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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon Joan A. Madden PART 11
Justice

In re Oliver L. Vela

-v-

Financial Industry Regulatory Authority

INDEX NO. 103697/08
MOTION DATE 4-21-08
MOTION SEQ. NO. 001
MOTION CAL. NO. ____

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, It is ordered that this ~~motion~~ application is decided in accordance with the annexed Memorandum Decision + Order.

FILED
JUL 18 2008
COUNTY CLERK'S OFFICE
NEW YORK

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

Dated: July 16, 2008

HON. JOAN A. MADDEN J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 11

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In the Matter of Application of

OLIVER L. VELEZ,

Petitioner,

For an order Pursuant to Article 75 of the CPLR
to Permanently Stay Arbitration

-against-

Index No. 103697/08

FINANCIAL INDUSTRY REGULATORY
AUTHORITY DISPUTE RESOLUTION, INC.
(FORMERLY, THE NASD), GREG CAPRA
and PRISTINE CAPITAL HOLDINGS, INC.,

Respondents.

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MADDEN, J:

In this action, petitioner Oliver L. Velez (Velez) moves, by order to show cause, pursuant to CPLR 7502 and 7503, to permanently stay Arbitration No. 07-02396 before respondent Financial Industry Regulatory Authority Dispute Resolution, Inc. (FINRA), formerly, the NASD,[1] and captioned In the Matter of the Arbitration between Greg Capra and Pristine Capital Holdings, Inc. v Oliver L. Velez (the NASD Arbitration) on the ground that no valid agreement to arbitrate exists between petitioner and respondents Greg Capra (Capra) and Pristine Capital Holdings, Inc.

FACTS

In 1994, Velez and Capra founded Pristine Capital Management, Inc. (Pristine

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[1] In 2007, the regulatory arm of the NASD merged with the New York Stock Exchange and adopted the FINRA name. For case of reference, this opinion will continue to use the more familiar NASD name.

Capital) (Velez Aff., ¶ 3). Velez and Capra each held 50% of the equity (id.). In 2001, Velez and Capra founded Pristine Securities, Inc. d/b/a Mastertrader.com (MTC), a broker-dealer registered with the Securities and Exchange Commission (the SEC), and a member of the NASD (id., ¶ 4). In 2001, Velez and Capra founded Pristine Services, Inc. (PSI) (id., ¶ 5). In 2001, Velez and Capra reorganized Pristine Capital. As a result, Pristine Capital became a holding company for MTC and PSI. In addition, Pristine Capital was renamed Pristine Capital Holdings, Inc. (PCH), and the shares of PCH were allocated 47% to Velez and 47% to Capra (id., ¶ 6). Velez was the chairman and chief executive officer of PCH (id., ¶ 6), and Capra was its president (Capra Aff., ¶ 22). Neither PCH nor PSI are members of the NASD.

PSI provides educational support and information services to active securities traders via the internet, seminars, publications and DVDs, and is considered to be a leader in the securities industry (id., ¶ 20). As a broker-dealer and because of its membership in the NASD, MTC is subject to the federal securities laws, and the rules and regulations promulgated by the NASD and the SEC, which mandate arbitration of disputes between and among member firms, associated persons and certain others arising from the securities business (id., ¶ 21). Neither PSI nor MTC are parties in the instant action, or in the related arbitration proceeding.

Velez contends that his role in PSI was limited to conducting seminars on how to trade securities (Velez Aff., ¶ 7). Velez further contends that he had no role in the management of MTC, and that his role was limited solely to that of a capital contributor or investor (id., ¶ 8).

PSI and MTC engage in the cross-marketing of their products and services to each other's customers. PSI, the subsidiary on the education side of PCH's business, develops new clients – investors who wish to learn how to transact profitably in the stock market. Once the

new customers subscribe to a PSI product or service, they are then referred to NASD member firm MTC, for execution of their brokerage transactions. Also, new brokerage clients acquired by PSI are encouraged to purchase PSI educational products, using a variety of promotional incentives (Capra Aff., ¶ 23).

Among its many regulatory duties, the NASD regulates marketing to public customers of member firms like MTC. When MTC was formed in 2000, the NASD initially restricted it from marketing its products and services in connection with PSI (id., ¶ 24; Exh F).

According to Capra, the cross-marketing strategy between the PSI and MTC is a significant part of the PCH business model. It required NASD approval as a condition of permitting the cross-promotional strategies between the companies. The regulator further required, as a condition of its approval of the marketing techniques, that Velez and Capra become licensed, registered principals of MTC to ensure the NASD's oversight and jurisdiction over the executives of PCH, Velez and Capra, over the member firm MTC, and the nonmember firm PSI, and over the holding company PCH, regarding the marketing activities of the affiliated firms (id., ¶ 25).

