AMERICAN ARBITRATION ASSOCIATION
Commercial Arbitration Tribunal

In the Matter of the Arbitration between

Case Number: 14-20-1300-0075

Fineburg Law Associates, P.C., f/k/a
Fineburg McCarthy, P.C.,
(Claimant/Counterclaim Respondent)
Represented by Daniel S. Bernheim, 3d, Esquire
-vs-
Gary J. McCarthy, Esquire
(Respondent/Counterclaimant,
Third-Party Claimant),
(Represented by Gene M. Linkmeyer, Esquire
-and-

Gary J. McCarthy, Esquire,
Fineburg McCarthy, P.C.
(Derivative Claimant)
Represented by Gene M. Linkmeyer, Esquire
-vs-

Herbert R. Fineburg, Esquire
(Third-Party Respondent,
Derivative Respondent)
Represented by Daniel S. Bernheim, 3d, Esquire
-and-

Joseph Armstrong, Esq., Joseph Hayes, Esq.
and Ted Greenberg, Esq.
(Additional Defendants)
Represented by Don P. Foster, Esquire

OPINION

THIS ARBITRATOR'S GENERAL OBSERVATIONS

This Arbitration presents for decision numerous claims and counterclaims filed by Herbert Fineburg ("Fineburg") and Gary McCarthy ("McCarthy") who for many years were friends and also partners in law firm of Eizen Fineburg & McCarthy (alternatively "EFM" or the

"Law Firm") and subsequently Fineburg and McCarthy.[1] This Arbitration also presents for decision third-party claims filed by McCarthy against Joseph Armstrong, Joseph Hayes and Ted Greenberg ("Additional Defendants").[2]

Regrettably, after many years of a harmonious relationship as friends and a profitable relationship as law partners, the harmony and cooperation enjoyed by Fineburg and McCarthy turned to anger and discord when Fineburg terminated McCarthy by locking him out of the partnership offices in January of 2013.[3]

Was McCarthy's departure either a resignation or a termination for "cause" under the Shareholder Agreement, as Fineburg contends? Or was it the result of a squeeze out and an act of shareholder oppression, as McCarthy contends?

The answers to these questions will guide this Arbitrator's resolution of most of the parties' competing claims which include, among others, (1) Fineburg's demand for a declaration that McCarthy's departure was either a resignation or a termination for "cause" and Fineburg's claim, in the nature of recoupment, for reimbursement of $1.3 million of fees the Law Firm paid on McCarthy's behalf and (2) McCarthy's claim for indemnification of the $1,589,024 paid for his defense following his termination and his claim for damages resulting from Fineburg's alleged shareholder oppression and squeeze-out.

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1 The third partner in EFM was Bernard Eizen ("Eizen"). Eizen resigned before the claims and counterclaims in this Arbitration were filed and his ownership interest in the firm was extinguished by consent.

2 The third-party claims were filed originally in the Philadelphia Court of Common Pleas and were transferred to this Arbitration by the Court by Order dated May 18, 2015. These claims are discussed below.

3 Fineburg and McCarthy were shareholders in EFM and subsequently, in Fineburg and McCarthy. In this Opinion, I shall at times refer to them colloquially as "partners."

This Arbitrator is called upon to decide these and other disputes after conducting 24 days of evidentiary hearings; consideration of relevant portions of over 4,000 pages of Notes of Testimony; consideration of three sets of Post-Hearing Briefs filed by each of the three interest groups involved in this Arbitration; consideration of Answers to scores of "Questions" directed to counsel at the conclusion of the evidentiary hearings and the parties' respective replies to the Answers to these Questions; and after Oral Argument held on September 22, 2016.

Given the frustration and anger on all sides both before and after McCarthy's departure, it is not surprising that I am presented with a "Tale of Two Cities" – two world views on what transpired during a course of events that occurred over several years.[4] With respect to most key issues of fact and law, the parties' views are diametrically opposed. Given faded memory over the years and inconsistent testimony on most key issues, piecing the pieces of the puzzle together in a coherent fashion was a challenging task for this Arbitrator.

Regardless of whether or not the parties agree with my findings and conclusions, it is my hope that their long-running dispute can be set aside and that they will turn from living in the past to looking toward the future. It is my further hope that the finality of this Award will permit all parties to lead productive lives as they did for decades before experiencing all of the financial and emotional costs which resulted from their struggles over so many years.

BACKGROUND OF THE DISPUTE

All parties agree that the genesis of this dispute involved McCarthy's legal representation of Sal Pelullo in connection with certain consulting agreements and asset purchase

[4] Given inconsistent testimony and alternative theories, the parties' presentations more appropriately could be referred to as a "Tale of Many Cities."

agreements. The parties further agree that Sal Pelullo was acting in concert with Nicodemo Scarfo, Jr. ("Scarfo")[5] and that Agreements drafted by McCarthy facilitated the illegal and fraudulent taking of more than $12 million of investors' monies in FirstPlus Financial Group ("FirstPlus"). Scarfo, Pelullo and McCarthy, as well as others, were indicted for their participation in the above transactions. Scarfo and Pelullo were convicted. McCarthy was acquitted.

In ways that will be discussed in greater detail below, Fineburg argues that McCarthy was the only one in his firm with full knowledge of the activities of Pelullo and Scarfo and that McCarthy hid relevant information concerning the representation of Scarfo from Fineburg. In response, McCarthy argues that he was duped by Pelullo and, while admitting to poor judgment, that he had no reason to know the transactions were bogus. McCarthy also argues that Fineburg knew everything that he, McCarthy, knew. What the respective parties did and did not know as well as what they should have known are among the key issues in this Arbitration.[6]

WHAT WERE THE RELEVANT FACTS KNOWN TO McCARTHY?

I shall not summarize the many scores of pages of briefing nor the numerous days of testimony on this issue. Instead, I will summarize the key facts which were critical to the

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[5] The parties have not disputed the fact that Nicodemo "Nicky" Scarfo, Jr., the son of Nicodemo Scarfo, Sr., was well known in the region for his involvement in organized crime related activities. Over the years, both father and son were convicted for numerous organized crime related activities.

[6] Fineburg states that he does not seek to retry the criminal case in which the Government argues that the key transactions were "transparently bogus." This Arbitrator recognizes that Fineburg cannot wisely make such an argument as, perhaps, transparently bogus agreements should have been recognized as such not only by McCarthy but also by Fineburg and others in the firm. Of course, in addition, Fineburg's case for breach of fiduciary duties presents different issues and different burdens of proof.

decisions I ultimately have made in this arbitration. I will discuss separately (1) the early Scarfo related transactions, (2) the April 27, 2007 meeting and the (3) consulting agreements and asset purchase agreements (collectively the "Agreements").

1. The Early Scarfo Related Transactions

The record is uncontroverted that as early as 2006 the firm opened up files and performed work on behalf of the Scarfo family. In particular, the firm, through McCarthy, serviced as clients of the firm Learned Associates of North America, LLC ("Learned") and the LMDS 2006 Trust. Learned was established on behalf of the LMDS 2006 Trust which was created for Dominica Scarfo, mother of Nicky Scarfo, Jr. While McCarthy's testimony called into question the time he may have first seen the trust document, he does not deny that he had a copy of the trust nor that the firm had in its possession a trust which, on the front page refers to Nicodemo Scarfo, Jr. McCarthy was the only one who had the document and he placed it into the file without having it scanned into the firm's computer system.

McCarthy further did not follow the firm's otherwise consistent practices with respect to opening and servicing these Scarfo related files. Among other things, McCarthy proceeded to perform work on behalf of Learned and the LMDS 2006 without a conflicts check. If McCarthy had read the trust the name Nicky Scarfo would have surfaced. With respect to Learned, a file memo states that Learned was being prepared for the LMDS Trust which had been prepared by a Thomas Shea on behalf of his client, Dominica Scarfo. The same memo indicates that Learned was to be formed, that the firm was to create an operating agreement for

Learned and a management agreement for Learned and Seven Hills to control the soon-to-be formed Globalnet.[7]

While McCarthy contends otherwise, I find the creation of an LLC, an operating agreement and other transaction documents to have created an attorney-client relationship. I specifically disagree with Michael Downey's (McCarthy's expert witness) comparison of Learned to Legal Zoom.

