**FILED,** Clerk of the Supreme Court, 20 Feb 2024, **088645**

# Supreme Court of New Jersey

Docket No. 088645

LAURENCE J. RAPPAPORT, Individually and as a member of Rapad Real Estate Management, LLC, KABR Management, LLC, KABR Management II, LLC, KABR Management III, LLC, and KABR Management IV, LLC,
*Plaintiff-Respondent*,

- vs. -

KENNETH PASTERNAK, Individually and as a member of Rapad Real Estate Management, LLC, KABR Management, LLC, KABR Management II, LLC,

*(For Continuation of Caption See Inside Cover)*

CIVIL ACTION

ON PETITION FOR CERTIFICATION FROM THE FINAL JUDGMENT OF THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION

DOCKET NOS. A-000491-21 and A-000492-21

Sat Below:

HON. RICHARD J. GEIGER, J.A.D.
HON. RONALD SUSSWEIN, J.A.D.
HON. MARITZA B. BYRNE, J.A.D.

## REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIFICATION ON BEHALF OF DEFENDANTS-PETITIONERS

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*Defendants-Petitioners.*

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LAURENCE J. RAPPAPORT, Individually and as a Member of KABR Management, LLC and KABR Management II, LLC,

*Plaintiff-Respondent,*

- vs. -

KENNETH PASTERNAK, Individually and as a Member and Manager of KABR Management, LLC and KABR Management II, LLC; ADAM ALTMAN, Individually and as a Member and Manager of KABR Management, LLC and KABR Management II, LLC; THE SARA PASTERNAK 2008 IRREVOCABLE TRUST, as a Member and Manager of KABR Management, LLC and KABR Management II, LLC; THE RACHAEL PASTERNAK 2008 IRREVOCABLE TRUST, as a Member and Manager of KABR Management, LLC and KABR Management II, LLC; and THE DANIEL PASTERNAK 2008 IRREVOCABLE TRUST, as a Member and Manager of KABR Management, LLC and KABR Management II, LLC,

*Defendants-Petitioners.*

# TABLE OF CONTENTS

**Page**

# TABLE OF AUTHORITIES

**Page(s)**

## Cases



## Statutes



## Other Authorities



"Rb" refers to Respondents' Brief.

In responding to the Petition for Certification, Rappaport elides the issue at the heart of Defendants' challenge -- the level of deference a court must afford an arbitrator's decision that the parties submitted a claim for determination within the scope of the arbitration agreement. Here, a seasoned and highly respected arbitrator who presided over thirteen days of hearings and reviewed an almost 10,000-page record repeatedly found that the issue of Rappaport's membership interest/carried interest was squarely subject to arbitration. That arbitration decision was confirmed by the Chancery Division. Yet, the Appellate Division conducted a de novo review of the record without reference to the Arbitrator's findings and paid scant attention to the dictates of Tretina Printing Inc. v. Fitzpatrick & Associates, Inc., 135 N.J. 349 (1994), which requires heightened judicial deference to private-sector arbitration decisions.

Unquestionably, under the New Jersey Arbitration Act (NJAA), a court may -- indeed must -- modify an arbitration award if the "claim [was] not submitted to the arbitrator and the award may be corrected without affecting the merits of the decision upon the claims submitted." N.J.S.A. 2A:23B-24. But the standard of review is set by this Court, as made clear in Tretina. The precise deferential standard of review in determining whether a claim was submitted to an arbitrator has not been addressed by this Court -- whether that standard bars modification of an arbitration determination absent "corruption, fraud, or other

undue means," N.J.S.A. 2A:23B-23(a)(1), or some other highly deferential review standard. At the very least, the Arbitrator had to be clearly mistaken whether the issue of membership/carried interest was subject to arbitration.

Questions about whether a claim was submitted for arbitration are fact-sensitive, calling for the exercise of an arbitrator's judgment and deference by a reviewing court, most particularly in the setting of a private-sector arbitration bargained for by the parties.

The Appellate Division's improper modification of the private-sector arbitration award here is the consequence of a fundamental misunderstanding of the sweeping scope of deference intended by Tretina. In that case, the Chancery Division deferred to the arbitrator's judgment on all but one claim, confirming and modifying the award pursuant to N.J.S.A. 2A:23B-24[1] by reducing the amount of the award. 135 N.J. at 353-54. On appeal, the Appellate Division vacated the award under N.J.S.A. 2A:23B-23 after "conducting a detailed analysis of the contract and of the arbitration proceedings." Id. at 354.

The Supreme Court rejected the approaches of both the Chancery Division and Appellate Division and deferred to the arbitrator in all respects, explaining

[1] Since Tretina was decided, the Legislature has amended the NJAA several times. E.g., L. 2003, c. 95, § 24. Notably, the provisions that Tretina cited as N.J.S.A. 2A:24-8 and N.J.S.A. 2A:24-9 have been reformulated as N.J.S.A. N.J.S.A. 2A:23B-23 and 2A:23B-24. Compare id., with Tretina, 135 N.J. at 355.

that "the record before us contains not even a hint of misconduct by the arbitrator," and that "no statutory ground exists for invalidating or modifying the award." Id. at 358. The Court explained that the "clear implication from [N.J.S.A. 2A:23B-24] is that the Legislature intended that judicial review correct mistakes that are obvious and simple-errors that can be fixed without a remand and without the services of an experienced arbitrator." Id. at 360.

