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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: Joan B. Lobis Justice

PART 6

Index Number : 108492/2011
BAKER, JOHN J.
vs.
MERRILL LYNCH, PIERCE, FENNER
SEQUENCE NUMBER : 002
OTHER RELIEFS

INDEX NO. _____
MOTION DATE 9/15/11
MOTION SEQ. NO. _____

The following papers, numbered 1 to ____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). 1-4
Answering Affidavits — Exhibits _____ | No(s). 7-8
Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion is

THIS MOTION IS DECIDED IN ACCORDANCE WITH THE ACCOMPANYING MEMORANDUM DECISION ORDER & JUDGMENT

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

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 141B).

Dated: 3/9/12

JOAN B. LOBIS, J.S.C.

1. CHECK ONE: ..... ☑ CASE DISPOSED ☐ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: .....MOTION IS: ☐ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY: IAS PART 6

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JOHN J. BAKER, NATALIE N. BAKER and
THE ESTATE OF HARRIET B. BAKER,

Petitioners,

Index No. 108492/11

-against-

Decision, Order, and Judgment

MERRILL LYNCH, PIERCE, FENNER &
SMITH, INCORPORATED,

Respondents.

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JOAN B. LOBIS, J.S.C.:

Motion Sequence Numbers 001 and 002 are hereby consolidated for disposition. In Motion Sequence Number 001, petitioners John J. Baker, Natalie N. Baker, and John Baker, as Personal Representative of the Estate of Harriet B. Baker,[1] bring this special proceeding, pursuant to Article 75 of the C.P.L.R., seeking an order confirming the arbitration award of the Financial Industry Regulatory Authority, Inc. ("FINRA") dated June 23, 2011 ("Award"). Respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch") cross-moves for an order vacating the Award. In Motion Sequence Number 002, petitioners move for sanctions against Merrill Lynch under 22 N.Y.C.R.R. § 130-1.1, and Merrill Lynch opposes the motion.

Petitioners' claims against respondent in the underlying arbitration proceeding relate to respondent's management of petitioners' investments in the Merrill Lynch Phil Scott Team Income Portfolio ("Income Portfolio"). Petitioners began seeing a drop in their account values in the fall of 2007. They raised concerns with Mr. Scott and his team, who advised them to "stay the

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[1] By stipulation dated December 12, 2011, and so-ordered on December 14, 2011, John Baker, as Personal Representative of the Estate of Harriet B. Baker, was substituted as a petitioner in place of "The Estate of Harriet B. Baker." Harriet B. Baker was a petitioner in the original arbitration and she died on June 24, 2011, after the Award was issued.

course." Apparently, petitioners' investments in the Income Portfolio rapidly declined during the economic crisis in late 2008 and early 2009, and despite respondent's advice to weather what it believed to be a temporary share price depreciation, petitioners liquidated their positions on March 6, 2009, the market's lowest day during the financial crisis. After petitioners pulled their money out of the Income Portfolio, the Income Portfolio experienced a "rapid recovery," such that respondent states that had petitioners remained in the Income Portfolio, they would have profited by $1,250,000.

Petitioners commenced arbitration proceedings against respondent by filing a statement of claim on or about December 1, 2009. In their statement of claim, petitioners set forth that they invested $6,500,000.00, their entire net worth, with Merrill Lynch. They stated that their financial goal was to preserve their principal and generate income with very conservative risk tolerances. The statement set forth that Merrill Lynch and Mr. Scott advised them to invest all their funds in the Income Portfolio. Petitioners claimed that they were informed that the Income Portfolio was stable, conservative, well-diversified, low risk, and safe, but in reality the Income Portfolio was concentrated in equities that were volatile during the downturn of the market from October 2007 through March 2009. Petitioners claimed that respondent took advantage of them and mismanaged their money by exposing them to unnecessarily high risk; recommending an investment strategy that did not suit their risk tolerance; failing to diversify their money; failing to follow their goals of preservation of capital and safety of principal; and misrepresenting the risks related to the investment in the Income Portfolio.

In their statement of claim, petitioners asserted the following causes of action against respondent: violation of the Securities and Exchange Act of 1934; unsuitability; common law fraud;

breach of fiduciary duty; breach of contract; failure to supervise; respondeat superior; negligence; gross negligence; and negligent supervision. Petitioners requested $1,700,000.00 in compensatory damages plus interest, unspecified punitive damages, and their expenses in bringing the arbitration. Respondents answered and asserted affirmative defenses. The arbitration hearing took place from March 21-30, 2011, and May 16-20, 2011. On June 23, 2011, FINRA served the parties with the written Award, which sets forth that respondent is liable to petitioners for compensatory damages in the amount of $880,000.00, and assessed $34,800 of the fees associated with the arbitration to respondent. Petitioners now seek an order confirming the Award.

