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# The Gavel

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Chadbourne & Parke LLP's Commercial Litigation group is proud to present the inaugural issue of *The Gavel*, our Commercial Litigation Newswire. *The Gavel* will provide an overview of current issues and hot topics in commercial litigation in the United States and abroad. In particular, it will include timely analysis of developments in those areas where our Commercial Litigation group is particularly active, including securities litigation, accountants' liability litigation, energy-related litigation, banking litigation and international and cross-border litigation. We will also pay particular attention to developments in one of our "home courts"— the Commercial Division of the New York State Supreme Court.

Chadbourne & Parke LLP has been providing counsel to clients on commercial litigation matters since the firm was founded in 1902. Throughout that time we have provided a wide range of clients with advice on the cutting edge issues of the day, and we continue to do so today. We hope that you benefit from the discussion herein, and welcome your comments.

IN THIS ISSUE

1 Deferred Prosecution Agreements Increase Exposure to Civil Liability

3 Recent Court Ruling Strikes a Cautionary Note for Delinquent SEC Filers

4 Nonsignatory Not Forced To Arbitrate

5 New York Courts May Have Jurisdiction to Hear Challenges to Out-of-State Arbitration Awards

7 Lawsuit Sought to Compel Public Service Commission to Review Proposed Merger

8 Et al.
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## Deferred Prosecution Agreements Increase Exposure to Civil Liability

Businesses facing the threat of indictment have become increasingly willing to enter deferred prosecution agreements with the government. In a deferred prosecution agreement, a business entity agrees to admit its wrongdoing and enact reform policies in exchange for a promise by the Justice Department not to seek an indictment as long as the business lives up to its agreement.

Though these agreements reduce the risk of criminal liability, two recent decisions from New York's Commercial Division indicate how deferred prosecution agreements can increase a firm's exposure to civil liability. In *Shalam v. KPMG LLP*, No. 112732/05, 2006 N.Y. Misc. LEXIS 2380 (Sup. Ct. Sept. 8, 2006) and *Williams v. Sidley Austin Brown & Wood, L.L.P.*, No. 60080/05, 2006 N.Y. Misc. LEXIS 2581 (Sup. Ct. Sept. 22, 2006), plaintiffs alleged that accounting firm KPMG colluded with the law firm Sidley Austin Brown & Wood, and others, to / *continued page 2*

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## Deferred Prosecution Agreements

*continued from page 1*

dupe wealthy investors into participating in tax shelter transactions that they knew would not withstand IRS scrutiny. In both cases, the court found that allegations based on defendants' admissions from deferred prosecution agreements satisfied the heightened pleading requirements for fraud claims.

As these decisions make clear, a firm threatened with criminal prosecution by the Justice Department faces difficult choices. On the one hand, the firm will feel enormous pressure to enter into a deferred prosecution agreement, to avoid being prosecuted and risking dramatic consequences. On the other hand, if a firm enters into a deferred prosecution agreement, the firm typically must make admissions that will increase the firm's exposure to civil liability.

### *Shalam v. KPMG LLP*

In *Shalam*, the founder and CEO of Audiovox alleged that in early 2000, partners at KPMG solicited his participation in a tax shelter transaction to offset capital gains realized from the sale of $55 million worth of stock. *Shalam v. KPMG LLP*, No. 112732/05, 2006 N.Y. Misc. LEXIS (Sup. Ct. Sept. 8, 2006). KPMG and Sidley Austin provided positive tax opinion letters on the transaction. *Id*. at *10. The IRS disallowed the tax shelter and ordered Shalam to pay back taxes, interest, and penalties. Shalam subsequently filed suit against KPMG, Sidley Austin, and other entities involved in the transaction including Bayerische Hypo-Und Vereinsbank AG and HVB Structured Finance, Inc. (referred to collectively as "HVB" by the court) alleging fraud and other claims. *Id*. at *11-12. The defendants moved to dismiss. The claims against KPMG and Sidley Austin were stayed because Shalam had participated in a class action against those defendants. *Id*. at *3.

