Mathews v Chen
2020 NY Slip Op 30398(U)
February 10, 2020
Supreme Court, New York County
Docket Number: 101554/2018
Judge: Jennifer G. Schecter

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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DEVIS MATHEWS,

Plaintiff,

-against-

KEVIN CHEN, WEATHERVANE FINANCIAL LLC, WEATHERVANE CAPITAL INC., IRON HORSE ASSET MANAGEMENT LLC, PHOENX FINANCIAL CONSOLIDATED HOLDINGS LP, PHX MANAGEMENT LLC, PHOENIX FINANCIAL SERVICES INC., PHX FINANCIAL INC., and KAJJ MANAGEMENT LLC,

Defendants.

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Index No.: 101554/2018

DECISION & ORDER

JENNIFER G. SCHECTER, J.:

By order dated November 12, 2019, plaintiff's claims were dismissed except for his breach-of-contract claim against defendant Kevin Chen (Dkt. 35; *see* Dkt. 40 [11/12/19 Tr.]). Chen moves for reargument, contending that the remaining claim is subject to mandatory FINRA arbitration. Plaintiff opposes the motion.

The issue is whether a dispute over whether an individual ultimately has an equity stake in a FINRA member necessarily "arises in connection with the business activities" of that member entity so as to subject the dispute to mandatory arbitration under FINRA Rule 12200 (*see Citigroup Glob. Markets Inc. v Abbar*, 761 F3d 268, 274 [2d Cir 2014]). In this case, plaintiff alleges that he and Chen entered into an agreement to form Blackwall Capital Management, LLC (the Company) in 2011 and that they would each be 50% members of the Company. Shortly thereafter, the Company, through another

company in which the Company was the general partner, acquired Grandview Capital, Inc. (later rebranded with the Blackwall name), a broker-dealer that is a FINRA member (the Broker-Dealer).[1] Plaintiff became the Broker-Dealer's CEO. The following year, in 2012, Chen terminated plaintiff as CEO. In 2019, plaintiff commenced this action, asserting a breach-of-contract claim based on Chen's failure to recognize plaintiff as a 50% owner of the Company, which, in turn, would give him an indirect 50% interest in the Broker-Dealer. Plaintiff claims he has been wrongfully excluded from the Company and that he has not been paid his share of its profits.

In denying dismissal, this court observed that defendants did not cite any case holding that a dispute over whether, prior to the formation and operation of a company, the parties agreed that each would own a 50% stake is subject to mandatory FINRA arbitration (*see* Dkt. 40 at 16). The question in the court's mind was whether a threshold dispute over whether a party has a stake in a FINRA member arises from that entity's business activities if such interest arises from an alleged agreement that predates the activities and indeed the existence of that FINRA entity. Here, the Company itself is not a FINRA member and only acquired a FINRA-member-subsidiary after the alleged oral agreement was reached.

[1] The complaint is somewhat unclear about whether plaintiff claims to have a direct 50% interest in the partnership or whether that interest derives from his alleged stake in the Company. For the purposes of this motion, this is immaterial.

On reargument, Chen has still not cited any authority compelling arbitration of the ownership issue.[2] His purported best case is *Christensen v Nauman* (73 F Supp 3d 405 [SDNY 2014]).[3] *Christensen*, however, did not involve a dispute over whether the plaintiff had any stake in the FINRA member at the outset, but rather concerned disputes arising during the period of plaintiff's ownership, including dilution of his interest (*see id.* at 408). The court did not purport to opine on the arbitrability of a claim that accrued prior to the occurrence of business activities of the FINRA member and which is based entirely on allegations regarding what occurred before the parties acquired the FINRA member. Instead, the primary issue decided by the court was whether disputes concerning compensation and corporate governance are both subject to arbitration (*see id.* at 412). The court rejected that distinction as immaterial (*see id.* at 413 ["his dispute with defendants exclusively involved the management, or alleged mismanagement, of that business—specifically, defendants' alleged failure to distribute profits or sales proceeds of that business, KCCI, to Christensen, or to respect his rights as a director ... It is only because of Christensen's business relationship with KCCI and its fellow owners—the individual defendants he sues—that he has an internal corporate governance claim to pursue"] [emphasis added]).[4]

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[2] Plaintiff did not agree to a broader scope of arbitration in his Form U4. He merely agreed to arbitrate claims required by FINRA rules (*see* Dkt. 47 at 13).

[3] Chen does not contend there is any controlling appellate authority that supports his argument.

[4] Derivative claims were held not subject to FINRA arbitration (*see id.* at 414). Plaintiff does not assert any derivative claims in this action.

Christensen is therefore inapposite. Here, the question is whether the parties had an agreement – before the Company was formed and its later-acquired broker-dealer operated – that plaintiff would own 50% of the Company (which is not even a FINRA member). The facts pertinent to this dispute have nothing to do with how the Company and the Broker-Dealer were operated or their internal affairs. Thus, the business activities of a FINRA member or an associated person do not give rise to this dispute and plaintiff's claim is not subject to FINRA arbitration.

That said, if plaintiff is found to own equity in the Company and consequently in the Broker-Dealer, there may well be issues that arise out of the Broker-Dealer's business activities that must be arbitrated such as the failure to provide plaintiff with his pro rata share of the profits. Thus, the threshold question of ownership[5] must be decided by the court and then, if plaintiff really does own a 50% stake in the Company, Chen may seek to compel arbitration of issues related to the Broker-Dealer's business activities.[6]

Accordingly, it is

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[5] Arguably, the claim should be considered one for a declaratory judgment and not breach of contract, but plaintiff's labeling of the claim does not subject it to dismissal (*Leon v Martinez*, 84 NY2d 83, 88 [1994] ["the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one"]).

[6] In *Christensen* it made sense to arbitrate first because it was unclear whether plaintiff even had viable derivative claims. Here, plaintiff will not have any arbitrable claims unless he owns a stake in the non-FINRA member Company, and that question is not subject to arbitration. It makes no sense to proceed to arbitration first or in tandem as the arbitration would be moot if Chen prevails here. For the avoidance of any doubt in the future, the court finds that Chen's litigation of the threshold ownership question by virtue of this decision shall not be deemed a waiver of arbitration so long as he does not seek in this action to assert claims beyond the scope of this limited issue. To the extent that Chen has already commenced a FINRA arbitration on these issues, this decision should guide the parties. That said, since the specific claims asserted in the arbitration have not been disclosed to the court, the court will not opine on the propriety of that arbitration at this time.

ORDERED that Chen's motion for reargument is granted and, upon reargument, the court adheres to its previous decision that the parties' disputes over whether plaintiff is a 50% member of the Company (and/or has a 50% stake in the partnership) is not subject to mandatory FINRA arbitration but that any direct claims that arise from the Broker-Dealer's business activities will be subject to arbitration if and when plaintiff is held to be a member of the Company (and/or 50% owner of the partnership) and such direct claims are stayed pending determination of whether plaintiff has any stake in the Company (and/or the partnership) and discovery will be limited to the threshold question of plaintiff's alleged ownership; and it is further

ORDERED that a preliminary conference will be held on February 27, 2020 at noon, and the parties shall submit their joint letter at least one week beforehand; and it is further

ORDERED that pursuant to CPLR 8501 and 8503 plaintiff must give security for costs by an undertaking in the amount of $500.

Dated: February 10, 2020 ENTER:

Jennifer G. Schecter, J.S.C.