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Securities Law Update – March 2008

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FUTURES 101

For a great tutorial on soybean futures contracts, read the Seventh Circuit's February 7, 2008 opinion in [ADM Investor Services, Inc. v. Collins](#), provided below.

THE OSCAR FOR CHUTZPAH GOES TO....

[Prudential v. Ajamie](#), a February 27, 2008 decision from the Southern District of New York, addresses whether the representation of a party in arbitration without admission to the New York courts represents the unauthorized practice of law. After retaining co-counsel not admitted to practice in New York, the New York lawyer attempted to avoid paying co-counsel, arguing that he was not admitted. The Court appropriately awarded the Oscar for Chutzpah for having the audacity to try to stiff co-counsel.

CHAPTER 517 EXEMPT TRANSACTIONS

[Calnin v. Hilliard](#), a Wisconsin federal decision, contains one of the few reported decisions addressing the registration provisions contained in Florida's Blue Sky Statute, Chapter 517. The question presented was whether the securities at issue were required to have been registered under section 517.07, or whether they were exempt by virtue of the number of investors.

FINRA ACTION DISMISSED BY NY COURT OF APPEALS

In [FINRA v. Fiero](#) the New York Court of Appeals dismissed for lack of subject matter jurisdiction FINRA's attempt to obtain a judgment for \$1.3 million arising from a former member's failure to pay a disciplinary fine. The Court held that pursuant to section 27 of the Securities and Exchange Act of 1934, federal courts had exclusive jurisdiction for all matters related to violations of the federal securities laws.

WORLD COM ARBITRATION AWARD REMANDED TO ARBITRATORS

In this Second Circuit opinion, Rich v. Citigroup, a federal district court is directed to remand an arbitration award to the Arbitrators for clarification. A panel of three arbitrators awarded a lump sum to investors who suffered WorldCom, as well as other losses. Because the investors had failed to request exclusion from a WorldCom class action settlement, they were barred from recovering WorldCom losses. Citigroup appealed the \$315,000.00 award, believing the Arbitrators had exceeded their authority. Although vacated at the trial level, the appellate court held it premature to vacate the award without clarification that the Award was indeed related to WorldCom losses, as opposed to losses from other securities.

**ADM INVESTOR SERVICES, INC., Plaintiff-Appellee, v.
MARK W. COLLINS, Defendant-Appellant.**

No. 06-4412

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

2008 U.S. App. LEXIS 2690

**September 25, 2007, Argued
February 7, 2008, Decided**

PRIOR HISTORY:

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 05 C 1823. John F. Grady, Judge.

DISPOSITION: AFFIRMED.

CORE TERMS: margin, customer's, margin call, clearing, soybean, spread, futures contracts, commission merchant, counterparty, investor, dealer, futures market, short position, deposit, selling, margin requirements, illegal contracts, derivatives, offsetting, defaulting, trading, posted, buying, seller, stood, buyer, delivery, traded, broker

COUNSEL: For ADM INVESTOR SERVICES, INCORPORATED, Plaintiff-Appellee: Thomas M. Knepper, KNEPPER & GLADNEY, Chicago, IL.

For MARK W. COLLINS, Defendant-Appellant: Craig E. Collins, Topeka, KS.

JUDGES: Before EASTERBROOK, Chief Judge, and BAUER and KANNE, Circuit Judges.

OPINION BY: EASTERBROOK

OPINION

EASTERBROOK, *Chief Judge*. Mark Collins traded futures contracts on the Chicago Board of Trade through ADM Investor Services, a futures commission merchant (the equivalent of a stockbroker for derivatives). Over the course of 18 months, Collins made almost \$ 1 million. His last trade, on July 27, 2004, was in soybean contracts. Collins purchased 40 contracts for delivery in August 2004 while selling 40 contracts for delivery in November. Matched pairs of long and short contracts take a position in the difference between the prices, which the futures business calls the spread. On July 27 the August contract was selling for \$ 6.69 per bushel and the November contract for \$ 5.89, a spread of 80 [cent]. Collins stood to make money if the spread increased and to lose if it decreased.

Three days later the spread was down to 30 [cent]. The November price had declined to \$ 5.69, so the short position for that month had increased in value, but the August price stood at \$ 5.995, and Collins had lost \$ 99,000 more on his long position than he gained on his short position. ADM made a margin call. Collins posted only \$ 15,000, so ADM liquidated his position by offsetting purchases. It sent Collins a bill for \$ 85,521.83, which he did not pay. ADM filed this suit under the

diversity jurisdiction to collect, and the district court entered judgment in its favor. 2006 U.S. Dist. LEXIS 3282 (N.D. Ill. Jan. 26, 2006), 2006 U.S. Dist. LEXIS 68049 (N.D. Ill. Sept. 26, 2006).

Collins has two defenses. One is that Shell Rock Enterprises, an introducing broker, has paid ADM about \$ 75,000 under its contractual guarantee of Collins's trades. This means, Collins insists, that ADM is not the real party in interest. The brief reads as if counsel (Collins's brother) had never heard of the collateral-source doctrine. That a third party reimburses part of a loss does not disable the injured person from recovering under tort or contract law. ADM did not assign its rights to Shell Rock (there is no subrogation agreement), so ADM is the proper plaintiff. How ADM and Shell Rock settle accounts between themselves is none of Collins's business.

The other defense is that the soybean contracts were "illegal" because on July 27, 2004, a margin call was outstanding on another of Collins's trades. He insists that ADM should have used the money tendered as margin on the soybean spread to satisfy the margin call on the existing trade; had ADM done this, it could not have executed the soybean-spread trades, because the initial margin would have been insufficient. Rule 431.012(11) of the Chicago Board of Trade provides:

Members shall not accept orders for new trades from a customer, unless the minimum initial margin on the new trades is deposited and unless the margin on old commitments in an account equals or exceeds the initial requirements on hedging and spreading trades and/or the maintenance requirements specified in Regulations 431.03 and 431.05 on all other trades.

The Commodity Exchange Act requires futures commission merchants to abide by a board of trade's rules; it follows, Collins insists, that his trades of July 27 were illegal and that he need not cover his losses. He invokes the principle that courts do not enforce "illegal contracts"--for example, cartel agreements or wagering debts in states where gambling is prohibited. ADM replies that on July 27 Collins still had time to meet the margin call on his older trades, so "the maintenance requirements specified in Regulations 431.03 and 431.05 on all other trades" did not prevent ADM from allowing its customer to make additional trades. We need not decide whether this is right, because Collins's argument founders on more fundamental grounds.

A soybean spread is not "illegal" in the sense of the rule against enforcing "illegal contracts." There is nothing unlawful about buying or selling futures contracts for soybeans. They are freely traded on public exchanges. A contract does not become "illegal" just because a trader fails to put down a deposit (that's what margin is in a futures market), any more than a buyer's failure to post earnest money makes a contract to sell Blackacre "illegal." Failure to post security as required enables the other side to rescind but does not provide benefits to the person who has failed to honor his own obligations.

Another way to see this is to ask why margin is required in futures transactions. In securities markets, the full purchase price must be paid to the seller before a transaction is complete; margin is a loan from the dealer to the customer, secured by the assets acquired in the transaction. The Federal Reserve regulates these loans, along with many other aspects of financial intermediation, as part of its control of the aggregate money supply. Regulation of this kind could be seen as an effort to protect the general public from the effects of investors' and brokers' activities. Margin in the futures business, by contrast, does not represent an extension of credit, and there are no third-party effects.

A futures contract is executory; no asset changes hands when the contract is formed. See generally *CFTC v. Zelener*, 373 F.3d 861 (7th Cir. 2004). The buyer (the holder of the long

position) transacts with the seller (the creator of the short position) through a clearing corporation. When a long and a short agree to a contract, each makes his promise to the clearing corporation, which then becomes the counterparty of each original party. The risk that the clearing corporation assumes is that an obligor won't perform when the time comes to deliver the soybeans (or to pay for them). Reducing this risk of nonperformance, usually called the "counterparty risk" in derivatives markets, is the role of margin. See Lester G. Telser, *Margins and Futures Contracts*, 1 J. Futures Markets 225 (1981); Haiwei Chen, *Price Limits and Margin Requirements in Futures Markets*, 37 Financial Rev. 105 (2002).

Exchanges and clearing corporations set margin high enough that short-term price movement is likely to leave a net equity balance available to the dealer. If price movements reduce its security unduly, the dealer may have time to demand an additional deposit--and to liquidate the position, before the balance goes negative, as a form of self-protection if the investor does not meet the margin call. Occasionally, though, prices move so fast that a position's value is negative before a margin call can be issued; what happened in July 2004 to the August--November soybean spread shows the risk. The futures commission merchant then is on the hook, for it is a condition of participation in these markets that each dealer guarantee customers' trades. When Collins did not post the margin, ADM had to buy offsetting positions in the market, which enabled the clearing corporation to close Collins's trades without absorbing a loss.

It should now be apparent that margin requirements in futures markets are not designed to protect investors such as Collins from adverse price movements. Margin protects counterparties from investors who may be unwilling or unable to keep their promises. Counterparties are protected directly by clearing corporations (that's why trading can be anonymous and contracts homogeneous); clearing corporations are protected not only by the balance in their portfolios (every long position exactly offsets a short) but also by the futures commission merchants, which generally are substantial businesses; the futures commission merchants are protected, to a degree, by the margin deposits posted by customers such as Collins. So the person injured by a shortfall of margin was ADM, not Collins, and ADM's failure to take all available steps to protect itself from defaulting customers is hardly a reason why customers should be allowed to renege. No surprise, then, that both circuits that have addressed the issue have held that a customer's failure to post required margin for a futures contract does not excuse him from paying. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brooks*, 548 F.2d 615 (5th Cir. 1977); *Thomson McKinnon Securities, Inc. v. Clark*, 901 F.2d 1568 (11th Cir. 1990). We agree with these decisions. As Justice Holmes once put it, there is a vital "policy of preventing people from getting other people's property for nothing when they purport to be buying it ." *Continental Wall Paper Co. v. Louis Voight & Sons Co.*, 212 U.S. 227, 271 (1909) (Holmes, J., dissenting).

Still another way to see this point is to observe that balky customers are not in the zone of interests protected by margin-posting requirements. Margin protects dealers and counterparties *from* defaulting customers, who are in no position to complain when the protection of their trading partners turns out to be incomplete.

Collins is particularly poorly positioned. Almost \$ 450,000 of his \$ 1 million net profit on transactions through ADM came from trades executed while a margin call was pending on another open position. If, as Collins maintains, any contract entered into while a margin call is pending is void, then Collins is the loser: the cost to him of avoiding an \$ 85,000 debt will be the need to make restitution of the rest, for a net judgment of \$ 365,000 in ADM's favor. Collins should give thanks that he has lost this appeal.

AFFIRMED

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PRUDENTIAL EQUITY GROUP, LLC, Plaintiff, -v- THOMAS R. AJAMIE et al., Defendants.

07 Civ. 5606 (JSR)

**UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT
OF NEW YORK**

2008 U.S. Dist. LEXIS 14108

February 27, 2008, Decided

CORE TERMS: arbitration, summary judgment, fee agreement, unauthorized, cross-claim, practice of law, law firms, matter of law, attorneys' fees, Unauthorized Practice of Law, retainer agreement, legal services, breach of contract, contractual, malpractice, informal, jointly, prong, interpleader action, agrees to pay, contractual provision, specific provision, services performed, legal fees, final disposition, bringing suit, participating, fee-sharing, enforceable, settlement

COUNSEL: For Prudential Equity Group, LLC, Plaintiff: David A. Picon, Karen Deborah Coombs, LEAD ATTORNEYS, Proskauer Rose LLP (New York), New York, NY.

For Thomas R. Ajamie, Ajamie, LLP, Defendants: Dona Szak, LEAD ATTORNEY, PRO HAC VICE, Ajamie, LLP, Houston, TX; Robert David Kraus, LEAD ATTORNEY, Kraus & Zuchlewski LLP, New York, NY.

For Robert Weiss, Robert H. Weiss & Associates, LLP, Defendants: Richard M Maltz, New York, NY.

For John Moscow, Defendant: Robert Lloyd Herbst, LEAD ATTORNEY, Beldock Levine & Hoffman LLP, New York, NY.

For Rosner Napierala, LLP, Brian Rosner, Defendants: Michael David Malloy, Finestein & Malloy, LLC, Chatham, NJ.

For Wallace Showman, Defendant: Robert David Kraus, LEAD ATTORNEY, Kraus & Zuchlewski LLP, New York, NY.

For Martin Kroll, Kroll, Moss & Kroll, LLP, Defendants: Martin N. Kroll, Kroll Moss & Kroll LLP, Garden City, NY.

For Wallace Showman, Cross Claimant: Robert David Kraus, LEAD ATTORNEY, Kraus & Zuchlewski LLP, New York, NY.

For Thomas R. Ajamie, Ajamie, LLP, Cross Claimants: Dona Szak, LEAD ATTORNEY, PRO HAC VICE, Ajamie, LLP, Houston, TX; Robert David Kraus, LEAD ATTORNEY, Kraus & Zuchlewski LLP, New York, NY.

For Brian Rosner, Rosner Napierala, LLP, Cross Defendants: Michael David Malloy, Finestein & Malloy, LLC, Chatham, NJ.

For Martin Kroll, Kroll, Moss & Kroll, LLP, Cross Defendants: Martin N. Kroll, Kroll Moss & Kroll LLP, Garden City, NY.

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For John Moscow, Cross Defendant: Robert Lloyd Herbst, LEAD ATTORNEY, Beldock Levine & Hoffman LLP, New York, NY.

For John Moscow, Cross Claimant: Robert Lloyd Herbst, LEAD ATTORNEY, Beldock Levine & Hoffman LLP, New York, NY.

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For Brian Rosner, Rosner Napierala, LLP, Cross Claimants: Michael David Malloy, Finestein & Malloy, LLC, Chatham, NJ.

JUDGES: JED S. RAKOFF, U.S.D.J.

OPINION BY: JED S. RAKOFF

OPINION

OPINION AND ORDER

JED S. RAKOFF, U.S.D.J.

Defendants Robert Weiss and Robert H. Weiss & Associates, LLP (the "Weiss defendants") and Thomas R. Ajamie and Ajamie, LLP (the "Ajamie defendants") each move for summary judgment. For the reasons set forth below, the motion of the Weiss defendants is granted in part and denied in part, and the motion of the Ajamie defendants is likewise granted in part and denied in part.

This interpleader action arises from a conflict over how the attorneys' fees resulting from a successful arbitration should be divided among the attorneys who might have a claim to them and who, being litigators, were unable to resolve the dispute among themselves. In 2002, members of a family known as the Sahnis sought to arbitrate certain claims against Prudential Equity Group, LLC ("Prudential"). See Weiss Defendants' Statement of Material Facts Pursuant to Local Rule 56.1 ("Weiss 56.1") P 1; Ajamie Defendants' Rule 56.1 Counterstatement and Statement of Additional Facts ("Ajamie 56.1") P 1. The Sahnis first retained defendant Martin Kroll and his firm, defendant Kroll, Moss & Kroll LLP, but subsequently terminated the Kroll defendants and retained the Weiss defendants to pursue their claims. Weiss 56.1 P P 3-5; Ajamie 56.1 P P 3-5. Weiss then recruited Mr. Ajamie, a lawyer admitted only in Texas, to work on the arbitration, and entered into an original, and, later, an amended fee-sharing agreement with the Ajamie defendants. Weiss 56.1 P P 9, 11-12, 14, 20; Ajamie 56.1 P P 9, 11-12, 14, 20. Mr. Ajamie, in turn, sought assistance from two other attorneys, defendants Wallace Showman and John Moscow. Weiss 56.1 P P 25, 29; Ajamie 56.1 P P 25, 29.