The court, however, denied HVB's motion to dismiss. HVB had argued, in part, that Shalam had failed to satisfy the pleading requirement necessary to sustain his fraud allegation. *Id*. at *2. To satisfy the pleading requirement, Shalam relied in part on admissions of wrongdoing made by HVB in a deferred prosecution agreement. These admissions included a statement that HVB "participated in a number of fraudulent tax shelter transactions devised by others." *Id*. at *33. Shalam also seized upon portions of the deferred prosecution agreement in which HVB described how it marketed these types of tax shelter schemes. *Id*. at *33-34.

HVB tried to convince the court that these admissions should not be used by Shalam in his civil action. HVB argued that it had admitted to committing fraud only against the United States, but "not against investors like plaintiff who took full advantage of tax savings generated" by the disallowed transactions. *Id*. at *35. The court rejected HVB's argument, refusing to dismiss Shalam's fraud claim. The court found that the admissions provided a sufficient basis to draw "a solid inference" that HVB both marketed and facilitated the tax transactions in a way that defrauded Shalam. *Id*. at *36.

### *Williams v. Sidley Austin Brown & Wood, L.L.P.*

*Williams* provides another recent example of a plaintiff using a deferred prosecution agreement to state a claim for fraud. *See Williams v. Sidley Austin Brown & Wood*, No. 60080/05, 2006 N.Y. Misc. LEXIS 2581 (Sup. Ct. Sept. 22, 2006). Like *Shalam*, the plaintiffs in *Williams* alleged that KPMG, Sidley Austin, and HVB solicited their involvement in a tax shelter transaction that was subsequently disallowed. *Id*. at *2-3. The plaintiffs sued, alleging fraud and conspiracy to commit fraud. *Id*. The defendants moved to dismiss on the grounds that the complaint failed to plead fraud with particularity. *Id*. at *3.

After the motion papers were submitted and oral arguments on the motion were heard, the deferred prosecution agreement became available to the plaintiffs. This was the same deferred prosecution agreement that was at issue in *Shalam*. The court, unaware of the deferred prosecution agreement, initially granted the motion to dismiss. Nevertheless, when the plaintiffs moved to renew that motion, the court allowed them to amend the complaint by supplementing it with information contained in the deferred prosecution agreement. *Id*. at *3. The court determined that "all of the documents comprising the deferred prosecution agreement will be considered to the extent that they are relevant to the causes of action alleged by plaintiffs." *Id*. at *6. With the new information from the deferred prosecution agreement, the court found that the plaintiffs had satisfied the pleading requirement for fraud.

### Conclusion

Because admissions contained in deferred prosecution agreements can be used by plaintiffs to plead a civil fraud claim, firms threatened with criminal prosecution must tread carefully. Their first priority, of course, will be to avoid a criminal indictment. Even when successful in that goal, however, if the government insists on a deferred prosecution agreement businesses will likely face an increased exposure to civil liability as a result of admissions made in that agreement.

Recently, the Department of Justice has moderated its guidelines for determining when it will pursue criminal prosecution of a business entity. *See* "U.S. Department of Justice Moderates Guidelines for Prosecution of Corporate Fraud," *Chadbourne & Parke LLP Client Alert* at 1-3 (Dec. 2006). Whether these changes lead to fewer investigations and prosecutions of corporations, only time will tell. In the meantime, businesses faced with the

threat of criminal prosecution must be mindful that statements made in deferred prosecution agreements can increase a business's exposure to civil liability. ◎