Further, operating documents were being sent to an email address of Scarfo which was not placed in the firm's Outlook. And finally, in contrast to the firm's consistently followed practices, certain Pelullo related documents did not have footers.

It should also be noted that McCarthy did not produce evidence of any other client for whom the firm's procedures were not followed. The relevance of all of the above facts is discussed below.

2. The April 27, 2007 Meeting

On April 27, 2007, a number of individuals met in the offices of EFM with McCarthy for the purpose of discussing a takeover of FirstPlus. At the meeting were Sal Pelullo and Nicky Scarfo, among others.

Did McCarthy know that Nicky Scarfo was one of the persons in the meeting? McCarthy's position over time was inconsistent on this point. What is clear is that in a manner inconsistent with EFM's standard practices, the name Scarfo does not appear on any firm

[7] In the way of further background, in the summer of 2006, McCarthy formed the Coconut Grove Trust for Sal Pelullo's family and Seven Hills Management Company, LLC, a holding company owned by the Pelullo family trust. Learned and Seven Hills ultimately were the companies through which Scarfo and Pelullo created entities which were later sold to FirstPlus in connection with their scheme to defraud FirstPlus.

document showing his attendance. Did McCarthy think that Scarfo was a person introduced to him at the meeting as "cousin Nick?"[8] Or that McCarthy knew and everybody knew that Scarfo attended the meeting– the version of McCarthy's account throughout these arbitration proceedings.

Based upon my review of McCarthy's memorandum of October 27, 2010, the "review with John Josephs," all relevant documents, and the testimony, I find that McCarthy did know that Scarfo was at the April 2007 meeting.[9] Whether "everyone knew," as McCarthy contends, and precisely what they knew about what transpired at the meeting, is discussed below.

3. The Consulting Agreements And Asset Purchase Agreements

McCarthy's uncontroverted testimony is that he walked away from any engagement to represent anyone present at the April, 2007 meeting in connection with the acquisition of FirstPlus because acquisitions were not within the field of his high competence. If only McCarthy had walked away from **any** continuing involvement – the firm may well have remained intact.

So, what happened next? Over the course of the remainder of 2007, McCarthy represented Pelullo in a number of transactions relating to FirstPlus – the consulting agreements and asset purchase agreements. McCarthy was asked initially to draft consulting agreements on behalf of Seven Hills and Learned.[10]

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[8] The version of McCarthy's account of what transpired at the meeting throughout the criminal investigation.

[9] This is the position McCarthy has adopted in this Arbitration.

[10] Whether McCarthy drafted the agreements himself or had others, such as Mr. Federici, draft them, it is clear that Mr. McCarthy reviewed the documents.

I will not herein attempt to review the specifics all of the transactions and Agreements. While the Agreements may or may not have been "transparently bogus," they all have something in common – they all transferred from First Plus substantial sums of money to Pelullo and Scarfo. Further, they all have "red flags" which Fineburg argues alerted or should have alerted McCarthy to Pelullo's and Scarfo's efforts to facilitate an illegal scheme to extract millions of dollars from FirstPlus. As just one example, one consulting agreement called for payments to a Pelullo-Scarfo colleague (Maxwell) in the amount of $100,000 per month without any metrics or performance requirements.

Moreover, the Rutgers, Globalnet and Premier transactions are equally troubling. I find the Globalnet transaction to have raised a particularly bright red flag as it had virtually no assets, no profits and substantial debt and was acquired for $850,000. While a "Fairness Opinion" was prepared in connection with the transaction, the opinion raised on its face a number of problems not noticed by McCarthy.[11]

In response to Fineburg's assertions that McCarthy knew or should have known he was engaged in furthering Pelullo's and Scarfo's illegal scheme, McCarthy argues that he relied on Pelullo's representations and that he was "duped." The issue of reliance is considered below.

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[11] In 2006, McCarthy formed a series of companies owned by Seven Hills and Learned (Rutgers, Globalnet Enterprise, Globalnet and Premier). These companies were later sold to FirstPlus for millions of dollars as a part of the Pelullo-Scarfo scheme to defraud FirstPlus.

DID McCARTHY KNOW OF THE FRAUD?

Fineburg has argued, alternatively, that McCarthy knew of the fraud, that on some basis over time he had to know, and that he clearly should have known. With respect to actual knowledge, Fineburg argues that "to pretend that McCarthy did not recognize what was actually taking place with FirstPlus as he orchestrated one deal after another would be blindness . . . ." [12]

I find that McCarthy did not know he was facilitating Pelullo's and Scarfo's conspiracy to defraud FirstPlus (that he was not a knowing participant in a conspiracy to commit fraud).

First, there is no direct evidence that McCarthy did know of the fraud.

Second, it is simply counterintuitive to think that McCarthy knowingly would have placed his firm and himself at risk for a number of reasons, including the following:

- ✓ McCarthy had an outstanding reputation as a professional, including his reputation for quality of work.
- ✓ McCarthy had genuine pride in his reputation for integrity.
- ✓ McCarthy enjoyed for decades a very good relationship with his partners, Eizen and Fineburg.
- ✓ In a working environment of trust and cooperation, the three partners worked together exceedingly well with far less disharmony than experienced by partners in many law firms.
- ✓ McCarthy enjoyed the status and, perhaps, the power of managing the firm's finances, among other management responsibilities.

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[12] This section is devoted to the issue of whether McCarthy knew of the fraud. Whether he should have known is discussed below.

- ✓ McCarthy enjoyed the benefits of a highly profitable firm including, among other things, high income and the flexibility enjoyed mostly in smaller firms which permit profitable investment vehicles and offer the additional benefits of tax shelter.

- ✓ There was no evidence to suggest that McCarthy acted unprofessionally or unethically on any other occasion over the many years of his relationship with Eizen and Fineburg.

Why would McCarthy risk his good reputation and all of the above benefits he enjoyed for so many years and risk criminal prosecution? After all, notwithstanding what Pelullo or Scarfo may have thought were "layers of onions" that gave them protection, McCarthy was bright enough to have known that the risk of this particular fraud being uncovered was significant. I cannot think of one reason McCarthy would have engaged in such self-destructive behavior and taken such a risk.

Finally, I note the absence of what may be the most common feature in criminal conspiracies to commit fraud — an interest in receiving the financial rewards of a crime. Fineburg contends that the legal fees were such a benefit, but the fees were not substantial as a percentage of McCarthy's origination and fees were less important to McCarthy in a firm where a partner's share of firm income was not dependent upon origination.

Once again, I find for all of the above reasons that McCarthy did not know of the fraud.[13] This Arbitrator agrees with McCarthy's contention that he did not know the full extent of Scarfo's involvement until after he became privy to the Government's evidence.

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[13] McCarthy argues that this finding is case dispositive. He asks how he could have disclosed the fraud to Fineburg if he did not know of the fraud? For reasons discussed below, this is the wrong question to ask and my finding of "no actual knowledge" does not dispose of Fineburg's claims of breach of fiduciary duties.

SHOULD McCARTHY HAVE KNOWN OF THE FRAUD?

In many respects, this question goes to the very heart of the case and is one of the key issues for me in this arbitration.

"How is it possible that McCarthy did not know of the fraud?" In the criminal trial, this rhetorical question was pursued to persuade a jury that McCarthy knew of the fraud. For the reasons stated above, I have concluded that McCarthy did not know of the fraud.

At the same time, I have asked myself over and over a related question – "How can we explain McCarthy's lack of knowledge?"

McCarthy's position is that although some of his practices may not have been best practices, they were within the parameters of what is acceptable, especially in a smaller firm which cannot regulate and police practices in the same way as larger firms; that he relied on third-party Fairness Opinions; that so many others who participated in these transactions were also unable to recognize the criminal conspiracy; and that he relied on representations by Pelullo.