Although the circumstances are disputed, it is clear that at some point Weiss ceased to play an active role in the arbitration. Weiss 56.1 P P 18-19; Ajamie 56.1 P P 19, B-2 to B-3, B-17. Eventually, the Sahni clients were successful in the arbitration against Prudential, and the arbitration award was confirmed in New York state court. Weiss 56.1 P P 42, 45; Ajamie 56.1 P P 42, 45. Prudential, in possession of the attorney's fee portion of the arbitration award, instituted this interpleader action when it became clear that the various attorneys involved in the arbitration could not agree on how the fees should be divided.

In the instant motion, the Weiss defendants argue, first, that the Ajamie defendants are not entitled to any fees; second, that, if the first argument fails, the fees should be split in accordance with the amended fee agreement; and, third, that the Ajamie defendants are solely responsible for the fees of the additional attorneys (Showman and Moscow) who were brought in to assist. Only the second argument has merit.

As to the first argument, the Weiss defendants contend that the fee-sharing agreement with the Ajamie defendants cannot be enforced--and that the Ajamie defendants are therefore not entitled to any of the attorneys' fees--because Ajamie engaged in the unauthorized practice of law by participating in an arbitration in New York even though he was not admitted to the New York bar. Given that it was Weiss who brought Ajamie into the arbitration, this argument wins the Oscar for chutzpah. But on the merits it fails.

Since there is no New York state authority definitively addressing the applicability of New York's unauthorized practice rules to the arbitration context, the Court must predict how the New York Court of Appeals would decide this issue. See *Fieger v. Pitney Bowes Credit Corp.*, 251 F.3d 386, 399 (2d Cir. 2001). But the Court is not reduced to reading entrails, because in *Donald J. Williamson, P.A. v. John D. Quinn Construction Corp.*, 537 F. Supp. 613 (S.D.N.Y. 1982), Judge Edward Weinfeld--perhaps the greatest judge ever to sit in this District--held that a non-New York lawyer participating in an arbitration in New York did not commit unauthorized practice under New York law. *Id.* at 616. As Judge Weinfeld noted, there are material differences between an arbitration and a judicial proceeding, with the former being far more informal and applying much less stringent rules of evidence and procedure. *Id.* at 616.

Williamson has been followed by other courts in this District and elsewhere, see, e.g., *Siegel v. Bidas Sociedad Anonima Petrolera Industrial Y Comercial*, No. 90 Civ. 6108, 1991 WL 167979, *5 (S.D.N.Y. Aug. 19, 1991); *Colmar, Ltd. v. Fremantlemedia N. Am., Inc.*, 344 Ill. App. 3d 977, 988 (App. Ct. 2003), and has been praised by commentators, see, e.g., Samuel Estreicher & Steven C. Bennett, Is Arbitration the Unauthorized Practice of Law?, N.Y.L.J., Jan. 6, 2005, at 3 (describing *Williamson* as "[o]ne of the earliest and most widely quoted authorities in this area"). It may also be noted that in 1975, and again in 1991, committees of the Association of the Bar of the City of New York found that participation in a New York arbitration by an out-of-state lawyer was not the unauthorized practice of law. See Committee Report, Labor Arbitration and the Unauthorized Practice of Law, 30 Rec. Ass'n B. City N.Y. 422, 428 (1975); Committee Report, Recommendation and Report on the Right of Non-New York Lawyers to Represent Parties in International and Interstate Arbitrations Conducted in New York, 49 Rec. Ass'n B. City N.Y. 47, 47-48 (1991).

Against this authority, Weiss relies principally on the controversial California decision in *Birbrower, Montalbano, Condon & Frank, P.C. v. Superior Court*, 949 P.2d 1 (Cal. 1998). In *Birbrower*, the California Supreme Court "decline[d] ... to craft an arbitration exception to [the California] prohibition of the unlicensed practice of law in this state." *Id.* at 9. *Birbrower*, however, was promptly overruled by the California legislature. See Cal. Civ. Proc. Code § 1282.4 (providing an arbitration exception to unauthorized practice rules). Moreover, even *Birbrower* itself took pains to distinguish *Williamson*, see *Birbrower*, 949 P.2d at 8-9, and thus is of little help in predicting how the New York Court of Appeals would decide this issue.

This Court finds Judge Weinfeld's reasoning wholly persuasive and is certain the New York Court of Appeals would find likewise. Although, in the quarter century since Judge Weinfeld wrote, arbitration proceedings have become more protracted and complex, not to mention costly, they still retain in most settings their essential character of private contractual arrangements for the relatively informal resolution of disputes. Indeed, the Court notes that the rules of the New York Stock Exchange, where the Sahni arbitration was held, do not require members of the arbitration panel to be lawyers at all. See N.Y. Stock Exch. Rule 607. It would be incongruous to apply a state's unauthorized practice rules in such an informal setting. Whatever beneficent purposes New York's prohibition against the unauthorized practice of law may serve in protecting clients and regulating lawyers' conduct, it is not designed as a trap for the unwary or as a basis on which New York lawyers can extend a monopoly over every private contractual dispute-resolving mechanism.

Accordingly, the Court concludes that Ajamie was not engaged in the unauthorized practice of law and, hence, that the Weiss defendants are not entitled to summary judgment denying the Ajamie defendants any recovery.¹ There is greater merit, however, to the Weiss defendants' fallback position, their second argument, that they are at least entitled as a matter of law to some recovery because their fee agreement with Ajamie is enforceable as a matter of law.

1 Because Ajamie did not engage in the unauthorized practice of law, the Court need not reach the issue of whether Weiss, having brought Ajamie into the case, would be barred by the doctrine of unclean hands from contending that Ajamie may not recover attorneys' fees.

After the Weiss defendants were retained by the Sahni clients, they entered into a fee agreement with the Ajamie defendants that provided that:

This letter sets forth our agreement to work together on behalf of the Sahni Clients. We will jointly represent the Sahni Clients in connection with their securities claims against Prudential Securities, Inc. and all other associated parties with respect to [specific account numbers].

We [the Ajamie defendants] will work with you [the Weiss defendants] on behalf of the Sahni Clients in preparing and presenting their claims against the parties who have caused the Sahni Clients financial loss. We will contribute 50% and you will contribute 50% of the cost and expense necessary to bring these matters to arbitration or settlement, and we will receive 50% and you will receive 50% of all proceeds that your firm is entitled to receive under its retainer agreement with the Sahni Clients.

You have consulted the Sahni Clients and you represent to us that they are aware of our participation in the matter and have consented to it.

Affidavit of Robert Weiss, Exhibit G ("Fee Agreement").

Subsequently, the agreement was amended as follows:

This agreement will confirm our agreement today to revise our original letter agreement concerning fees and services in this case, dated October 29, 2002.

We agree to amend that agreement to reflect that Ajamie, L.L.P. will receive 66% of all fees recovered in this case, and Robert H. Weiss & Associates, P.C. will receive 34% of all fees recovered. Mr. Ajamie agrees to handle the case and continue to try it before the NYSE panel. Mr. Ajamie will continue to pay all expenses (which he will recover first before the fees are divided 66%-34%).

Mr. Weiss also agrees to pay from his 34% all amounts due to other lawyers or law firms who make a claim or lien against this case. Mr. Weiss will defend, settle or resolve those claims without recourse to you or the Sahni Family.

Affidavit of Robert Weiss, Exhibit L ("Amended Fee Agreement").

The parties concur that these agreements are governed by New York state law. In New York, courts look to ethics rules for guidance in determining whether fee agreements are enforceable. *See, e.g., Benjamin v. Koepfel*, 650 N.E.2d 829, 832-33 (N.Y. 1995). New York Disciplinary Rule 2-107(A) provides that:

A lawyer shall not divide a fee for legal services with another lawyer who is not a partner in or associate of the lawyer's law firm, unless:

1. The client consents to employment of the other lawyer after a full disclosure that a division of fees will be made.
2. The division is in proportion to the services performed by each lawyer or, by a writing given the client, each lawyer assumes joint responsibility for the representation.
3. The total fee of the lawyers does not exceed reasonable compensation for all legal services they rendered the client.

N.Y. Comp. Codes R. & Regs., tit. 22, § 1200.12 (emphasis supplied).

It is undisputed that the first and third requirements of DR 2-107(A) are here met. As to the second requirement, the parties disagree as to whether the "division is in proportion to the services performed by each lawyer." This dispute is irrelevant, however, because the alternative prong of the second requirement--that "by a writing given the client, each lawyer assume[d] joint responsibility for the representation"--is here met.²

² *Benjamin v. Koepfel*, 650 N.E.2d 829 (N.Y. 1995), relied on by Ajamie, is therefore inapplicable because it relates to the "services performed," rather than the "joint responsibility," prong of DR 2-107(A)(2).

With respect to "joint responsibility," Weiss was directly retained by the Sahnis and, indeed, was the only lawyer involved in the arbitration who had a retainer agreement directly with the Sahni clients. Weiss 56.1 P P 5, 13, 33, 35-36, 43; Ajamie 56.1 P P 5, 13, 33, 35-36, 43. Weiss never sought to withdraw as the Sahnis' counsel and he thus remained responsible for the representation; indeed he would have been liable to the Sahnis in a malpractice action. *See Aiello v. Adar*, 750 N.Y.S.2d 457, 464-66 (Sup. Ct. 2002) (finding that joint responsibility means "joint and several liability ... for any act of malpractice that occurs" and holding that "remain[ing] the attorney of record in the case ... is an unequivocal indication" that attorney would remain liable for malpractice). The "joint responsibility" requirement is thus satisfied.

As for a "writing given the client," the letter that Weiss and Ajamie provided to the Sahnis to advise them that the fee agreement had been amended confirms that Weiss remained jointly responsible for the case: it informed the Sahnis that the two firms "have been representing [the Sahnis]," that the firms "have revised the cooperation agreement between [the firms]" but that the agreement "does not increase the amount ... that will be payable by [the Sahnis]" and that "[t]he terms of [the Sahnis'] ... retainer agreement with [Weiss's] law firm remain unchanged." Affidavit of Robert Weiss, Exhibit M (letter dated February 23, 2004). The letter ends with: "[t]hank you for your continuing to place your trust and confidence in us." *Id.* This writing clearly reaffirms for the Sahnis

that Weiss remained their attorney and that he continued to take responsibility for the arbitration along with Ajamie. *Cf. Robert P. Lynn, Jr., LLC v. Purcell*, 835 N.Y.S.2d 664, 666 (App. Div. 2007) (finding that a client letter which stated that two firms will "undertake to represent you" and that the first firm "will work with the [second] firm" was "sufficient to establish that the parties undertook joint responsibility for the representation"). Accordingly, all the requirements of the "joint responsibility" prong of DR 2-107(A)(2) are met.

Ajamie nevertheless tries to avoid summary judgment by arguing that, because Weiss allegedly failed to do any of the actual work on the arbitration once Ajamie entered the case, Weiss never fulfilled his part of the bargain. But the amended fee agreement, in contrast to the original fee agreement, contains no requirement that Weiss work on the arbitration; on the contrary, it expressly provides that "Mr. Ajamie agrees to handle the case and continue to try it before the NYSE panel." Amended Fee Agreement, *supra*. The amended fee agreement thus makes plain to the Ajamie defendants and to any reasonable reader that Weiss, while remaining jointly responsible for the representation, was delegating the actual trial work to Ajamie and, concomitantly, was now providing Ajamie with a larger share of the fee.

Accordingly, the Weiss defendants are entitled to partial summary judgment enforcing the amended fee agreement as a matter of law.

The Weiss defendants' third argument for summary judgment is that the Ajamie defendants retained other counsel (Showman and Moscow) to work on the arbitration without giving Weiss notice or obtaining his permission, and thus the Ajamie defendants are solely responsible for paying those attorneys. This argument is unpersuasive.

Under New York law, "[a]bsent a specific provision to the contrary, an attorney ... to whom [a] case is referred for purposes of handling it to final disposition will ordinarily be held responsible for absorbing the cost of any additional legal services, such as those of outside trial or appellate counsel, incurred in the course of attaining that final disposition." *A. Stanley Proner, P.C. v. Julien & Schlesinger, P.C.*, 520 N.Y.S.2d 771, 773 (App. Div. 1987). This rule would require Ajamie to pay the attorneys he hired to work on the arbitration were it not for the fact that the amended fee agreement contains a "specific provision to the contrary." *Id.* The agreement provides that "Mr. Weiss ... agrees to pay from his 34% all amounts due to other lawyers or law firms who make a claim or lien against this case." Amended Fee Agreement, *supra*. This language is unambiguous in requiring that Weiss pay the fees of the other attorneys from his portion of the fee.

Weiss argues that the word "due" must mean amounts already due at the time the agreement was entered into, which would be only fees due to the Kroll defendants. This interpretation, however, is belied by the rest of the sentence--particularly the use of the plural ("lawyers" and "law firms") and the use of the subjunctive ("who make a claim or lien"). The only reasonable interpretation of the term "due," in this context, therefore, is amounts due to any lawyer or law firm if and when such person or firm actually makes a claim, rather than amounts due when the agreement was entered into. Accordingly, summary judgment in favor of Weiss on this issue is denied.

Remaining to be considered is the summary judgment motion of the Ajamie defendants. The Ajamie defendants move for partial summary judgment on the portions of the Weiss defendants' cross-claims that are based on claims of breach of contract, repudiation of contract, and violation of the duty of good faith and fair dealing.

Specifically, the Weiss defendants' first cross-claim, entitled "Breach of Contract," is based on the premise that the Ajamie defendants "have denied [the Weiss defendants] their portion of the legal fees from the Sahni settlement by repudiating the parties' Amended Fee Agreement." The Weiss Defendants' Answer to Complaint for Interpleader and Claim ("Weiss Answer") P 77. This

"repudiati[on]" occurred, according to the Weiss defendants, when the Ajamie defendants "sued Weiss in Texas seeking to deny Mr. Weiss any legal fee and to repudiate the validity of their agreement." *Id.* at 74.

Under New York law, a party claiming a breach of contract must show 1) a contract, 2) adequate performance by the party, 3) breach by the other party, and 4) damages. *24/7 Records, Inc. v. Sony Music Entm't, Inc.*, 429 F.3d 39, 41-42 (2d Cir. 2005). The breach of the amended fee agreement that the Weiss defendants allege is that the Ajamie defendants "repudiate[d] the validity" of the amended fee agreement by bringing suit in Texas state court to determine the parties' respective rights and obligations under the agreement. See Weiss Answer P P 74, 77. However, bringing suit to determine the meaning of an agreement is not a breach of that agreement absent some explicit contractual provision that the party will not bring suit. See, e.g., *Bridgeport Music Inc. v. Universal Music Group, Inc.*, 440 F. Supp. 2d 342, 345 (S.D.N.Y. 2006) ("When parties have differing positions as to the meaning of a contractual term, it can not be deemed a breach for one party to sue to enforce its view of the contract."). There was no such contractual provision here. Accordingly, since the Weiss defendants do not allege any other breach of the agreement, the Ajamie defendants are entitled to summary judgment dismissing the breach of contract cross-claim.