# Recent Court Ruling Strikes a Cautionary Note for Delinquent SEC Filers

A recent decision by New York County's Commercial Division threatens to be a new tool for helping shareholders make big returns in a short period of time. In *Bank of New York* v. *BearingPoint, Inc.*, No. 600169/06, 2006 N.Y. Misc. LEXIS 2448 (N.Y. Sup Ct. Sept. 18, 2006), a Supreme Court judge ruled that a bond issuer violated the terms of its indenture by failing to file financial reports with the Securities Exchange Commission ("SEC") and the indenture trustee. In the past, bondholders have not typically viewed such a filing delinquency as a material breach. Peter Lattman & Karen Richardson, *Hedge Funds Play Hardball With Firms Filing Late Financials*, Wall St. J., Aug. 29, 2006, at A1. Instead, bondholders would either ignore the failure to file or look the other way upon receiving minimal consent fees from the bond issuer. *Id*. A new trend is emerging, however, as an increasing percentage of corporate bonds are held by activist investors and event driven hedge funds who use their equity or debt in companies to force corporate action by managers. These investors can make substantial profits by buying bonds, often below par value, and forcing accelerated redemption at par value from delinquent filers. Caroline Salas, *Hedge Funds Threatening Option Scam Defaults Win Case*, Bloomberg News, Oct. 6, 2006, http://www.bloomberg.com (search "Search News" for "Hedge Funds Threatening"; then follow hyperlink to article). Companies that do not have the resources to redeem their bonds on an accelerated basis are sometimes willing to pay large fees to avoid insolvency and bankruptcy. *Id*.

BearingPoint, Inc., a publicly held global management and technology consulting firm, issued $175 million of 2.27 percent convertible bonds to be due in 2024. *BearingPoint*, 2006 N.Y. Misc. LEXIS, at *2. Due to internal accounting problems, BearingPoint failed to file its annual report for year-end 2004, then subsequently failed to file its next two quarterly reports. *Id*. The company also failed to file copies of the annual and quarterly reports with the indenture trustee, as it was specifically required to do under the indenture. *Id*.

In response to these failures to file, The Bank of New York, as indenture trustee on behalf of all holders of the bonds, served BearingPoint with a notice of default, giving the company sixty days to cure the default. *Id.* at *3. When BearingPoint still failed to provide the reports within the cure period, the trustee served a notice of acceleration upon the company demanding the outstanding debt be paid in full. *Id.* at *4. BearingPoint ignored the notice of acceleration, and The Bank of New York brought suit against BearingPoint for breach of contract. *Id.* at *5. The Bank of New York alleged that BearingPoint breached the indenture by failing to file with the trustee, and also by failing to file with the SEC, which the trustee claimed was a condition precedent for filing with the trustee. *Id*. The trustee sought either an acceleration of the debt, or damages. *Id.* at *6.

BearingPoint responded that its obligation to provide copies of reports to the trustee was dependent upon its filing with the SEC, and that it did not have an independent duty to the Bank of New York to make any SEC filings. *Id.* at *10. Thus, BearingPoint claimed that it could choose not to file with the SEC, and therefore avoid its obligation to file with its investors. *Id.* at *18.

The court rejected BearingPoint's argument, asserting that BearingPoint's "tortured parsing" of the filing provision in the indenture "vitiates the clear purpose of the Indenture to provide information to the investors so that they may protect their investment." *Id*. The court observed that "only by guarding against incomplete information, can investors make informed decisions about their investment and guard against the risks attendant to incomplete information." *Id.* at *20. In support of its decision, the court pointed to the language of the indenture, which expressly required the company to file with the trustee copies of any documents that it was required to file with the SEC under Sections 13 or 15(d) of the Exchange Act. *Id.* at *18.

The court was also influenced by language in the indenture requiring the company to comply with Section 314(a) of the Trust Indenture Act of 1939 ("TIA"). *Id.* at *19. The TIA prohibits the sale of bonds over $5 million unless the issuer and holders sign an indenture detailing the terms of the bond issue. 15 U.S.C. § 77nnn. The TIA also requires the appointment of an indenture trustee who may seize company assets in the case of insolvency. *Id*. Section 314(a)(1) of the TIA specifically provides that the issuer must file copies of its SEC filings with the appointed indenture trustee. *Id*.

Because BearingPoint failed to fulfill its filing obligations, the court granted summary judgment to the plaintiff on the breach of contract claim and ordered a trial to determine damages. *BearingPoint*, 2006 N.Y. Misc. LEXIS, at *23. However, the parties subsequently came to an agreement upon which BearingPoint would file their financial reports on an agreed-upon schedule and pay a higher interest rate on the debentures if the plaintiffs would discontinue the lawsuit. Press Release, BearingPoint, *BearingPoint Reaches* */ continued page 4*

## Delinquent SEC Filers

*continued from page 3*

*Agreement in Principle with Holders of a Majority of Series A and B Debentures for Consents and Waivers and to Drop Pending Lawsuit* (Nov. 3, 2006), http://www.bearingpoint.com/ (follow "News" menu to "Press Releases").

