Matter of Melius v Paulson Inv. Co., Inc.
2010 NY Slip Op 33042(U)
October 18, 2010
Supreme Court, Nassau County
Docket Number: 012997/2010
Judge: Ira B. Warshawsky
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SHORT FORM ORDER

SUPREME COURT - STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:
HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 8

In the Matter of the Application Between

GARY MELIUS and ROGER BAHNIK,

Petitioners,

INDEX NO.: 012997/2010
MOTION DATE: 08/20/2010
MOTION SEQUENCE: 001 and 002

-against-

PAULSON INVESTMENT COMPANY, INC. and JOHN L. DONAHUE,

Respondents,

For an Order pursuant to CPLR § 7511 to Vacate an Arbitration Award.

The following papers read on this motion:

Notice of Motion, Verified Petition, Affidavits & Exhibits Annexed 1
Petitioners' Memorandum of Law in Support of Motion to Vacate the Arbitration Award 2
Notice of Cross-Petition 3
Answer and Cross-Petition 4
Affirmation of Richard J. Babnick, Jr. in Support of Cross-Petition To Confirm Arbitration Award and in Opposition to the Petition to Vacate the Award & Exhibits Annexed 5
Respondents' Memorandum of Law in Opposition to the Petition to Vacate the Arbitration Award and in Support of their Cross-Petition to Confirm, or Alternatively, to Modify and Confirm, the Award and Enter Judgment Thereon 6
Affirmation of Ronald R. Rosenberg in Opposition to Cross-Petition and in Further Support of Motion to Vacate Award 7

Motion (Sequence No. 1) by the attorneys for the petitioners for an order pursuant to CPLR § 7511 and/or 9 U.S.C. § 10 vacating the award of the arbitrators dated May 27, 2010 (the "Award"), which was issued in *In the Matter of the Arbitration Between Paulson Investment Company, Inc., as Claimant against Gary Melius and Roger Bahnik, as Respondents v RBC Correspondent Services and John L, Donahue, Third Party Respondents* by the Financial Industry Regulatory Authority ("FINRA"), Arbitration Number 09-00005 and pursuant to CPLR § 7511(d) directing that a new hearing be held before a new panel of arbitrators selected pursuant to FINRA's rules is granted; cross-motion (Sequence No. 2) by the attorneys for the respondents for an order pursuant to CPLR § § 7510 and 7511 granting the Cross-Petition confirming the Award and directing Paulson Investment Company, Inc. ("Paulson") to apply the proceeds in petitioners' account maintained at Paulson to the Award; or, alternatively, pursuant to CPLR §§ 7510 and 7511(c) modifying and confirming the Award allowing for the offset of the proceeds in petitioners' Paulson account; awarding petitioners, pursuant to the Margin Agreement entered into between Paulson and petitioners, their reasonable attorneys' fees incurred in the instant proceeding (in addition to the attorneys' fees awarded to Paulson by the arbitrators in the Award that were incurred in connection with the arbitration proceeding) and directing the Clerk to enter judgment based upon the confirmed Award is denied.

Petitioners Gary Melius and Roger Bahnik (collectively, the petitioners) bring this proceeding to vacate the arbitration award dated May 27, 2010 rendered by an arbitration panel adjudicating claims pursuant to the FINRA Code of Arbitration Procedure for Customer Disputes in favor of respondents Paulson Investment Company, Inc. (Paulson) and John L. Donahue (Donahue) (collectively, the respondents) in the arbitration entitled *Paulson Investment Company Inc. v Gary Melius and Roger Bahnik v RBC Correspondent Services and John L. Donahue*, FINRA Case No. 09-00005 (the "Arbitration"). Respondents Paulson and Donahue bring the Cross-Petition, pursuant to CPLR § § 7510 and 7511, to confirm and/or enter judgment on the Award.

