

Case No. 24-147

IN THE
SUPREME COURT OF THE UNITED STATES

LEVI QUINTANA

Petitioner,

v.

JONATHAN KRAUT,

Respondent.

FILED
JUN 24 2024
OFFICE OF THE CLERK
SUPREME COURT U.S.

ORIGINAL

ON PETITION FOR A WRIT OF CERTIORARI TO
THE CALIFORNIA SUPREME COURT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Petitioner was a partner in a general partnership wherein he sought a buyout of his partnership interest and damages related for wrongful disassociation. The dispute over partnership dissolution became the subject of an arbitration proceeding from which the proceeding went horribly wrong. The proceeding was marked with irregularities from the outset, when the arbitrator, instead of simply utilizing applicable federal tax statutes on partnership dissolution in order to determine the basis of partnership assets and partnership liabilities according to applicable Internal Revenue Service codes and regulations, instead, created a private loan agreement and mischaracterized partner draws as loans made to the Petitioner by the Respondent, which placed personal liability for such draws on the Petitioner only.

Despite Petitioner's objections and arguments against this and other errors, the arbitrator ruled in favor of Respondent. Petitioner sought relief from the award in the trial court, alerting the court to the arbitrator's failures to follow applicable tax and related statutes for determining partner shares, debts and capital accounts and therefore exceeding her authority given as an arbitrator. The court denied Petitioner's motion to set aside the award, ignored Petitioner's records and affidavits that undermined the arbitrator's award. The Second District Court of Appeal for the State of California refused to reverse the trial court's ruling by denying Petitioner's appeal. Petitioner proceeded with a

Petition for Review with the California Supreme Court, arguing that the full development of these troubling facts that could establish that the arbitrator, not only failed to follow basic statutory codes and regulations in determining partnership interests and liabilities, that she exceeded her authority by creating a loan agreement from partner draws without any written agreement. The California Supreme Court denied the Petition for Review.

The question presented is:

Whether the California Supreme Court erred in its ruling, given that the arbitrator not only failed to follow applicable federal statutes, codes and regulations in a partnership dissolution matter but in addition, engaged in gross unfairness as alleged by the Petitioner herein.

PARTIES TO THE PROCEEDING

All parties to the proceeding are named in the caption of the case on the cover page.

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IN THE
SUPREME COURT OF THE UNITED STATES

I. PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the California Supreme Court.

II. OPINIONS BELOW

The opinion of the highest state court to review the merits appears at Appendix A to the petition and is unpublished. The Court of Appeals for the State of California Division Four's Opinion denying Petitioner's appeal is unpublished and is attached as Appendix B.

III. JURISDICTION

The date on which the highest state court decided was March 27, 2024. A copy of that decision appears at Appendix A.

The jurisdiction of this Court is invoked under 28 U. S. C. §1257(a).

**STATUTORY AND REGULATORY
PROVISIONS INVOLVED**

This case involves 26 U.S. Code §465 which covers the loss limitation rules related to amounts at risk as in limitations on deducting partnership losses as well as 26 U.S. Code §752 which covers the

treatment of liabilities for a partnership. It also involves 26 CFR §1.707-1 covering transactions between partner and partnership as well as 26 CFR §1.752-2 covering partner's share of recourse liabilities.

STATEMENT OF THE CASE

This Petition arises from an effort by the Petitioner to have the Court overrule an arbitrator's award. The grounds include gross unfairness by the arbitrator and failing to apply and account for statutory codes and regulations that govern partnership dissolution. Prior decisions by this Court set forth the grounds under which an arbitration award can be overruled, especially in a case where the arbitrator substitutes her judgment for of the parties, where the award does not draw its essence from the parties' agreement, where the award contains numerous errors, and the award is against public law or policy.

This matter, involving a dispute over partnership dissolution and determination of interests and liabilities, became subject to binding arbitration with the American Arbitration Association.

In addition to his claims for breach of contract, breach of fiduciary duty and other alleged misconduct related to the operation of the partnership, Petitioner sought a buyout of his partnership interest pursuant to the partnership agreements and applicable rules and regulations governing dissolution and buy outs if any of partner's

interests.

Petitioner's claims arose out of two written agreements, one entitled "Partnership Agreement for Secure Net Protection Between Levi Quintana and Jonathan Kraut" ("2007 Agreement") and another agreement entitled "Partnership Agreement for Secure Net Protection Between Existing Partners Levi Quintana and Jonathan Kraut and New Partner Aldric Horton." ("2016 Agreement").

The Petitioner's allegations of wrongdoing arose out of being forced out of the partnership, and he sought to be paid his portion of his partnership interest pursuant to applicable statutes and the parties' agreements.

