

Williamson v Koch

2007 NY Slip Op 30922(U)

April 18, 2007

Supreme Court, New York County

Docket Number: 0600286/2006

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
RICHARD A. WILLIAMSON, ESQ., as Successor
Liquidating Trustee of Lipper Convertibles, L.P.

INDEX NO. 600286/2006

Plaintiff,

MOTION DATE _____

-against-

MOTION SEQ. NO. 001

Edward Koch,

Defendant.

MOTION CAL. NO. _____

-----X
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 _____

<u>PAPERS NUMBERED</u>

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: April 18, 2007

FILED
APR 25 2007
NEW YORK
COUNTY CLERK'S OFFICE

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: I.A.S. PART 3

-----x
RICHARD A. WILLIAMSON, ESQ., as Successor
Liquidating Trustee of Lipper Convertibles, L.P.

Index No. 600286/2006

Plaintiff ,

-against-

Edward Koch,

DECISION and ORDER

Defendant.

FILED

APR-25 2007

NEW YORK
COUNTY CLERK'S OFFICE

MOSKOWITZ, J:

This action arises out of the demise of Lipper Convertibles, L.P. ("Lipper Convertibles" or the "Partnership"). Richard A. Williamson, the Successor Liquidating Trustee ("Trustee" or "Plaintiff") that this court appointed in the liquidation proceeding of the Partnership, *In the Matter of the Application of Lipper Holdings, LLC*, Case No. 603563/2002, seeks to recover amounts he claims represent overpayments to defendant Edward Koch ("Koch").

The Partnership was a private investment hedge fund that Lipper Holdings LLC managed. By 1995, Koch's capital account with the fund was \$1,013,517.00. Between July 1, 1995 and May 1, 1996, the Partnership paid to Koch \$1,334,238 in distributions from his individual capital account. On May 1, 1996, Koch withdrew from the Partnership and the Partnership paid Koch \$1,119,238 in distributions from his individual capital account. In July 1996, Koch reinvested in the Partnership by making capital contributions totaling \$1,128,704. On or around February 1, 2000, Koch again withdrew from the Partnership and the Partnership paid Koch \$1,692,160 in distributions from his individual capital account.

Unfortunately, the net asset value of Lipper Convertibles was 40% less than what the

Partnership had reported in its financial statements. Plaintiff alleges that, because of this overstatement in value, Koch received \$548,953.00 more than he should have at the time he withdrew from the Partnership. Plaintiff seeks to recover the amount of this alleged overpayment. Plaintiff asserts two causes of action: (1) unjust enrichment and (2) money had and received. Koch has moved to dismiss all claims. He claims that plaintiff lacks standing to bring this action and, alternatively, that the statute of limitations bars the claims.

I. Standing

Defendant contests plaintiff's standing on the grounds that any loss was in the nature of a direct injury to those limited partners who did not liquidate their holdings in the Partnership until after the fraud came to light (the "remaining limited partners"). Defendant contends that the Partnership itself experienced no injury because the remaining limited partners must bear the expense of any over payments to former limited partners through a reduction in their capital accounts.

A. Judicial Estoppel

Defendant first argues that plaintiff has taken the position in this litigation, and in related cases, that only the remaining limited partners suffered the injury. Defendant points out that the complaint in this action contains allegations that

to the extent [the] Koch overpayment is not repaid, it is borne by those other limited partners who had not withdrawn prior to the discovery of the overvaluation, most of the other limited partners having incurred significant losses as a result of the overvaluation. (Complaint ¶ 27).

Defendant continues pointing out that the complaint does not allege specific losses the

Partnership suffered other than the legal expenses in connection with these recovery efforts. Defendant also identifies numerous instances in related lawsuits such as *Williamson v Barish*, Index No. 602033/2004 where the plaintiff asserts that the overpayment to the former limited partners in those cases came directly out of the pockets of the remaining limited partners. (*See* Def. Rcply Mem. at 2).

Despite this earlier language, in opposition to this challenge to his standing, plaintiff claims that the overpayments only indirectly injured each limited partner by “the proportionate reduction in his or her individual capital account.” (Pl. Opp. Mem. at 5). Plaintiff claims that the immediate injury was to the Partnership because the overpayment caused a reduction in the Partnership’s assets. Defendant argues that the court should preclude plaintiff from making this argument due to his prior position.

“The doctrine of judicial estoppel or estoppel against inconsistent positions precludes a party from taking a position in one legal proceeding which is contrary to that which he or she took in a prior proceeding, simply because his or her interests have changed.” (*Festinger v Edrich*, 32 AD3d 412 [2d Dept 2006] [plaintiff’s claim of an ownership interest in certain property contradicted his assertion in earlier lawsuit that he had no assets]). However, here judicial estoppel is not appropriate. Plaintiff has not previously had occasion to defend a challenge to its standing on the basis that the overpayments to the former limited partners only injured the remaining limited partners. Accordingly, plaintiff has not had a chance to take an inconsistent position.