The Weiss defendants' second cross-claim, entitled "Denial of Fees for the Unauthorized Practice of Law," is premised on the Weiss defendants' argument, which the Court has now rejected as a matter of law, that Ajamie engaged in the unauthorized practice of law. Although the Ajamie defendants, through an apparent oversight, have not formally moved for summary judgment on this cross-claim, their opposition to the Weiss defendants' own summary judgment motion on this issue is tantamount to a motion for summary judgment dismissing this claim, and, in any event, given that both sides have already put before the Court all their factual and legal arguments on this issue, the Court exercises its power to grant summary judgment in favor of the Ajamie defendants on the Weiss defendants' second claim. See *Bridgeway Corp. v. Citibank*, 201 F.3d 134, 140 (2d Cir. 2000).

Finally, as to the Weiss defendants' third cross-claim,³ entitled "Tortious Interference with the Attorney-Client Relationship and the Violation of Good Faith and Fair Dealing," the Court finds that there remain genuinely disputed issues of material fact that preclude summary judgment on this claim, and hence the Ajamie defendants' motion with respect to this claim is denied.

3 The Ajamie defendants have not moved for summary judgment on the Weiss defendants' fourth cross-claim.

Accordingly, the summary judgment motion of the Weiss defendants is granted in so far as it seeks enforcement of the amended fee agreement as a matter of law and is denied in all other respects, and the summary judgment motion of the Ajamie defendants is granted as to the dismissal of the Weiss defendants' first and second cross-claims but is denied in all other respects.

Counsel for all parties are reminded that trial of all remaining claims will commence at 9 a.m. on April 7, 2008. The Clerk of the Court is directed to close documents number 65 and 67 in the Court's docket.

SO ORDERED.

JED S. RAKOFF, U.S.D.J.

Dated: New York, New York

February 27, 2008

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JOHN J. CALNIN, et al., Plaintiffs, v. WALLACE J. HILLIARD, Defendant. JOHN F. BUTZ, et al., Plaintiffs, v. WALLACE J. HILLIARD, Defendant. GREG J. DECLEENE, et al., Plaintiffs, v. WALLACE J. HILLIARD, Defendant. REVOCABLE LIVING TRUST OF ROY E. DOWNHAM of JANUARY 30, 1979, et al., Plaintiffs, v. WALLACE J. HILLIARD, Defendant. GREGORY J. LARSEN, Plaintiff, v. WALLACE J. HILLIARD, Defendant.

Case No. 05-C-694, Case No. 05-C-784 (Consolidated with 05-C-694), Case No. 05-C-958 (Consolidated with 05-C-694), Case No. 05-C-1092 (Consolidated with 05-C-694), Case No. 05-C-1148 (Consolidated with 05-C-694)

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WISCONSIN

2008 U.S. Dist. LEXIS 8590

February 5, 2008, Decided

February 5, 2008, Filed

CORE TERMS: stock, misrepresentation, securities law, claims filed, omission, summary judgment, exempt, statutes of limitations, time-barred, Securities Act, material fact, causation, investor, cause of action, commuter, fly, air, material misrepresentations, failure to register, finder of fact, fraud-related, registration, scheduled, airline, soliciting, accredited, invested, genuine issues, commuter airline, pecuniary loss

COUNSEL: For John J Calnin, Yvonne M Calnin, Bernard A Dahlin, III, Alfred H Fleck, individually and as Trustee of the Alfred H & Jeane K Fleck Revocable Trust, Thomas J Hahn, Sara Hahn, Kenneth L Jossart, individually and as Trustee of the Kenneth & Lucille Jossart Revocable Trust 1-24-94, Lucille C Jossart, individually and as Trustee of the Kenneth & Lucille Jossart Revocable Trust 1-24-94, Randy Keuntjes, Sue Keuntjes, Roger R Kimps, individually and as Trustee of the Roger R and Starlene F Kimps Family Living Trust UDO 9/27/91, Starlene F Kimps, individually and as Trustee of the Roger R and Starlene F Kimps Family Living Trust UDO 9/27/91, David W Krutz, individually and as Trustee of the David W. & Yvonne M. Krutz Revocable Trust, Yvonne M Krutz, individually and as Trustee of the David W. & Yvonne M. Krutz Revocable Trust, Jimmy L McKeefrey, Patrick G McKeefrey, David G Perret, Sr, Kathryn M Perret, Kramer J Rock, individually and as Trustee of the Kramer J. Rock & Carolyn F. Rock Revocable Trust of 1997, Carolyn F Rock, individually and as Trustee of the Kramer J. Rock & Carolyn F. Rock Revocable Trust of 1997, David W Schonke, Janice F Schonke, Stephen F Schonke, Paul E Soletski, Dawn M Soletski, Donald W Zellner, Rita F Zellner, Plaintiffs: George Burnett, LEAD ATTORNEY, Joseph W Laframboise, Liebmann Conway Olejniczak & Jerry SC, Green Bay, WI.

For Jeane K Fleck, individually and as Trustee of the Alfred H. & Jeane K. Fleck Revocable Trust, Alyce G Dahlin, individually and as Trustee of the Bernard E. and Alyce G. Dahlin Revocable Trust dated December 20, 1993, Bernard E Dahlin, individually and as Trustee of the Bernard E. and Alyce G. Dahlin Revocable Trust dated December 20, 1993, Brian Dahlin, Stephanie L Giannunzio, Stacy L Karle, RDR Investments LLP, The Alfred H & Jean K Fleck Revocable Trust, The Bernard E & Alyce G Dahlin Revocable Trust Dated December 20 1993, The David W & Yvonne M Krutz Revocable Trust, The Kenneth & Lucille Jossart Revocable Trust 1-24-94, Roger R and Starlene F Kimps Family Living Trust UDO 9/27/91, The Kramer J Rock & Carolyn F Rock Revocable Trust of

1997, Plaintiffs: George Burnett, Joseph W Laframboise, Liebmann Conway Olejniczak & Jerry SC, Green Bay, WI.

For Janice M Butz, John F Butz, John F and Janice M Butz Revocable Trust, Flanagan Brothers Inc, Putney Capital LLP, Daniel D Whetter, Greg J DeCleene, Ann M DeCleene, Revocable Living Trust of Roy E Downham of January 30 1979, Roy E Downham, Gregory J Larsen, Consolidated Plaintiffs: George Burnett, LEAD ATTORNEY, Liebmann Conway Olejniczak & Jerry SC, Green Bay, WI.

For Wallace J Hilliard, Defendant: Sean O Bosack, LEAD ATTORNEY, Godfrey & Kahn SC, Milwaukee, WI; Winston A Ostrow, LEAD ATTORNEY, Sherry D Coley, Godfrey & Kahn SC, Green Bay, WI.

JUDGES: J.P. Stadtmueller, U.S. District Judge.

OPINION BY: J.P. Stadtmueller

OPINION

ORDER

The plaintiffs in this consolidated action sue defendant Wallace J. Hilliard ("Hilliard") for allegedly violating the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5(b); 15 U.S.C. § 78j, by making material misrepresentations and omissions in connection with the sale of securities. The plaintiffs also allege nine claims under Wisconsin and Florida state laws. The court has federal question jurisdiction over the first cause of action and supplemental jurisdiction pursuant to 28 U.S.C. § 1367 over the nine state law claims. On May 4, 2007, Hilliard filed a motion for partial summary judgment and the plaintiffs also moved for summary judgment. On June 26, 2007, the plaintiffs withdrew their motion, noting that Hilliard's affidavit submitted in response to their motion created genuine issues of material fact. Accordingly, the court will deny the plaintiffs' motion as moot. Hilliard's motion for partial summary judgment will be granted in part and denied in part for the reasons stated below.

BACKGROUND

The plaintiffs in *Calnin, et al. v. Hilliard*, Case No. 05-C-694, filed suit on July 1, 2005, and on November 16, 2005, the court consolidated *Calnin, et al.* with four other actions: *Butz, et al. v. Hilliard*, Case No. 05-C-784; *DeCleene, et al. v. Hilliard*, Case No. 05-C-958; *Downham, et al. v. Hilliard*, Case No. 05-C-1092; and *Larsen v. Hilliard*, Case No. 05-C-1148. On May 2, 2006, the plaintiffs in this consolidated action filed a third amended complaint, setting forth the following causes of action:

1. Alleged misrepresentations in connection with sales and purchases of securities contrary to 17 C.F.R § 240.10b-5(b); 15 U.S.C. § 78j(b);
2. Alleged misrepresentations in connection with sales and purchases of securities contrary to Wis. Stat. § 551.41(2) (2005-06);
3. Alleged misrepresentations in connection with sales and purchases of securities contrary to Fla. Stat. § 517.301(2)(a)(2006);
4. Alleged failure to register securities contrary to Wis. Stat. § 551.21(1);

5. Alleged failure to register securities contrary to Fla. Stat. § 517.07(1);
6. Alleged failure to obtain a license to sell securities contrary to Wis. Stat. § 551.31(1);
7. Alleged failure to register to sell securities contrary to Fla. Stat. § 517.12(1);
8. Alleged misrepresentations to induce members of the public to purchase securities contrary to Wis. Stat. § 100.18;
9. Alleged strict liability misrepresentations; and
10. Alleged negligent misrepresentations.

The third amended complaint named 42 plaintiffs. Several plaintiffs voluntarily dismissed their claims and the following plaintiffs remain: John and Yvonne Calnin (the "Calnins"), Greg and Ann DeCleene (the "DeCleenes"), Flanagan Brothers, Inc. ("Flanagan Brothers"), the Alfred H. and Jeane K. Fleck Revocable Trust (the "Fleck Trust"), Alfred H. and Jeane K. Fleck (the "Flecks"), Thomas J. and Sarah Hahn (the "Hahns"), the Kenneth L. and Lucille C. Jossart Revocable Trust of January 29, 1994 (the "Jossart Trust"), Kenneth L. and Lucille C. Jossart (the "Jossarts"), David W. and Yvonne M. Krutz Revocable Trust (the "Krutz Trust"), David W. and Yvonne M. Krutz (the "Krutzes"), Janice and David Schonke (the "Schonkes"), Stephen F. Schonke, Paul and Dawn Soletski (the "Soletskis"), Daniel Whetter ("Mr. Whetter"), and Donald and Rita Zellner (the "Zellners").

This case arises out of the plaintiffs' purchase of stock in Florida Air Holdings, Inc. ("FAH"), a Florida corporation that is now dissolved. Beginning in early 2001, Hilliard and others solicited a number of individuals, including the plaintiffs, to purchase stock in FAH. FAH's original business plan was to fly as a charter airline and as a regional commuter airline to provide services between cities in Florida otherwise lacking commuter air services. (Hilliard Aff. P 9.) FAH had regulatory authority permitting it to fly as a charter airline, which FAH utilized until it went out of business in June 2004. FAH, however, did not have authority permitting it to fly as a scheduled commuter airline.

In February 2001, Hilliard acquired Sunrise Airlines, Inc. ("Sunrise"), which had filed for bankruptcy protection. Sunrise owned a Federal Aviation Regulation Part 121 Commuter Air Carrier Operating Certificate ("Certificate") which gave Sunrise regulatory authority to fly as a commuter airline. The Certificate, however, was suspended as a result of Sunrise's bankruptcy filing. In March 2001, Hilliard transferred his ownership of Sunrise capital stock to FAH and began efforts to activate Sunrise's commuter air carrier authority. If the U.S. Department of Transportation ("DOT") approved the Certificate for reinstatement, FAH would be able to operate as planned, as a commuter airline with scheduled routes between Florida cities.

On February 8, 2002, the DOT issued an "Order to Show Cause" tentatively approving the Certificate unless cause was shown indicating that the application for reinstatement should not be approved. In response to the Order to Show Cause, the Federal Aviation Administration ("FAA") notified the DOT that there were pending regulatory sanctions against another company owned by Hilliard, Plane-1 Leasing, Co. ("Plane-1"). The DOT requested an explanation concerning these pending regulatory sanctions against Plane-1. After the DOT received the explanation in May 2002, the DOT withdrew its tentative approval of the Certificate for reinstatement, citing the unresolved FAA allegations against Plane-1 as a significant contributing factor. (LaFramboise May 4, 2007 Decl. Exs. B and C.) Ultimately, as a result of the DOT's dismissal of the application for reinstatement, FAH went out of business in June 2004, when it was sold to Golden Airways, Inc.

Hilliard began soliciting funding for FAH in Wisconsin and Florida in early 2001. Hilliard distributed business plans, subscription agreements, and prospective investor letters to potential investors. The plaintiffs purchased stock in FAH at various times between February 2001 and March 2003. The plaintiffs allege that Hilliard misrepresented material facts and omitted facts material to the financial solvency of FAH and the ability of FAH to gain approval from the DOT to fly regularly scheduled commuter flights. For example, the plaintiffs contend that Hilliard made misrepresentations and omissions by: (1) failing to disclose the pending regulatory sanctions against Plane-1; (2) overstating FAH's assets such as the value of the airplanes and airplane parts that FAH purchased; and (3) omitting facts regarding the substantial liabilities of Sunrise and FAH such as Sunrise's failure to pay payroll taxes to the Internal Revenue Service. The plaintiffs assert that these actions caused them to suffer financial losses.

ANALYSIS

Summary judgment is appropriate where the moving party establishes that there is no genuine issue of material fact and that the party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). "Material facts" are those facts which "might affect the outcome of the suit," and a dispute about a material fact is "genuine" if a reasonable finder of fact could find in favor of the nonmoving party. See *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). Summary judgment is appropriate where a party has failed to make "a showing sufficient to establish the existence of an element essential to that party's case and on which the party will bear the burden of proof at trial." *Celotex*, 477 U.S. at 322-23. A party opposing summary judgment may not rest upon the mere allegations or denials of the adverse party's pleading, but must set forth specific facts showing that there is a genuine issue for trial. Fed. R. Civ. P. 56(e). Any doubt as to the existence of a material fact is to be resolved against the moving party. *Anderson*, 477 U.S. at 255.

Hilliard moves for partial summary judgment pursuant to Fed. R. Civ. P. 56 on all the claims alleged by the plaintiffs, with the exception of some of the plaintiffs' claims alleged under the Wisconsin Uniform Securities Law and the Florida Securities Act; Hilliard concedes that genuine issues of material fact exist in regards to these claims. Hilliard sets forth several arguments in support of his motion for partial summary judgment. Specifically, Hilliard asserts: (1) the plaintiffs' claims under Rule 10b-5 and the plaintiffs' common law claims of strict liability misrepresentation and negligent misrepresentation should be dismissed because the plaintiffs cannot prove any actual loss or any causal connection between the plaintiffs' actual loss and any misrepresentation or omission by Hilliard; (2) certain plaintiffs' claims are barred by the applicable statutes of limitations set forth in the Wisconsin Uniform Securities Law and the Florida Securities Act; (3) the Wisconsin Uniform Securities Law claims alleged by Stephen F. Schonke and the Hahns should be dismissed because these plaintiffs purchased FAH stock from outside Wisconsin; (4) plaintiffs' "failure to register" claims should be dismissed because the securities at issue were exempt from the registration requirements under the Wisconsin Uniform Securities Law and the Florida Securities Act; (5) plaintiffs' claims that Hilliard was required to obtain a license to sell securities under Wisconsin and Florida laws should be dismissed because Hilliard was exempt from the licensing requirements; (6) plaintiffs' claims of misrepresentation under Wis. Stat. § 100.18 should be dismissed; (7) the claims of plaintiffs the Perrets and Stephen F. Schonke should be dismissed for lack of reliance; and (8) the individual plaintiffs who were never owners of any FAH stock should be dismissed under Fed. R. Civ. P. 17(a). The court will address Hilliard's arguments in turn.