As business partners starting in or about March 2007 pursuant to a written partnership agreement, the parties' rights and obligations were spelled out in detail.

When another partner was brought in around October 2016, the parties' rights and obligations were again spelled out in detail in a separate agreement.

Both partnership agreements and tax returns as well as numerous financial documents were submitted to the arbitrator who was required to utilize proper statutes and regulations including but not limited to Internal Revenue Tax rules and regulations to determine each partner's interests, share of liabilities (whether nonrecourse or recourse), distributions and partnership losses if any.

Rather than making proper determinations as to each partner's interests and liabilities, the Arbitrator improperly determined that the partner draws to Petitioner were loans to be paid back to the Partnership and to the Respondent. These findings were inconsistent with any of the applicable Internal Revenue Code statutes and regulations governing partnerships. In contrast, the Arbitrator never addressed whether the draws to other partners were either loans or simply draws.

The arbitrator also ignored and failed to account for the information contained in the partnership tax returns and the associated K-1 forms in order to come up with her erroneous findings and determinations that Petitioner's draws were simply loans subject to being paid back without requiring any elements of valid loan agreements.

The arbitrator in committing a grossly unfair decision, failed to account the parties' agreements which spelled out the rights and obligations of each partner with respect to each other and to the partnership business itself. The arbitrator treated Petitioner unfairly in finding evidence of a promise where none existed that Petitioner must pay back the draws he took from the partnership as loans owed to either the partnership or to Respondent.

When a conflict occurred between the partners and Petitioner was forced out of the partnership, he rightfully demanded a buyout of his partnership interest pursuant to applicable statutes and regulations including but not limited to applicable

Internal Revenue Service codes.

Instead of evaluating partnership interests pursuant to those applicable buyout provisions under federal statutes, the Arbitrator instead remade the partnership agreements into loan/promissory agreement(s), where none previously existed, as between Petitioner and the partnership and as between the Petitioner and the Respondent. The remade contracts treated all of petitioner's biweekly partner draws that he took prior to his ouster, as loans from the partnership to be paid directly to Respondent.

The Arbitrator even erroneously ruled that all payments for work Petitioner performed from a separate business were also loans that he took from either the partnership or from the Respondent. The arbitrator did so without having any agreements justifying the material terms required of any contract or loan agreements signed by any of the parties. She did so by improperly classifying partner draws and the losses that the partnership recorded for certain years and that such amounts were loans that required appellant to pay respondent in violation of statutes, rules and regulations governing partnership transactions.

When the arbitrator remade the partnership agreements into loan agreements without the essential terms of loans such as the parties to the contract, the amount of the loan, the interest rate, the terms of repayment, and other fees and charges, she substituted her judgment for that of the parties, as the award contains no reference to applicable

federal statutes that govern determination of partner draws, interests and liabilities.

She exceeded her authority by creating and remaking the parties' partnership agreements into written promissory notes in finding that 1) the partner draws to petitioner made by the partnership and another separate company unrelated to the partnership and not a party to the partnership agreements during the period of 2007 through 2017 in the total amount of \$223,050.00 was in fact a loan to be paid directly to Respondent himself individually, and 2) that Petitioner owed respondent an additional amount for partnership operating losses in the total amount of \$129,143.00. These determinations were made without regard to partnership tax and regulation rules as required by law.

REASONS FOR GRANTING THE WRIT

This Court's intervention is necessary and critical to the fair and uniform enforcement of the federal tax laws and regulations related to partnerships as they are applied by arbitrators to partnership disputes in private arbitrations. The legal question presented here is unquestionably important as it arises frequently in cases in private lawsuits and other legal proceedings involving arbitrators substituting their own judgment as opposed to uniformly and fairly applying rules and regulations on partnership dissolutions and in making determinations of partner interests and liabilities. The Court should grant the petition for the reasons which raise important questions as to the

arbitrator's powers in scope and breadth in law.

The Court's attention should focus on the standards set forth in the case of W.R. Grace & Co v. Rubber Workers Local 759 461 U.S. 757 (1983) which relied on the standards for overruling arbitrator's awards as set forth in the case of Steelworkers v. Enterprise Wheel and Car Corporation, 363 U.S. 593 (1960). These cases set forth grounds for properly attacking an arbitration award to include fraud, misconduct, and gross unfairness by the arbitrator. The same standard was explained in the U.S. Court of Appeals for the Third Circuit in the case of Arco-Polymers, Inc. v. OCAW, Local 8-74, 517 F. Supp. 681 (W.D. Pa. 1981).