Paulson commenced the Arbitration against petitioners before the FINRA to collect approximately $123,000 in margin debt that petitioners allegedly had incurred in their joint brokerage account at Paulson. In the arbitration, petitioners subsequently filed a counterclaim and

third-party claims against RBC Correspondent Services and Donahue, who was the registered representative assigned to the subject account. On or about May 25, 2010, after four days of hearing and receiving post-hearing briefs, the Arbitration Panel (the "Panel") issued a unanimous award in favor of respondents and against petitioners jointly and severally in the amount of $94,115 on the margin debt claim; $59,549 in attorneys' fees under the Margin Agreement; expungement of this matter from Mr. Donahue's securities license; and dismissal of petitioners' counterclaim and third-party claims.

Petitioners argue that the award should be vacated due to a conflict of interest between Arbitrator Scott W. Mulford and respondents' law firm.

In March 2009, the parties made their selection of arbitrators. Chairman Joseph B. Russell, Public Arbitrator Mary Ellen Burns, and Non-Public Arbitrator Michael Tully were selected.

On March 22, 2010, just one week before the hearing, petitioners received a letter from the Case Administrator stating that Arbitrator Tully had "withdrawn from the Panel" and that Scott W. Mulford was being named as his replacement. The arbitrator disclosure statement for Mr. Mulford showed that (i) he was a financial advisor and broker, like respondent John Donahue; (ii) he had just completed basic FINRA training in October 2009; and (iii) he had never participated in an arbitration. It also showed that he was employed by Wells Fargo and before that, Wachovia Securities. Petitioners argue that the appointment of Mr. Mulford was improper in that the arbitrator should have come from the ranked list submitted by the parties, citing FINRA Rule 12411(b). Rule 12411 provides the procedure when there are no remaining arbitrators who were on the consolidated lists. FINRA Rule 12411(c) states:

> If there are no available arbitrators of the required classification on the consolidated list, the Director will appoint an arbitrator of the required classification to complete the panel from names generated by the Neutral List Selection System. The Director will provide the parties information about the arbitrator as provided in Rule 12403, and the parties shall have the right to object to the arbitrator as provided in Rule 12410.

At the time petitioners accepted the panel which included Arbitrator Mulford, no disclosure was made to petitioners that Mr. Mulford worked for Wells Fargo and that

respondents' law firm also represented Wells Fargo and before that Wachovia Securities.

Respondents acknowledge that their law firm represents Wells Fargo and before that Wachovia Securities, which is also an employer of Arbitrator Mulford. Mr. Mulford's Disclosure Statement (Exhibit "3" to Answer and Cross-Petition) shows that he has worked as a Senior Financial Advisor for Wells Fargo since 2005 and is currently a Senior Financial Advisor and Managing Principal for Wells Fargo. Mr. Mulford described his employment as follows:

> "Since 2005, I have been employed as Senior Financial Advisor and Managing Principal at Wells Fargo Advisors Network. I supervise daily trading activity for a team of three Financial Advisors, with the ultimate accountability for the management of 800 plus client accounts and a portfolio of asset[s] totaling over $125 million . . . ."

It is undisputed that Arbitrator Mulford works for and is paid by the same company that Sichenzia Ross represents. Respondents argue that because petitioners' counsel accepted the Panel "as is," petitioners should be deemed to have waived any objections to the alleged conflict of interest. Petitioners were unaware, until after the Award was rendered, that Sichenzia Ross represented Mulford's employer, Wells Fargo as well as the respondents. Petitioners argue that the only party with knowledge of the dual representation was respondents' counsel who failed to disclose this fact to the Panel, the petitioners or their counsel.

The failure of an arbitrator to disclose facts that may reasonably support an inference of bias is grounds to vacate an award pursuant to CPLR § 7511. (*See J.P. Stevens & Co. v Rytex Corp.*, 34 NY2d 123 [1974]; also *SOMA Partners LLC v Northwest Biotherapeutics, Inc.*, 41 AD3d 257 [1st Dept 2007]). Petitioners argue that had they been aware that respondents' counsel represented Wells Fargo and that Mr. Mulford was employed by Wells Fargo they would not have voluntarily proceeded with the arbitration, but rather would have objected to the arbitration panel. Any relationship that raises even a suggestion of possible bias should be disclosed. (*Siegel v Lewis*, 40 NY2d 687 [1976]; *SOMA Partners, LLC v Northwest Biotherapeutics, Inc.*, 41 AD3d at 258).