First, Hilliard argues that the plaintiffs' Rule 10b-5 claims should be dismissed because "[t]he Plaintiffs have failed to produce any evidence of any actual out-of-pocket loss or evidence of any causal connection between any alleged misrepresentation or omission and any loss." (Def.'s Br.

10, May 4, 2007.) In order to prevail on a private cause of action under Rule 10b-5, plaintiffs must prove six basic elements: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) justifiable reliance; (5) economic loss; and (6) "loss causation," i.e., a causal connection between the material misrepresentation and the loss." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341-42, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005) (citations omitted); see also *Tricontinental Indus. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824, 842 (7th Cir. 2007), *Caremark, Inc. v. Coram HealthCare.*, 113 F.3d 645, 648 (7th Cir. 1997). Hilliard argues that expert testimony is necessary to prove the fifth and sixth elements, economic loss and loss causation, and that the plaintiffs have failed to offer any admissible evidence of economic loss or loss causation.

With respect to Rule 10b-5 causes of action, causation has two necessary components: "transaction causation" and "loss causation." *Caremark, Inc.*, 113 F.3d at 648. "To plead transaction causation, the plaintiff must allege that it would not have invested in the instrument if the defendant had stated truthfully the material facts at the time of the sale." *Id.* "To plead loss causation, the plaintiff must allege that it was the very facts about which the defendant lied which caused its injuries." *Id.* The statute expressly imposes on the plaintiff "the burden of proving" that the defendant's misrepresentations "caused the loss for which the plaintiff seeks to recover." *Dura Pharm.*, 544 U.S. at 345-46 (quoting 15 U.S.C. § 78u-4(a)(4)).

The plaintiffs contend that they have presented evidence of transaction causation and loss causation. The plaintiffs assert that they presented evidence demonstrating that Hilliard made material misrepresentations and omissions regarding FAH, and that these misrepresentations and omissions caused them to suffer financial loss. Specifically, the plaintiffs allege Hilliard told the plaintiffs that they were purchasing an airline that would begin scheduled commuter service soon. (Plaintiffs' Proposed Findings of Fact ("PPFOF") PP 30, 31; Laframboise May 4, 2007 Decl. Ex. A-1, p. 4 ("Final DOT approval is pending but expected momentarily".)) The plaintiffs also allege Hilliard failed to disclose significant problems with FAH and Hilliard's affiliated companies when he was soliciting their investments. The plaintiffs state that these hidden problems included the pending FAA sanctions against Plane-1, the fact that Sunrise owed approximately \$ 300,000 in back payroll taxes, bank loan defaults of FAH and affiliated companies reaching approximately \$ 8,000,000, and the financial problems of Discover Air, a company that FAH merged with in May 2002. (PPFOF PP 29, 48, 50, 67, 72.) The plaintiffs also state that they relied upon Hilliard's material misrepresentations and omissions regarding FAH's ability to obtain DOT approval to fly scheduled commuter flights when they purchased FAH stock. The plaintiffs state by affidavit that this omission caused them to suffer their financial losses. Specifically, the plaintiffs state that if "Hilliard had informed us of his problems with the Federal Aviation Administration, we would not have invested in the airline." (Affidavits of Flecks, Schonkes, Perrets, Krutzes, Calnins, Soletski, Downs, Whetter, Zellners, DeCleenes, Jossarts, Stephen F. Schonke, and Hahns at P 2.) Hilliard disputes these allegations and notes that the plaintiffs were provided with written materials that disclosed that FAH did not have DOT approval to fly as a commuter airline and that FAH might not ever receive such approval. (LaFramboise May 4, 2007 Decl. Exs. T and Y.)

Hilliard asserts that the plaintiffs have failed to present evidence of loss causation. Hilliard states that the plaintiffs' sole expert witness presented no testimony to help a fact finder determine whether matters allegedly concealed or something else caused FAH to fail. Hilliard argues that the plaintiffs' failure to present any expert testimony regarding the cause of FAH's demise should be dispositive of their Rule 10b-5 claims because, in order to prove loss causation, the plaintiffs must distinguish between the fraud-related and non-fraud-related reasons behind the failure of an investment. In support of this position, Hilliard cites to *In re Imperial Credit Indus. Sec. Litig.*, 252 F. Supp. 2d 1005, 1015 (C.D. Cal. 2003). The plaintiffs contend that *Imperial Credit* is inapposite because *Imperial Credit*, unlike the instant case, dealt with publicly traded stocks. This case, the

plaintiffs assert, is a simple case where FAH's inability to obtain DOT approval to fly scheduled commuter flights led to its demise. The plaintiffs argue that their loss was entirely caused by the fraud-related reasons.

The parties disagree as to what caused FAH to fail as a business. The plaintiffs assert that FAH's inability to obtain DOT approval to fly scheduled commuter flights doomed FAH as a business. The plaintiffs also assert that FAH failed to obtain the DOT approval primarily because of the pending FAA sanctions against Plane-1. Indeed, the DOT cited the unresolved FAA allegations against Plane-1 as a significant contributing factor to its decision to withdraw its tentative approval. (LaFramboise Decl. Exs. B and C.) Hilliard contends that DOT's decision was based on several factors in addition to the FAA's allegations. (*Id.* at Ex. C.)

Hilliard cites no binding authority that requires the plaintiffs to produce an event study conclusively demonstrating that Hilliard's alleged fraud-related conduct caused the plaintiffs' damages. The plaintiffs are required to demonstrate a "legally sufficient evidentiary basis" that would permit a reasonable finder of fact to conclude that Hilliard's alleged fraud-related conduct caused the plaintiffs' damages. See *Imperial Credit*, 252 F. Supp. 2d at 1014. The plaintiffs presented evidence suggesting that they relied upon Hilliard's material omissions described above when they invested in FAH, and they presented evidence suggesting that the FAA's pending regulatory sanctions against Plane-1, which were allegedly hidden from the plaintiffs when they invested, caused the plaintiffs to suffer pecuniary loss. Indeed, even though some of the plaintiffs may have offered various opinions at their depositions regarding the cause of FAH's demise, a reasonable finder of fact could conclude from the DOT letters (LaFramboise May 4, 2007 Decl. Exs. B and C) that the pending regulatory sanctions against Plane-1, and FAH's subsequent inability to obtain DOT approval to fly commuter flights, caused FAH to go out of business. Thus, viewing the facts in the light most favorable to the plaintiffs, as the court must, a reasonable finder of fact could conclude that Hilliard hid material facts from the plaintiffs in soliciting their investments and that the plaintiffs' losses were caused by these hidden facts. Furthermore, to defeat the plaintiffs' Rule 10b-5 claim at the summary judgment stage, Hilliard would have to establish that, as a matter of undisputed fact, the depreciation in the value of FAH's shares could not have resulted from the alleged fraud-related conduct. See *Caremark*, 113 F.3d at 650. Hilliard, however, has not established that FAH's demise was not caused by any of the alleged fraud-related conduct.

The parties also dispute the actual value of the FAH shares purchased by the plaintiffs. The plaintiffs assert that the FAH shares they purchased were worthless in light of the alleged misrepresentations and omissions. Hilliard asserts that the shares had value at the time the plaintiffs invested because FAH operated as a charter airline and still had the potential to operate as a commuter airline. Although the plaintiffs have not presented expert testimony as to the specific amount of damages they suffered as a direct result of the alleged misrepresentations and omissions, the plaintiffs may be able to "establish 'facts and circumstances tending to show the probable amount of . . . damages' sufficient to allow the trier of fact to form a 'reasonable and probable estimate' of recoverable damages." *Miller v. Asensio & Co.*, 364 F.3d 223, 231 (4th Cir. 2004) (quoting *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 565, 51 S. Ct. 248, 75 L. Ed. 544 (1931)). In sum, genuine issues of material fact exist as to the cause of FAH's demise and the amount of damages that the plaintiffs would have incurred but for the alleged fraud-related conduct. In light of the foregoing, the court is obliged to deny Hilliard's motion for summary judgment on the plaintiffs' Rule 10b-5 claim.

Hilliard also asserts that plaintiffs' common law claims of strict liability misrepresentation and negligent misrepresentation should be dismissed because the plaintiffs cannot prove any actual loss or any causal connection between the plaintiffs' actual loss and any alleged fraud-related conduct by Hilliard. However, as noted above, the plaintiffs presented evidence from which a

reasonable finder of fact could conclude that Hilliard hid material facts from the plaintiffs in soliciting their investments and that the plaintiffs' losses were caused by these hidden facts. Accordingly, the court is obliged to deny Hilliard's motion for summary judgment on the plaintiffs' common law claims of strict liability misrepresentation and negligent misrepresentation.

Second, Hilliard argues that several of the plaintiffs' claims are barred by the applicable statutes of limitations. Prior to the Sarbanes-Oxley Act of 2002, securities fraud claims under Rule 10b-5 were subject to a one-year/three-year statute of limitations scheme, requiring a plaintiff to bring suit within one year of the discovery of facts constituting a violation, and within three years of the actual violation. See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364, 111 S. Ct. 2773, 115 L. Ed. 2d 321 (1991). However, the Sarbanes-Oxley Act lengthened this statute of limitations period by replacing the one-year/three-year scheme with a two-year/five-year scheme. See 28 U.S.C. § 1658(b). Hilliard concedes that all the plaintiffs commenced their respective actions within five years of their purchases of FAH stock. As such, Hilliard does not argue that the plaintiffs' Rule 10b-5 claims are time-barred. However, Hilliard does argue that the some of the plaintiffs' claims under the Wisconsin Uniform Securities Law and the Florida Securities Act are time-barred by the applicable statutes of limitations.

Claims brought under the Wisconsin Uniform Securities Law are subject to a three-year statute of limitations. Wis. Stat. § 551.59(5) ("[n]o action shall be maintained under this section unless commenced before the expiration of 3 years after the act or transaction constituting the violation . . ."). The plaintiffs did not respond to Hilliard's argument that some of the plaintiffs' claims under the Wisconsin Uniform Securities Law, Wis. Stat. §§ 551.21, 551.31, and 551.41, are time-barred by the three-year statute of limitations. Thus, pursuant to Wis. Stat. § 551.59(5), all the plaintiffs' Wisconsin Uniform Securities Law claims arising from stock purchases occurring more than three years before the filing of their claims are time-barred by the statute of limitations. The affected claims are as follows:

The Calnins' Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on March 28, 2002, and June 6, 2002;

The DeCleen's Wisconsin Uniform Securities Law claims filed on September 6, 2005, regarding stock purchased on August 15, 2002;

The Flanagan Brothers' Wisconsin Uniform Securities Law claims filed on July 21, 2005, regarding stock purchased on January 17, 2002;

The Fleck Trust's Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on October 26, 2001, and February 16, 2001;

The Hahns' Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on May 7, 2001;

The Jossart Trust's Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on August 17, 2001, and December 14, 2001;

The Krutz Trust's Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on May 31, 2002;

The Perrets' Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on January 4, 2002;

The Schonkes' Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on April 9, 2001, and June 12, 2001;

The Soletskis' Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on May 4, 2002;

Mr. Whetter's Wisconsin Uniform Securities Law claims filed on July 21, 2005, regarding stock paid for¹ on July 12, 2002; and

The Jossarts' Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding the unpaid amount of \$ 80,000 on the loan as of October 2001.

Because the plaintiffs do not dispute that these claims are time-barred by the three-year statute of limitations under Wis. Stat. § 551.59(5), the court will grant summary judgment in favor of Hilliard on these claims. For the sake of clarity, the court notes that the following Wisconsin Uniform Securities Law claims are not time-barred by Wis. Stat. § 551.59(5):

The Calnins' Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on January 31, 2003, in the amount of \$ 20,000;

The Flanagan Brothers' Wisconsin Uniform Securities Law claims filed on July 21, 2005, regarding stock purchased on July 31, 2002, in the amount of \$ 100,000;

The Krutz Trust's Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on February 26, 2003, in the amount of \$ 20,000;

The Perrets' Wisconsin Uniform Securities Law claims filed on September 16, 2005, regarding stock purchased on March 11, 2003, in the amount of \$ 20,000;

Stephen F. Schonke's Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on August 29, 2002, in the amount of \$ 50,000; and

The Zellners' Wisconsin Uniform Securities Law claims filed on July 1, 2005, regarding stock purchased on October 1, 2002, in the amount of \$ 50,000.

1 Although Mr. Whetter signed the Subscription Agreement on July 24, 2002, he paid for his stock on July 12, 2002. The plaintiffs do not contest Hilliard's assertion that the date on which Mr. Whetter paid for the stock, July 12, 2002, is the date on which the statute of limitations started to run under the "commitment theory" of securities law. See *APA Excelsior III L.P. v. Premiere Techs.*, 476 F.3d 1261, 1267 (11th Cir. 2007).

Hilliard also argues that the Florida Securities Act claims of the following plaintiffs are time-barred by the statute of limitations set forth in Fla. Stat. § 95.11(4)(e): the De Cleenes, the Flanagan Brothers, The Krutz Trust, Stephen F. Schonke, Mr. Whetter, and the Zellners. The statute of limitations for securities fraud under the Florida Securities Act has two components. First, "the law suit must be commenced within two years 'from the time the facts giving rise to the cause of action were discovered or should have been discovered with the exercise of due diligence.'" *Byrne v. Gulfstream First Bank & Trust Co.*, 528 F. Supp. 692, 695 (S.D. Fla. 1981) (quoting Fla. Stat. § 95.11(4)(e)). "[T]he second prong of the test . . . requires that actions of this type be instituted 'not more than five years from the date [the] violation occurred.'" *Id.* The "violation" that starts the limitations period is when the purchaser contracts to buy the security. *Armbrister v. Roland International Corp.*, 667 F. Supp. 802, 823 (M.D. Fla. 1987).

Although all the plaintiffs commenced their respective actions within five years of their purchases of FAH stock, Hilliard asserts that plaintiffs the De Cleenes, the Flanagan Brothers, The

Krutz Trust, Stephen F. Schonke, Mr. Whetter, and the Zellners all received a letter and additional "compensatory" stock in April 2003 that should have put these plaintiffs on notice of their claims more than two years before they filed their Florida Securities Act claims. The April 2003 letter to these plaintiffs provides, in relevant part:

Wally Hilliard has appealed to the board of directors of Florida Air Holdings, Inc. to offer compensation to the investors who purchased stock at the price of \$ 400.00 per share during the period of May to December, 2002. The price per share was predicated on the value that Discovery Air brought to the company.

(Ostrow Aff. Ex. H.) Hilliard asserts that the April 2003 letter should have indicated to these plaintiffs that they were being compensated for untrue representations regarding the value of FAH's stock. Hilliard asserts that because these plaintiffs waited for over two years from the date of this letter to file their Uniform Florida Securities Act claims, the claims are barred by Fla. Stat. § 95.11(4)(e).