Other decisions that have expanded the grounds to include where the arbitrator substitutes his judgment for that of the parties, where the award does not draw its essence from the contract, the award contains material error, and the award is against public law or policy. They include Bacardi Corp. v. Congreso de Union, 692 F.2d 210 (1st Cir. 1982), Miller Brewing Co. v. Brewery Workers, 562 F. Supp. 1368 (E.D. Wis. 1983) and St. Louis Theatrical Co. v. Local 6, 715 F.2d 405 (8th Cir. 1983) as cases where the arbitrator exceeded their authority. Cases in which the arbitrator substituted his own judgment for those of management include Riceland Foods v. Carpenters Local 2381, 737 F.2d 758 (8th Cir. 1984) and Zeigler Coal Co. v. District 12, 484 F. Supp. 445 (C.D. ILL. 1980).

In this matter, Petitioner previously sought a ruling that the arbitrator exceeded her powers in

issuing an award that was erroneous as a matter of law and not supported by substantial evidence. The trial court ruled against the Petitioner and in agreeing with the trial court, the Court of Appeal denied the appeal and ruled that the arbitrator did not exceed her powers and therefore affirmed the trial court's ruling. The State Supreme Court thereafter denied Petitioner's Petition for Review.

A. The Arbitrator failed to account for tax returns and the K-1 forms on which the partnership activities were reported.

All partnership activities are reported to each partner on a K-1 form which includes the partner's share of that year's activity within the partnership. The K-1 also indicates each partner's share of liabilities for that year. While the information is critical in determining a partner's interest, and liabilities if any, the arbitrator in this matter failed to consider them in calculating and determining interests and liabilities. Rather than utilizing rules and regulations in statutes, the arbitrator erroneously found that loans were made. This exceeded her powers by remaking the parties' partnership agreements into loan agreements, thereby creating new rights and obligations where none of the partnership tax returns or K-1 forms indicated or reflected. As the Court is aware, Internal Revenue Code Section 752 covers the treatment of liabilities for a partnership and Section 465 covers the loss limitation rules related to amounts if any at risk which also covers limitations on deducting partnership losses. None of these sections were utilized by the arbitrator in ruling on

the award.

Moreover, transactions between partner and partnership are governed by 26 CFR §1.707-1. Arbitrator's determination that the partner draws made by a partnership to the Petitioner for services rendered were actually loans runs counter to subsection (c) Guaranteed payments which treat such payments as income and not loans.

Additionally, the Arbitrator failed to account each partner's share of any liabilities under 26 CFR §1.752-2 which requires that all items of income, gain, loss or deduction should have been allocated among the partners pursuant to the partnership agreement and any alleged obligations that Petitioner owes to the Respondent or to the partnership should have been imposed by the partnership agreement, including payment obligations if found in the agreements.

Such payment obligations must have been disclosed to the Internal Revenue Service for the taxable year in which such obligations were undertaken. None of the information was properly analyzed and undertaken by the arbitrator in making his award.

Subsection (c) states that "A partner bears the economic risk of loss for a partnership liability to the extent that the partner or a related person makes a nonrecourse loan to the partnership and the economic risk of loss for the liability is not borne by another partner." This is compounded by another error wherein the arbitrator found that the

Petitioner's obligation arose in the absence of a promissory note signed by him.

By fabricating previously nonexistent provisions and remaking the existing partnership agreements without any legal basis, the arbitrator exceeded her authority by issuing an award and fashioning a remedy that is not rationally related to the parties' agreements.

She exceeded her powers as an arbitrator by creating a contract, a promissory note(s) where none existed previously, between petitioner and the partnership and as between Petitioner and the Respondent himself individually without requiring any required elements to establish a valid written enforceable contract as between the three parties. The arbitrator ultimately issued an award that was fraudulent and grossly unfair to Petitioner.

The evidence supported a finding that the arbitrator acted in a manner not authorized by the contract or by law by committing fraud, misconduct and further engaging in gross unfairness in favor of Respondent and against Petitioner.

B. The Court of Appeal's Decision Conflicts with the Legal Standards for Judicial Review

The legal standards governing judicial review of arbitration awards are well established.

"California law favors alternative dispute resolution as a viable means of resolving legal conflicts. 'Because the decision to arbitrate

grievances evinces the parties' intent to bypass the judicial system and thus avoid potential delays at the trial and appellate levels, arbitral finality is a core component of the parties' agreement to submit to arbitration.' (Moncharsh v. Heily & Blasé (1992) 3 Cal.4th 1, 10).

Generally, courts cannot review arbitration awards for errors of fact or law, even when those errors appear on the face of the award or cause substantial injustice to the parties. (Id. at pp. 6, 28.) . . .