Velez and Capra were the only individuals involved in obtaining the lifting of the NASD restriction against the cross-marketing approach, and acting also as principals and agents for MTC, PSI and PCH. Capra alleges that he and Velez discussed in depth, and fully comprehended, the regulatory purposes that required their licensure and registration with the NASD (id., ¶ 26). Indeed, to meet the requirements imposed by the NASD in 2001, to become licensed "Registered Principals" of MTC, Velez and Capra embarked on an intensive three-month study regime, so that they could simultaneously pass the "Series 7 General Sales" exam

and the "Series 24 General Principal" exam. As part of the licensing process, both Velez and Capra each executed a Form U-4, a "Uniform Application for Securities Industry Registration" (id., ¶ 27; Velez Aff., ¶ 9). Form U-4 is a notice filing to regulators and to the public at large that a particular person is associated with a broker-dealer. Once they passed the two exams, Velez and Capra each became an "Associated Person" and Registered Principal of MTC (Capra Aff., ¶ 28; Exhs G and H). The referenced marketing restrictions were then removed (id., Exh I).

Form U-4 contains a clause which binds a signatory to arbitrate disputes before self regulatory organizations (SROs), including the NASD:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions or by-laws of the SROs indicated in [this form] as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.

Form U-4, ¶ 5. In addition to an agreement to arbitrate, Form U-4 also states that:

> I apply for registration with the jurisdictions and SROs indicated in [this form] as may be amended from time to time and, in consideration of the jurisdictions and SROs receiving and considering my application, I submit to the authority of the jurisdictions and SROs and agree to comply with all provisions, conditions and covenants of the statutes, constitutions, certificates of incorporation, by-laws and rules and regulations of the jurisdictions and SROs as they are or may be adopted, or amended from time to time. I further agree to be subject to and comply with all requirements, rulings, orders, directives and decisions of, and penalties, prohibitions and limitations imposed by the jurisdictions and SROs, subject to right of appeal or review as provided by law.

Id., ¶ 2.

Capra alleges that both he and Velez reviewed the Form U-4 prior to completing and signing it, and discussed it in depth with each other and others, and that "[w]e fully

understood the import of the arbitration clause contained therein" (Capra Aff., ¶ 29). Indeed, two years later, in 2003, PCH, PSI, MTC, Velez and Capra prosecuted a NASD arbitration proceeding (see NASD Case No. 03-06185, In the Matter of the Arbitration between Pristine Securities LLC d/b/a Mastertrader.com, Pristine Services, Inc., Pristine Capital Holdings, Inc., Oliver L. Velez and Gregory Capra v Instinet Clearing Services, Inc., Terra Nova Trading, LLC and George Muniz), in which they were jointly and severally awarded more than $160,000 against another company (id., ¶ 30).

On November 20, 2006, Velez was relieved of his executive duties as chairman and CEO and removed as an officer and director of PCH, as a result of the discovery of more than $250,000 of corporate funds converted to his personal use, and other misdeeds (Capra Aff., ¶ 33; Velez Aff., 10). Velez and Capra mutually agreed that he would remain employed by PCH in an undefined capacity, pending an investigation into his alleged malfeasance (Capra Aff., ¶ 33).

In February of 2007, both Velez and Capra resigned as licensed principals of MTC (Velez Aff., ¶ 10; Capra Aff., ¶ 32). In order to effectuate the resignations, PSI filed a Form U-5 (Uniform Termination Notice for Securities Industry Registration) on behalf of Capra and Velez with the NASD on February 13, 2007 (Velez Aff., ¶ 11).

Shortly after leaving MTC, Velez founded Velez Capital Management LLC. Capra alleges that Velez formed this company to compete directly against PCH, by copying its marketing techniques, and using the very strategies regulated by the NASD in the PCH business model (Capra Aff., ¶ 35). Velez was terminated by PCH on February 21, 2007 (id., ¶ 36). Because Velez was a licensed principal of MTC, a NASD member firm, the nature of his

termination in February 2007 and related subsequent events also triggered a mandatory, internal regulatory review and related filings with the NASD (id., ¶ 39).