Tretina's strong standard of deference applies to the Arbitrator's finding that the membership/carried interest issue was properly subject to arbitration. The panel in this case erred in modifying the Arbitration Award because there was no hint of fraud, corruption, or similar wrongdoing by the Arbitrator. Nor could the modification of the Arbitration Award be justified, even by some other heightened standard of deference.

In this case the parties agreed to be bound by the AAA Commercial Rules, which were incorporated into the Arbitration Agreement. Under those rules, the Arbitrator was authorized to determine the scope of the matters submitted for adjudication. See Rule 7(a) ("The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim.").

Here, the Arbitrator found that Rappaport submitted a claim for $25

million in carried interest as a member of KABR. The panel did not have the authority to second guess that decision in the absence of egregious error. In public-sector arbitrations, reviewing "courts have no business overruling [the arbitrator] because their interpretation of the contract is different from his." See Borough of E. Rutherford v. E. Rutherford PBA Loc. 275, 213 N.J. 190, 202 (2013) (citation omitted). In private-sector arbitrations, the standard is even more deferential. See Tretina, 135 N.J. at 357 (a court may "not vacate an award even though it might be based on a mistake of law."). Indeed, Tretina adopted Chief Justice Wilentz's concurrence in Perini Corp. v. Greate Bay Hotel & Casino, Inc., 129 N.J. 479 (1992). See Tretina, 135 N.J. at 358.

The Chief Justice's concurrence explained that, under N.J.S.A. 2A:23B-24, judicial correction of factual errors is so limited that neither "gross" nor "ordinary" errors will result in vacation or modification of an award. Perini, 129 N.J. at 542 (Wilentz, C.J., concurring). With regard to "errors of law," he noted that such errors "had to be so egregious that one need only look at the cover page, at the award, to know that a horrible mistake had been made." Ibid. In other words, the error had to be "so horrible that without getting involved at all with the merits of the proceeding, with the thousands of pages of transcripts . . . , one could say that there was fraud or corruption or some similar wrongdoing that requires vacating the arbitrators' award." Ibid.

Rappaport is incorrect that the panel's failure to apply the highly deferential standard of review to a private-sector arbitration is not a matter of public importance. Lawyers, courts, and arbitrators need to know the standard of judicial review that governs an arbitration determination in which one of the parties argues that a claim was not submitted for arbitration.

To the extent that Rappaport is saying that a standard of deference does not apply to N.J.S.A. 2A:23B-24, he does not cite any cases to support that assertion. Nothing in our jurisprudence suggests that deference should not be afforded to an arbitrator's determination that an issue is before him. Even outside of arbitration, deference applies to a trial court's factfindings because our "judicial system . . . assigns different roles to trial courts and appellate courts." See State v. S.S., 229 N.J. 360, 379 (2017). Greater deference applies to an arbitrator's factfindings.

**Rappaport and the Panel Failed to Pay Due Deference to the Arbitrator.**

Rappaport has no adequate answer to the statutory bar against modification of an award where it affects the merits of the claim that was submitted. Rappaport ignores that the Arbitrator awarded $4.9 million as compensation for his damages, "both as a manager and member of the KABR Entities." (Pa2286-98.) The appellate panel clearly erred in assigning the entire value of the Arbitration Award to only one of the claims that the Arbitrator

decided. Rappaport's argument that modification of part of the Arbitration Award was permissible in the "interest of justice," (Rb3), is at direct odds with the express provisions of section 2A:23B-24, which does not permit vacatur on general equitable grounds.

**The Appellate Division Misunderstood the Record.**

Even a de novo review of the record makes clear that the Appellate Division misread the record, which was replete with Rappaport repeatedly advancing his membership-interest claim. One need look no further than Rappaport's pleading, which asserted that (1) "Pasternak began a systematic campaign to circumvent Rappaport's interests in [KABR], as both a member, chief executive officer, and a manager of each. . .," (Pa327 ¶ 97 (emphasis added)), and (2) his contention of the presence of "an actual controversy between Rappaport, on the one hand, and the Respondents, on the other hand, concerning the improper attempt to terminate or change Rappaport's obligations -- as an owner of [KABR]" under the KABR operating agreements, (Pa339 ¶ 171 (emphasis added)).

In addition, in several causes of action, Rappaport alleged that the Defendants' conduct was "deliberately designed to deprive Rappaport of the reasonable expectations of his membership interests in [KABR], thereby frustrating Rappaport's reasonable expectations with respect to his membership

interests." (Pa374 ¶ 332 (emphasis added); see also Pa376 ¶ 343 (same); see also Pa359-372 ¶¶ 249, 265, 276, 287, 298, 309, 320.)