In response, the plaintiffs note that their claims are based on more than just the allegedly hidden financial problems of Discover Air and FAH's acquisition of Discover Air. And the plaintiffs point out that the April 2003 letter does not mention anything about the facts underlying the plaintiffs' claims regarding the FAA allegations against Plane-1, the approximately \$ 300,000 in back payroll taxes owed by Sunrise, or the bank loan defaults of FAH and affiliated companies reaching approximately \$ 8,000,000. According to the plaintiffs, the April 2003 letter did not put them on notice of their claims because it did not suggest any wrong-doing or misrepresentation; rather, the letter appeared to simply be correcting a mistake. The plaintiffs state that they did not learn of the alleged misrepresentations and omissions giving rise to their claims until after FAH went out of business in June 2004. (Affidavits of Flecks, Schonkes, Perrets, Krutzes, Calnins, Soletski, Downs, Whetter, Zellners, DeCleenes, Jossarts, Stephen F. Schonke, and Hahns at P 4.) Thus, viewing the facts in the light most favorable to the plaintiffs, a reasonable finder of fact could conclude that the plaintiffs who received the April 2003 letter were not put on notice of their Florida Securities Act claims by receiving that letter. As such, these claims may not be time-barred by the statute of limitations, Fla. Stat. § 95.11(4)(e), and the court is obliged to deny Hilliard's motion for summary judgment on these claims.

Third, Hilliard argues that the Wisconsin Uniform Securities Law claims alleged by Stephen F. Schonke and the Hahns should be dismissed because these plaintiffs purchased FAH stock from outside Wisconsin and that Act does not apply to transactions occurring outside Wisconsin. These plaintiffs have alleged Wisconsin Uniform Securities Law claims under Chapter 551 of the Wisconsin Statutes. The territorial scope of Chapter 551 is as follows:

(1) The provisions of this chapter concerning sales and offers to sell apply when a sale or offer to sell is made in this state or when an offer to purchase is made and accepted in this state. The provisions concerning purchases and offers to purchase apply when a purchase or offer to purchase is made in this state or an offer to sell is made and accepted in this state.

Wis. Stat. § 551.66(1). Hilliard asserts that Stephen F. Schonke and the Hahns cannot raise claims under the Wisconsin Uniform Securities Law because they purchased FAH stock outside Wisconsin, FAH is a Florida corporation, Hilliard is a resident of Florida, and the only contact between Hilliard and Stephen F. Schonke and Mr. Hahn was by telephone, facsimile, or mail from

Florida, when Stephen F. Schonke was in Germany and Mr. Hahn was in Guam. (Hilliard Aff. PP 38, 39.) To the best of his recollection, Hilliard believes that any communications from him to these plaintiffs originated in Florida. (*Id.*) Thus, Hilliard asserts, because there was no contact between the State of Wisconsin and Mr. Hahn's or Stephen F. Schonke's transactions, the plain language of Wis. Stat. § 551.66 requires the dismissal of the Hahns' and Stephen F. Schonke's claims under the Wisconsin Uniform Securities Law.

In response, the plaintiffs contend that Hilliard's affidavit, indicating that, to the best of his recollection, any communications from him to Stephen F. Schonke or Mr. Hahn originated in Florida, offers insufficient evidence to warrant summary judgment on these claims. (Hilliard Aff. PP 38, 39.) The plaintiffs suggest that in order for Hilliard to be entitled to summary judgment on these claims, he must offer proof that he did not make an offer of FAH stock to Stephen F. Schonke or the Hahns from Wisconsin.

While it is true that any doubt as to the existence of a material fact is to be resolved against Hilliard, the moving party, the plaintiffs may not rest upon the mere allegations or denials of the adverse party's pleading, but must set forth specific facts showing that there is a genuine issue for trial. See *Anderson*, 477 U.S. at 255; Fed. R. Civ. P. 56(e). Here, the plaintiffs offer no evidence suggesting that Hilliard initiated any communication with Stephen F. Schonke or the Hahns from Wisconsin. Because the plaintiffs failed to present any evidence sufficient to establish that there was any relevant contact between the State of Wisconsin and Stephen F. Schonke's or the Hahns' transactions, an element essential to these plaintiffs' Wisconsin Uniform Securities Law claims, see Wis. Stat. § 551.66(1)-(4), the court is obliged to grant summary judgment in favor of Hilliard on these claims. See *Celotex*, 477 U.S. at 322-23. Accordingly, Stephen F. Schonke's and the Hahns' Wisconsin Uniform Securities Law claims will be dismissed.

Fourth, Hilliard argues that the plaintiffs' "failure to register" claims should be dismissed because the securities at issue were exempt from the registration requirements under the Wisconsin Uniform Securities Law and the Florida Securities Act. The plaintiffs' third amended complaint raises "failure to register" claims under Wisconsin and Florida laws. Wis. Stat. § 551.21; Fla. Stat. § 517.07. Under Wis. Stat. § 551.21, securities sold in the State of Wisconsin must be registered with the Department of Financial Institutions. However, registration is not required if the security or transaction is exempt under § 551.22 or § 551.23. See Wis. Stat. § 551.21(1)(b). Wisconsin Statute § 551.23 exempts from registration "[a]ny offer or sale of a security to . . . [a]n accredited investor." Wis. Stat. § 551.23(8)(g). Similarly, under Fla. Stat. § 517.07, securities sold in the State of Florida must also be registered. See Fla. Stat. § 517.07(1). However, registration is not required if the security or transaction is exempt under § 517.061. See *id.* Florida statute § 517.061 exempts securities offerings involving no more than 35 purchasers. See Fla. Stat. § 517.061(11)(a)(1). And accredited investors are excluded from the purchasers counted toward calculation of the total number of purchasers. Fla. Stat. § 517.061(11)(b)(5). Hilliard asserts that because the plaintiffs were accredited investors, the securities at issue were exempt from the registration requirements under the Wisconsin Uniform Securities Law and the Florida Securities Act, and, therefore, the plaintiffs' "failure to register" claims should be dismissed.

It is undisputed that upon purchasing stock in FAH, each of the plaintiffs signed a Subscription Agreement in which they represented and warranted that they were accredited investors. The plaintiffs did not respond to this argument in their brief in opposition to Hilliard's motion for partial summary judgment, but in their brief in support of their motion for summary judgment, they state that Stephen F. Schonke and the Hahns were not accredited investors when they purchased FAH stock. However, as noted above, these plaintiffs cannot raise claims under the Wisconsin Uniform Securities Law. In addition, even if Stephen F. Schonke and the Hahns were not accredited investors, they would have been the only two unaccredited investors, and, therefore, the sales of

FAH stock fell within the 35 purchaser requirement in Fla. Stat. § 517.061(11)(a)(1) rendering the transactions exempt. In light of the foregoing, the court is obliged to conclude that the securities at issue were exempt from each state's securities registration requirements. Accordingly, the court will grant summary judgment in favor of Hilliard on the plaintiffs' "failure to register" claims, and these claims, the fourth and fifth causes of action in the plaintiffs' third amended complaint, will be dismissed.

Fifth, Hilliard argues that the plaintiffs' claims that he was required to obtain a license to sell securities under Wisconsin and Florida laws should be dismissed because he was exempt from the licensing requirements. The plaintiffs allege Hilliard was required under Wisconsin and Florida laws to register to sell securities. Agent licensing in Wisconsin is required under Wis. Stat. § 551.31. The plaintiffs allege Hilliard was an "agent" within the meaning of Wis. Stat. § 551.02(2), and that he failed to obtain a license as required by Wis. Stat. § 551.31(1). Wisconsin Statute § 551.02(2) defines an "agent" as follows:

"Agent" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect transactions in securities. A partner, officer or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent if he or she is within this definition. "Agent" does not include an individual who represents an issuer in doing any of the following:

(a) Effecting transactions in a security exempted by s. 551.22.

(b) Effecting transactions exempted by s. 551.23, other than transactions exempted under s. 551.23 (8) (g), (10) or (19) in which the individual receives a commission or other remuneration directly or indirectly for soliciting or selling to any person in this state.

(c) Effecting other transactions if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state.

Wis. Stat. § 551.02(2).

It is undisputed that Hilliard did not receive any commission or other remuneration directly or indirectly for soliciting or selling FAH stock. Accordingly, Hilliard was not an "agent" within the meaning of Wis. Stat. § 551.02(2). Furthermore, licensing is not required if the person is exempt under Wis. Stat. § 551.31(1)(d). Wisconsin Statute § 551.31(1)(d) exempts an "agent who is acting exclusively as an agent representing an issuer of securities and who makes offers and sales of the issuer's securities in transactions that are exempt under s. 551.23(8)(g)" Wis. Stat. § 551.31(1)(d). As noted above, all of the transactions were exempt under Wis. Stat. § 551.23(8)(g) because the transactions were sales to accredited investors. As such, the court concludes that Hilliard was exempt from the licensing requirements under Wis. Stat. § 551.31. In addition, the plaintiffs did not respond to Hilliard's argument that he was also exempt from the licensing requirements under the Florida Securities Act. See Fla. Stat. § 517.12(3) ("registration requirements of this section do not apply in a transaction exempted by s. 517.061(1)-(12)") Accordingly, the court will grant summary judgment in favor of Hilliard on the plaintiffs' claims that Hilliard failed to obtain a license under Wis. Stat. § 551.31(1) and Fla. Stat. § 517.12, and these claims, the sixth and seventh causes of action in the plaintiffs' third amended complaint, will be dismissed.

Sixth, Hilliard raises several arguments against the plaintiffs' claims of misrepresentation under Wis. Stat. § 100.18. Wisconsin Statute § 100.18(1) prohibits the making "to the public" of an

advertisement, statement, or representation which "contains any assertion, representation or statement of fact which is untrue, deceptive or misleading." *Id.* Hilliard asserts that all the plaintiffs' claims under Wis. Stat. § 100.18 should be dismissed because the claims are based on alleged failures to disclose, not misrepresentations, and nondisclosures are not actionable under § 100.18. See *Tietsworth v. Harley Davidson*, 2004 WI 32, P 40, 270 Wis. 2d 146, 677 N.W.2d 233 ("Silence - an omission to speak - is insufficient to support a claim under Wis. Stat. § 100.18(1)."). Hilliard also argues that the plaintiffs' Wis. Stat. § 100.18 claims should be dismissed because the plaintiffs have failed to produce evidence of any pecuniary loss caused by any misrepresentation by Hilliard. Section 100.18(11)(b)(2) creates a cause of action in favor of "[a]ny person suffering pecuniary loss because of a violation of this section by any other person," to "recover such pecuniary loss, together with costs, including reasonable attorney fees" *Id.*

The plaintiffs contend that they presented evidence demonstrating that their claims are based on Hilliard's material misrepresentations, in addition to omissions. For example, the plaintiffs allege Hilliard told them that they were purchasing an airline that would begin scheduled commuter service soon. (PPFOF PP 30, 31; LaFramboise May 4, 2007 Decl. Ex. A-1, p. 4 ("Final DOT approval is pending but expected momentarily").) In addition, the plaintiffs presented evidence to support their claim that Hilliard misrepresented the financial status of FAH by inflating the value of his contribution to the airline. (LaFramboise May 4, 2007 Decl. Exs. X and Y.) And, as noted above, the plaintiffs presented evidence to support their claims that they relied upon Hilliard's alleged misrepresentations (and omissions) when they invested in FAH, and that these material misrepresentations (and omissions) caused the plaintiffs to suffer pecuniary loss. (PPFOF PP 29, 48, 50, 67, 72; Affidavits of Flecks, Schonkes, Perrets, Krutzes, Calnins, Soletski, Downs, Whetter, Zellners, DeCleenes, Jossarts, Stephen F. Schonke, and Hahns at P 2.) Although these material facts are disputed, viewing the facts in the light most favorable to the plaintiffs, a reasonable finder of fact could conclude that Hilliard made misrepresentations which caused the plaintiffs to suffer pecuniary loss. Accordingly, the court will deny Hilliard's motion to dismiss all the plaintiffs' claims under Wis. Stat. § 100.18.

However, Hilliard has demonstrated that, for the reasons stated below, he is entitled to summary judgment on all but one of the plaintiffs' Wis. Stat. § 100.18 claims. Wisconsin Statute § 100.18 only applies to statements made "to the public," and statements made to persons with whom a contractual relationship exists are not statements made "to the public" within the meaning of § 100.18. See *Kailin v. Armstrong*, 2002 WI App. 70, P 44, 252 Wis. 2d 676, 643 N.W. 2d 132 (2002). Hilliard asserts that, under the holding in *Kailin*, once the plaintiffs purchased FAH shares and became co-owners of FAH, their subsequent additional purchases were not subject to § 100.18. The plaintiffs contend that § 100.18 does apply to their subsequent additional purchases, because the subsequent purchases required the plaintiffs to enter into new Subscription Agreements. However, it is undisputed that at the time the plaintiffs made the subsequent purchases, they had a "particular relationship" with Hilliard (as co-owners) and FAH (as owners). And "the important factor in defining 'the public' is 'whether there is some particular relationship between the parties.'" *Kailin*, 2002 WI App. 70, P 44, 252 Wis. 2d 676, 643 N.W.2d 132 (quoting *State v. Automatic Merchandisers of Am., Inc.*, 64 Wis. 2d 659, 664, 221 N.W.2d 683 (1974)). Therefore, under the holding of *Kailin*, once the plaintiffs purchased FAH stock, they did not qualify as "the public" under the statute for their subsequent purchases. See *id.* As such, the court concludes that the plaintiffs' Wis. Stat. § 100.18 claims involving the following purchases should be dismissed as "second purchases" outside of the scope of Wis. Stat. § 100.18:

The Calnins' purchases on June 6, 2002, and January 31, 2003;

The Flanagan Brothers' purchase on July 31, 2002;

The Fleck Trust's purchase on October 26, 2001;
The Jossart Trust's purchase on December 14, 2001;
The Krutz Trust's purchase on February 26, 2003;
The Perrets' purchase on March 11, 2003; and
Mrs. Schonke's purchase on June 12, 2001.

In addition, the plaintiffs do not dispute that all their § 100.18 claims arising from stock purchases occurring more than three years before the filing of their claims are time-barred by the three-year statute of limitations set forth in § 100.18(11)(b)(3). Thus, the following Wis. Stat. § 100.18 claims are time-barred by Wis. Stat. § 100.18(11)(b)(3):

The Calnins' Wis. Stat. § 100.18 claims filed on July 1, 2005, regarding stock purchased on March 28, 2002, and June 6, 2002;

The DeCleeness' Wis. Stat. § 100.18 claims filed on September 6, 2005, regarding stock purchased on August 15, 2002;

The Flanagan Brothers' Wis. Stat. § 100.18 claims filed on July 21, 2005, regarding stock purchased on January 17, 2002;

The Fleck Trust's Wis. Stat. § 100.18 claims filed on September 16, 2005, regarding stock purchased on February 16, 2001, and October 26, 2001;

The Hahns' Wis. Stat. § 100.18 claims filed on September 16, 2005, regarding stock purchased on May 7, 2001;

The Jossart Trust's Wis. Stat. § 100.18 claims filed on September 16, 2005, regarding stock purchased on August 17, 2001, and December 14, 2001;

The Krutz Trust's Wis. Stat. § 100.18 claims filed on September 16, 2005, regarding stock purchased on May 31, 2002;

The Perrets' Wis. Stat. § 100.18 claims filed on September 16, 2005, regarding stock purchased on January 4, 2002;

The Schonkes' Wis. Stat. § 100.18 claims filed on July 1, 2005, regarding stock purchased on April 9, 2001, and June 12, 2001;

The Soletskis' Wis. Stat. § 100.18 claims filed on July 1, 2005, regarding stock purchased on May 4, 2002;

Mr. Whetter's Wis. Stat. § 100.18 claims filed on July 21, 2005, regarding stock paid for (see footnote no. 1 on p. 16 above) on July 12, 2002; and

The Jossarts' Wis. Stat. § 100.18 claim filed on September 16, 2005, regarding the unpaid amount of \$ 80,000 on the loan as of October 2001.