In August 2007, Capra and PCH commenced the NASD Arbitration against Velez, alleging copyright and trademark infringement, unfair competition, breach of contract and covenant not to compete, breach of duty of loyalty, tortious interference, conversion and faithless servant. Although Velez refused to participate in the NASD Arbitration, on September 21, 2007, FINRA Dispute Resolution informed Velez that he was required to arbitrate the dispute (Capra Aff., ¶ 5; Exh A [9/21/07 Letter from FINRA Dispute Resolution to Velez [Exh A] ("your submission to this arbitration is mandatory and not voluntary ... [and] [t]herefore you are required by the Rules of FINRA Dispute Resolution to arbitrate this matter")]). On September 21, 2007, Velez filed a petition to stay arbitration in this court before the Honorable Jane Solomon, which was removed to federal court, and eventually remanded back to state court.

A panel of arbitrators was appointed in January of 2008, the Initial Prehearing Conference in the NASD Arbitration was had on March 11, 2008, and a hearing schedule was adopted that set hearing dates for the arbitration in September of 2008 (Capra Aff., ¶ 7).

To date, Velez refuses to cooperate with MTC in responding to and meeting NASD regulatory requirements related to his termination and to which he voluntarily submitted when he executed the Form U-4. Also, he refuses to participate in the NASD Arbitration.

DISCUSSION

The parties here do not contest the validity of the arbitration clause itself. Instead, they dispute the identity of the parties who are bound by the agreement in the Form U-4 executed by Velez and Capra. In support of his motion to permanently stay the NASD Arbitration, Velez

makes two main arguments. First, Velez argues that there is no valid agreement to arbitrate between the parties because he is not a signatory to any arbitration agreement with respondents. Second, Velez argues that this matter is not arbitrable because NASD member firm MTC is not a party to the arbitration, and the claims asserted by respondents in the NASD Arbitration arise only in connection with the business of PCH, which is not a NASD member firm. Conversely, respondents argue that Velez is bound to arbitrate this dispute by reason of his execution of the Form U-4, and as an "Associated Person" of MTC pursuant to the rules of the NASD. Non-signatory PCH is also bound, respondents contend, as an intended third-party beneficiary of the arbitration agreement set forth in the Forms U-4 executed by its controlling principals and direct co-owners.

It is well-established that parties to a commercial transaction "will not be held to have chosen arbitration as the forum for the resolution of their disputes in the absence of an express, unequivocal agreement to that effect" (Matter of Acting Supt. of Schools of Liverpool Cent. School Dist [United Liverpool Faculty Assn.], 42 NY2d 509, 512 [1977]; accord God's Battalion of Prayer Pentecostal Church, Inc. v Miele Assocs., LLP, 6 NY3d 371 [2006]; Matter of Primex Intl. Corp. v Wal-Mart Stores, Inc., 89 NY2d 594 [1997]). Thus, a party will not be compelled to arbitrate "absent 'evidence which affirmatively establishes that the parties expressly agreed to arbitrate their disputes'" (Matter of Waldron [Goddess], 61 NY2d 181, 183 [1984] [citation omitted]; Matter of Pharmacia & Upjohn Co. [Elan Pharmaceuticals, Inc.], 10 AD3d 331, 333 [1st Dept 2004] ["a court will not order a party to submit to arbitration absent evidence of that party's 'unequivocal intent to arbitrate the relevant dispute'"], quoting Primavera Labs., Inc. v Avon Prods., Inc., 297 AD2d 505, 505 [1st Dept 2002]).

In determining whether parties have entered into a valid arbitration agreement, courts should apply "ordinary state-law principles that govern the formation of contract" (First Options of Chicago, Inc. v Kaplan, 514 US 938, 944 [1995]). Under New York law, it is for the court, not the arbitrator, to decide whether both parties have made a valid agreement to arbitrate (Matter of Primex Intl. Corp. v Wal-Mart Stores, Inc., 89 NY2d 594, supra; accord Eiseman Levine Lehrhaupt & Kakoyiannis, P.C. v Torino Jewelers, Ltd., 44 AD3d 581, 583 [1st Dept 2007] ["The law is settled that whether a controversy is properly subject to arbitration is initially one for the courts to determine"]; Primavera Labs., Inc. v Avon Prods., Inc., 297 AD2d at 505 ["The threshold determination of whether there is a 'clear, unequivocal and extant agreement to arbitrate' the disputed claims is to be made by the court and not the arbitrator (citation omitted)"]).

Despite this overwhelming precedent in favor of court determination as to whether an agreement to arbitrate exists, respondents nevertheless assert that "the determination of the parties subject to the arbitration agreement" is a "condition precedent to the arbitrability of the dispute," and is thus an issue of procedural arbitrability for the arbitrators, not the court, to decide (Opp Mem., at 10). Thus, respondents argue, the NASD arbitrators, rather than this court, should determine whether the parties intended respondent PCH to be bound by the arbitration agreement set forth in the Forms U-4 signed by both Velez and Capra. Respondents' contention, however, lacks merit.

