

**Matikos Capital Mgt. LLC v Frontpoint
Partners LLC**

2007 NY Slip Op 32419(U)

July 30, 2007

Supreme Court, New York County

Docket Number: 0604103/2006

Judge: Charles E. Ramos

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Charles Edward Ramos

PART 53

P Index Number : 604103/2006
— MATIKOS CAPITAL MANAGEMENT LLC
vs
FRONTPOINT PARTNERS LLC
Sequence Number : 001
DISMISS ACTION

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____
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

decided in accord with the attached decision.

FILED

AUG - 6 2007

NEW YORK
COUNTY CLERK'S OFFICE

Dated: 7/30/07

CHARLES E. RAMOS

J.S.C.

Check one: FINAL DISPOSITION

NON-FINAL DISPOSITION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION
-----X

MATIKOS CAPITAL MANAGEMENT LLC, and
WILLIAM FEINGOLD,

Plaintiffs,

-against-

Index No.
604103/2006

FRONTPOINT PARTNERS LLC., PHILIP N. DUFF,
W. GILLESPIE CAFFRAY AND PAUL GHAFFARI,

Defendants.

-----X

Charles Edward Ramos, J.S.C.:

Corporate defendant FrontPoint Partners LLC and individual defendants Philip N. Duff, W. Gillespie Caffray, and Paul Ghaffari move, pursuant to CPLR 3211(a)(1) and (7), to dismiss plaintiffs' complaint. Plaintiffs Matikos Capital Management LLCs and William Feingold allege breach of contract, breach of fiduciary duty, unjust enrichment and seek an accounting.

BACKGROUND

FrontPoint LLC ("FrontPoint") is an investment management company that operates a series of hedge funds with approximately \$5.5 billion in assets under management. In December 2006, Morgan Stanley & Company ("Morgan Stanley") acquired the Delaware chartered FrontPoint. The individual defendants are three founding members of FrontPoint, each of whom sat on FrontPoint's Management Committee and controlled the firm's day-to-day operations when this action commenced. Plaintiffs Matikos Capital Management LLC ("Matikos Capital") and William Feingold were minority "C" unit equity interest holders in FrontPoint. Plaintiffs' complaint alleges that defendants wrongfully denied

plaintiffs access to FrontPoint's financial records, its restructuring plans, and its acquisition efforts. Against both corporate and individual defendants, plaintiffs assert breach of contract and claims for an accounting. Plaintiffs also assert claims for breach of fiduciary duty and unjust enrichment against the individual defendants.

Plaintiffs filed their complaint on November 28, 2006, while FrontPoint's Third Amended and Restated Limited Liability Company Agreement ("LLC Agreement") was in effect. The LLC Agreement is governed by Delaware law. Pursuant to § 3.04 of the LLC Agreement, FrontPoint members were issued Class "B" equity interest units at the time of their affiliation with the company. When a member disaffiliated from FrontPoint that member's vested equity interest was downgraded to Class "C" designated units. (LLC Agreement § 3.07). Plaintiffs Matikos Capital and William Feingold are both former FrontPoint members. In 2003 and 2006 respectively, Matikos Capital and William Feingold disaffiliated from FrontPoint, thereby converting their Class "B" equity interest units into the more limited Class "C" units.

Class "C" units are not afforded the same rights and privileges as Class "A" and Class "B" units. More specifically, the LLC Agreement states that Class "C" equity interest holders "shall not have any voting rights" and shall have no "pre-emptive rights" with regard to the dilution of their existing shares through the Board of Manager's issuance of new equity units. (LLC Agreement § 3.06, § 3.12). Furthermore, § 5.06 of the LLC

Agreement sanctions FrontPoint's merger or consolidation if such action is met with the "affirmative vote of Members holding individually or in the aggregate at least 65% Voting Interest in the Company."

Notwithstanding these provisions, Class "C" unit holders are not without participative rights. Section 11.02(b) of the LLC Agreement provides:

(i) any amendment of this Agreement imposing additional obligations upon, or otherwise adversely affecting the rights of, one or more particular (but less than all) classes of Units or one or more particular (but less than all) classes or series of other Interests may be approved only (A) by the affirmative vote of Members holding at least 65% of the Voting Interests of each affected class of Units calculated by including in the denominator thereof only the Outstanding Units of the affected class of Units, (in the case of Class A Units, Class B Units or Class D Units), or (B) in the case of all other classes or series of Interests, by 65% of the economic interests represented by each affected class or series of other Interests;...