In his pre-hearing brief, Rappaport repeated these claims and sought "a judgment requiring that various compensation due him as a member of [KABR] continue to be paid pursuant to the terms of the operating agreements." (Pa1024-25 (emphasis added).) He also filed a motion in limine seeking a declaration that as "a member . . . entitled to the profits, losses, and distributions set forth in Articles 3, 4, and 5 of the operating agreements[,]" he is "entitled to such compensation going forward." (Pa1093.)

At the arbitration hearing, Rappaport twice asserted his membership claim for carried interest. Rappaport engaged in a colloquy with his attorney at the hearing and was asked the value of his "current carried interest." He responded, "aggregated with the monies that my wife and I owned in the investment, I think, it came out -- I'm trying to think. I guess somewhere in the 20 -- in the low 22 to $25 million would have been where it came out with just the carried interest." (Da4; see also Pa1440 ("I'm asserting the fact that I am entitled to that and I am fully vested in the carried interest.").)

In his closing, Rappaport's counsel told the Arbitrator, "[t]his case is and should be about what Mr. Rappaport is entitled to as a member, owner and CEO of the KABR entities . . . ." (Pa1099 (emphasis added).) Counsel further argued

that under the operating agreements, Rappaport was entitled to "the carried interest in perpetuity" and that "if he were to be deprived of that, that's nearly 20 or more million dollars." (Pa1101; Pa1105 (emphasis added).)[2]

In his post-hearing brief, Rappaport argued that he "is fully vested and entitled to carried interest." (Pa1197; see also Pa1203 ("The value of Rappaport's carried interest is $25 million dollars.").) He also submitted a proposed form of Award which awarded a declaratory judgment that Rappaport "is a member of KABR" who is "entitled to the carried interest paid by the KABR Funds . . . ." (Pa1237-39.)

**The Arbitrator Understood the Issues Before Him.**

No one understood the history of the dispute between the parties and the issues submitted to arbitration better than the Arbitrator, the Honorable James Zazzali (ret.). The parties chose him -- not a court -- to resolve the claims and counterclaims. The Arbitrator was not rendering decisions on phantom issues. In issuing the Initial Award, the Arbitrator declared that "Rappaport seeks carried interest, claiming that he is owed $25M on carried interest as of 2018," but he has "failed to prove the value of any carried interest." (Pa237.) In issuing the second and Final Award, the Arbitrator held: "I find that Claimant has not

[2] This quote disproves Rappaport's contrived claim, (Rb18), that his counsel did not assert a claim for carried interest in his summation.

established by a preponderance of the credible evidence that he has proven carried interest . . . [or] the value of his current interest at the time of his termination." (Pa244-63.) After the Chancery Division remanded the matter for further findings on the issue of Rappaport's membership interest, the Arbitrator issued a Remand Order, asserting that he "intended that the $4.9 million Award [completely] compensat[e] . . . [Rappaport] for [all] damages." (Pa2286-98.) The Chancery Division confirmed the Award, stating "the [A]rbitrator carefully reviewed and considered the record." (2T55-21 to 56-2.)

Under any deferential standard of review, this Arbitrator's decision must be upheld and the determination of the Appellate Division, which parsed the record as though it were the chosen factfinder, must be rejected. Rappaport's argument that he did not have notice that his membership interest was in dispute and that the Arbitrator sprang the issue sua sponte on his unsuspecting attorney finds no credible support in the record. In fact, Rappaport testified he was on notice before the arbitration hearing began that Respondents were contesting his right to carried interest. (See Da5.)

Rappaport's revisionist line that Defendants waived or disavowed any claim to his membership interest and future carried interest is without basis. He cites to a single sentence to the effect that his removal as an officer in January 2019 "has nothing to do with his status as an equity owner." But that was simply

an argument that Defendants' removal of Rappaport as an officer before the arbitration did not adequately establish his claim for minority oppression, not a concession that Rappaport's membership interest was not part of the arbitration.

Importantly, the Arbitrator reviewed Defendants' express requests to terminate Rappaport as a member during the arbitration, in post-hearing submissions on that specific issue, and in post-hearing motion practice regarding Rappaport's request for clarification that he was entitled to carried interest in perpetuity as a member of KABR. The Arbitrator is faulted by Rappaport -- and now by the Appellate Division -- for deciding the issue before him.

**Certification is Necessary to Clarify the Standard of Review.**

The finality of private-sector arbitrations has been placed in question in this case. The bar and our courts need this Court's guidance on the standard of review that prevails when an Arbitrator determines that an issue is subject to arbitration. As Chief Justice Wilentz plainly stated in Perini, "[t]he very purpose of committing a dispute to arbitration is to get away from the judiciary." 129 N.J. at 542. This Court's intervention is necessary to reset the boundaries of judicial review of private-sector arbitrations. Certification should be granted.

## CONCLUSION

For the foregoing reasons, Defendants-Petitioners respectfully request that the Court grant this Petition for Certification.

Respectfully Submitted,

Dated: December 7, 2023
New York, New York

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