The *BearingPoint* decision was handed down at time when many corporations are vulnerable to similar claims. The SEC is reportedly investigating over 120 companies for fraud related to the back-dating of stock options to executives. Lattman & Richardson, *supra*, at A1. As these companies scrutinize their financial statements for inaccuracies that may have resulted from the back-dating, some miss their filing deadlines. *Id*. Delinquent filers are susceptible to default notices, litigation, forced bond redemptions, and consent fee negotiations. Because the back-dating scandal has also caused the bonds of the companies under investigation to trade at lower prices, bondholders may be further tempted to give notice of default and demand acceleration so they may recoup their investment at face value. Over the past eighteen months, at least twenty-five companies have had their bonds accelerated or were forced to pay multimillion dollar fees to bondholders. *Id*. ◎

# Nonsignatory Not Forced To Arbitrate

A New York federal district judge recently ruled that a claims handler could not be forced to participate in arbitration proceedings pursuant to agreements between a reinsurer and its two reinsureds, because the claims handler was not a signatory to such agreements. *Castlewood (US), Inc*. v. *Nat'l Indem. Co*., 2006 U.S. Dist. LEXIS 77634 (S.D.N.Y. Oct. 24, 2006). Castlewood (US), Inc. ("Castlewood"), together with Seaton Insurance Company ("Seaton") and Stonewall Insurance Company ("Stonewall"), brought an action in the Southern District of New York for declaratory and injunctive relief against National Indemnity Company ("NICO"), claiming that, as a nonsignatory, Castlewood was not bound to the arbitration clauses in the agreements between NICO and Castlewood and Stonewall, NICO's two reinsureds.

Castlewood specializes in the operation and management of insurance companies in run-off. *See* Castlewood (US), Inc. homepage, http://www.castlewood-us.com. NICO provides reinsurance protection to insurance companies that are in run-off. *Castlewood*, 2006 U.S. Dist. LEXIS 77634, at *2-3. Seaton and Stonewall were both insurers in runoff that entered into separate agreements with NICO whereby NICO agreed to provide them with reinsurance coverage (collectively the "Reinsurance Agreements"). *See id*. at *3. In 1998 and 2000, NICO agreed to reinsure Seaton for up to $350 million and Stonewall for up to $240 million. *Id*. The Reinsurance Agreements contained arbitration clauses whereby the parties agreed to refer all disputes to an arbitration tribunal in New York City and to have their disputes governed by New York law. *Id*. at *3-4.

In 2006, Castlewood entered into separate agreements with Seaton and Stonewall to provide them with administrative services in connection with their run-off business (collectively the "Administration Agreements"). *Id*. at *4-5. Seaton and Stonewall each agreed to pay Castlewood approximately $1.8 million annually through 2008 for such services. *Id*. at *5.

In January 2006, shortly before Castlewood entered into the Administration Agreements with Seaton and Stonewall, NICO issued separate arbitration demands to Seaton and Stonewall seeking documents that NICO believed it was entitled to under the Reinsurance Agreements. *Id*. at *7. In May 2006, NICO amended its arbitration demand to add Castlewood as a respondent, asserting that Castlewood was not authorized to manage any claims for which Seaton and Stonewall sought coverage under the Reinsurance Agreements. *Id*.

Claiming that, as a nonsignatory, it was not bound by the arbitration clauses in the Reinsurance Agreements, Castlewood filed suit against NICO. Verified Complaint For Injunctive Relief and Declaratory Judgment, *Castlewood (US), Inc*. v. *Nat'l Indem. Co*., 2006 U.S. Dist. LEXIS 77634 (S.D.N.Y. Oct. 24, 2006) (No. 06-CV-6842). Castlewood claimed that it would suffer irreparable harm if it were forced into an arbitration in which it had no contractual duty to participate. *Reply Mem. Of Law In Further Support of Pls.' Order To Show Cause For Injunctive Relief* at 5, 2006 U.S. Dist. LEXIS 77634 (S.D.N.Y. Oct. 24, 2006) (No. 06-CV-6842). In response, NICO argued that "arbitration does not in itself constitute irreparable harm," and, in the alternative, that Castlewood was nonetheless subject to arbitration based on the theories of assumption and estoppel. *Castlewood*, 2006 U.S. Dist. LEXIS 77634, at **15, 17.