In *In re Sobel*, 37 AD3d 877, the court refused to vacate an award where the "industry arbitrator was employed by a large, national brokerage firm whose outside counsel also was the

respondent's counsel." In *Sobel*, the industry arbitrator was disclosed to the parties and the Panel:

> "The replacement arbitrator was a former employee of a large brokerage firm that had been represented by respondent's counsel. This was disclosed and there was no evidence that the arbitrator, while at his former job, had any professional dealings with respondent's counsel." (emphasis added).

Contrary to the arguments made by the respondents' attorneys, *Sobel* supports vacatur of the Award. The purpose of disclosure is to assure transparency so all parties have the necessary facts to make an informed decision as to whether a conflict of interest exists. To overcome the inference of bias and conflict of interest it is not persuasive at this stage of the proceedings for respondent's counsel to assert that prior to the hearing none of the attorneys at the firm had ever met or communicated with Arbitrator Mulford or that he was a complete stranger to anyone at the respondent's law firm; or that one of the petitioners was not credible, "a proven liar." (Affirmation in support of cross-motion, p. 6, ¶ 21). Respondents' attorney's conclusion that there was no appearance of impropriety is of little weight without input from the arbitrator, and all parties after the disclosure is made and before the commencement of the hearing.

FINRA Rule 12410(a)(1) provides that:

> Before the first hearing session begins, the Director may remove an arbitrator for conflict of interest or bias, either upon request of a party or on the Director's own initiative.
>
> (1) The Director will grant a party's request to remove an arbitrator if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration. The interest or bias must be definite and capable of reasonable demonstration, rather than remote or speculative. Close questions regarding challenges to an arbitrator by a customer under this rule will be resolved in favor of the customer.

In the Matter of Uniformed Firefighters Association Local 287 v City of Long Beach, 307 AD2d 365 [2nd Dept. 2003], the Appellate Division Second Department stated:

> "Precisely because arbitration awards are subject to such judicial deference, it is imperative that the integrity of the process, as opposed to the correctness of the individual decision, be zealously

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> safeguarded. The basic fundamental principles of justice require complete impartiality on the part of the arbitrator and mandate that the proceedings be conducted without any appearance of impropriety" (internal citations omitted).

The petitioners' motion to vacate the Award in its entirety and direct a new hearing be held before another arbitration panel with different arbitrators is granted.

The cross-motion to confirm the award is denied for the reasons previously stated. The cross-motion is also denied for the reasons set forth hereinafter.

Paragraph 4 of the Award states:

> The Panel recommends the partial expungement of Section 4 of the Customer Complaint Disclosure Reporting Page filed in connection with the above captioned arbitration from Respondent John Leonard Donahue's (CRD #2326696) registration records maintained by the Central Registration Depository ("CRD"), with the understanding that pursuant to Notice to Members 04-16, Respondent John Leonard Donahue must obtain confirmation from a court of competent jurisdiction before the CRD will execute the expungement directive.
>
> The Panel recommends that the following language in Section 4 of the Customer Complaint Disclosure Reporting Page be expunged "Customers allege representative did not follow customer instructions concerning liquidation of their joint margin account to satisfy a margin debit, and that he charged excessive commissions in their joint margin account" and be replaced with the following language "Representative failed to follow customer's order to sell a total of 30,000 shares of a certain stock at the market price in that he offered and sold only 10,000 shares on the date the order was given, resulting in a loss to customer of $8,200.00."
>
> Unless specifically waived in writing by FINRA, parties seeking judicial confirmation of an arbitration award containing expungement relief must name FINRA as an additional party and serve FINRA with all appropriate documents (emphasis added).

The cross-motion seeking judicial confirmation of the award contains expungement relief, but respondents failed to name FINRA as an additional party or to serve FINRA with all appropriate documents. There is no indication that FINRA waived these requirements in writing

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(Exhibit No. 1, Affirmation in support of cross-petition to confirm).

All proceedings under Index No. 12997/10 are terminated.

This decision is the order of the Court.

Dated: October 18, 2010

J.S.C.

ENTERED

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NASSAU COUNTY
COUNTY CLERK'S OFFICE