"The California Arbitration Act (Code Civ. Proc., § 1280 et seq.) provides limited grounds for judicial review of an arbitration award. Under the statutes, courts are authorized to vacate an award if it was (1) procured by corruption, fraud, or undue means; (2) issued by a corrupt arbitrator; (3) affected by prejudicial misconduct on the part of the arbitrator; or (4) in excess of the arbitrator's powers. (Code Civ. Proc., § 1286.2, subd. (a)) An award may also be corrected for (1) evident miscalculation or mistake; (2) issuance in excess of the arbitrator's powers; or (3) imperfection in the form. (Code Civ. Proc., § 1286.6)" (Richey v. AutoNation, Inc. (2015) 60 Cal.4th 909, 916.) The grant or denial of petition to confirm or vacate arbitration award is subject to an overall independent review on appeal.

While the Court of Appeal in its Opinion ruled that Petitioner's contentions amounted to challenges to the legal and factual bases for the arbitrator's award, the issue that the Court of Appeal failed to address was whether the arbitrator acted in excess of

her powers when she remade the agreements into promissory note(s) where none previously existed.

The record is clear. The arbitrator found new contractual rights and obligations that were never created nor contemplated in the parties' agreements.

By arbitrarily remaking the existing partnership agreements into loan agreements, the Arbitrator exceeded her powers. She ignored federal statutes, rules and regulations by arbitrarily creating material terms of a loan, including the loan amounts, interest rates, repayment terms, or the names of the parties to the loans. In doing so, the arbitrator violated petitioner's rights and well-defined public policies, by conducting the arbitration in a way that exceeded her authority.

By creating rights and obligations for an alleged loan(s) which were never part of the parties' Partnership Agreements, she violated the rights and policies governing the conduct of the arbitration itself and therefore her decision is subject to being vacated or corrected. *Sargon Enterprises, Inc. v. Browne George Ross LLP* (2017) 15 Cal.App.5th 749, 765 ("for the proposition that where an arbitrator's decision has the effect of violating a party's statutory rights or well-defined public policies – particularly those rights and policies governing the conduct of the arbitration itself – that decision is subject to being vacated or corrected.")

Courts have vacated arbitral awards under the

“exceeded powers” standard where the arbitrators’ decision addressed issues not submitted to arbitration (Roadway Package Sys. Inc. v. Kayser 257 F.3d 287, 300-01 (3rd Cir. 2001), involved parties or transactions outside the scope of the arbitration clause (Eljer Mfg. Inc. v. Kowin Dev. Corp. 14F.3d 1250, 1253 (7th Cir. 1994). In this matter, the arbitrator displayed a “manifest disregard of the law” which warrants review and reversal. First Options of Chicago Inc. v. Kaplan 514 U.S. 938, 942 (1995) (“parties [are] bound by [an] arbitrator’s decision not in ‘manifest disregard’ of the law”).

The Court of Appeal’s opinion failed to address whether the parties’ 2007 and 2016 Partnership Agreement contained repayment terms, interest rates and who was loaning money to whom. As indicated in the Opinion, the only mention of any loan in the Agreements is contained in the 2007 agreement wherein “subsistence loans” if any were limited to a total of \$8,000 for the first five (5) months of the partnership business.

The 2007 Partnership Agreement provided:

“Subsistence Loans: Kraut has agreed to loan Quintana funds not to exceed two thousand dollars (\$2,000) per month, as necessary for a period not to exceed four (4) months. It is anticipated that Quintana will receive loans directly from PARTNERSHIP FIRM on or before the firth (5th month of PARTNERSHIP operations.”

Additionally, the parties’ 2016 Partnership Agreement demonstrates that all partner draws and allocations were simply draws and not loans.

By making a specific finding that all partner draws taken by Petitioner were specific loans made either by the Partnership or Respondent, the arbitrator arbitrarily remade the contract with new and different terms.

This remade agreement was the basis for the award. Simply, the arbitrator cannot lawfully characterize the \$219,038.43 as "loans" and remake a contract separate and apart from the parties' partnership agreements. By choosing to disregard laws governing partnerships and creating rights and obligations where none existed prior to the parties' arbitration, the arbitrator artificially created a written and enforceable loan agreement without meeting the requirements for a valid written contract.

Public policy requires that arbitrators should endeavor to follow the plain language of the law and not create new rights and obligations not at issue in the proceeding. By doing so however, she violated petitioner's unwaivable statutory rights and exceeded her powers as an arbitrator.

CONCLUSION

Without appropriate relief, Petitioner and other similarly situated parties in arbitration proceedings will never get an appropriate chance at appellate review of substantial legal disputes that occur in such proceedings. This Court should grant certiorari to review the California Supreme Court's refusal to review the Court of Appeals decision on the

issues raised by the Petitioner or grant such other relief as justice requires.

Dated:

July 30, 2024

Respectfully submitted,



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