I find that McCarthy should have known of the fraud given the conclusions that would have been reached with the exercise of objective and reasonable judgment. The combination of (1) the early representations (e.g., the trust), (2) the April 27, 2007 meeting, with Pelullo, Scarfo and others to discuss the acquisition of First Plus, and (3) the consulting agreements and APA's, presented to McCarthy information which not only raised red flags on their own but also should have raised questions about Scarfo's continuing participation in or benefit from the Agreements. The hardest questions for me in this arbitration are the following:

How could McCarthy not have recognized the possibility of Scarfo's continuing participation in the FirstPlus transactions? Why did McCarthy not ask Pelullo "Is Scarfo still involved"? How is it possible that McCarthy did not connect the dots?

What was clear to McCarthy is that in April of 2007, Pelullo and Scarfo both had some interest in a takeover of FirstPlus. Why else would Scarfo have been at the meeting other than some possible interest in the plan to take over the bank?[14] McCarthy argues that he walked away from the acquisition assignment due to his lack of expertise. But McCarthy later re-entered the picture to assist Pelullo with the subsequent First Plus related Agreements. **Did McCarthy then ask the question: "Is Scarfo still involved or interested?"** Did McCarthy have any reason to believe that Scarfo walked away from a possible interest in the takeover of First Plus? Did McCarthy ask Pelullo whether he was still discussing the details of a FirstPlus takeover with Scarfo? Did not the sale of worthless companies (Rutgers and Globalnet) raise questions for McCarthy about Scarfo's continuing participation? The answer to these and similar questions is a clear "no." There is no record evidence to suggest that McCarthy made inquiries a reasonably objective person would have made.

I recognize that these questions assume Scarfo's possible interest in the transaction from the mere fact of attendance at a meeting. Yet, the above questions go to the very core of the dispute. McCarthy states in his submission, "It is not objectively reasonable to assume that Scarfo's attendance (and non-participation) in one meeting indicates he had an active continuing role in subsequent transactions. From McCarthy's view he was not an active

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[14] I am not persuaded by McCarthy's argument premised upon the fact that the details of a criminal conspiracy were not discussed at the meeting or the fact that Scarfo just "sat there." Nor am I persuaded by Michael Downey's characterization of Scarfo's involvement at the meeting as "tangential." While Scarfo's presence at the meeting was perhaps uneventful to McCarthy at the time, it became a significant factor once McCarthy undertook the drafting of the follow-on FirstPlus Agreements.

participant in the creating companies . . . . ." I agree. While it is not objectively reasonable to assume from Scarfo's attendance that he **necessarily** had an active continuing role, I find as the only objectively reasonable assumption from Scarfo's attendance is that he **may possibly** have had a continuing role.

So, why did McCarthy not make an inquiry about Scarfo's continuing role? McCarthy suggests as the answer, in part, that he relied upon Pelullo's representations. In this Arbitrator's view, this reliance is the underlying cause of the events which ensued – the investigation, the indictment, the trial, the costs of trial and the collapse of the firm.

More specifically, I find McCarthy's reliance upon Pelullo's representations to have been unreasonable. McCarthy was well aware of Scarfo's relationship with Pelullo, among other reasons, because Pelullo brought Scarfo to the meeting. So, again, why did McCarthy rely on Pelullo? How is it that he was duped? While the record does not establish McCarthy's state of mind, perhaps the answer lies in McCarthy's blind trust of Pelullo given their longstanding relationship over so many years. Perhaps there was some desire to please Pelullo and tell him what he wanted to hear.[15] Perhaps due to McCarthy's friendship with Pelullo he did not want to confront him. Perhaps McCarthy was lulled by the fact that he had represented Pelullo in previous transactions which were legitimate. Perhaps there was some interest in continuing the Pelullo work which continued to fuel firm income.[16] Perhaps McCarthy was so busy with the details of the FirstPlus work that he did not have time to think about the big picture. Perhaps the overall demands of a busy practice and McCarthy's responsibilities as managing partner left him

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[15] As evidenced by McCarthy's response to a Pelullo inquiry demanding the money -- "I have your back."

[16] Again, while not de minimus, the revenues brought in from FirstPlus related transactions were not substantial compared to the very substantial total revenue which McCarthy originated. At the same time, the total revenues from all Pelullo transactions over the years were not insignificant.

no time to think. Perhaps the reason is a combination of these factors. As the record does not permit any answers these questions shall remain unanswered. In the final analysis, however, it is this Arbitrator's conclusion that McCarthy's blind trust of Pelullo is the root cause of all the disastrous results that followed.[17]

In conclusion, regardless of whether McCarthy was motivated by friendship, loyalty, trust, or profit, I am able to reach only one conclusion—that McCarthy, because of his blind trust in Pelullo, acted in a reckless disregard of the facts. In short, if McCarthy had not suspended reasonable belief and if he had made a more objective analysis of the facts before him or asked Pelullo the above questions, he would have known about Scarfo's continuing role when drafting the Agreements. Given my finding that McCarthy had genuine pride in his reputation for integrity, I have little doubt that if he had exercised reasonable belief and make an appropriate inquiry he would then have refused the representations that led to his firm's collapse.[18]

WHAT DID McCARTHY DISCLOSE TO FINEBURG? WHAT DID FINEBURG KNOW AND NOT KNOW?

McCarthy argues, in essence, "Fineburg knew everything." I disagree.

First, Fineburg was not aware of the initial representations of Scarfo family interests (e.g. Learned Associates and LMDS 2006 Trust). Moreover, not only were these initial representations not disclosed, I find they were concealed. As I have stated, there is no record evidence to suggest that McCarthy failed to follow the rules in any other firm representation.

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[17] I find McCarthy's reliance on Pelullo even less reasonable when I add to the equation Pelullo's prior felony conviction.

[18] With respect to McCarthy's reliance on third-parties, I would simply note that there is no evidence to suggest that these parties possessed knowledge of any Scarfo connection to either Pelullo or McCarthy.

Accordingly, I find that McCarthy's practices with respect to the initial representations were not accidental. Perhaps McCarthy's conduct was driven by an interest in avoiding any uneasiness in discussing the representation, directly or indirectly, of Scarfo related interests, even perfectly legal representations. Of course, at the time, this early concealment arguably fell into the "no harm, no foul" category. The problem arises, however, when the connection to Scarfo continued in April, 2007, and subsequently, in connection with the drafting of the Agreements which brought Learned, as just one example, back into the picture.

Second, I find that Fineburg was unaware of Scarfo's presence at the April, 2007, meeting. Given Scarfo's reputation, it is almost inconceivable that if told about Scarfo's presence at the firm before McCarthy undertook the drafting of the Agreements, Fineburg would not have asked, in words or substance, "What was the purpose of the meeting?"

Third, and equally important, there is no record evidence whatsoever to suggest that McCarthy told Fineburg that the **subject of the meeting** was the takeover of FirstPlus.

Fourth, whatever knowledge Fineburg may have had about the questionable Agreements, Fineburg's lack of knowledge of the early transactions and the April, 2007, meeting prevented him from assessing the Agreements in full context.

This brings us to the heart of another core issue in this dispute. I find that the above concealment together with failures to disclose the details of the April, 2007, meeting deprived Fineburg of the opportunity to make his own objective analysis of whether or not the firm should undertake the later assignments to draft the Agreements (which facilitated the Scarfo-Pelullo conspiracy and fraud). As stated, with full knowledge of (1) the early transactions, **and** (2) the presence of Pelullo and Scarfo at the April, 2007 meeting, **and** (3) the

subject discussed at the meeting (FirstPlus), **and** (4) the questionable FirstPlus related Agreements, an objective analysis would, at the very least, have led to an inquiry which would have revealed Scarfo's continuing participation in the takeover of FirstPlus.[19] Fineburg, without a longstanding relationship with Pelullo, almost certainly would not have trusted Pelullo's representations nor would he likely have been duped.[20] In sum, the concealment and failure to make the above disclosures deprived Fineburg of the opportunity to make such a critical inquiry.[21]

As stated above, McCarthy asks how he could have disclosed the fraud if he was unaware of the fraud. As suggested above, that is the wrong question and one that misinterprets the issue. McCarthy's obligation was to refrain from concealing the initial Scarfo related representations in the first instance. McCarthy's further obligation was to disclose all critical **facts**, not the fraud, which in turn, would have permitted his partners to make their own objective analysis and participate in a decision concerning whether or not to continue to represent Pelullo in connection with the FirstPlus Agreements.