Because the plaintiffs do not dispute that these claims are time-barred by the three-year statute of limitations under Wis. Stat. § 100.18(11)(b)(3), the court will grant summary judgment in favor of Hilliard on these claims.

The plaintiffs also do not contest Hilliard's argument that "compensatory" stock issued to certain plaintiffs on April 25, 2003, was not induced by statements or advertisements and thus, is excluded from the scope of Wis. Stat. § 100.18. In addition, although Stephen F. Schonke's § 100.18 claim filed on July 1, 2005, regarding stock purchased on August 29, 2002, is not time-barred by Wis. Stat. § 100.18(11)(b)(3), or a "second purchase" outside of the scope of Wis. Stat. § 100.18, as noted above, the plaintiffs presented no evidence sufficient to establish that there was any relevant contact between Wisconsin and Stephen F. Schonke's transactions. The scope of Wis. Stat. § 100.18(1) is limited to publications "in this state." *Id.* Accordingly, Stephen F. Schonke's § 100.18 claim will be dismissed because there is no evidence of contact between the State of Wisconsin and Stephen F. Schonke's transactions, an element essential to his § 100.18 claim. *See Celotex*, 477 U.S. at 322-23. In light of the foregoing, the court notes that the Zellners' § 100.18 claim filed on July 1, 2005, regarding stock purchased on October 1, 2002, in the amount of \$ 50,000, is the only § 100.18 claim that is not time-barred by Wis. Stat. § 100.18(11)(b)(3), or dismissed as a "second purchase" or otherwise outside of the scope of Wis. Stat. § 100.18.

Seventh, Hilliard argues that all the claims of the Perrets and Stephen F. Schonke should be dismissed for lack of reliance. Proof of reliance on a misrepresentation is a requirement for a cause of action under Rule 10b-5, as well as for a claim under the Wisconsin Uniform Securities Law, the Florida Securities Act, and under the common law of misrepresentation. *See TriContinental*, 475 F.3d at 842; *Carney v. Mantuano*, 204 Wis. 2d 527, 554 N.W.2d 854 (Wis. Ct. App. 1996) (Wisconsin Uniform Securities Law); *E.F. Hutton & Co. v. Rousseff*, 537 So. 2d 978 (Fla. 1989) (Florida Securities Act); *Lewis v. Paul Revere Life Ins. Co.*, 80 F. Supp. 2d 978, 999 (E.D. Wis. 2000) (misrepresentation); *Whipp v. Iverson*, 43 Wis. 2d 166, 169-70, 168 N.W.2d 201 (1969) (misrepresentation). "A fraudulent representation . . . is actionable only if there is reasonable reliance, a requirement intended in part to screen out trivial or concocted fraud claims." *In re Barnes*, 969 F.2d 526, 529 (7th Cir. 1992) (applying Wisconsin law).

Hilliard states that he did not speak to the Perrets or Stephen F. Schonke or send them written documents regarding FAH before these plaintiffs purchased FAH shares. In fact, these plaintiffs purchased FAH shares based upon conversations they had with relatives who already owned FAH shares. Hilliard asserts that since he had no direct contact with these plaintiffs before they purchased FAH shares, there is no way they could have relied upon any alleged misrepresentation or omission by Hilliard. And any alleged misrepresentation or omission that occurred after these plaintiffs purchased their shares cannot provide a basis for their claims. *See APA Excelsior III L.P.*, 476 F. 3d at 1267 (quoting *SEC v. Nat'l Student Mktg. Corp.*, 457 F. Supp. 682, 703-04 (D.D.C. 1978) ("there is little justification for penalizing alleged omissions or misstatements which occur thereafter and which have no effect on the decision.")). As such, Hilliard asserts, the claims of these plaintiffs should be dismissed for lack of reliance.

The plaintiffs agree that reliance is a necessary element of their claims; however, they contend that there is no requirement that the alleged misrepresentations or omissions be *directly* communicated to the plaintiff. The plaintiffs allege that the Perrets and Stephen F. Schonke relied upon misrepresentations and omissions made by Hilliard when they purchased their FAH shares, and these misrepresentations and omissions were communicated to these plaintiffs through other individuals. The plaintiffs assert that the injuries of the Perrets and Stephen F. Schonke were a direct result of the actions of Hilliard, and the fact that Hilliard's communications did not come directly from him should not be fatal to their claims. *See, e.g., Schaefer v. First Nat'l Bank*, 326 F. Supp. 1186, 1193 (N.D. Ill. 1970) ("privity is not required for an action to be maintainable under Rule 10b-5"); *Geo. H. McFadden & Bro., Inc. v. Home-Stake Production Co.*, 295 F. Supp. 587, 589 (N.D. Okl. 1968) ("one may recover for an SEC violation falling under Rule 10b-5 even though there is no direct personal relationship.").

Hilliard cites no binding authority suggesting that an alleged misrepresentation or omission must be communicated directly from the defendant to the plaintiff in order to establish reliance. Indeed, Rule 10b-5 provides that it is "unlawful for any person, *directly or indirectly*" to make any material misrepresentation or omission in connection with the sale of securities. 17 C.F.R. § 240.10b-5 (emphasis added); see also *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996) ("[t]here is no requirement that the alleged violator directly communicate misrepresentations to plaintiffs for primary liability to attach.") (citing *SEC v. Holschuh*, 694 F.2d 130, 142 (7th Cir. 1982)). Stephen F. Schonke's father, David Schonke, testified at his deposition that Hilliard failed to disclose the FAA allegations to him before he invested in FAH. (Laframboise June 11, 2007 Decl. Ex. JJ.) And Stephen F. Schonke testified at his deposition that he relied upon conversations with his father when he purchased FAH stock. (Ostrow Aff. Ex. CC.) Similarly, David Perret testified at his deposition that he learned from his brother-in-law, Kenneth Jossart, that according to Hilliard, FAH was about to start flying. (LaFramboise June 11, 2007 Decl. Exs. GG and II; PFFOF PP 82, 84.) The fact that the alleged misrepresentations or omissions were not directly communicated to these plaintiffs by Hilliard does not require the court to conclude that these plaintiffs cannot establish that they relied upon the alleged misrepresentations or omissions made by Hilliard. Indeed, viewing the facts in the light most favorable to the plaintiffs, a reasonable finder of fact could conclude that Hilliard made the alleged misrepresentations or omissions knowing they would be communicated to other investors, and that the Perrets and Stephen F. Schonke relied upon these alleged misrepresentations or omissions. Accordingly, the court will deny Hilliard's motion for summary judgment on all the claims of the Perrets and Stephen F. Schonke for lack of reliance.

Finally, Hilliard argues that the individual plaintiffs who were never owners of any FAH stock should be dismissed under Fed. R. Civ. P 17(a). Rule 17(a) requires that claims be prosecuted in the name of the real party in interest. It is undisputed that the Jossart Trust and the Krutz Trust were shareholders in FAH and are, therefore, real parties in interest. Hilliard asserts that the Jossarts and the Krutzes, as beneficiaries of their respective trusts, are not real parties in interest. However in addition to being beneficiaries of their respective trusts, the Jossarts and the Krutzes are also trustees of their respective trusts, authorized to pursue claims on behalf of the trusts. (Third Am. Compl. PP 17, 23.) Therefore, as the trustees of their respective trusts, it appears the Jossarts and the Krutzes are also real parties in interest. See, e.g. *Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 465, 100 S. Ct. 1779, 64 L. Ed. 2d 425 (1980) (holding that a trustee is a real party to the controversy when he possesses certain customary powers to hold, manage, and dispose of assets for the benefit of others). Accordingly, even though the plaintiffs did not respond to this argument, the court will deny Hilliard's motion for summary judgment on the individual claims of the Jossarts and the Krutzes.

Accordingly,

IT IS ORDERED that the defendant's motion for partial summary judgment (Docket # 77) be and the same is hereby **GRANTED** in part, and **DENIED** in part, as set forth above;

IT IS FURTHER ORDERED that the fourth, fifth, sixth, and seventh causes of action in the plaintiffs' third amended complaint be and the same are hereby **DISMISSED** for the reasons set forth above;

IT IS FURTHER ORDERED that the plaintiffs' motion for summary judgment (Docket # 81) be and the same is hereby **DENIED** as moot.

Dated at Milwaukee, Wisconsin, this 5th day of February, 2008.

BY THE COURT:

/s/ J.P. Stadtmueller

J.P. Stadtmueller
U.S. District Judge

[- Return to Page 1 -](#)

Financial Industry Regulatory Authority, Inc., Formerly Known as National Association of Securities Dealers, Inc., Respondent, v John J. Fiero et al., Appellants.

No. 2

COURT OF APPEALS OF NEW YORK

2008 NY Slip Op 1030; 2008 N.Y. LEXIS 136

February 7, 2008, Decided

NOTICE:

THE LEXIS PAGINATION OF THIS DOCUMENT IS SUBJECT TO CHANGE PENDING THE RELEASE OF THE FINAL PUBLISHED VERSION. THIS OPINION IS UNCORRECTED AND SUBJECT TO REVISION BEFORE PUBLICATION IN THE OFFICIAL REPORTS.

DISPOSITION: Order reversed, with costs, and complaint dismissed.

CORE TERMS: Exchange Act, fine, summary judgment, subject matter jurisdiction, disciplinary proceeding, disciplinary, registration, securities laws, federal district, arbitration award, exclusive jurisdiction, self-regulatory, broker-dealer, consolidation, implementing, membership, thereunder, plus interest, discipline, collection

COUNSEL: Brian D. Graifman, for appellants.

Terri L. Reicher, for respondent.

JUDGES: Opinion by Judge Read. Chief Judge Kaye and Judges Ciparick, Graffeo, Smith, Pigott and Jones concur.

OPINION BY: Read

OPINION

READ, J.:

In the early 1990s, John J. Fiero registered with the National Association of Securities

Dealers (NASD) (now called the "Financial Industry Regulatory Authority," or "FINRA"), a self-regulatory organization (SRO), as a securities representative. Relatedly, Fiero Brothers -- a broker-dealer firm owned by Fiero, the company's president and sole employee -- became a member of NASD¹. SROs are quasi-governmental entities with a duty under the Securities Exchange Act of 1934, as amended, "to promulgate and enforce rules governing the conduct of [their] members" (*Barbara v New York Stock Exchange, Inc.*, 99 F3d 49, 51 [2d Cir 1996]; see 15 USC § 78c[a][26]; § 78f[b]; § 78s[g]). The SEC must approve or reject any rule, practice, policy or interpretation proposed by an SRO (see 15 USC § 78s[b]; *Barbara*, 99 F3d at 51 [describing role of SROs in enforcing federal securities laws]).

1 On July 26, 2007, the Securities and Exchange Commission (the Commission or SEC) gave the final regulatory approval needed for consolidation of NASD and NYSE Regulation, Inc., a wholly-owned subsidiary of New York Stock Exchange LLC, to form FINRA. Essentially, the member firm regulation and enforcement functions and employees from NYSE Regulation transferred to NASD, which then adopted FINRA as its new corporate name. As a result of the consolidation, FINRA is the sole SRO providing member firm regulation for securities firms that do business with the public in

the United States (see 72 Fed Reg 42169, 42170 [Aug. 1, 2007]).

When Fiero applied for securities industry registration with NASD, he signed Form U-4 in which he "agree[d] to be subject to and comply with all requirements, rulings, orders, directives and decisions of, and penalties, prohibitions and limitations imposed by [NASD], subject to rights of appeal or review as provided by law." Similarly, Fiero Brothers subjected itself to NASD's rules and discipline when it filed Form BD to apply for broker-dealer registration.

On February 6, 1998, NASD's Department of Enforcement filed a disciplinary complaint alleging that Fiero and Fiero Brothers (collectively, the Fieros) had carried out a so-called "bear raid" to drive down the price of securities underwritten by another NASD member, causing that firm and its clearing firm to collapse while generating significant profits for the Fieros. In October 1999, an NASD hearing panel held a disciplinary hearing on the complaint; on December 6, 2000, the panel issued a decision finding that the Fieros had violated section 10(b) of the Exchange Act (15 USC § 78j[b]), SEC Rule 10b-5 and NASD Rules 2120 and 2110. The panel ordered Fiero Brothers expelled from NASD membership; barred Fiero from associating with any member firm in any capacity; fined the Fieros, jointly and severally, \$ 1 million; and imposed hearing costs totaling \$ 10,809.25. The Fieros appealed to NASD's National Adjudicatory Council, which affirmed the panel's findings and upheld its sanctions in a decision dated October 28, 2002.

The Fieros did not exercise their statutory rights to appeal the NASD's final disciplinary disposition to the SEC and, if aggrieved by the Commission's final order, the United States Court of Appeals (see 15 USC § 78s[d], § 78y[a]). The SEC may bring an action in federal district court to enforce its order affirming sanctions imposed by NASD for violation of the Exchange Act and its implementing rules (see 15 USC § 78u[e][1]; see also *SEC v Vittor*, 323 F3d 930 [11th Cir 2003]).

On December 22, 2003, NASD commenced an action in Supreme Court, alleging that the Fieros had refused to pay the fine and costs, "although due and duly demanded," and seeking judgment against them in the amount of \$ 1,010,809.25, plus interest, costs and disbursements. The Fieros subsequently moved to dismiss the complaint, principally claiming that NASD lacked authority to recover the fine because it "was not affirmed by the SEC, confirmed by a court, or otherwise converted into a judgment"; for its part, NASD moved to dismiss numerous counterclaims asserted by the Fieros.

On September 12, 2005, Supreme Court granted NASD's motion and denied the Fieros' motion, concluding that "NASD's claim [was] firmly based on ordinary principles of contract law" since the Fieros "expressly agreed to comply with all NASD rules, including the imposition of fines and sanctions" when they executed NASD registration forms. The court further observed that "New York State courts have long recognized the right of a private membership organization to impose fines on its members, when authorized to do so by statute, charter or by-laws", and that "NASD is not 'just a private club,' but a self-regulatory organization, federally-mandated under . . . the Exchange Act to discipline its members and enforce the federal securities laws as well as its own SEC-approved rules." Supreme Court concluded that "[t]he NASD rules relied upon by [NASD] appear[ed] to authorize imposition and collection of [the] fines" at issue.

The Fieros soon thereafter moved for summary judgment dismissing the complaint as time-barred under CPLR 215(5) and CPLR 7510, which prescribe one-year limitations periods for an action upon an arbitration award and a proceeding to confirm an arbitration award respectively. On December 14, 2005, Supreme Court denied this motion, rejecting the notion that the disciplinary proceeding was an arbitration.

Next, NASD moved for summary judgment, and on May 11, 2006, Supreme Court granted the motion, awarding NASD over \$ 1.3 million in fines and costs plus interest from December

2, 2002. Supreme Court observed that "NASD [had] met its burden of establishing a *prima facie* basis for entitlement to summary judgment" by submitting documentary evidence demonstrating undisputed facts in what "really amount[ed] to a collection action to recover fines and costs levied by NASD against [the Fieros] in a . . . disciplinary proceeding." The court also concluded that the Fieros' affirmative defense of selective enforcement was not "legally or factually sufficient to justify denial of summary judgment."

The Fieros appealed Supreme Court's order and judgment granting NASD summary judgment. On October 26, 2006, the First Department unanimously affirmed in an opinion endorsing Supreme Court's reasoning. We subsequently granted the Fieros' motion for leave to appeal, and now reverse on the ground that state courts do not have subject matter jurisdiction over this lawsuit. Although the issue of subject matter jurisdiction was not raised in the lower courts, "a court's lack of subject matter jurisdiction is not waivable, but may be [raised] at any stage of the action, and the court may, *ex mero motu* [on its own motion], at any time, when its attention is called to the facts, refuse to proceed further and dismiss the action" (*Matter of Fry v Village of Tarrytown*, 89 NY2d 714, 718 [1997] [quotation marks and citation omitted]).