In its cross motion, respondent argues that the Award should be vacated under the Federal Arbitration Act ("FAA") and New York law on the grounds that the arbitration panel ("Panel") engaged in prejudicial misconduct by refusing to hear evidence pertinent and material to the controversy. The Panel ruled that all evidence following petitioners' filing of their statement of claim on December 1, 2009 was irrelevant. Respondent had wanted to submit evidence related to petitioners' later investments with RBC Wealth Management ("RBC"), to which they moved their money after the arbitration had already been commenced; specifically, respondent sought to admit evidence related to petitioners' risk tolerance as they stated it to RBC. Respondent also wanted to submit evidence regarding the later performance of the Income Portfolio, and expert opinion evidence that respondent's recommendation for petitioners to remain invested in the Income Portfolio was consistent with petitioners' stated risk tolerance. Respondent maintains that this evidence was relevant and necessary to showing that its management of petitioners' money in the Income Portfolio and its advice regarding same was both appropriate and correct. Respondent argues that the Panel's determination to preclude evidence subsequent to the commencement of the

arbitration proceeding amounted to prejudicial misconduct because it prevented respondent from presenting evidence material to its defense. Respondent argues that the unfair ruling regarding evidence amounts to misconduct requiring vacatur of the Award

Respondent also asserts that the arbitrators—one arbitrator, in particular—repeatedly fell asleep during the hearing over the parties' objections. Respondent argues that habitual sleeping during the hearing amounts to arbitrator misconduct and requires that the Award be vacated.

In opposition, petitioners argue that respondent's cross motion is baseless and that there are no grounds to vacate the Award. They point out that respondent failed to attach a complete transcript or record of the arbitration hearings upon which the court might rely. They argue that the Panel properly considered and rejected respondent's arguments regarding discovery, and properly limited the evidence admitted to that which occurred prior the commencement of arbitration. They also dispute respondent's characterization of the Panel as "habitually" falling asleep during the proceedings. Rather, petitioners assert that the Panel was alert, asked numerous questions, and thoroughly reviewed the evidence. Additionally, they maintain that when petitioners moved to recuse from the Panel one of the arbitrators—the one who had been falling asleep—due to bias in favor of respondent as perceived by petitioners, respondent opposed petitioners' motion even after several hearing sessions of the arbitrator's purported sleeping. Moreover, petitioners argue that respondent failed to object to either issue on the record during the arbitration.

It is well established, in both New York and Federal practice, that "an arbitrator's rulings . . . are largely unreviewable." In re Falzone v. New York Cent. Mut. Fire Ins. Co., 15

N.Y.3d 530, 534 (2010) (citations omitted). See also, e.g., Wein & Malkin LLP v. Helmsley-Spear, Inc., 6 N.Y.3d 471, 479 (2006); Tempo Shain Corp. v. Bertek, Inc., 120 F.3d 16, 19 (2d Cir. 1997). Both the Federal Arbitration Act ("FAA") (9 U.S.C. § 1 et seq.) and Article 75 of the C.P.L.R. contain similar provisions for confirmation and vacatur of an arbitration award. Under New York State and Federal law, the court must grant a party's application to confirm an award as long as the application is made within one year of the award and as long as the award has not been vacated or modified. 9 U.S.C. § 9; C.P.L.R. § 7510. Under both Federal and State practice, a party moving to vacate an award bears the burden of proving that the award is subject to vacatur. See, e.g., Boggin v. Wilson, 14 A.D.3d 523, 524 (2d Dep't 2005); Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp., 103 F.3d 9, 12 (2d Cir. 1997). "The arbitrator's rationale for an award need not be explained, and the award should be confirmed if a ground for the arbitrator's decision can be inferred from the facts of the case[.]" D.H. Blair & Co., Inc. v. Gottdiener, 462 F.3d 95, 110 (2d Cir. 2006) (citations and internal quotation marks omitted). Further, "[o]nly a barely colorable justification for the outcome reached by the arbitrators is necessary to confirm the award." Id. (citations and internal quotation marks omitted). See also In re Brown & Williamson Tobacco Corp. v. Chesley, 7 A.D.3d 368, 372 (1st Dep't 2004).

Under the FAA, in pertinent part, a court may vacate an award "where the arbitrators were guilty of misconduct . . . in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced[.]" 9 U.S.C. § 10(a)(3). Similarly, under New York law, in pertinent part, an arbitration award shall be vacated if the court finds that the rights of any party were prejudiced by misconduct. C.P.L.R. § 7511(b)(1)(i). However, "[a]rbitrators enjoy broad discretion to decide whether to hear certain evidence[,] . . . [and]

need only hear enough evidence to make an informed decision." Fellus v. Sterne, Agee & Leach, Inc., 783 F. Supp. 2d 612, 621 (S.D.N.Y. 2011). Indeed, "it is well within an arbitrator's authority to refuse to hear evidence that is of little relevance." Century Indem. Co. v. Certain Underwriters at Lloyd's, London, 584 F.3d 513, 558 (3d Cir. 2009). A party seeking to vacate an award must make a showing that the misconduct amounts "to a denial of fundamental fairness of the arbitration proceeding." Fellus, 783 F. Supp. 2d at 618 (citations and internal quotation marks omitted). See also Century Indem., 584 F.3d at 557; Kaminsky v. Segura, 26 A.D.3d 188, 189 (1st Dep't 2006).

