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Arbitration Awards

Recent Ruling Vacates $28 Million Finding for Claimant

BY TAMARA LOOMIS

PICTURE A snowball in hell. According to the conventional wisdom, that is how much chance a party has of successfully appealing an arbitration award.

Guess what? Hell just got air conditioning. That is, if you arbitrate in Manhattan, where experts say a recent decision by a New York state appellate court just made it that much easier to appeal an arbitration award.

"This is dramatically new law," said George Brunelle, of Brunelle & Hadjikow in Manhattan.

The decision Mr. Brunelle is referring to is *Sands Brothers & Co., Ltd. v. Generex Pharmaceuticals, Inc., 2002 N.Y. Slip. Op. 07711 (Oct. 29, 2002*). In it, the Appellate Division, First Department, vacated an arbitration panel's award worth $28 million.

The vacatur was unusual enough, but the court went much further, ruling that Sands Brothers could no longer seek lost profits, effectively making its claim worthless. Adding a final insult to the claimant's injury, it also threw out the arbitration panel, because of "questions [that] arose" as to whether two of the arbitrators had conflicts of interest.

Arbitration experts said such actions by a court reviewing an arbitration award are virtually unheard of.

"It flies in the face of what most of us consider the rules of the road of judicial involvement in arbitration cases," Mr. Brunelle said. "Courts are not supposed to get involved in the merits of a dispute"

He added that "you can count on one hand" the instances in which a New York court has overturned an arbitration award.

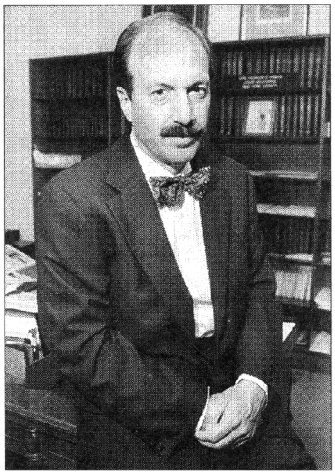

PHOTO BY RICK KOPSTEIN

Justice Ramos

Atypical Case

From the onset, the case was not your run-of-the-mill arbitration dispute, the vast majority of which are brought by unhappy brokerage customers or disgrunted employees. Its genesis was a 1997 agreement between the small investment house Sands Brothers and Generex, a start up biotech company, in which Sands Brothers would be Generex's "exclusive financial adviser and consultant" in exchange for $12,000 up front, $12,000 per quarter and 17 percent of Generex common stock.

About a year into the three year contract Sands Brothers brought a New York Stock Exchange claims against Generex for non-payment. After a 15-day hearing, the arbitrators found in Sands Brothers' favor, granting it the money owed and stocks due.

New York County Supreme Court Justice Charles E. Ramos confirmed the award. But on appeal, in the first of what experts described as several curious decisions, the First Department vacated the stock remedy award as "too idefinite to enforce," and directed the arbitrators to " consider a new remedy (possibly an award of money damages)." Alternatively, the court said the panel could award the stock remedy again "if it should explicitly find ... that all that remain open are boilerplate provisions."

After another hearing, the arbitration panel again granted Sands Brothers the stocks due, finding - as they thought the court required - that "all that remained open were boilerplate provisions.

"The case went back to Justice Ramos who, in an abrupt about-face, vacated the arbitration award. Where before he held the award to be "final definite," this time, Justice Ramos held that Sands Brothers had failed to provide "any competent evidence" to support the award.

The case went back to the First Department, which in October 2002 confirmed the vacatur of the award, threw out the arbitration panel and reduced the damages to nominal reliance damages.

As of this writing, a motion by Sands Brothers for reconsideration is pending before the First Department, However, the case may effectively be over. Courts rarely reverse themselves on such motions, and because the decision was unanimous, Sands Brother have no appeal as of right to the Court of Appeals.

New Territory Forged

Arbitration experts said the First Department's decision forges new territory in several respects, but added they were most struck by the direction that on remand, Sands Brothers would no longer be allowed to seek lost profits, which comprised almost all its damages.