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[19] This Arbitrator rejects McCarthy's "context" argument (e.g., McCarthy had every reason to believe the FirstPlus deals were legitimate and similar to the previous NBFS matter on behalf of Pelullo). Among other distinctions, Scarfo was not present when Pelullo first met with McCarthy to discuss the NBFS deal.

[20] In this Arbitrator's view, it is likely that a disclosure of the substance of the April, 2007 meeting before embarking upon the drafting of the agreements would have led to discussions that would have ended any further representation of Pelullo in connection with FirstPlus related transactions.

[21] This Arbitrator recognizes that, either as of the time of the target letter or post-indictment, Fineburg learned of the substance of the Government's case and did not take immediate action to terminate McCarthy. Nor does the record suggest that Fineburg reacted with outrage. So how do we explain Fineburg's continued support of McCarthy post-indictment after he knew the full extent of the fraud? The answer may lie in the difference between (1) what Fineburg would have done if there were full contemporaneous disclosures and (2) Fineburg's support after the indictment which can be characterized as "damage control" in the interest of preserving his own reputation and the reputation and well-being of the firm. It is also possible that it simply took Fineburg time to internalize and recognize the full extent of McCarthy's conduct.

CONNECTING THE DOTS

McCarthy argues that the facts on hand in 2007 were not enough to raise anyone's suspicion, including the auditor and the value expert (whose jobs were to notice) and that no one could have connected the dots. However, as suggested above, the auditors and value expert as well as others involved did not possess the full range of knowledge which McCarthy possessed.

McCarthy specifically contends that Fineburg knew just as much about Scarfo's participation as McCarthy did – "not much." Perhaps I can best illustrate the reason I disagree with this statement by providing the following chart:

What McCarthy Knew	Did Feinberg Know?
Early transactions, Learned, LMDS, etc. procedures not being followed; and	No
Scarfo present at April 2007 meeting; and	No[22]
Discussion of FirstPlus takeover at April 2007 meeting; and	No
Consulting contracts; and	Yes[23]
Asset Purchase Agreements	Yes[24]

[22] Whether McCarthy told Fineburg about Scarfo's presence at the firm in April, 2007, shortly after McCarthy saw Scarfo at the Christmas Party in the end of 2007 presented a difficult question for me. Neither side's version adds up completely. Far more importantly, the evidence is clear that any disclosure which may have been made was insufficient. McCarthy testified that he told Fineburg "about the meeting." **McCarthy did not testify that he told Fineburg that the purpose of the meeting was a takeover of FirstPlus.** Consequently, any disclosure by McCarthy shortly after the Christmas party would have been incomplete unless it also included a disclosure of the April, 2007 meeting **and** the fact that FirstPlus was the subject of the meeting. In this regard, I note that McCarthy testified "I don't know when the name FirstPlus came up."

[23] Answer gives McCarthy the benefit of doubt.

[24] Answer gives McCarthy the benefit of doubt.

The bottom line: I simply do not agree with McCarthy's contention that "Fineburg knew just as much about Scarfo's participation as McCarthy did." [25] Nor do I agree that Fineburg had the same opportunity to connect the dots.

Was the failure to connect the dots "willful blindness?" I think not. In this Arbitrator's view, this term is used in the criminal context to apply to a situation where one **intentionally** places himself in a position to be unaware of key facts. I have already stated the reasons why I find McCarthy was not a knowing participant in a conspiracy and these very same reasons suggest a finding of "no willful blindness." However, I find that the blind trust of Pelullo that led to McCarthy's failing to connect all the dots does constitute a reckless disregard of the facts. While McCarthy denies such a disregard, I cannot help but think that McCarthy has asked himself on more than one occasion. "How could I have been so blind?"

THIS ARBITRATOR'S DETERMINATION OF CREDIBILITY ISSUES

In considering the conflicting views of the parties concerning what transpired, I was challenged to consider which of the various competing stories I would accept. I specifically was called upon to resolve the allegations made by both parties that the other party was "lying."

As should be obvious, I reached my factual determinations without reaching a conclusion that either party lied in presenting their views of the dispute. In particular, Fineburg's

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[25] In reaching my conclusion on this key issue, I note that in deciding in Fineburg's favor, I am left with questions I cannot resolve completely (e.g., "NS involved" and Fineburg's billing for discussing Scarfo). I would note only that if I were to have decided in favor of McCarthy I would have had many more unresolved questions. I note, in particular, the numerous rhetorical questions presented on pages 14 and 15 in Fineburg's reply memorandum to McCarthy's response to Arbitrator questions.

written submissions contained repeated assertions that McCarthy was lying through the Arbitration.[26]

I do understand completely the frustration and anger on the part of both Fineburg and McCarthy, partners whose lives previously were marked by friendship and trust. Partners whose lives were turned upside down by the events which triggered the collapse of the firm. However, these events occurred many years ago before this arbitration and recollections do fade over time. Moreover, there are a number of cognitive illusions and irrational attachments to positions which make it difficult for any party in a dispute to recall and relate facts accurately and objectively. At the top of the list of cognitive drivers here is "selective perception." Parties invariably perceive facts in ways that serve their own interests. A similar concept is "assimilation bias" – a tendency for individuals to see or hear only that information which favors their own position. There is also "cognitive dissonance"– the fact that it is uncomfortable for most people to consider data that contradicts their own viewpoint. There is "attributional bias" – the tendency to impute negative actions and intent to a person even in the absence of a negative act simply because the parties are in a dispute. There is also advocacy bias, reactive devaluation, certainty bias, confirmation bias, hindsight bias and many other psychological barriers which make it difficult to recall past events accurately and to make objective assessments and conclusions.

In the instant case, all of the above psychological distortions were exacerbated by anger, frustration and distrust. These considerations permeated this dispute and, as a consequence, I am not surprised the parties contend that each other was lying. In sum, I believe

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[26] Among other assertions, Fineburg points to McCarthy's ever changing testimony, his selective memory and reliance upon facts purportedly learned at the criminal trial which cannot be the subject of cross-examination.

the above psychological phenomena, rather than lies, offer the better explanation of why the parties' views in this arbitration are so diametrically opposed.[27]

DID McCARTHY'S CONCEALMENT AND NON-DISCLOSURES CONSTITUTE A BREACH OF FIDUCIARY DUTIES TO HIS PARTNER?

In order to decide the issues of cause termination vs. shareholder oppression and the claim for indemnification for legal costs, this Arbitrator must decide whether McCarthy breached his fiduciary duty to Fineburg.

It is axiomatic that partners stand in a fiduciary relationship to one another in all matters pertaining to the partnership. A partnership relationship requires honesty, good faith, fairness and loyalty. It imposes high standards of care and a duty to act for the common benefit of all partners in transactions relating to the enterprise. It also imposes a duty to refrain from acts of concealment that may affect the well-being of the enterprise.

For the reasons set forth above, I find that McCarthy's concealment, his failure to recognize the many red flags raised by the Agreements he drafted, his failure to ask key questions, his blind trust of Pelullo, and his failure to disclose material information placed the enterprise and his other partners at risk. I specifically find that McCarthy's loyalty to Pelullo as a client and maybe a friend compromised his duty of loyalty to Fineburg as a partner. But for

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[27] Taken together, these cognitive distortions served as a basis for "motivated reasoning" on McCarthy's part. Motivated reasoning takes confirmation bias and other biases to another level and leads people to believe what they truly want to believe while ignoring all contrary data. Motivated reasoning explains, for example, why many individuals truly believe that global warming does not exist.

McCarthy's concealment and non-disclosures, the emotional, financial and reputational damage suffered by all parties could have been avoided.

