

EBC I, Inc. v Goldman Sachs & Co.

2006 NY Slip Op 30033(U)

March 20, 2006

Supreme Court, New York County

Docket Number: _300601/8052

Judge: Karla Moskowitz

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

PRESENT: Hon. KARLA MOSKOWITZ PART 03
Justice

-----X
EBC I, INC., f/k/a eTOYS INC., BY THE POST-EFFECTIVE DATE COMMITTEE,

Plaintiff,

- against -

GOLDMAN SACHS & CO.,

Defendant.
-----X

INDEX NO 601805/2002

MOTION DATE _____

MOTION SEQ. NO. 004

MOTION CAL. NO. _____

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

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits _____

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying Decision and Order.

Dated: March 20, 2006

FILED
MAR 22 2006
NEW YORK
COUNTY CLERK'S OFF


KARLA MOSKOWITZ

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 3

----- X
EBC I, INC., f/k/a eTOYS INC., BY THE POST-
EFFECTIVE DATE COMMITTEE,

Index No. 601805/2002

Plaintiff,

- against -

DECISION and ORDER

GOLDMAN SACHS & CO.,

Defendant.

----- X
MOSKOWITZ, J.:

Defendant Goldman Sachs & Co. (Goldman Sachs) moves, pursuant to CPLR 3211 (a) (3) and (a) (7), for dismissal of the amended complaint on the grounds that plaintiff, EBC I, Inc., f/k/a eToys Inc., by the Post Effective Date Committee, lacks standing to sue for breach of fiduciary duty and that the amended complaint fails to state a cause of action.

Plaintiff cross-moves for an order (1) imposing sanctions upon Goldman Sachs for filing a frivolous second motion to dismiss, (2) barring Goldman Sachs from filing any additional motions for summary judgment, and (3) pursuant to CPLR 3124, compelling the production of certain documents and electronic data.

The original complaint contained five causes of action for breach of fiduciary duty, breach of contract, fraud, professional malpractice and unjust enrichment. Previously, Goldman Sachs moved to dismiss the entire complaint on the ground of failure to state a cause of action. By decision dated April 28, 2003, this court granted the motion to the extent of dismissing all causes of action, except the first cause of action for breach of fiduciary duty and granted plaintiff leave to replead the cause of action for fraud.

The Appellate Division modified the decision by reinstating the causes of action for

breach of contract, malpractice and unjust enrichment (7 AD3d 418 [2004]). The Court of Appeals, in turn, modified the Appellate Division by dismissing the breach of contract, malpractice and unjust enrichment causes of action, and affirming the denial of the motion as to the breach of fiduciary duty cause of action and the granting of leave to replead the fraud cause of action (5 NY3d 11 [2005]).

Nevertheless, the amended complaint contains the same five causes of action as in the original complaint, because plaintiff served the amended complaint prior to the Court of Appeals' issuance of its decision. Based upon that decision, the breach of contract, malpractice, and unjust enrichment causes of action are not viable. Hence, at issue are the causes of action for breach of fiduciary duty and the repleaded fraud cause of action.

As stated above, in its review of the original complaint, the Court of Appeals determined that the breach of fiduciary duty claim is viable. Goldman Sachs has not demonstrated that there is anything in the amended complaint that makes this no longer so. The Court of Appeals ruled that a cause of action for breach of fiduciary duty may survive, for pleading purposes, where the plaintiff alleges that, apart from the terms of the contract, the underwriter and issuer created a relationship of higher trust than would arise from the underwriting agreement alone. The Court stated further that the complaint alleges an advisory relationship that was independent of the underwriting agreement. eToys hired Goldman Sachs to provide it with advice for its benefit and Goldman Sachs thereby had a fiduciary obligation to disclose any conflict of interest concerning the pricing of the initial public offering (IPO). Allegedly, Goldman Sachs breached this duty by concealing from eToys its divided loyalty arising from its profit-sharing arrangements with clients (5 NY3d at 20).

Goldman Sachs now argues, unpersuasively, that plaintiff lacks standing to sue for breach of fiduciary duty because the Martin Act (General Business Law § 352) does not create a private right of action. The Martin Act regulates those selling securities. Its purpose is to advance the public's knowledge about the securities offered for sale, (*People v Landes*, 84 NY2d 655 [1994]), to protect the public and prevent fraud in the offering of securities (*Phoenix Tenants Assn. v 6465 Realty Co.*, 119 AD2d 427 [1st Dept 1986]). Here, the claim does not allege a deception upon the public, but, rather, upon the issuer of the securities. Moreover, the statute prohibits deceptive conduct that is meant to:

“induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities, as defined in section three hundred fifty-two of this article, regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted”

(General Business Law § 352-c [c]). The alleged malfeasance here was not to “induce or promote the issuance, distribution, exchange, sale, negotiation or purchase” of eToys's securities. Thus, *Horn v 440 E. 57th Co.* (151 AD2d 112 [1st Dept 1989]), upon which Goldman Sachs heavily relies, does not apply. In addition, although the Court of Appeals did not discuss the Martin Act in its decision in this case, it did permit the breach of fiduciary duty claim to proceed.¹ Further, courts routinely resolve these types of breach of fiduciary claims on the merits (*see e.g. De Kwiatkowski v Bear Stearns & Co.*, 306 F3d 1293 [2d Cir 2002]).

