitability, not portfolio management. However, the door was apparently left open for petitioners to recall Mr. Conner at a later date once they had provided a foundation sufficient to satisfy the panel that de facto control was an issue. It is noted that at the time Mr. Conner was offered as an expert witness there had already been fifteen days of hearings.

Petitioners argument is founded on the assertion that the panel totally ignored one of the legal arguments forming the basis of their claim. This is not supported by the evidence. As indicated in the transcript, the panel considered the argument of de facto control but did not find it relevant. As a consequence, the question is whether the court has the ability to overturn an arbitral award based on an arbitration panel's decision that a legal argument is not relevant, not based on its failure to consider a legal argument.

"An arbitration award may be vacated on three narrow grounds: it violates a strong public policy, is irrational, or clearly exceeds a specifically enumerated limitation on the arbitrator's power [internal quotation marks and citations omitted]." (*United Federation of Teachers, Local 2, AFT, AFL-CIO v Board of Education of the City School District of the City of New York*, 1 NY3d 72, 79 [2003]). In the case at bar, petitioner would proffer that the rationale for vacating the arbitration award would be that the panel's action in not finding a legal argument relevant was either contrary to public policy or irrational based on a manifest disregard of the law. Neither appears to be the case.

The evidence presented at the hearing was sufficient for the arbitrators to conclude that

Hilel did not exercise de facto control over petitioners' trust account. The paperwork submitted stated that the account was to be non-discretionary, and the panel only found one trade to have been unauthorized by petitioners. In his initial paperwork to establish the account, petitioner Gaston Banna (Banna) stated that he had assets of over \$10 million, had knowledge of and experience in dealing with stocks, bonds and mutual funds for twelve to nineteen years, reviewed financial reports daily, and was interested in a growth account that would be invested in stocks, bonds, mutual funds and options. He further indicated that he had no liquidity needs. Also, according to the papers he signed, he was looking for a portfolio that would contain 60-80% equities. Although petitioners characterize Banna as an unsophisticated individual with only the equivalent of a high school education, his own written statements to respondents indicate an extremely wealthy person with a significant degree of investment experience.

As stated above, pursuant to CPLR 7506 (c), an arbitrator may hear any evidence that he or she considers relevant, and may exclude that evidence he or she deems irrelevant, provided that such exclusion is not irrational. An arbitrator's decision as to which evidence is relevant and material is not subject to judicial scrutiny (*Credit Suisse First Boston Corporation v Crisanti, supra*), and therefore that arbitral determination is not in and of itself contrary to public policy. Petitioners have provided no argument with respect to the arbitrators' decision on this issue that it violates public policy.

Furthermore, an award may be found on review to be rational if any plausible basis exists for its conclusion is apparent to the court, provided that the arbitrators considered the evidence in "good faith." (*Caso v Coffey*, 41 NY2d 153, 158 (1976); *Travelers Insurance Company v Job*, 239 AD2d 289 [1st Dept 1997]). There is no evidence presented that the arbitrators in the instant

matter did not exercise good faith in reviewing the evidence. Also, there is a plausible basis for the panel's determination that respondent did not exercise de facto control over petitioners' account. (*Azrielant v Azrielant, supra*).

Even though there was evidence that respondent did not specifically delineate transaction fees in reports to petitioners, and that the monthly reports were held by respondent, at petitioners' written request, and only transferred to petitioners sporadically, enough evidence was presented that indicate that petitioners were knowledgeable and experienced investors, and that the account was designated by petitioners in writing to be non-discretionary so as to support the panel's findings. Courts are obliged to give deference to the decisions of the arbitrators. *Matter of Henneberry*, 10 NY3d 278, 284 (2008). In other words, the court is bound by the arbitrators factual findings (*World Diamond Trade Corp. and Siegmann*, 158 AD2d 300, 301 [1st Dept 1990]), and are not permitted to review mistakes of law or facts. (*See Meehan v Nassau Community College*, 242 AD2d 155 [2d Dept 1998]).

Petitioners also argue that, separate and distinct from the theory of de facto control, there is an issue of the unsuitability of the individual transactions related to petitioners' account and respondent's obligations with respect to the transactions made on petitioners' behalf. It was based on this evidence that the panel rendered its eventual award.

As the court said in *de Kwiatkowski v Bear, Stearns & Co., Inc.*, (306 F3d 1293 [2d Cir 2002]), a broker ordinarily has no duty to monitor a nondiscretionary account. Although on a transaction-by-transaction basis the broker owes duties of diligence and competence in executing the client's trade orders, such duties do not create ongoing duties.

Although there is evidence to support an argument that respondent provided constant

investment advice and suggestions to petitioners, there is also evidence to indicate that petitioners agreed to all but one trade effectuated on their behalf by respondent, for which the arbitrators rendered an award. As stated previously, a court may not set aside an arbitrator's decision merely because it may disagree with it. (*Board of Education of Central School District No. 1 of Towns of Niagara, Wheatfield, Lewiston and Cambria, supra*). In other words, a court "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. (*Matter of New York State Correctional Officers & Police Benevolent Assoc., Inc. v New York State*, 94 NY2d 321, 326 [1999]).

Based on the preceding, there is no basis for the court to vacate the arbitral award based on the panel's alleged disregard of the theory of de facto control.

4. The Alleged Failure of the Arbitrators to Follow the Procedures of CPLR 7506 (c) to Permit Petitioners to Present Evidence in Support of Their Claims.

Petitioners do not present any argument on this point other than the panel's refusal to hear their expert testify on certain matters which has previously been discussed and requires no further elucidation.

CONCLUSION

It is hereby

ORDERED and ADJUDGED that the petition to vacate the arbitral award is denied.

Dated: June 12, 2008

ENTER:

J.S.C.

UNFILED JUDGMENT
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