Once again, McCarthy argues "How can someone disclose something they do not know?" Again, the argument that McCarthy could not have disclosed the fraud because he did not recognize the fraud himself misses the mark. Fineburg's argument is that McCarthy acted in reckless disregard of the **facts** concerning his representation of Pelullo.[28] That **he failed to disclose the underlying facts – not the fraud itself** – which if disclosed would have permitted Fineburg to reach his own conclusions. Because McCarthy's submission frames the issue as "disclosure of the fraud," it does not discuss in any detail the issue of concealment (filing opening, footer, etc.). Moreover, if the issue is disclosure of underlying facts, then the "Scarfo Story" is clearly not a "red herring." Nor is the "Scarfo story" one premised on hindsight bias.

Accordingly, I find that McCarthy breached his fiduciary duties to his partners and, in particular, the duty of loyalty.[29]

THE *DISNEY* REQUIREMENT OF INTENT

During oral argument, this Arbitrator asked counsel for Fineburg and McCarthy whether McCarthy's reckless disregard of the facts and consequent failure to disclose material facts would be a sufficient basis to find that McCarthy breached fiduciary duties of good faith and loyalty. Counsel for McCarthy argued that a "reckless disregard of the facts" was

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[28] The underlying facts include the early representations of Scarfo and the fact of and subject matter of the meeting with Pelullo and Scarfo at EFM's offices.

[29] Whether or not a breach of a fiduciary duty serves as a basis for a cause termination under the shareholder agreement is discussed below.

insufficient for such a finding as the Disney case (Delaware Supreme Court) requires a finding of intent. This Arbitrator then requested post-hearing briefs from both Fineburg and McCarthy.

In his post-oral argument submission, McCarthy argues that under Disney an "intentional disregard of duties is needed to establish a breach of good faith." More specifically, McCarthy argues that under Disney, in order to rebut the presumption of good faith and to prove bad faith, Fineburg must show that McCarthy "consciously and intentionally disregarded responsibilities." Mere negligence or even gross negligence does not evidence bad faith, McCarthy contends. McCarthy's submission then details the numerous reasons why McCarthy's conduct did not rise to the level of intent required by Disney.

In response, Fineburg argues that McCarthy's argument is inapposite to this case. In essence, Fineburg argues that the Disney decision has no applicability to this dispute as the Disney case was concerned with the Delaware Supreme Court's definition of bad faith when applied to the business judgment rule. In contrast, the issue in this arbitration is whether McCarthy breached his duty of loyalty to a partner by failing to disclose material information which failure placed the enterprise at risk.

This Arbitrator agrees with the analysis offered by Fineburg. For the reasons stated in this Opinion in detail, McCarthy's duty of loyalty to Fineburg was compromised by his relationship with Pelullo which resulted in McCarthy failing to ask Pelullo questions about Scarfo's possible continuing interest in the FirstPlus transactions and failing to recognize the red flags presented by these transactions which facilitated the Pelullo-Scarfo fraud. Again, Disney requires an element of intent (or scienter) to rebut the presumption of the business judgment rule. However, Disney does not require a finding of intent when the issue is whether reckless

disregard of the facts and consequent failure to disclose material facts results in a breach of a duty of loyalty.[30]

McCarthy specifically argues that in order to prove bad faith Fineburg would have to establish, under Disney, that McCarthy's conduct exhibited a "conscious disregard for his responsibilities." As explained, the Disney standard is not the applicable test. Rather, the test is whether McCarthy's failure to disclose is a breach of his duty of loyalty requiring his actions to be in the best interests of the law firm.

Even if a conscious disregard for his responsibilities were the test to determine a breach of duty of loyalty (which it is not), it is a test McCarthy would have failed. If this were the test, this Arbitrator would have found that McCarthy's (1) concealment of early Scarfo representations, (2) failure to make a timely disclosure of the April, 2007, meeting with Pelullo and Scarfo, (3) failure to make a timely disclosure that the subject of a FirstPlus acquisition was the subject of the meeting, (4) failure to ask Pelullo whether Scarfo was still interested or involved, and (5) failure to recognize any of the numerous red flags in the follow-on Agreements, when taken together, do constitute a "conscious disregard of his responsibilities."

WAS McCARTHY'S DEPARTURE EITHER A RESIGNATION OF A TERMINATION FOR CAUSE?[31]

Fineburg argues that either by resignation or termination for cause McCarthy has received his lawful interest in the firm. I shall consider these possibilities separately.

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30 The issue of whether there was sufficient intent to establish bad faith in order to overcome the presumption of the business judgment rule is a moot point in this arbitration.

31 Or was McCarthy's departure a squeeze out, as McCarthy contends?

1. Did McCarthy Resign?

After the FBI raid, the target letter, the indictment, and shortly after Eizen's announcement that he would depart the firm and the meeting at Greenberg's apartment shortly thereafter, [32] McCarthy on April 17, 2012, sent an email which states:

> You are a good man, an honorable man and a great friend. I can unequivocally say that there is no on (sic) in my life from family to friends that has stood by my side as you have. Do not take this as a burden but as a compliment to the person you are. I am and will always be indebted to you. Your parents did a tremendous job in raising you and Lynn and your children are blessed to have you as a husband and father as I am in having you as a friend.
>
> I promise you that I will do nothing to hurt you in any way whatsoever or put you through any more pain than I have already have. **If and when the time comes, I will step aside without any issue or fanfare whatsoever.** We have liquid funds in EFM and Square that will pay off Hopewell, and have no debt other than 75,000 due PNC which is easily payable. We have good cases in the pipeline and a great team. I will continue to work diligently to stabilize the firm and our client base. I will work until you decide otherwise. You have my word. **I will not burden you with any sense of responsibility for me as you have done more than enough nor will I burden you with any debt or obligation.** I am a firm believer that goodness is rewarded as you will be both in this life and the next. Please do not response (sic) to this email as none is needed or expected. Gary. (emphasis added).

Fineburg contends that this email constituted an express offer to resign which remained open and, if accepted before it was withdrawn, was irreversible and binding. Alternatively, Fineburg contends that this email confirmed McCarthy's resignation. While I agree that the email was an offer to resign, I find that the email itself did not constitute a

[32] There is insufficient evidence to support the conclusion that McCarthy offered to resign at the meeting in Greenberg's apartment.

resignation nor did Fineburg consistently characterize it as a resignation. Moreover, it would have been easy at any point after the email was received and before the lockout for Fineburg to have stated, in words or substance, "Your offer to resign is hereby accepted." But he did not. Instead, Fineburg's written communications to McCarthy in a letter of termination and in pleadings, reflect that Fineburg consistently characterized McCarthy's departure as a "termination."[33]

2. Was McCarthy Terminated For Cause?

Fineburg contends that as President of the firm he had the authority to discharge McCarthy for cause.

Initially, I agree with Fineburg that a fair reading of the Shareholders Agreement, set forth in Schedule "A" thereto, sets forth the definition for "Good Cause" which is intended to be the definition for "Cause." The term is defined as "the failure of Employee to dedicate his fulltime and best efforts to the Corporation . . . ." In order to reach a decision, it is necessary for this Arbitrator to determine the meaning of "best efforts."[34] First, I disagree with McCarthy that "best efforts" is solely a quantitative standard. To decide otherwise would render the phrase almost meaningless given the requirement of "fulltime." [35] Second, I conclude that "best efforts" means acting in a manner that furthers the interests of the enterprise. Over decades of law practice and service as a neutral, I have seen many employment contracts which have set forth a

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[33] In contrast, Fineburg characterized Eizen's departure as a "resignation."

[34] I reject Fineburg's contention that McCarthy was devoting too much of the firm's time to assist McCarthy in the criminal investigation and the bankruptcy litigation and, as a consequence, could be dismissed for "cause" for failure to work fulltime.

[35] As is axiomatic, contracts must be interpreted in a manner that will give meaning to all words and phrases.

requirement, in words or substance, that an employee devote his or her "fulltime and best efforts, energy and skill, in performing his (her) duties in a manner which will faithfully and diligently further the business and interests of the company (firm or enterprise)." It is hard to imagine any definition of "best efforts" that would not incorporate such a requirement or one which is similar. Of course, what matters here is what the parties meant by "best efforts" in the context of their Shareholder Agreement.[36] Giving the words their ordinary and plain meaning, I conclude the best efforts must mean something more than being productive while working fulltime (as McCarthy suggests).[37] Further, simply clocking hours without any meaningful effort would not require a "best efforts" clause (a McCarthy example) as such conduct would be less than a "fulltime" effort.