As for the fraud cause of action, the Court of Appeals stated that the issue is limited to

¹ The court cannot resolve on these papers whether the Court of Appeals implicitly rejected the Martin Act (*cf.* Affidavit of Murielle J. Steven, sworn to on October 7, 2005, at Exhibit 15, and Goldman Sachs Reply Memorandum of Law, dated November 10, 2005, at 25 n 9).

whether the courts below abused their discretion in granting plaintiff leave to replead. It found no abuse of discretion because plaintiff's allegations, if accompanied by sufficient detail, would be adequate to support a fraud claim (5 NY3d at 23).

In its decision in this case, the First Department stated:

“At the least plaintiff should have identified the person(s) who made this misrepresentation, and, to that end, the motion court correctly dismissed the fraud claim with leave to replead (CPLR 3016 [b]). However, further facts concerning the participants and mechanisms of the alleged kickback scheme need not be pleaded”

(citations omitted) (7 AD3d at 420).

The Court of Appeals left this part of the Appellate Division's decision undisturbed.

In the amended complaint, plaintiff alleges that Goldman Sachs materially misled eToys about the compensation that it would receive for underwriting the IPO. Pursuant to the additional compensation/kickback arrangements, Goldman Sachs actually received substantially higher compensation than it had contractually agreed to accept and concealed these kickbacks from eToys and its management (amended complaint, ¶ 51). Goldman Sachs' concealment of the additional compensation also violated SEC regulations (Item 501 of Regulation S-K, 17 CFR 229.501) and NASD rules (Conduct Rule 2110, Conduct Rule 2710 [c] [2] [B], Conduct Rule 2330 [f]) (*id.*, ¶ 52).

Plaintiff alleges further that, during the pricing process, Goldman Sachs' investment bankers – Lawton Fitt, George Lee, and Betty Hung – gave eToys' officers and directors ongoing advice about the fair value and appropriate pricing for the IPO (*id.*, ¶ 57). Plaintiff points to evidence of the representations in March 15, 1999, April 22, 1999 and March 19, 1999 letters to the SEC that state that Goldman Sachs represented to eToys that market conditions and

anticipated demand for the Company's Common Stock drove the IPO price (*id.*, ¶ 58). At a telephone conference call held on May 19, 1999, with eToys officials, including Edward Lenk and certain directors of eToys, Fitt, Lee, and Hung set the final IPO price at \$20 per share and eToys accepted the pricing on the same conference call. Allegedly, these statements were materially misleading because of Goldman Sachs' intentional or reckless pricing of the IPO (*id.*, ¶¶ 60-62). Goldman Sachs' assertion that the fraud claim lacks adequate detail is inconsistent with the First Department's directive that "further facts concerning the participants and mechanisms of the alleged kickback scheme need not be pleaded" (7 AD3d at 420). Thus, the repleaded allegations satisfy the courts' pleading requirements.

Goldman Sachs also argues that the court should dismiss the case for failure to substitute plaintiff, namely the Post Effective Date Committee in place of the Official Committee of Unsecured Creditors. However, by order dated November 1, 2002, the Bankruptcy Court declared that the Post Effective Date Committee:

"shall be deemed automatically substituted, without further notice or hearing, for the Creditors' Committee in any adversary proceeding, contested matter or other action or proceeding wherever pending in which the Creditors' Committee is a party in interest. No right, claim or cause of action shall be deemed waived, dismissed, lapsed or otherwise forfeited solely by reasons of the dissolution of the Creditors' Committee"

(Findings of Fact, Conclusions of Law and Order Under 11 USC 1129 [a] and [b], dated November 1, 2002, at 26).

Goldman Sachs argues further that the court should dismiss the complaint because discovery has produced no evidence of kickbacks. The request for dismissal on this ground is premature because there is outstanding discovery, including depositions, as well as the discovery issues plaintiff raises in its cross-motion (*Groves v Land's End. Hous. Co.*, 80 NY2d 978 [1992];

First Bank of Ams. v Motor Car Funding, 257 AD2d 287 [1st Dept 1999]). The discovery issues raised in plaintiff's motion for an order compelling Goldman Sachs to produce certain documents and electronic data is hereby referred to The Honorable John Bradley, J.H.O., appointed pursuant to CPLR 3104 to supervise all further discovery in this action.

Finally, plaintiff's cross-motion for an order imposing sanctions upon Goldman Sachs for filing a frivolous second motion to dismiss and barring it from filing any additional motions for summary judgment is denied. The motion is not frivolous, and, if so advised, Goldman Sachs may move for summary judgment after the parties have completed discovery.

Accordingly, it is

ORDERED that Goldman Sachs & Co.'s motion for dismissal of the breach of fiduciary duty and fraud causes of action is denied; and it is further


ORDERED that the branch of the cross-motion that seeks an order compelling the production of certain documents and electronic data is respectfully referred to John Bradley, Esq., who is hereby designated pursuant to CPLR 3104 to supervise all further discovery in this action; and it is further

ORDERED that the cross-motion is otherwise denied.

Dated: March 10, 2006

ENTER:

FILED
MAR 22 2006
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J.S.C.