"The agreement between the parties was to arbitrate' all disputes'," said Jonathan Kord Lageman, a Manhattan-based lawyer who specializes in securities arbitration. "Courts may vacate awards, but they can not alter the terms of the agreement to arbitrate, which must be enforced as written," he said.

Continued on page 8

New York Law Journal

Ruling Vacates $28 Million Arbitration Award

Continued from page 5

But the First Department apparently did modify the agreement, Mr. Lagemann said, "which it had no authority to do."

Mr. Lagemann also questioned the First Department's remand to a new panel of arbitrators, which he said "appear to approve Justice Ramos' statement [in his Feb. 25, 2002, decision] 'that a challenge will be granted where it is reasonable to infer an absence of impartiality and to avoid the appearance of impropriety.' "

"This seemingly contradicts the U.S. Supreme Court decision In Commonwealth Coatings [*Corp. v. Continental Casualty Co., 393 U.S. 145 (1968)*], which held that the appearance of bias may not disqualify an arbitrator," Mr. Lagemann said.

One of the arbitrators on the three-member panel had disclosed that his mother had sought estate planning advice from a partner of Sands Brothers' counsel, Richard Roth, of Littman Krooks & Roth in Manhattan. Another had disclosed that she owned - closed that she owned shares in a company that is a shareholder of Generex.

All the experts polled said such disclosures did not even come close to warranting disqualification.

Mr. Lagemann described the decision to kick out the panel as "off the charts."

All three arbitrators declined to comment on the case.

Rams Pushed Envelope

Like the appellate court, Justice Ramos also pushed the envelope by getting involved in the merits of the dispute, which the courts are prohibited from doing under New York state law, experts said.

Article 75 of the Civil Practice Law and Rules, which governs arbitration, state that " the court shall not consider whether the claim with respect to which arbitration is sought is tenable, or otherwise pass on the merits of the dispute."

Yet Justice Ramos did just that, said Rick Ryder, who covered the case in his newsletter, the Securities Arbitration Commentator.

"It's a really good example why courts shouldn't get involved in the merits of an award," he said. "This kind of meddling, creates a great deal of confusion about what an arbitrator is supposed to do."

Paul Bschorr a partner at Dewey Ballantine who represents Generex, said he agreed that the court typically should not look into the merits.

"But this case was different," he said. "Here we had a specific direction to the arbitrator to make certain findings."

"They didn't do that," Mr. Bschorr said. "That's why they were reversed."

He added that he could see why at first glance, people wonder what is going on. "But this is a very specific situation," he said.

Judicial Frustration

Arbitration experts offered other possible explanations for the unusual set of decisions.

"There's a growing judicial frustration with having to rubber stamp arbitration awards," Mr. Ryder said. "Judges are frustrated by being told they have to put a blindfold on."

He said recent decisions in California, Florida and the Sixth and Second Circuits reflect this increasing tendency to review arbitration awards more closely.

And Justice Ramos himself has continued to delve - or attempted to delve - into the merits of arbitration awards.

Shortly before his second Sands Brothers decision, in *In re UBS Warburg v. Auerbach, Pollack & Richardson, 2001* N.Y. Misc LEXIS 1324 (Oct.2, 2001), Justice Ramos reduced a $5.6 million award to something less than $400,000, finding that the award must be vacated "based upon the arbitration panel's irrational refusal to even consider the applicable law."

He has also tried to conduct an inquiry into the $625 millon award to six law firms who handled New York state's case against the tobacco industry. The First Department is weighing the question whether he has the jurisdiction to do so.

Mr. Ryder said the particulars of the case itself may have had an effect. "When I first read about this case, it seemed as if Sands Brothers was seeking millions of dollars for very little work," he said. "Maybe that's what put off the appellate court."

Sands Brothers has had more than its share of regulatory problems, and that "background noise" might also explain what happened, experts said. Whatever was going on behind the scenes, the decision is now the law in the First Department, and that, said arbitration experts, should give lawyers pause.

"From now on, if I end up on the losing side of an arbitration decision [in Manhattan], I'd feel almost obligated to consider an appeal," Mr. Brunelle said.

"This decision is going to come back to haunt the rest of us."