In Howsam v Dean Witter Reynolds, Inc. (537 US 79 [2002]), the United States Supreme Court held that the application of a NASD rule imposing a time limit on submission of disputes for arbitration was a matter presumptively for the arbitrator, rather than the court, to

decide. In reaching this determination, the Court distinguished between threshold issues of "substantive arbitrability [which] are for a court to decide," and those of issues of "procedural arbitrability," such as "time limits, notice, laches, estoppel, and other conditions precedent [which] are for the arbitrators to decide" (id. at 85). The category of substantive arbitrability includes disputes about "whether the parties are bound by a given arbitration clause" (id. at 84; accord Mulvaney Mech., Inc. v Sheet Metal Workers Intl. Assn., Local 38, 351 F3d 43 [2d Cir 2003]). Thus, it is clear that the issues of whether Velez is bound by the arbitration agreement set forth in the Forms U-4, and whether the parties intended respondent PCH to be bound by such arbitration agreement, are for the court to decide.

In support of his motion to stay arbitration, Velez first argues that he cannot be compelled to arbitrate because, as a result of his resignation from MTC, he is "not a party to any agreement with Respondents to arbitrate any matter before the NASD" (Velez Aff., ¶ 28), and he is "not an officer, director, or principal of any NASD member firm or any self regulatory organization and [does] not currently maintain any registration or securities licenses which would require that [he] submit to arbitration" (id., ¶ 29). The court rejects this argument. By virtue of their ownership interests in PCH and their prior "licensed principal" status with MTC, Velez and Capra are known by the term "person associated with a Member" or "Associated Person," defined as follows:

> (1) A natural person registered under the Rules of the NASD; or
>
> (2) A sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not

> any such person is registered or exempt from registration with NASD under the By-Laws or the Rules of NASD. *For purposes of the Code, a person formerly associated with a member is a person associated with a member.*

NASD Code of Arbitration Procedure, § 13100 (r) (emphasis added). Thus, although Velez and Capra resigned as registered principals of MTC, due to their ownership interest, and as persons formerly associated with a member, they continue to be Associated Persons of MTC, for arbitration purposes. Pursuant to the NASD rule, Associated Persons, like licensed individuals, are required to arbitrate all controversies between or among members, such as MTC, or themselves as associated persons, that arose from their employment relationship and securities industry related business activities:

> Required Arbitration
>
> (a) Generally
> Except as otherwise provided in the Code, a dispute must be arbitrated under the Code if the dispute arises out of the business activities of a member or an associated person and is between or among:
>
> Members;
> Members and Associated Persons; or
> Associated Persons.

NASD Code of Arbitration Procedure, § 13200. Thus, this section clearly supports the NASD's position, as stated in their correspondence to him, that they have jurisdiction over Velez in this arbitration matter (see Capra Aff., Exh A).

Velez also argues that although he was originally a "Registered Principal" with MTC, he was basically an investor who had nothing to do with the management of MTC, and thus, he cannot be compelled to arbitrate (Velez Aff., ¶ 30). This argument lacks merit, as

respondents present evidence that Velez was more than a silent investor in MTC. Capra alleges, and Velez admits (see Velez Aff., ¶ 7), that Velez conducted PSI's seminars, and, as a result of the cross-marketing strategy between PSI and MTC, was the largest source of new brokerage accounts for MTC (see Capra Aff., ¶ 23 ["Indisputably, the most significant developer of new customers was Plaintiff Velez through his seminar presentations"]). Indeed, these cross-marketing practices – the soliciting of prospective brokerage clients for MTC by Velez through PSI – were specifically regulated by the NASD.

Velez further argues that NASD member MTC is not a party to the NASD Arbitration, and that all of the claims in the arbitration arise solely in connection with the business of PCH, a non-NASD member, and a non-signatory to the arbitration agreement contained in the Forms U-4 executed by Velez and Capra. As such, Velez argues, these claims are ineligible for arbitration. Conversely, respondents contend that, in reviewing the text of the Form U-4 arbitration agreement, the circumstances surrounding its execution and its prior invocation by Velez, Capra, PCH, PSI and MTC in another arbitration proceeding, it is clear that there was an express and unequivocal intent that Velez, Capra and their three companies would arbitrate any claims involving any and/or all of them, arising from their businesses.