District Judge Kenneth M. Karas ruled in favor of Castlewood and granted its request for a preliminary injunction, holding that Castlewood was not compelled to join the pending arbitration, but dismissed Seaton and Stonewalls claims on the basis that they failed to establish irreparable harm. *Id*. at *2.

When evaluating whether to issue a preliminary injunction, a court of course considers whether the plaintiff is likely to suffer irreparable harm and has a likelihood of success on the merits of the case. *Id*. at *13. The court held that Castlewood satisfied the

irreparable harm requirement, stating that "[c]ompelling arbitration of a matter not properly subject to arbitration constitutes 'per se irreparable harm.'" *Id*. at *14-15.

The court also determined that, as a nonsignatory to the Reinsurance Agreements containing the arbitration clauses, Castlewood could not be compelled to join the arbitration proceedings unless it fell within a few limited exceptions. *Id*. at *16. The five theories pursuant to which the Second Circuit will enforce an arbitration agreement against a nonsignatory are: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel. *Merrill Lynch Inv. Managers* v. *Optibase, Ltd*., 337 F.3d 125, 129 (2d Cir. 2003). NICO's argument that Castlewood should be compelled to arbitrate was based only upon the theories of assumption and estoppel. *Id*. at *17.

## The Assumption Theory

Under the assumption theory, a nonsignatory to an arbitration agreement may nonetheless be bound if its "subsequent conduct indicates that it is assuming the obligation to arbitrate." *Castlewood*, 2006 U.S. Dist. LEXIS 77634, at * 17 (quoting *Thomson-CSF, S.A.* v. *Am. Arbitration Ass'n*, 64 F.3d 773, 777 (2d Cir. 1995)). To prevail under this theory, NICO would have had to establish that Castlewood demonstrated a "clear intent to arbitrate the dispute." *Id*. at *17.

NICO argued that Castlewood manifested an intent to arbitrate by acknowledging in the Administration Agreements that it had read the Reinsurance Agreements and that it would "at all times cause the services to be provided in a manner consistent with [Seaton's and Stonewall's] rights and obligations under the Reinsurance Agreements." *Id*. at *18. The court found this insufficient to establish assumption and made a "significant distinction" between a nonsignatory attempting to compel a signatory to arbitrate and a signatory attempting to compel a nonsignatory to arbitrate. *Id*. In the former situation, a nonsignatory can compel a signatory to participate in arbitration proceedings if the nonsignatory had been assigned rights by a signatory to the same agreement containing the arbitration clause. *Id*. In the latter situation, however, a signatory cannot compel a nonsignatory to arbitrate where the nonsignatory has not been assigned any rights under the original agreement. *Id*. As such, NICO, a signatory, could not compel Castlewood, a nonsignatory, to participate in the arbitration proceedings because neither Seaton nor Stonewall expressly assigned their rights under the Reinsurance Agreements to NICO. *See id*.

## The Estoppel Theory

Next, under the estoppel theory, Castlewood could only be compelled to participate in an arbitration if it "knowingly exploit[ed]" an agreement containing an arbitration clause. *Id*. at *20. This exception applies only where the nonsignatory receives direct benefits from the agreement. *Id*. at *21.

NICO claimed that Castlewood received direct benefits from the Reinsurance Agreements in that these agreements helped Castlewood obtain the later Administration Agreements with Seaton and Stonewall. *Id*. at *21. The court rejected this argument, stating that Castlewood retained only indirect benefits from the Reinsurance Agreements. *Id*. NICO also sought to enforce the arbitration clauses not in its own Reinsurance Agreements, but in the Administration Agreements between Castlewood and Seaton and Stonewall. The court stated the obvious in holding that NICO could not enforce the arbitration clauses of the Administration Agreements as the pending arbitration was not triggered by those contracts. *Id*. at *23.