McCarthy argues that reaching the above conclusion would yield an interpretation that one could embezzle after the age of 65 as one would have to exercise best efforts only until the age of 65. I disagree. An inartful provision at best, it is far more reasonable to assume that the parties had something else in mind after the age of 65 (such as "part-time and best efforts") and simply failed to reach a more comprehensive agreement.

McCarthy further argues that Fineburg's interpretation would yield a result that could permit Fineburg to send a letter of termination one day before receipt of a $10 million fee for not dedicating qualitative "best efforts" on behalf of the firm. First, such a theoretical risk exists even under McCarthy's preferred interpretation as such a letter could be sent for failing to dedicate one's fulltime efforts to the firm. Second, as a practical matter, the risk is mitigated by

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[36] Neither party offered any parol or extrinsic efforts to support their interpretation of "best efforts."

[37] In addition, I note that the duty to act in a manner that furthers the interests of the enterprise is one that exists at law separate and apart from the parties' Shareholder Agreement.

real world consequences in the litigation or arbitration that unquestionably would ensue (including possible payment of the other party's legal fees) from a baseless termination.

Accordingly, for all of the above reasons, I conclude that McCarthy's active concealment and non-disclosures placed the welfare of the firm at risk and, as a consequence, McCarthy both breached his fiduciary duty to his partners and failed to dedicate his best efforts to the firm. McCarthy's termination, therefore, was one for "cause." As a consequence of McCarthy's employment termination, he is entitled to only that which the parties provided for under such circumstances in their Shareholders Agreement ($10,000).

SHAREHOLDER OPPRESSION AND SQUEEZE OUT

1. An Introduction

Shareholder oppression generally refers to conduct that defeats the reasonable expectations of minority shareholders in a corporation. More specifically, McCarthy relies on Viener v. Jacobs for the general proposition that in Pennsylvania an attempt by majority shareholders to "freeze out" minority shareholders for the purpose of continuing the enterprise for their own benefit constitutes a breach of the majority shareholders' fiduciary duty to the minority shareholders.

In the instate case, McCarthy argues that Fineburg's decision, as a controlling (majority) shareholder was an "economic grab" for the sole purpose of depriving McCarthy from obtaining the reasonable expectations to which he was entitled as a shareholder. **I find my decision that Fineburg terminated McCarthy for "cause" as a consequence of McCarthy's**

breaches of fiduciary duties to be inconsistent with McCarthy's claim of oppression.[38] More specifically, I find my conclusion that Fineburg's purpose in terminating McCarthy, to preserve and protect the enterprise which had been placed at risk as the result of McCarthy's active concealment and failures to disclose, to be inconsistent with McCarthy's story of oppression. Nevertheless, given the numerous days of testimony and extensive briefing on "oppression," I believe the parties are entitled to a very brief summary statement on how this Arbitrator would have decided the key oppression issues were there no findings of breach of fiduciary duties and cause termination. Accordingly, McCarthy's key contentions are discussed below on a summary basis.

2. "A 50% Shareholder In A Close Corporation Can Be A "Majority" Shareholder"

For the reasons set forth in McCarthy's submissions, I would have found Fineburg to be a "controlling" shareholder. Although I agree with Fineburg's analysis of the case of Liss v Liss, I disagree as a matter of law that a case of oppression cannot exist against a 50% shareholder.[39] For reasons set forth in this Opinion, however, the facts do not support a case of oppression. Again, the entire case for oppression depends on a finding that McCarthy did not breach his fiduciary duties to Fineburg.

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[38] I note that McCarthy has advanced an argument to support the contention that a finding of a breach of fiduciary duty and a finding of oppression are not mutually inconsistent. This Arbitrator agrees, but only to the extent that McCarthy's termination was for a legal reason that exists outside the Shareholder Agreement. In the instant case, I have found the breach of fiduciary duty to justify a "cause" termination under the Shareholder Agreement. I also specifically disagree with McCarthy's contention that Fineburg's motive was simply about money. No doubt saving the substantial cost of continuing payments for McCarthy's legal fees was a consideration, but even this motivation does not constitute oppression when Fineburg's decision was primarily for the purpose of saving an enterprise which was at risk due to McCarthy's conduct.

[39] Take, for example, a business where a 50% partner is managing a business and the other 50% partner is a passive investor. In such an instance, if the managing partner cashed out by taking high management fees, declaring no dividends, excluding the investor from participation in key decisions such as a potential sale of the business and refusing to give meaningful financial information, I appropriately could find such conduct to be oppression.

3. "The Business Judgment Rule Does Not Apply"

For the reasons set forth in McCarthy's submissions, among others, I would have ruled that the business judgment rule cannot serve as a basis to insulate Fineburg from liability.[40]

4. "Entire Fairness Is The Standard"

I agree with McCarthy that "entire fairness" would have been the appropriate test. However, I would have found Fineburg's decision to terminate McCarthy to have satisfied the entire fairness standard of Orchard v. Cavelli. While McCarthy ascribes to Fineburg a singular financial motive, I have found that Fineburg was motivated by a genuine concern for the need to preserve a firm that was about to disintegrate and a genuine concern about reputational risk.[41] Moreover, rather than engaging in the type of mean-spirited conduct that typically accompanies oppression, Fineburg cooperated with McCarthy in connection with turning over his client files. Accordingly, I would have found that Fineburg met his burden in establishing his actions were "entirely fair" (i.e., Fineburg's actions were premised upon McCarthy's failures to disclose, there was a basis to terminate for "cause," there was no intent to deprive McCarthy of financial benefits, and McCarthy, in fact, was not so deprived).

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[40] McCarthy contends that this Arbitrator must elect either (1) the business judgment rule or (2) entire fairness as a standard. I would have decided this controversy utilizing the standard of "entire fairness" if I were to have made such an election.

[41] The risk of disintegration, which was due in large measure to the fallout from McCarthy's non-disclosure, satisfies the entire fairness standard of Orchard v. Covelli. This Arbitrator has taken note of Fineburg's argument that McCarthy's application of the "entire fairness" doctrine to this case is in error. The point is moot and, in any event, I would have decided in Fineburg's favor on the issue of entire fairness. As stated, this Arbitrator finds that Fineburg's concerns about reputational risk were real and genuine (just as they were for Eizen when he left the firm). This is especially so given the fact that McCarthy was about to start a long criminal trial.

5. "McCarthy Was Denied The Reasonable Expectations Of Ownership" And The Issue of "Fairness"

As discussed, the purpose of McCarthy's termination was a legitimate business purpose and not an attempt to deprive McCarthy of the reasonable expectations of his ownership interest in the firm. Moreover, given McCarthy's breach of fiduciary duties, it would not be reasonable on his part to expect anything more than that which the Shareholder's Agreement provided for in a "cause" termination. And, as stated, in the absence of oppression, we do not even get to the issue of "reasonable expectations."

In McCarthy's email to Fineburg , he stated that he was willing to leave the firm without any obligation on the part of the firm. What prompted McCarthy's change of mind? There is no clear basis in the record to answer this question. My guess is that McCarthy's frustration and anger level increased exponentially when the parties were unable to work out an acceptable office sharing and client sharing arrangement and McCarthy was locked out of his office. While the lockout may or may not have been the best way for Fineburg to have terminated McCarthy, it was entirely predictable that after decades of a very good professional and personal relationship that McCarthy would react with enormous anger. However, a lockout may possibly have been the best way to proceed. While no party is required to agree to anything in a negotiation, I find that McCarthy's continued intransigence and his rejections of reasonable compromise solutions placed Fineburg and his colleagues in an untenable position given the additional financial and reputational costs that would have arisen if the stalemate continued. Not to mention the disintegration of the firm if Armstrong and Hayes were to have left.