Moreover, the Trustee’s position is not inconsistent. The Trustee has alleged injury to both the Partnership and the remaining limited partners indirectly. The injury to the remaining

limited partners is indirect because of the reduction by the proportionate share in each individual remaining partner's capital account. Therefore, plaintiff has not taken an inconsistent position and judicial estoppel is inapplicable.

B. Who Suffered the Injury and Who Benefits from the Recovery

Defendant then claims that it is the remaining limited partners who experienced injury directly because they are the ones who must bear the expense of the overpayments out of their capital accounts. Plaintiff claims that the Partnership suffered the initial injury because the overpayments reduced the available assets of the Partnership and that any recovery the remaining limited partners may receive must flow through the Partnership.

Under New York law, limited partners cannot pursue a direct lawsuit to recover for wrongs that injured the partnership. (*See Morgado Family Partners, L.P. v Lipper*, 19 AD 3d 262, 262-263 [1st Dept 2005]). By the same token, a partnership entity cannot recover for wrongs that only injured the limited partners individually. (*Id.* at 263). This distinction between derivative and direct is sometimes an easy determination. For example, it is now rather well-settled that claims alleging waste or mismanagement usually derive from the rights of the entity. (*See, e.g. Broome et al v ML Media Opportunity Partners, L.P.*, 273 AD2d 63, 64 [1st Dept 2003]). Similarly, a claim for diminution in share value is also derivative. (*See O'Neill v. Warburg, Pincus & Co.*, __ AD3d ___, 2007 WL 1052907 at * 1 [1st Dep't April 10, 2007]).

However, in other situations, whether a wrong affects the business entity on the one hand or the shareholders or limited partners on the other can be a troubling inquiry for the courts. Not only is it sometimes difficult to discern the direction of the harm, but no appellate court in New York has clearly articulated the appropriate legal test to make that determination.

Given the lack of direction among New York appellate courts, for the reasons that Justice Ramos so clearly articulated in *Higgins v New York Stock Exchange, Inc.* 10 Misc3d 257 (NY Cty 2005), this court also adopts the standard from the Supreme Court of Delaware in *Tooley v Donaldson*, 845 A2d 1031, 1033 (Del. 2004). Under the “*Tooley test*,” a court considers:

(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually.)¹

In *Higgins*, Justice Ramos relied on *Tooley* to hold that plaintiffs who lost their seats on the New York Stock Exchange (“NYSE”) as part of a merger could bring a class action against the corporation’s CEO and board members claiming that the proposed merger agreement undervalued their equity interests. In reaching this conclusion, Justice Ramos reasoned that the NYSE had suffered no injury, but had actually benefitted because it had retained the shareholder’s equity:

[t]he element that distinguishes the harm flowing in the first instance to the plaintiff, rather than the corporation, is that the plaintiff’s interests were at odds with the corporation’s interests: in paying the plaintiff less for his shares, more equity remained on the corporation’s balance sheet, translating into the appearance of more corporate assets.

(*Higgins* at 272).

Higgins relied on an Appellate Division, First Department case: *Bernstein v Kelso*, 231 AD2d 314 (1st Dept 1997). In *Bernstein*, the plaintiffs, who alleged that they had cashed out their shares in the defendant corporation at an allegedly unfair price to them, sued for breach of

¹ It should be noted that the Appellate Division, First Department has cited *Tooley* favorably on several occasions, most recently in *Buechner v Avery*, ___ NYS2d ___, 2007 WL 896969 at *1 (1st Dept March 27, 2007) and *Nemazee v Premier Purchasing Partners, L.P.*, 24 AD2d 196 (1st Dept 2005).

fiduciary duty among other things. The court held that the wronged shareholders had standing to pursue those claims. (*Id.* at 323).

Here, we have the converse situation. The individuals who cashed out early received too much for their interest, rather than too little. Applying the rationale from *Higgins*, if a partnership would have benefitted from paying out too little, it certainly would suffer injury from paying out too much. This stands to reason. If the benefit from paying too little is to have more assets to use for other purposes, the injury from paying too much also inures to the business entity that would have fewer assets to run its business or attract future investors. Therefore, “the Partnership” is the answer to the first question from *Tooley*: “who suffered the alleged harm?” (*Cf. Paradiso & Dimenna, Inc. et al v. DiMenna*, 232 AD2d 257 [1st Dep’t 1996] [conversion of funds from corporate account “resulted in corporate injury because it deprived [the corporation] of those [funds]” *citing Glenn v. Hotelrom*, 74 NY2d 386, 392).