Judge Karas's ruling demonstrates that courts in the Second Circuit continue to be reluctant to impose arbitration on non-parties to arbitration agreements. Stating that "the Second Circuit has held that irreparable harm results from arbitrating a dispute involving a party who is not covered by the arbitration agreement," one court recently held that a nonsignatory to an arbitration agreement could not be forced to arbitrate, even though it was closely affiliated with one of the signatories to the agreement. *Masefield AG* v. *Colonial Oil Inds*., Inc., 2005 U.S. Dist. LEXIS 6737, at *21 (S.D.N.Y. Apr. 18, 2005). Similarly, another court held that a buyer who was not a signatory to a joint venture agreement containing an arbitration provision was not bound to arbitration with the signatories to such agreement. *Tellium, Inc.* v. *Corning Inc*., 2004 U.S. Dist. LEXIS 2289, at *8 (S.D.N.Y. Jan. 15, 2004). ◎

# New York Courts May Have Jurisdiction to Hear Challenges to Out-of-State Arbitration Awards

In a case of first impression, the Second Circuit held that a New York court may be able to assert personal jurisdiction over the parties to an action challenging an arbitration award that was issued outside of the state. Even though the arbitration at issue took place in Florida, pursuant to a contract governed by Delaware law, the Second Circuit found that New York's courts could assert personal jurisdiction over the parties to the arbi- / *continued page 6*

## Challenges to Arbitration Awards

*continued from page 5*

tration in an action challenging an arbitration award if the underlying contract involved sufficient contacts with New York. In so holding, the Second Circuit reversed a Southern District of New York decision that found personal jurisdiction was lacking. *Solé Resorts, S.A. de C.V. v. Allure Resorts Management, LLC*, 450 F.3d 100 (2d Cir. 2006) ("Solé II"), *rev'g Solé Resorts, S.A., de C.V. v. Allure Resorts Mgmt., LLC*, 397 F. Supp. 2d 426 (S.D.N.Y. 2005) ("Solé I").

The case arose out of a business venture between Solé Resort, S.A. de C.V. ("Solé"), a Mexican hotelier, and Allure Resorts Management, LLC ("Allure"), a resort management entity formed under the laws of the Turks & Caicos Islands, with its principal place of business in the Dominican Republic. *Solé II*, 450 F.3d at 101. The two parties entered into a contract whereby Allure would manage Solé's hotel resort in Tulum, Mexico. *Id*. The agreement provided it was governed by Delaware law. *Id*. The contract also contained an arbitration clause, designating Miami, Florida as the situs for arbitration. *Id*.

The contract made no reference to the possibility of arbitrating or litigating in New York. Nevertheless, the underlying transaction did have some New York contacts. *Id*. at 101-02. For instance, Solé's principal owner had a residence in New York, and Allure mailed a business plan to him at his New York address. *Id*. at 102. In addition, Solé's counsel for the deal was based in New York. *Id*. During contract negotiations, this attorney sent and received "numerous" e-mails from New York containing drafts of the agreement, and also participated in several conference calls while in New York. *Id*. Moreover, an Allure representative traveled to New York to develop plans to market the hotel in New York. *Id*. Finally, after the business relationship deteriorated, a representative of Solé informed a representative of Allure that Solé was thinking of backing out of the deal. *Id*. This exchange took place at John F. Kennedy International Airport in New York. *Id*. When Solé ultimately decided to terminate the agreement a few days later, it did so in a letter mailed from New York. *Id*.

Allure responded to Solé's termination notice by initiating an arbitration proceeding in Miami, Florida, pursuant to the parties' contract. *Id*. The arbitration panel found in Allure's favor, awarding it over two million dollars in damages for lost future profits. *Id*. Solé then brought an action to vacate the award in the Southern District of New York. *Id*. Solé claimed that the arbitrators did not apply the proper law when assessing damages and that the amount of the award was arbitrary and capricious. *Id*.

Allure made a motion to dismiss the action on the grounds that the courts of New York state did not have personal jurisdiction over Allure. *Id*. While general jurisdiction was lacking, Solé argued that the court could assert jurisdiction over Allure under Civil Practice Law and Rules Section 302(a), New York's long-arm jurisdiction statute. *Solé I*, 397 F. Supp. 2d at 428.