Though the arbitrators provided no reasoning in support of the Award and respondent failed to provide the court with the entire record for the underlying arbitration proceedings and hearings, from the submissions that the parties do provide, there is no basis for the court to vacate the Award. The arbitrators were within their authority to limit the evidence to that which was relevant to the disputes. The disputes pertained to respondent's relationship, interactions, and communications with petitioners prior during the economic downturn, leading up to petitioners' decision to liquidate their positions in the Income Portfolio. Thus, there were grounds for the arbitrators to limit admissible evidence to that which pertained to the time period in question. This ruling followed written submissions, oral argument, and argument during the hearing. Further, respondent had a full opportunity to present evidence related to the time period in question. Respondent has not made a showing that it was subject to a fundamental unfairness such that it was deprived of a fair hearing.

Further, there is no basis in the record to vacate the Award due to arbitrator misconduct for sleeping during the hearings. Respondent failed to provide clear and convincing

proof of this claim. In re Moran v. N.Y. City Transit Auth., 45 A.D.3d 484, 484 (1st Dep't 2007). Respondent's claim that the arbitrator "habitually" or "repeatedly" fell asleep during the proceedings is contradicted by petitioners' account of the proceedings, and there is no indication in the excerpts of the transcripts provided by respondent that respondent objected to the arbitrator's alleged sleeping. See id. at 484-85.

In Motion Sequence Number 002, petitioners seek sanctions against respondent under 22 N.Y.C.R.R 130-1.1(a) for filing what petitioners allege is a frivolous cross motion to vacate the Award. Petitioners argue that respondent's cross motion states no real basis in law to vacate the Award; that the cross motion is inundated with misrepresentations and omissions; that respondent fails to attach a complete transcript of the underlying hearings; and that respondent filed the cross motion only to delay payment of the Award. In opposition, respondent argues that sanctions are inapplicable because it has made cogent arguments based upon existing law; that it acted in good faith in filing the cross motion; that petitioners failed to cite a single alleged false statement made in the cross motion; and that the court should, instead, sanction petitioners or their attorneys for filing a frivolous sanctions motion.

Section 130-1.1(a) sets forth that the court has discretion to award reimbursement for "actual expenses reasonably incurred and reasonable attorney's fees, resulting from frivolous conduct as defined in this Part." The court also has discretion to "impose financial sanctions upon any party or attorney . . . who engages in frivolous conduct[.]." Section 130-1.1(c) sets forth that conduct is frivolous if

> (1) it is completely without merit in law and cannot be supported by a reasonable argument for an extension, modification or reversal of existing law;
>
> (2) it is undertaken primarily to delay or prolong the resolution of the litigation, or to harass or maliciously injure another; or
>
> (3) it asserts material factual statements that are false.
>
> Frivolous conduct shall include the making of a frivolous motion for costs or sanctions under this section. In determining whether the conduct undertaken was frivolous, the court shall consider, among other issues the circumstances under which the conduct took place, including the time available for investigating the legal or factual basis of the conduct, and whether or not the conduct was continued when its lack of legal or factual basis was apparent, or should have been apparent, or was brought to the attention of counsel or the party.

The cross motion is not so lacking in merit as to warrant sanctions. There exists some predicate for vacating an arbitration award on the basis that certain evidence was excluded by the arbitrators, or on the basis that an arbitrator was sleeping during testimony, even though respondent failed to sufficiently demonstrate that vacatur was warranted based on these arguments under these circumstances herein. Further, respondent's failure to include a copy of the transcript is not necessarily grounds for sanctions because the court was able to reach a decision on the basis of the excerpts submitted. The court declines to consider respondent's dueling request for sanctions on the grounds that respondent failed to properly move for such relief. See Thomas v. Drifters, Inc., 219 A.D.2d 639, 640 (2d Dep't 1995); C.P.L.R. Rule 2215. Accordingly, it is hereby

ADJUDGED that the petition (Motion Sequence Number 001) is granted and the award rendered in favor of petitioners and against respondent is confirmed; and it is further

ADJUDGED that petitioners John J. Baker, Natalie N. Baker, and John Baker, as Personal representative of the Estate of Harriet B. Baker, having an address at 16 Herdt Farm Lane, Pound Ridge, New York, 10576, do recover from respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated, having an address at One Bryant Park, New York, New York, 10036, the amount of _____, plus interest at the rate of ____% per annum from the date of _____, as computed by the Clerk in the amount of $ _____, together with costs and disbursements in the amount of $ _____ as taxed by the Clerk, for the total amount of $_____, and that the petitioner have execution therefor; and it is further

ORDERED that respondent's cross motion to vacate the Award is denied; and it is further

ORDERED that petitioners' motion for sanctions (Motion Sequence Number 002) and respondent's request for sanctions as contained in its opposition to Sequence 002 are denied.

Dated: March 9, 2012

ENTER:

JACOB. LOBIS, J.S.C.