Much has been made by McCarthy that he was kicked out of the firm with nothing, a result that McCarthy calls "corporate capital punishment." This is more especially the case, contends McCarthy, where Fineburg retained all the cash, accounts receivables and work in process from the "old firm" (i.e., the entire $2.4 mm in asset value of the old firm).

McCarthy's submissions scream about the unconscionability of such a result. While the point is moot as I have decided there was a breach of fiduciary duty and a "cause" termination, the issue of fairness so permeated this dispute that it calls for some discussion.[42] Accordingly, when I weigh and balance the issue of fairness, I have recognized the following:

- ✓ McCarthy's email reflected a willingness at one point in time to accept the very result Fineburg is seeking ("nor will I burden you with any debt or obligation" = zero share value).
- ✓ Eizen walked away from the firm on similar terms (albeit voluntary).
- ✓ At the time of termination, the reputational risk to Fineburg for reasons caused by McCarthy was a risk that was continuing one and the risk of the firm's disintegration was real.
- ✓ McCarthy would not under any circumstances be entitled to the amount he has claimed as the Friedlander report raised a number of questions including, for example, the failure to include certain expenses which, when resolved, would have resulted in a significantly reduced claim.
- ✓ While not controlling, it is not irrelevant that McCarthy walked away from the firm with his clients which were generating seven figures of income annually and without any debt.
- ✓ Fineburg was deprived of substantial revenues he otherwise would have received prior to McCarthy's termination had EFM not incurred substantial financial obligations on McCarthy's behalf.

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42 The issue of "fairness" raised by McCarthy is separate and apart from the issue of "entire fairness."

In the final analysis, McCarthy contended that it was "unfathomable to think he would walk away from the firm's obligation to indemnify him, pay his tax obligations and his fair share value." [43] Of course, the issues of indemnity and tax obligations stand separate and apart from the issue of share value. However, even an unfairness cannot dictate the result McCarthy is seeking with respect to share value as the parties to the Shareholder's Agreement specifically agreed to the result that would obtain in the event of a "cause" termination.

McCARTHY'S CLAIM FOR INDEMNIFICATION FOR FEES AND EXPENSES

McCarthy argues that he is entitled to be indemnified by Fineburg for his legal fees in connection with his criminal defense.[44]

McCarthy's claim is simple: indemnification is mandated by both the By-Laws of Fineburg & McCarthy and by statute (15 Pa. C.S. § 1743). Simply stated, McCarthy argues, among other things, that he was "successful" in the criminal trial and that an acquittal necessarily requires indemnification.

Fineburg's initial opposition is also simple: (1) McCarthy lacks standing as he did not pay his ongoing legal fees, (2) the law firm of McCarthy Weidler did pay the legal fees and, (3) the McCarthy Weidler law firm's deduction of the expenses for legal fees supports the conclusion that McCarthy, personally, did not pay.

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[43] It is hard to conclude , as McCarthy contends, that it was unfathomable for McCarthy to walk away from his share value as that is precisely what McCarthy proposed in his email to Fineburg.

[44] McCarthy seeks all legal expenses in connection with the U.S. Attorney's investigation as well as expenses post-indictment prior to McCarthy's termination were paid by Fineburg & McCarthy. In this Arbitration, Fineburg also seeks reimbursement for legal expenses paid prior to McCarthy's termination.

While both parties briefed numerous subordinate issues relating to McCarthy's claim for indemnification, this Arbitrator initially must address the threshold issue of "standing." Again, Fineburg argues that McCarthy has no standing to present a claim which asks for indemnification for expenses that he, personally, did not pay. In response, McCarthy argues that he did pay these expenses in the form of a loan to the McCarthy Weidler firm. Fineburg counters by arguing that there is no evidence to support the contention that monies were advanced by McCarthy in the form of a loan.

Upon review of the testimony, this Arbitrator concludes that McCarthy did not meet his burden of proof in establishing that he advanced monies for the legal expenses in the form of a loan. In essence, the existence of a promissory note could not be confirmed. While Exhibit R #152 ("Letter of Agreement") purported to serve as such evidence, McCarthy's testimony concerning when this undated document was prepared was neither clear nor convincing. Moreover, Ms. Weilder's testimony explaining this document was both vague and uncertain.

Pursuant to the above analysis, I find that McCarthy lacks standing to seek indemnification in this Arbitration. As this finding precludes McCarthy's claim, it is not necessary to resolve the various competing positions on subordinate issues such as, for example, whether McCarthy is entitled to indemnification pursuant to the firm's By Laws; whether Section 1743 incorporates the "good faith" requirement of Section 1741 or merely refers to Section 1741; the proper application of the Hermelin case and Delaware law; and whether or not the allegations in the Ironshore litigation, an action not predicted on the law firm's By-Laws or the Pennsylvania indemnity statute, have any bearing upon this Arbitration.

McCARTHY'S TAX REIMBURSEMENT CLAIM

McCarthy's claim for reimbursement for income tax payments made without reimbursement from the law firm, in the amount of $457,136, is premised primarily upon past practice. More specifically, it was the practice in 2010 and 2011 to distribute an amount of cash due to each Shareholder of EFM to reimburse the shareholders for the tax burden imposed upon them by having to report four streams of pass-through income on their personal tax returns (EFM, PC, BHG, EFM Assoc. and Square). McCarthy contends that Fineburg accounted in 2012 and 2013 for only the first three streams of income (EFM PC, BHG and EFM Assoc.) and not the fourth stream (Square). By ignoring the partners' income from Square, McCarthy argues that his reportable income was reduced thereby reducing the law firm's tax reimbursement obligation to him by a commensurate amount.

I find that McCarthy is not entitled to additional tax reimbursement payments for a couple of reasons. First, prior practice is not a sufficient basis to **require** distributions from Square. The only obligation to make such distributions arises in the Law Firm's Shareholder's Agreement and such obligation is specific to the Law Firm and one that does not require distributions from Square. Second, there is no suggestion that Fineburg received a distribution from Square in excess of the amount distributed to McCarthy.

It is not entirely clear to this Arbitrator whether McCarthy's position is contrary to Square's tax reporting position or whether the doctrine of res judicata and collateral estoppel should be applied, as suggested by Fineburg. However, these points are moot as I have decided the issue in favor of Fineburg on other grounds.

FINEBURG'S CLAIM FOR RECOUPMENT/REIMBURSEMENT OF FEES AND EXPENSES

In this Arbitration, Fineburg seeks reimbursement for the $1.3 million paid on behalf of McCarthy for legal fees and expenses in connection with his defense. By stipulation, the parties agreed that Fineburg's claim for reimbursement was limited to recoupment (i.e. a set off against any award made in favor of McCarthy and against Fineburg in this Arbitration). As this Final Award does not include any award in favor of McCarthy, this Arbitrator has denied Fineburg's recoupment claim as moot.[45]

McCARTHY'S CLAIMS AGAINST ADDITIONAL DEFENDANTS ARMSTRONG, HAYES AND GREENBERG – BACKGROUND

In addition to his claims against Fineburg, McCarthy has pursued claims against Joseph Armstrong ("Armstrong"), Joseph Hayes ("Hayes") and Ted Greenberg ("Greenberg") collectively referred to as "Additional Defendants." McCarthy's claims were transferred to this Arbitration by the Philadelphia Court of Common Pleas. McCarthy dismissed one of the counts originally set forth in his court pleading and continues to pursue herein his claims for civil conspiracy, interference with business relations, breach of fiduciary duty and professional negligence.[46]

In sum, the Additional Defendants contend that the third-party claims are completely baseless and were filed solely out of personal animus to punish them for aligning with Fineburg in the McCarthy Fineburg dispute. This Arbitrator shall consider separately the

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[45] Accodingly, McCarthy's arguments opposing Fineburg's recoupment claim, including estoppel and ratification, need not be considered

[46] The Amended Complaint filed with the court serves as the Statement of Claim in this Arbitration.

claims against (1) Greenberg and (2) Armstrong and Hayes. All three were non-equity salaried employees of the firm who also held the position of "Director."