For a New York court to have jurisdiction over a non-domiciliary under Section 302(a), the cause of action must arise out of acts that fall into any one of four categories: (1) business transactions in New York, or contracts to supply goods or services in New York; (2) torts committed in New York; (3) torts committed in another jurisdiction that cause injuries in New York; or (4) ownership, use or possession of real property in New York. Solé argued that the court could assert personal jurisdiction under Sections 302(a)(1) and (a)(3). *Solé I*, 397 F. Supp. 2d at 428.

With respect to Section 302(a)(1), the district court rejected Solé's argument on the grounds that there was no "substantial nexus . . . between Solé's contacts with New York and the claim made." *Id*. at 428-29. Solé's claim was based on the alleged wrongdoing of the arbitrators. *Id*. at 429. The district court found that the actions of arbitrators are deemed to have occurred in the situs of the arbitration, which in this case was Florida. *Id*. The limited contacts that the parties had with New York were unrelated to the actions of the arbitrators in Florida. *Id*. Since it found that Solé's cause of action arose out of the arbitrator's actions and not out of any of the activity that occurred in New York, the district court held that there was no personal jurisdiction over Allure. *Id*.

With respect to Section 302(a)(3), the district court again found there was no personal jurisdiction. *Id*. at 429-30. Solé had alleged in the arbitration that Allure committed the tort of fraudulent inducement when it sent its business plan to Solé at a New York address. *Id*. However, the arbitration panel had found that Allure had not committed this tort, and Solé was not challenging the arbitration panel's determination on this point. *Id*. Therefore, the district court held that Solé could not establish personal jurisdiction under Section 302(a)(3). *Id*. at 430.

On appeal, Solé claimed that the district court had erred in its analysis under Sections 302(a)(1) and (a)(3). 450 F.3d at 101. The Second Circuit, acknowledging that the case presented a novel issue in New York, agreed with Solé on both points. *Id*. at 104, 106.

First, the circuit court determined that the district court had erred in its Section 302(a)(1) analysis by focusing only on the actions of the arbitrators. *Id*. at 104. According to Chief Judge John M. Walker, Jr., the activities related to the underlying contract also should have been considered. *Id*. Chief Judge Walker observed that two requirements must be satisfied to establish personal jurisdiction under Section 302(a)(1): the defendant must have transacted business within the state, and the cause of action must arise out of that transaction. *Id*. at 103. Focusing on the second prong of this analysis, Chief Judge Walker found that, for a cause of action to arise from a particular transaction,

there must be "some articulable nexus between the business transacted and the cause of action sued upon," or "a substantial relationship between the transaction and the claim asserted." *Id.* This nexus must be more than "merely coincidental." *Id.*

The court focused on the fact that the *Solé* case involved a dispute over an arbitration, and "[a]rbitration is entirely a creature of contract." *Id.* at 104. The contract establishes which set of rules will govern the arbitration, what law shall be applied, where the arbitration shall take place, and which disputes are subject to arbitration. *Id.* The "arbitration proceeding is thus an extension of the parties' contract with one another." *Id.* Without the contract, there would never be an arbitration, or an arbitration award. *Id.* Likewise, without the contract, there would never be a cause of action challenging the arbitration award. *Id.* Thus, the court concluded that there is "a substantial relationship between a challenge to the arbitrators' decision and the contract that provided for the arbitration." *Id.* Therefore, if the contract providing for the arbitration involves any transaction of business in New York, then there is an "articulable nexus" between the New York contacts and a cause of action to challenge the arbitration award. *Id.* In such a situation, a New York court can assert personal jurisdiction.