Section 27 of the Exchange Act provides that "[t]he district courts of the United States . . . shall have *exclusive jurisdiction* of violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce

any liability or duty created by [the Exchange Act] or the rules and regulations thereunder" (15 USC § 78aa [emphasis added]). In this case, NASD is not seeking to adjudicate a state law claim. Instead, NASD brought this action to enforce a penalty imposed on the Fieros as a result of disciplinary proceedings provided for by the Exchange Act for violations of the Exchange Act and its implementing rules. Section 27 vests federal district courts with exclusive jurisdiction to entertain such a suit. Thus, state courts do not possess the power to hear and decide this controversy (see *American Distilling Co. v Brown*, 295 NY 36 [1945]). Because of our disposition of this appeal, we do not reach and express no opinion on any of the other issues raised by the parties and decided by the courts below.

Accordingly, the Appellate Division's order should be reversed, with costs, and the complaint dismissed.

* * * *

Order reversed, with costs, and complaint dismissed. Opinion by Judge Read. Chief Judge Kaye and Judges Ciparick, Graffeo, Smith, Pigott and Jones concur.

Decided February 7, 2008

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ELIZABETH H. RICH and DONALD RICH, Plaintiff-Appellants, v. PHILLIP L. SPARTIS and AMY JEAN ELIAS, Defendants-Appellees-Cross-Appellants, SALOMON SMITH BARNEY, INC., FORMERLY KNOWN AS CITIGROUP GLOBAL MARKETS, INC., Defendants-Appellees.

Docket Nos. 06-1723-cv(L); 06-1814-cv(XAP)

**UNITED STATES COURT OF APPEALS FOR THE SECOND
CIRCUIT**

2008 U.S. App. LEXIS 2815

**September 18, 2007, Argued
February 8, 2008, Decided**

PRIOR HISTORY:

Appeal and cross appeal from a judgment entered in the United States District Court for the Southern District of New York (Cote, J.) vacating NASD arbitration panel award of damages for brokerage account losses against individual stock brokers and their employer and confirming the panel's dismissal of the cross-claims of the brokers for indemnification from their employer, the District Court having determined, inter alia, that the claims for losses sustained by plaintiff in their brokerage account were released by a court order approving settlement of a class action.

DISPOSITION: Judgment vacated and remanded with instructions.

CORE TERMS: arbitration panel, arbitrator's, arbitration award, arbitration, stock, clarification, manifest, void, per share, lump sum, cross-claim, trading, class action, settlement, confirm, margin account, vacating, enjoined, vacated, arbitrators exceeded, ineligible, exceeded, advice, exercised options, closing price, compensatory, claim arising, citations omitted, indemnification, confirmation

COUNSEL: CULVER V. HALLIDAY (Kathryn V. Eberle, on the brief), Stoll, Keenon, & Ogden PLLC, Louisville, Kentucky, for Appellants.

SUSANNA BUERGEL (Eric S. Goldstein, on the brief), Paul, Weiss, Rifkind, Wharton & Garrison, New York, NY, for Appellees.

DAVID I. GREENBERGER, Liddle & Robinson, New York, New York, for Appellees-Cross-Appellants.

DAVID S. KAPLAN, Frost, Brown Todd, Louisville, Kentucky, for Appellees-Cross-Appellants.

JUDGES: Before: MINER, CABRANES, and STRAUB, Circuit Judges. Judge Straub concurs in a separate opinion.

OPINION BY: MINER

OPINION

MINER, Circuit Judge:

Plaintiffs-appellants, Elizabeth H. Rich and her husband, Donald Rich (the "Riches"), appeal from a judgment entered in the United States District Court for the Southern District of New York (Cote J.) vacating an award made in their favor by an arbitration panel established under rules adopted by the National Association of Securities Dealers ("NASD"). See *In re WorldCom Sec. Litig.*, No. 02-3288, 2006 WL 709101 (S.D.N.Y. Mar. 21, 2006). The award was made against defendant-appellee Solomon Smith Barney, Inc. ("SSB"), now known as Citigroup Global Markets, Inc. ("Citigroup"), and against Philip L. Spartis and Amy Jean Elias, stockbroker representatives employed by SSB. *Id.* at *1. Spartis and Elias cross appeal from the judgment insofar as it confirms the arbitration panel's dismissal of their cross claims for indemnity against Citigroup. The District Court determined, inter alia, that the arbitration award was solely for losses sustained by the Riches that were released by a court order approving settlement of a class action. See *In re WorldCom Sec. Litig.*, 2006 WL 709101, at *1. Accordingly, the District Court concluded that "the award of damages to the Riches must be vacated on the ground that

the arbitrators exceeded their authority when they granted damages to the Riches. . . . " Id. at *4. As to the arbitration panel's dismissal of the cross-claim, the District Court concluded that Spartis and Elias failed to show any basis for vacating the arbitration panel's decision. Id. We find that the District Court could not have determined that the arbitration award relied solely on WorldCom losses based on the record before us. We remand to the District Court to order the arbitration panel to clarify the award.

BACKGROUND

The Riches are residents of Louisville, Kentucky. As a long-term employee of WorldCom, Inc. ("WorldCom"), Mrs. Rich was provided with stock options as part of her compensation. Beginning in 1998, employees of WorldCom desiring to exercise their stock options were required to do so through the Atlanta, Georgia office of SSB. On July 2, 1998, and again on July 17, 1999, Mrs. Rich exercised stock options and immediately sold the acquired shares. Thereafter, SSB proposed an "exercise and hold" Plan (the "Plan") for WorldCom employees. Through the Plan, the employees would exercise their options and hold the shares for later sale pending anticipated increases in share prices. By holding the shares long enough, the employee shareholders would be able to have the increase in value taxed at capital gain rates.

In August of 1999, the Riches subscribed to the Plan by opening an account with SSB. They allege that they were advised in all matters relating to their account by Mr. Spartis and Ms. Elias. On August 5, 1999, Mrs. Rich exercised options for 10,012 shares of WorldCom stock at \$ 4.60 for 6,012 shares and \$ 17.87 for 4,000 shares. The closing price for each share that day was \$ 83.19. The Riches held their shares after financing the acquisition with funds borrowed from SSB by means of a margin account. On October 6, 1999, Mrs. Rich exercised options for 6,000 shares of WorldCom stock at an acquisition cost of \$ 8.94 per share. The closing price per share on that date was \$ 70.87. The Riches again paid for the shares through the margin account that they had established and again held the acquired shares as they claim they were advised to do.

On August 7, 1999, Mrs. Rich sold 10,012 shares of WorldCom stock and used the proceeds to purchase 11,700 shares of Sprint, Inc. ("Sprint") on that date. Allegedly, Mrs. Rich was advised that the "exercise and hold" strategy would be advanced by the Sprint purchase, since it was anticipated that Sprint would be merged into WorldCom. On January 31, 2000, Mrs. Rich exercised options to purchase 11,514 shares of WorldCom at \$ 5.82 per share. The closing price per share on that day was \$ 45.94. To finance this purchase, the Riches again used their margin account to borrow the necessary funds from SSB. Mrs. Rich exercised options through the SSB Plan one more time. On April 18, 2000, she exercised options for 13,500 shares of WorldCom at \$ 9.00 per share, with the closing price on that day being \$ 41.25 per share. This transaction also was financed through the margin account.

The Riches received margin calls in August and September of 2000 and responded with cash and securities, including liquidation of securities held in their account, to meet the calls. They first liquidated their 11,700 shares of Sprint and then began to sell the WorldCom shares to meet the margin calls. The Riches sold a total of 12,450 shares of WorldCom between September 13 and September 25, 2000. On September 26, they directed the sale, pursuant to a stop-loss order, of the remaining 22,030 shares of WorldCom in their account. The stock was sold that day for \$ 25.50 per share. The Riches paid SSB over \$ 25,000 in brokerage commissions and nearly \$ 100,000 in margin interest during the thirteen months they maintained their account at SSB. The Riches saw their WorldCom stock fall from \$ 83.00 to \$ 25.50 per share during that period. They saw the price of their Sprint stock fall from \$ 64.00 per share on the date of purchase to \$ 33.75 on the date of sale, August 11, 2000. Attributing their losses to the investment advice provided by SSB and its registered representatives, Spartis and

Elias, the Riches demanded arbitration of their claims for the losses sustained by filing a "Statement of claims" against SSB with NASD Dispute Resolution, Inc. Named as respondents in the arbitration were SSB, Spartis, Elias, and three other employees of SSB who were dismissed as respondents prior to the arbitration award.

The Statement of claims was filed on June 19, 2002, and included, generally, the historical facts described above. As claimants in the arbitration, the Riches sought compensation from the respondents for failing to advise them, inter alia, as to: the facts that would enable them to "adequately assess the risks of the SSB Option Plan"; the risks of drops in the stock prices of WorldCom and Sprint presented by the Plan; the risks posed by failing to diversify their stock holdings; the risks of utilizing a margin account; a suitable investment strategy other than the SSB Option Plan; and the conflict of interest stemming from the relationship between WorldCom and SSB as underwriter, market maker, and employer of Telecommunications Analyst Jack Grubman. The Riches also charged SSB and the manager of the Atlanta office with failing to adequately supervise Spartis and Elias. Detailed bases for the Riches claims were set forth in six separate "Counts" of the Statement of claims. They included: (i) Lack of Suitability; (ii) Lack of Supervision; (iii) Dishonest and Unethical Practice; (iv) Breach of Fiduciary Duty; (v) Negligence; and (vi) Gross Negligence. Compensatory damages of \$ 1,312,141.08 were claimed, along with punitive damages, attorneys' fees and costs, and interest.

Substantially denying the allegations made in the Statement of claims, SSB filed its Statement of Answer with Affirmative Defenses on September 6, 2002. A Statement of Answer with Motion to Dismiss and Cross-Claim, filed by Spartis and Elias on September 6, 2002, included affirmative defenses, denials of the allegations in the Statement of claims, an application for dismissal of the claim, and a request for indemnification relief from SSB. All parties concerned executed Uniform Submission Agreements submitting the Riches' claims to arbitration in accordance with the Rules of the NASD. On April 19, 2004, the NASD convened a three-person arbitration panel in Louisville, Kentucky. The panel, constituted according to NASD Rules, consisted of Robert P. Ross, Esq., designated "Public Arbitrator, Presiding Chair," Amelia F. Adams, Esq., designated "Public Arbitrator," and Todd Parker Lowe, designated "Non-Public Arbitrator." Testimony was taken and various motions were made at hearings that were held from April 19 to April 22, 2004 and on December 13 and 14, 2004. Sworn as witnesses were Spartis; Elias; William Hobby and Michael Grace, employees of SSB; Mrs. Rich; Dr. Craig J. McCann, a securities consultant; and John Fazio, Senior Vice President of Citigroup.

On December 14, 2004, counsel for Spartis and Elias brought to the panel's attention the lack of any evidence that Mrs. Rich had opted out of the WorldCom Securities Class Action, a necessary element to succeed in her arbitration claim. See *In re WorldCom Sec. Litig.*, 2006 WL 709101, at *1. The District Court had certified the plaintiff class in the WorldCom Securities litigation on October 24, 2003. See *In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267 (S.D.N.Y. 2003). A Notice of Class Action was disseminated to the plaintiff class on December 11, 2003. The Citigroup defendants, including SSB, entered into a proposed class settlement with the lead plaintiff on or about July 1, 2004, and a Notice of Proposed Settlement was distributed to the class on August 2, 2004. The District Court in the Southern District of New York ultimately set September 1, 2004 as the firm date for potential class members to seek exclusion from the plaintiff class.

On November 12, 2004, approximately one month prior to the final session of the arbitration panel considering the claims of the Riches, the District Court issued its "Judgment Approving Settlement and Dismissing Action Against the Citigroup Defendants" in the securities class action case. See *In re WorldCom Sec. Litig.*, No. 02-cv-3288 (S.D.N.Y. Nov. 12, 2004). The judgment enjoined class members "from instituting, commencing or prosecuting, either directly

or in any other capacity, any claim arising out of the matters giving rise to this Action." Id. at P 10. "Released Claims" is defined in the Judgment to include:

[A]ll claims . . . arising out of or relating to investments (including, but not limited to, purchases, sales, exercises, and decisions to hold) in securities issued by WorldCom, and/or in options or derivative instruments based in whole or in part on the value of securities issued by WorldCom . . . , including without limitation all claims arising out of or relating to any analyst research reports or other statements made or issued by the Citigroup Defendants concerning WorldCom

Id. at P6 (a). "Released Parties" was defined to include SSB as well as its former employees.

After hearing arguments on December 14, 2004 regarding the effect of the foregoing judgment on the arbitration proceeding, the Presiding Chair of the Arbitration Panel stated as follows:

Here's my ruling: We'll go ahead, and we will finish this arbitration and we will reach a decision. I presume that the respondents can go to the court in the class action and say, "Here's the arbitrators' decision; hold it void, because she's a member of the class." That being so, we will attempt to reach our decision based upon, one, it not be void; and, two, it being void. So we will have -- I'm thinking right now, we are going to reach a decision, and I'm thinking right now we will have two decisions. One as it relates to WorldCom and everything else in the account; one as it relates not to WorldCom and the class action suit, so that if they do go to void, there will be a remainder of the decision that remains valid.

The Arbitration Panel issued its Award on January 20, 2005, finding SSB, Spartis, and Elias jointly and severally liable to the Riches for \$ 315,000 in compensatory damages, \$ 63,000 in pre-judgment interest, \$ 50,000 in attorneys' fees, and \$ 20,000 in costs, with post-judgment interest to be paid at the rate of 12% per annum if the Award were not paid within 30 days. The Panel dismissed with prejudice the cross-claims of Spartis and Elias for indemnification. Although the Panel did not provide a statement of the reasoning behind its compensatory damages determination, it did include in its Award a Case Summary that included the following language: "Claimants alleged that Respondents gave them unsuitable investment advice to purchase WorldCom stock by means of a margin account with money borrowed from Salomon Smithy [sic] Barney, Inc. Claimants also alleged that Respondents never discussed the risks associated with the holding of the WorldCom shares."

By an action filed in the Circuit Court of the Commonwealth of Kentucky, Jefferson County, on January 31, 2005, the Riches sought confirmation of the Award. On February 7, 2005 the action thereafter was removed to the United States District Court for the Western District of Kentucky at the behest of Spartis and Elias. On February 2, 2005, while the action to confirm was pending in federal court in Kentucky, counsel for Spartis and Elias, by letter to Judge Cote of the Southern District of New York, who had directed the entry of judgment approving the settlement in the WorldCom Class Securities Action, advanced the argument that the judgment barred the enforcement of the Arbitration Award and requested the court to schedule a conference. In response, the District Court in New York on February 9, 2004, ordered the Riches to show cause "why they should not be enjoined from enforcing their NASD arbitration

award against Mr. Spartis and Ms. Elias." By letter dated February 11, 2005, Citigroup sought to join in the application made by Spartis and Elias.