McCARTHY'S CLAIMS AGAINST GREENBERG

In contrast to the specific allegations of breaches of duty caused by Armstrong and Hayes, McCarthy neither alleged nor testified to any specific actions by Greenberg which caused McCarthy any harm. In fact, with respect to many of the actions of Fineburg, Armstrong and Hayes -- actions which serve as the basis for McCarthy's allegations of breach and harm -- McCarthy recognized that Greenberg was kept in the dark. In McCarthy's moving brief, he contends, among other things, that **Armstrong** and **Hayes** (1) breached fiduciary duties owed as directors, (2) tortiously interfered with McCarthy's contractual relations, and (3) committed malpractice by misusing their former client's (McCarthy's) information to his disadvantage. Nowhere does the submission contend that **Greenberg** committed any of these alleged wrongs. While the submission does summarize additional acts of oppression on the part of "Respondents," the conduct complained of is the conduct of Fineburg and, to a lesser extent, Armstrong and Hayes. With respect to the decision to terminate a contract with McCarthy's defense counsel or in connection with the Hiltonia litigation, McCarthy in no way implicated Greenberg. Accordingly, this Arbitrator finds McCarthy's claims against Greenberg to be without any basis in fact or law and has denied all claims against Greenberg.[47]

[47] This Arbitrator did take note that McCarthy implicated Greenberg as a Director. However, there is no basis to find Greenberg liable as a director as no action was ever taken by a vote of the Board of Directors.

McCARTHY'S CLAIMS AGAINST ARMSTRONG AND HAYES

McCarthy's claims against Armstrong and Hayes arise from essentially three decisions: (1) the decision to cease paying for McCarthy's legal defense (including the $175,000 reimbursement from Howard Klein and the termination of contracts with both Klein and Post & Schell), (2) the decision to terminate McCarthy's employment and to lock him out of the premises, and (3) the decision to file certain papers in the Hiltonia action which he argues was professional malpractice.

With respect to McCarthy's allegations concerning Armstrong and Hayes, I agree with Armstrong and Hayes in the following respects:

- ✓ Not only was there no oppression by Fineburg but neither Armstrong nor Hayes engaged in any specific acts of oppression.
- ✓ Unlike McCarthy's allegations with respect to Fineburg, there is no contention that Armstrong or Hayes benefited from their conduct.
- ✓ None of the so call "adverse actions" was the result of decisions of the Board of Directors.[48]
- ✓ Neither Armstrong nor Hayes took any "exceptional measures" to terminate McCarthy.
- ✓ Neither Armstrong nor Hayes breached any duty owed to McCarthy.
- ✓ Neither Armstrong nor Hayes interfered with any contact of McCarthy.[49]
- ✓ Neither Armstrong nor Hayes committed any malpractice.[50]

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[48] The testimony of Rachel Weidler, an ally of McCarthy, was consistent on this point.

[49] This Arbitrator finds that the check from Howard Klein was returned as the result of a letter from Fineburg's attorney, Allen Frank, and not as the result of threats.

[50] I agree with Additional Defendants that the information used in the Hayes Certification was "generally known information" as the phrase is used in Rule 1.9(c) of the Rules of Professional Conduct. For the reasons argued by Additional Defendants, I agree that the Dougherty case is distinguishable.

- ✓ While I found the testimony of Michael Downey to be both informative and credible, I find certain of his conclusions (based upon hypotheticals) to be unsupported by the facts.

In addition to the above, I find the testimony of Armstrong and Hayes to have been credible and internally consistent. Accordingly, in accordance with all of the above findings and conclusions, this Arbitrator has denied all claims against both Armstrong and Hayes.[51]

McCARTHY'S DERIVATIVE CLAIMS

McCarthy, in addition to his individual direct claims, asserted derivative claims on behalf of the firm against Fineburg, as President and Director of the firm, and against directors, Hayes and Armstrong, for breach of their fiduciary duties to the firm.

McCarthy's derivative claims are based upon the same underlying contentions as his claims against Fineburg, Greenberg, Hayes and Armstrong. As I have decided that (1) McCarthy breached fiduciary duties and that Fineburg, Hayes and Armstrong did not and (2) McCarthy's termination was for "cause" and not a breach of contract, I find McCarthy's derivative claims to be without any basis. Accordingly, McCarthy's derivative claims have been denied.

McCARTHY'S CLAIM FOR PUNITIVE DAMAGES

All of McCarthy's claims for compensatory damages have been denied. Accordingly, this Arbitrator has denied McCarthy's claims for punitive damages.

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[51] I reach the above conclusions regardless of whether I consider McCarthy's claim from the perspective of (1) director liability or (2) intentional interference with contractual relations. I would add, however, that while I agree with the Additional Defendants' contentions that the third-party claims are without merit, I do not find that these claims were filed solely for the purpose of punishing Additional Defendants.

AWARD OF ATTORNEYS' FEES, ADMINISTRATIVE FEES AND EXPENSES

Each of the parties has requested this Arbitrator award attorneys' fees, administrative fees and expenses in accordance with Rule 47(c), Rule 53 and Rule 54 of the American Arbitration Commercial Arbitration Rules, amended and effective October 1, 2013. I shall consider separately the parties' requests for (1) administrative fees and compensation of the Arbitrator and (2) attorneys' fees.

1. Requests For Award Of Administrative Fees And Arbitrator Compensation

This Arbitrator's decision is that each party shall be responsible for the payment of administrative fees of AAA and this Arbitrator compensation as incurred. The request by the Additional Defendants for realignment of responsibility for these costs has been considered and denied.

2. Request For Award Of Payment Of Attorneys' Fees

a. Requests for Award of Attorneys' Fees By Both Fineburg And McCarthy

This Arbitrator has discretion to make an award of fees and costs pursuant to the Commercial Arbitration Rules of the AAA. In the exercise of this discretion, the requests by Fineburg and McCarthy have both been denied. I consider the American rule on fee shifting to be the better rule as individuals should not be discouraged from seeking redress for perceived wrongs.[52] As explained by the United States Supreme Court in a number of cases, because

[52] The American rule is not a rule. Rather, it is a default presumption in the absence of contract or statute providing for fee shifting.

litigation is uncertain at best, one should not be penalized for merely defending or prosecuting a lawsuit.

While this Arbitrator has the discretion to shift fees and costs, this Arbitrator is of the view that apportionment or shifting of fess is appropriate, in the absence of a contract or statutory mandate, only where one side's claims and defenses are completely without merit. Such is not the case in the disputes between Fineburg and McCarthy.

Clearly, Fineburg has prevailed on the issues of (1) termination for cause vs. oppression and (2) McCarthy's claim for indemnification. At the same time, in deciding the parties' claims and defenses this Arbitrator was challenged by the numerous difficult issues of fact presented by both parties. Moreover, this Arbitrator agreed with a number of McCarthy's arguments in defense of Fineburg's claims (e.g., the business judgment rule does not govern this dispute; McCarthy did not resign; a 50% shareholder who is not in control can pursue a claim for oppression; and McCarthy's lack of actual knowledge of the fraud perpetrated by Pelullo and Scarfo).

Accordingly, both Fineburg and McCarthy's fee shifting claims have been denied.

b. Request For Award Of Attorneys' Fees By Additional Defendants

While Armstrong and Hayes were the prevailing parties in this Arbitration, this fact alone does not entitle them to an award of fees and costs.[53] However, in contrast to McCarthy's assertions against Greenberg, McCarthy did advance colorable claims against Armstrong and Hayes.[54] In contrast, this Arbitrator has found McCarthy's claims against

[53] As suggested above, in the absence of a contract or statutory mandate for the recovery of fees and costs by a "prevailing party," the American rule expresses a preference for each party paying for their own fees and costs.

[54] For example, before deciding McCarthy's malpractice claim, this Arbitrator was challenged to consider the legitimate competing positions of all parties.

Greenberg to be completely without any basis in fact or law. Greenberg, however, was unable to meet his burden of proof establishing that he had paid his own fees or that he had an absolute and unconditional obligation to pay his own fees.

January 30, 2017
Date

Bennett G. Picker, Arbitrator