In addition, New York courts have held that where investors in a limited partnership are injured according to their pro rata share, rather than each or some suffering a distinct injury, the business entity bears the injury. (*See, e.g., Longo v Better Equities II, L.P.*, 278 AD2D 998 [1st Dept 2000] [failure to collect on unsecured notes]). Here, the interest of all the remaining limited partners decreased proportionately. There is no mention of any special injury to a particular partner that did not flow from the injury the Partnership experienced.

Finally, where claims allege injury affecting both the individual investor and the business entity, the claims are derivative. (*See e.g. Nemazee v Premier Purchasing Partners, L.P.*, 24 AD2d 196 [1st Dept 2005]). For injury to be direct to the shareholder or limited partner, that injury must be independent of any alleged injury to the corporation. (*Id.*). Here, the allegations

suggest that both the Partnership and the limited partners experienced injury, the limited partners through a reduction in their proportionate share of the Partnership assets and the Partnership from having less assets available to operate.

Determining who will receive the benefit of any recovery (*Tooley's* second factor) is also a close question. It is true that any recovery the Trustee obtains is for the ultimate benefit of the remaining limited partners. However, it is also true that this recovery must still flow through the Partnership with the Trustee distributing the proceeds of any recovery he might achieve. Therefore, although the limited partners are the ones who will ultimately benefit, that benefit flows through the entity. The same indirect benefit would occur had the Partnership assets realized a favorable rate of return.

It is also unclear how any action could proceed without the Trustee against the limited partners who cashed out early. The practical effect of defendant's argument would leave him open to several lawsuits from the limited partners who have sued, not to mention a class action. Also, no particular limited partner would be entitled to the entire overpayment. Thus, each lawsuit a limited partner could bring would recover only a proportionate amount. The Trustee can recover 100%. Finally, at this point, any claims that a limited partner could potentially bring run the risk of being time-barred. For all the foregoing reasons, the court holds that plaintiff has standing to assert the claims in the lawsuit.

II. Statute of Limitations

The parties agree that the applicable statute of limitations for unjust enrichment and money had and received is six years. They also both agree that the statute of limitations accrues at the time of the alleged wrongful payment. They disagree as to when the alleged wrongful

payment occurred. Plaintiff claims it can recover for overpayments “made on or after January 30, 2000, which includes the \$548,953 overpayment . . . paid to [Koch] on or after February 1, 2000.” (Pl. Opp. Mem. at 14).

Defendant characterizes the payment of Koch’s capital upon withdrawal from the Partnership as a “ministerial act.” (Reply Mem. at 11). He contends that “[i]f any “overpayments” were received by Koch . . . they would have been made (if at all) when Net Profits (less Net Losses) were allocated to Koch’s Capital Account by the Partnership in allegedly inflated amounts.” (Reply Mem at 11-12). In other words, defendant is arguing that the time of the alleged overpayment occurred over the years on a regular basis as allocations to Koch’s capital account that he could either re-invest or withdraw as he deemed appropriate. Defendant argues the funds were in essence his property despite leaving them in his capital account. In support of this position, defendant points out that once the funds became allocated to him, the partnership charged him incentive management fees and he paid taxes on those amounts.

However, the Partnership did not actually pay anything at the time the Partnership allocated the profits to Koch. Conceivably, had the discovery that the Partnership was grossly overvalued occurred before Koch withdrew, the Partnership would have adjusted the amounts in his capital account to reflect that mistake. Therefore, the time of the wrongful payment sufficient to trigger the statute of limitations occurred at the time Koch withdrew from the Partnership and received the balance in his capital account.

III. Equitable Tolling

As an alternative argument, plaintiff contends that even if the statute of limitations began upon the allocation of profits to Koch’s capital account, equitable tolling tolls the statute of

limitations. Plaintiff claims that these did not run until either: (1) the wrongdoers (here allegedly Kenneth Lipper) ceased control of the Partnership upon the appointment of plaintiff as Successor Liquidating Trustee in June 2003 and (2) until BDO Seidman completed its December 15, 2003 Supplementary Report because it was not until then that plaintiff was able to identify those limited partners who had received excess distributions.

The court declines to apply equitable tolling on either of the bases plaintiff has articulated. Plaintiff has not cited, nor is the court aware of, any decision in which a court applied equitable tolling against non-culpable third parties with no relationship to the wrongdoers other than that of a passive investor.

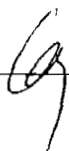
Accordingly, it is

ORDERED THAT defendant's motion to dismiss is denied; and it is further

ORDERED THAT the parties shall contact chambers to arrange for a compliance conference.

Dated: April 18, 2007

ENTER:

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J.S.C.

FILED
APR 25 2007
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