At the show cause hearing held before the District Court on February 25, 2005, the Riches conceded that they should be enjoined from enforcing any portion of their Award that related to their investments in WorldCom securities. Accordingly, the District Court, by Order dated March 3, 2005, enjoined the Riches "from seeking to enforce the Award with respect to all claims of every nature and description, known and unknown, arising out of or relating to investments (including, but not limited to, purchases, sales, exercises, and decisions to hold) in securities issued by WorldCom." The injunction order included the following provision: "IT IS HEREBY . . . ORDERED that the arbitration panel that issued the award is not enjoined from clarifying whether any portion of the Award relates to claims not covered by the Rich Injunction."

It appears that the NASD provided the Panel with a copy of the foregoing order. Upon application of Citigroup, and after receiving the submissions of the parties in connection with their quest for clarification as permitted by the District Court, the Panel on March 15, 2005 issued, without explanation, a one-line decision "determin[ing] that the Motion for Clarification is denied." Thereafter, the United States District Court for the Western District of Kentucky, where the action to confirm the Award remained pending, transferred the action to the Southern District of New York by Order dated April 12, 2005. The Kentucky court, citing 28 U.S.C. § 1404, determined that the interest of justice and the convenience of parties would be served by the transfer because "the New York court could decide both issues of whether to confirm the award and whether confirmation violates the injunction. It would be inconvenient and a waste of the parties' time to litigate these issues in two separate cases."

Spartis and Elias thereafter moved in the Southern District of New York to vacate the Arbitration Award in its entirety. On March 21 2005, the District Court issued its Memorandum, Order and Opinion vacating the Award insofar as it provided for recovery of damages by the Riches and confirming the Award insofar as it denied the cross-claims of Spartis and Elias. The District Court determined that the Award to the Riches was intended to compensate them only for losses arising out of the advice that Mrs. Rich exercise her options and hold the stock in WorldCom. See *In re WorldCom Sec. Litig.*, 2006 WL 709101, at *4. According to the District Court, that advice "was the focus of the claim, the evidence at the hearing, and the summation arguments of counsel." *Id.*

Turning to the Award itself, the District Court found that "[t]he award's own description of the claims focused exclusively on WorldCom and described no other stock." *Id.* In the opinion of the District Court, the decision of the Arbitration Panel to issue just one Award, having recognized its power to issue two Awards, and then to decline to clarify the Award after the Arbitrators were informed that no recovery could be had for WorldCom losses, provided "further evidence that the entirety of the award was for WorldCom trading losses." *Id.* The District Court concluded that "the award of damages to the Riches must be vacated on the ground that the arbitrators exceeded their authority when they granted damages to the Riches based on their WorldCom trading losses." *Id.* In confirming the dismissal of the cross-claims of Spartis and Elias, the District Court concluded that, "[g]iven the strong presumption of regularity to which an arbitration award is entitled, Spartis and Elias have not shown that the Panel lacked authority to issue an award and that the dismissal of their cross-claim should be vacated." *Id.*

This timely appeal and cross-appeal from the judgment of the District Court followed.

ANALYSIS

On appeal, the Riches again acknowledge that they cannot recover for their losses in WorldCom, but they contend that other losses in their SSB account justify the Award made by

the arbitration panel. Although ultimately vacating the arbitration award in their favor, the District Court recognized that "as a theoretical matter, the losses sustained by the Riches were large enough to permit the \$ 315,000 to be attributed to non-WorldCom losses." *Id.* But there is more than a theoretical basis for seeing the Award as encompassing losses attributable to securities in the Riches' account other than WorldCom. For one thing, Dr. McCann, damages expert for the Riches, testified before the panel that his report, with exhibits showing the losses in the Riches' account, would enable the panel to separate the WorldCom losses from losses attributable to other securities. For another, Citigroup's expert, John Fazio, testified before the panel that losses in the Sprint transactions totalled \$ 448,000. This sum equals the precise total of the panel's Award -- \$ 315,000 (compensatory damages) plus \$ 63,000 (pre-judgment interest) plus \$ 50,000 (attorneys' fees) plus \$ 20,000 (costs).

The Riches are also aided by the general rule that "[a]rbitration awards are subject to very limited review in order to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation." *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 12 (2d Cir. 1997). We have noted that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-307, creates a "strong presumption in favor of enforcing arbitration awards" and have gone so far as to say that courts have an "extremely limited" role in reviewing arbitration awards. *Wall Street Assoc., L.P. v. Becker Paribas, Inc.*, 27 F.3d 845, 849 (2d Cir. 1994) (citations omitted). Put another way, "an arbitration award should be enforced, despite a court's disagreement with it on the merits, if there is a barely colorable justification for the outcome reached." *Landy Michaels Realty Corp. v. Local 32B-32J Serv. Employees Int'l*, 954 F.2d 794, 797 (2d Cir. 1992) (quoting *Andros Compania Maritima, S.A. v. Marc Rich & Co.*, 579 F.2d 691, 704 (2d Cir. 1978)).

When an arbitration panel makes a lump sum award without further explanation, "courts generally will not look beyond the lump sum award in an attempt to analyze the reasoning processes of the arbitrators." *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117, 121 (2d Cir. 1991) (internal quotations omitted); see also, *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1214 (2d Cir. 1972) (stating that "there is no general requirement that arbitrators explain the reasons for their award.") The determination by the NASD panel in the case at bar is, essentially, a lump sum award even though the sum is broken down into component parts.

The Riches also are entitled to the benefit of the burden of proof that the FAA imposes upon SSB, Spartis, and Elias as challengers of the Award. See *Wall Street Assoc.*, 27 F.3d at 848. According to the FAA, challenges to an arbitration award "upon the application of any party to the arbitration," are limited to the following grounds:

- (1) where the award was procured by corruption, fraud, or undue means;
- (2) where there was evident partiality or corruption in the arbitrators, or either of them;
- (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or 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; or
- (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a).

The District Court concluded that the arbitrators exceeded their powers by granting damages to the Riches for their WorldCom trading losses. In *re WorldCom Sec. Litig.*, 2006 WL 709101, at *4. That conclusion, of course, is grounded in the finding that the Award encompassed only losses in WorldCom, any claim for such losses having been released by the WorldCom Securities Litigation Judgment. In addition to arguing on appeal that the District Court correctly determined that the arbitration panel exceeded its authority, SSB, Spartis, and Elias contend that the panel acted in manifest disregard of applicable law. Although "manifest disregard" is not included in § 10(a) of the FAA as a ground for vacating an arbitration award, we have noted that "if the arbitrators simply ignore the applicable law, the literal application of a manifest disregard' standard should presumably compel vacation of the award." Sobel, 469 F.2d at 1214.

In the same vein, we have said that "where a reviewing court is inclined to find that arbitrators manifestly disregarded the law or the evidence and that an explanation, if given, would have strained credulity, the absence of an explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard." *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (2d Cir. 1998); see also *NLRB v. Bristol Spring Mfg. Co.*, 579 F.2d 691, 704 (2d Cir. 1978). In a recent decision in which we affirmed a finding that a panel award was issued partially in manifest disregard of the law, we opined that "an arbitral award may be vacated for manifest disregard only where a petitioner can demonstrate both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well-defined, explicit, and clearly applicable to the case." *Porzig v. Dresdner, Kleinwort, Benson, N. Am., LLC*, 497 F.3d 133, 139 (2d Cir. 2007) (internal citations omitted).

We simply are not yet in a position to determine whether the Award of the NASD arbitration panel either exceeded its powers or was in manifest disregard of the law. And that is because of the confusion occasioned by the circumstances surrounding the delivery of the unexplained lump sum award in this case. Although, as has been shown, an arbitration panel may render a lump sum award without explaining its reasons, the unique situation presented here dictates that the Award be clarified. All parties agree that the Riches cannot recover for their WorldCom trading losses, but it is not clear whether those losses are reflected in all, part, or none of the Award. What is missing is an assessment by the arbitration panel sufficient to enable us to determine the validity of the Award in this unusual case. The confusion in the Award arises from the actions of the panel itself.

Before the Award was made, and on the last day of the arbitration panel hearing, the WorldCom Securities Litigation Judgment releasing all claims against SSB and its employees was brought to the attention of the panel. Two of the panel members, including the Presiding Chair, apparently are lawyers. Confronted with the judgment, however, the Presiding Chair failed to recognize the force of the Judgment and ruled that the panel would "go ahead, and . . . finish this arbitration and . . . reach a decision." The Chair "presume[d] that [SSB, Spartis, and Elias] can go to the court in the class action and say" that the arbitrators' decision is void. The Chair went on to say that the panel would "attempt to reach our decision based upon, one, it not be void; and two, it being void." By the foregoing, the panel, speaking through its Chair, seemed to leave to the district court the decision as to whether the Award would be barred by the WorldCom judgment.

Continuing with his ruminations, the Chair then introduced further confusion into his Ruling by speaking in terms of two decisions by the panel as follows:

I'm thinking right now we will have two decisions. One as it relates to WorldCom and everything else in the account; one as it relates not to WorldCom and the class action suit, so that if they do go to void, there will be a remainder of the decision that remains valid.

Despite the "thinking" of the Chair, the Award was made in terms of one, unexplained lump sum. While it is true, as noted by the District Court, that only WorldCom was mentioned in the panel decision, that mention was made only in the context of the Case Summary discussing the contentions of the parties. However, the Summary of the contentions of the parties clearly was not complete, since the Statement of claims, as well as testimony at the hearing, referred to trading losses in Sprint.

Evidence that the parties were confused by the Award is found in the application by Citigroup to the panel for clarification of the Award and the submissions of the parties in connection therewith. Although the District Court found that the denial of the motion without explanation, combined with the two-decision comments of the Presiding Chair, demonstrated that the entirety of the Award represented WorldCom trading losses, see *In re WorldCom Sec. Litig.*, 2006 WL 709101, at *4, these findings also support the proposition that the Award was not for WorldCom losses or not for WorldCom losses alone.

Ample authority supports our conclusion that the District Court should remand this case to the arbitration panel for clarification. In *Ottley v. Schwartzberg*, 819 F.2d 373 (2d Cir. 1987), we declared that "[i]ndefinite, incomplete, or ambiguous awards are remanded 'so that the court will know exactly what it is being asked to enforce.'" 819 F.2d at 376 (quoting *Am. Ins. Co. v. Seagull Compania Naviera, S.A.*, 774 F.2d 64, 67 (2d Cir. 1985)). In ordering a remand for clarification here, we do not require the arbitrators to state their reasons, but only to explain their indefinite, incomplete, and ambiguous award in a way sufficient to allow effective judicial review. See *Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 894 (2d Cir. 1985). We emphasize that the difficulty here lies not alone in the fact that a lump sum has been awarded without explanation but in the unique circumstances of this case where, as recognized by the parties previously, it is impossible to tell what the lump sum is for.

Because the lack of clarity in the arbitration panel's award does not permit us at this time to determine whether the Award was issued in manifest disregard of the law, see *Hardy v. Walsh Manning Sec., L.L.C.*, 341 F.3d 126, 129-30, 134 (2d Cir. 2003), or exceeded the powers of the arbitrators, see *Siegel*, 779 F.2d at 894, we will remand this case to the District Court with instructions to remand to the NASD arbitration panel for clarification of the Award. See *Colonial Penn Ins. Co. v. The Omaha Indemnity Co.*, 943 F.2d 327, 335 (3d Cir. 1991). Specifically, the panel should be ordered to specify whether the WorldCom trading losses suffered by the Riches are represented in all, part, or none of the lump-sum Award and, if part, the amount thereof. We recognize that the District Court permitted the parties to seek clarification before it ruled on the motion to confirm but believe the better practice would have been, as we now require, to order rather than permit clarification by the NASD arbitration panel. The District Court should then review the clarified award, reconsider its earlier decision in light thereof, and make such further determination as it may deem proper. The foregoing is not intended to express any opinion as to what that determination should be or as to the merits of the claims and cross-claims submitted to the arbitrators.

CONCLUSION

For the reasons set forth above, the judgment of the District Court is vacated, and the case is remanded to the District Court for further proceedings consistent with this opinion. In view of

the foregoing, we do not rule on the challenges made by Spartis and Elias to the District Court's confirmation of the arbitration panel's denial and dismissal of their cross claims for indemnification. Under the procedure set forth in *United States v. Jacobson*, 15 F.3d 19, 21-22 (2d Cir. 1994), we direct that the mandate shall issue forthwith and that jurisdiction shall be restored to this Court upon a letter request from any party. Upon such a restoration of jurisdiction, the case is to be sent to this panel.

CONCUR BY: STRAUB

CONCUR

STRAUB, *Circuit Judge*, concurring:

I agree with the majority with respect to the disposition of this case. I write separately to emphasize that while our role in reviewing an arbitration award is extremely limited, this case presents the type of extraordinary circumstances that warrant remand.

The majority reasons that remand is required here because "the lack of clarity in the arbitration panel's award does not permit us at this time to determine whether the Award was issued in manifest disregard of the law or exceeded the powers of the arbitrators." (internal citations omitted). Our caselaw suggests that such "lack of clarity" should result in upholding the award. We have held that even if it is "probable" that a panel based its award on legally erroneous grounds, the award should be upheld so long as there is a "plausible" legal basis for the award. See *Duferco Int'l. Steel. v. T. Klaveness Shipping*, 333 F.3d 383, 392 (2d Cir. 2003) ("In construing an arbitral award we look to only plausible readings of the award, and not to probable readings of it. Even absent a plausible reading free of error, we would confirm the award if we independently found legal grounds to do so."). We have also stated, however, that in some limited circumstances, arbitration awards may be remanded "so that the court will know exactly what it is being asked to enforce." *American Ins. Co. v. Seagull Compania Naviera, S.A.*, 774 F.2d 64, 67 (2d Cir. 1985). I believe remand is appropriate here because this case presents such "limited circumstances."

Here, the arbitration panel heard testimony with respect to securities losses sustained by the Riches. Due to an intervening class action settlement, some of those losses became ineligible for arbitration. The arbitration panel acknowledged this fact, and even indicated an intent to award for both the eligible and ineligible losses and to leave it to the District Court to void the award as it pertained to ineligible losses. However, in issuing the Award, the panel failed to specify the amount awarded for eligible losses versus the amount awarded for ineligible losses. Accordingly, the District Court was faced with an award that it could not enforce without further information. See *id.*; see also *New York Bus Tours, Inc. v. Kheel*, 864 F.2d 9, 12 (2d Cir.1988) ("When an arbitration award provides no clear instruction as to how a court asked to enforce the award should proceed, the court should remand to the arbitrator for guidance."). Given the unique facts of this case, I agree with the majority that remand in order to direct the arbitration panel to provide a breakdown of its award is the proper course of action.

I also emphasize that in ordering a remand here, we do not require the arbitrators to state the reasons for their award, but only to state the precise amount of the award attributable to WorldCom losses as well as the precise amount of the award attributable to non-WorldCom losses. We in no way intend to preclude the panel from answering that the award was intended to compensate solely for WorldCom losses or solely for non-WorldCom losses. "A remand for clarification in such circumstances would not improperly require arbitrators to reveal their reasons, but would instead simply require them to fulfill their obligation to explain the award sufficiently to permit effective judicial review." *Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 894

(2d Cir. 1985). "Such a limited review of an arbitrator's award is necessary if arbitration is to serve as a quick, inexpensive and informal means of private dispute resolution." *Id.* (internal quotation marks and citation omitted). Remand for the limited purpose of asking the arbitration panel to provide a breakdown of the award will ensure that the District Court "will know exactly what it is being asked to enforce." *American Ins. Co.*, 774 F.2d at 67.

Accordingly, I concur in the judgment.

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