The Second Circuit also found that there could be personal jurisdiction under Section 302(a)(3). *Id.* at 106. The court acknowledged that the arbitration panel had determined that Allure had not committed a tort against Solé, and that Solé had not challenged this part of the arbitrators' decision on the merits. *Id.* Nevertheless, the court held that, because "Solé's fraudulent inducement claim arose out of events surrounding the formation and performance of the contract," the district court should have looked at all of the facts surrounding the contract when making its determination. *Id.* Moreover, "all of the facts underlying that contract are substantially related to Solé's claim that the arbitrator's judgment is infirm." *Id.* Thus, the court determined that under both Section 302(a)(1) and Section 302(a)(3), it was not enough for the district court to simply look at the facts surrounding the Florida arbitration. *Id.* Rather, the district court should have looked at all of the facts surrounding the underlying contract to see if there was a sufficient connection to New York. *Id.*

The circuit court remanded the case to the district court with instructions to resolve the following issues: (1) whether Allure's New York contacts satisfied the definition of "transacting business" under Section 302(a)(1); (2) whether personal jurisdiction was supported by the fact that Allure sent a business plan to Solé's principal owner in New York under Section 302(a)(3); and (3) whether jurisdiction in New York would satisfy federal due process requirements. *Id.*

The *Solé* case provides a valuable lesson for parties drafting arbitration provisions. These terms often specify an exclusive jurisdiction in which parties may seek to confirm, vacate or modify arbitration awards. Without a doubt, Allure never expected that it could wind up in a New York court when it executed a contract with Solé that explicitly provided for disputes to be resolved through arbitration in Florida. Allure probably assumed that any actions to challenge or confirm an arbitration award would remain in Florida as well. The *Solé* case demonstrates that, absent a specific contractual provision directing that post-arbitration litigation take place in a particular jurisdiction, parties may end up litigating in a forum that they did not anticipate. ◎

# Lawsuit Sought to Compel Public Service Commission to Review Proposed Merger

A lawsuit that was filed to push an $11.13 billion merger forward was recently withdrawn after the political atmosphere in Maryland caused the merger to be canceled. The proposed merger was to involve two energy companies, FPL Group, Inc. and Constellation Energy. The Maryland legislature had made repeated efforts to block the merger beginning earlier in 2006, including passing a law, known as S.B.1, that prevented the PSC from reviewing the merger until all five members of the PSC were replaced with new members nominated by the legislature.

Finding itself in legal limbo, FPL filed suit on October 4, 2006, seeking to overcome this roadblock. *See FPL Group, Inc. v. State,* No. 24-C-06007950 (Md. Cir. Ct. Oct. 4, 2006). The suit named the PSC and the State of Maryland as defendants, and sought a declaratory judgment that the PSC was required to review the merger. (Verified Compl. for Declaratory J. & a [sic] for Prelim. & Permanent Inj. at ¶¶ 1-2.)

About a month before a scheduled hearing, Constellation decided to cancel the merger and FPL's case was withdrawn. Foster Electric Report, *After 10 Months, Constellation and FPL Walk Away From Their Mega-Merger Plans, Due in Part to Maryland's Stormy Political Environment* (Oct. 31, 2006). Describing the current political atmosphere in Maryland as a "perfect storm," Constellation explained that its decision was based on "continued uncertainty over regulatory and judicial matters in Maryland." Specifically, the company was concerned about "the potential for a protracted and open-ended merger review process." *Id.* ◎

# Et al.

## Newsworthy

On December 12, 2006 George Bundy Smith, a renowned judge who served for 14 years on New York's highest court, joined the Firm as a partner in the litigation department. Judge Smith was appointed to the New York Court of Appeals in 1992 by Governor Mario Cuomo and served until his retirement in September. His judicial career began in May 1975, when he was appointed to the Civil Court of New York City. He was a Justice of the Supreme Court of the State of New York, New York county from 1980 to 1986, and an Associate Justice of the Supreme Court, Appellate Division, First Department, from 1987 to 1992. Judge Smith has also served as an Adjunct Professor of Law at the Fordham University Law School since 1981.

## Awards

George Bundy Smith was honored with the 2007 Hon. William Brennan Award for Outstanding Jurist by the New York State Association of Criminal Defense Lawyers. In presenting the award, the Association cited Judge Smith's work in the civil rights movement and his thirty years of service as a judge.

On Thursday, November 9th, Alan Raylesberg was presented with the Humanitarian Award by the Award of Courage Corporation at its Award of Courage Dinner and Auction benefiting Memorial Sloan-Kettering Cancer Center. The event took place at the Grand Hyatt in New York.

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