"While CPLR 7501 requires that an agreement to arbitrate be in writing, this Court has recognized in certain limited circumstances the need to impute the intent to arbitrate to a nonsignatory" (TNS Holdings, Inc. v MKI Secs. Corp., 92 NY2d 335, 339 [1998]). "[A] non-signatory party may be bound to an arbitration agreement if so dictated by the 'ordinary principles of a contract and agency'"(Thomson-CSF, S.A. v American Arbitration Assn., 64 F3d 773, 776 [2d Cir 1995])

Here, respondents have raised an issue of fact as to whether a valid agreement to arbitrate was made between the parties by submitting evidence with respect to Velez and Capra's intent that nonsignatory PCH, their holding company, be bound by the arbitration agreement contained in the Forms U-4. Thus, Capra alleges that Velez and Capra were the only individuals involved in the NASD's oversight of the cross-marketing strategies between PSI and MTC, and acted as the principals and agents of PCH, MTC and PSI with respect to the regulatory process (Capra Aff., ¶ 26). Capra further alleges that he and Velez discussed in depth, and fully comprehended, the regulatory purposes that required their licensure and registration with the NASD (id., ¶ 29). Specifically, Capra alleges that "[h]aving successfully taken advantage of the agreement to arbitrate securities industry disputes, obviously we both clearly understood and were keenly aware that the U-4 contained an arbitration agreement that required all of our companies, and both of us as individuals, to arbitrate controversies arising from our business, and between and among ourselves and others associated with the securities industry" (id., ¶ 31). Respondents also present evidence that both Capra and Velez previously invoked the arbitration agreement in the Forms U-4 in another controversy in 2003 that included all three of their companies as well as themselves (id., ¶ 30).

In addition, under estoppel principles, a signatory of an arbitration agreement, like Velez, may be bound to arbitration with a non-signatory such as PCH, "when the issues the non-signatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed" (Thomson-CSF, S.A. v American Arbitration Assn., 64 F3d at 779).

Pursuant to CPLR 7503 (a), where is a question raised as to whether "a valid agreement [to arbitrate] was made" "it shall be tried forthwith in said court" (CPLR 7503 [a]; see Matter of

Pharmacia & Upjohn Co. [Elan Pharmaceuticals, Inc.], 10 AD3d 331, supra [the existence of a valid agreement to arbitrate is a question of fact to be resolved by the courts]; see also Matter of Allstate Ins. Co. v Feldman, 65 AD2d 571 [2d Dept 1978], appeal denied 47 NY2d 705 [1979]). Accordingly, because respondents have raised an issue of fact as to whether a valid agreement to arbitrate was made, this issue will be referred to a Special Referee to hear and report (see e.g. Matter of Bergassi v American Sur. Agency, Inc., 278 AD2d 413 [2d Dept 2000] [affirming order of Supreme Court directing hearing to determine whether valid agreement to arbitrate was made]; Weiss v Kozupsky, 237 AD2d 514 [2d Dept 1997] [given controversy as to whether there was an enforceable agreement to arbitrate, court should have directed a hearing as to whether or not there was an enforceable arbitration agreement]; Burbank Broadcasting Co. v Roslin Radio Sales, Inc., 99 AD2d 976 [1st Dept 1984] [disputed issues of fact as to whether company had agreed to arbitrate, which required an evidentiary hearing in proceeding by company to permanently stay arbitration]; Matter of Tringali [Focus on Sports], 91 AD2d 887, 887 [1st Dept 1983] [matter remanded to Supreme Court "for a hearing to determine whether a valid agreement for arbitration of the dispute was made"]).

Accordingly, it is hereby

ORDERED that the issue of whether a valid agreement to arbitrate was made between petitioner Oliver L. Velez and respondent Pristine Capital Holdings, Inc., or whether Oliver L. Velez should be estopped from avoiding arbitration with PCH, is referred to a Special Referee to hear and report with recommendations, except that, in the event of and upon the filing of a stipulation of the parties, as permitted by CPLR 4317, the Special Referee, or another person designated by the parties to serve as referee, shall determine the aforesaid issues; and it is further

ORDERED that the petitioner's motion to stay arbitration is held in abeyance pending receipt of the report and recommendations of the Special Referee and a motion pursuant to CPLR 4403 or receipt of the determination of the Special Referee or the designated referee; and it is further

ORDERED that counsel for the party seeking the reference or, absent such party, counsel for the plaintiff shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet[2] upon the Special Referee Clerk in the Motion Support Office in Rm. 119 at 60 Centre Street, who is directed to place this matter on the calendar of the Special Referee's Part (part 50R) for the earliest convenient date.

Dated: July 16, 2008

ENTER:

J.S.C.

HON. JOAN A. MADDEN
J.S.C.

FILED
JUL 18 2008
COUNTY CLERK'S OFFICE
NEW YORK

[2]Copies are available in Rm. 119 at 60 Centre Street, and on the Court's website.