Beyond awarding rights to each class of equity interest holders in the face of significant changes to the original contract terms, the LLC Agreement also contains terms describing FrontPoint's financial reporting requirements and fiduciary responsibilities. With respect to FrontPoint's financial reporting requirements, Section 6.04 requires that:

"The Company maintain or cause to be maintained true and proper books, records, reports and accounts in which shall be entered all transactions of the Company. Each Member shall be shown as a member of the Company on such books and records. Such books, records, reports and accounts shall be located at the principal place of business of the Company and available to any Member for inspection and copying during reasonable business hours for a purpose reasonably related to such Member's interests."

Subsections § 6.04(c) and (d) further state that annual reports and quarterly reports be issued within ninety and forty-five days after their respective termination periods. Section 6.03 requires FrontPoint undergo third-party appraisal within 30 days after January 1 of each year.

The LLC Agreement also contains provisions regarding the fiduciary duties of FrontPoint officers. Section § 5.07 of the LLC Agreement states:

"Except as otherwise expressly provided herein, the officers of the Company and the members of the Board, the Management Committee and any committee of the Board shall each have the duties, solely when acting in such capacities, as an officer or director, as the case may be, of a Delaware Corporation would then have had under the Delaware General Corporation Law. To the fullest extent permitted by applicable law, the duties in this Section 5.07 shall be owed only to the company."

Furthermore, § 10.01 of the LLC Agreement states:

"No Indemnified Person shall be liable to the Company or to the Members for any losses, claims, damages or liabilities arising from, related to, or in connection with this Agreement, the Company's business or affairs or any decision or activity of the type or character described or contemplated in this Agreement or any Transaction Document, except for any losses, claims, damages or liabilities resulting from such Indemnified Person's gross negligence, willful misconduct, criminal activity, bad faith or fraud"

The aforementioned provisions are critical to evaluating defendants' motion to dismiss.

Plaintiffs allege that in late 2005 they first learned that FrontPoint had been entertaining acquisition offers from Morgan Stanley. When the initial round of negotiations failed to produce an acquisition, FrontPoint was restructured. In reshaping the company, FrontPoint eliminated the position of

chief executive officer, expanded the Board of Managers, issued more Class "B" equity units, and changed the method for calculating compensation to management. While these changes were occurring, plaintiffs allege that defendants willfully and in bad faith ignored their information requests as to FrontPoint's general financial well-being, its restructuring efforts, and the status of the impending merger.

Plaintiffs argue that the scope of defendants' restructuring and the delay in supplying annual, quarterly, and third-party reports constitute breaches of the LLC Agreement. Plaintiffs further allege that the individual defendants orchestrated FrontPoint's reorganization in derogation of their fiduciary duty as corporate officers and that the individual defendants' actions resulted in their unjust enrichment. Accordingly, plaintiffs filed the complaint alleging causes of action for: (1) breach of contract against all defendants; (2) an accounting from all defendants; (3) breach of fiduciary duty against all individual defendants; (4) for unjust enrichment against all individual defendants. Defendants now move to dismiss all causes of action.

ANALYSIS

Defendants move to dismiss plaintiffs' four-count complaint based on documentary evidence (CPLR 3211(a)(1)) and for failure to state a claim (CPLR 3211(a)(7)). Defendants' motion to dismiss is denied.

Motion to Dismiss—The Standard of Review

To succeed upon a motion to dismiss under CPLR 3211(a)(1)

where a defense is founded upon documentary evidence, the moving party must show that the essential facts have been "negated beyond substantial question" by the evidentiary matter submitted. *Blackgold Realty Corp v Milne*, 119 AD2d 512, 513 (1st Dep't 1986), aff'd 69 NY2d 719 (1987). On a motion to dismiss, the facts alleged in the complaint are to be accepted as true, though a court is not required to accept "factual allegations that are plainly contradicted by the documentary evidence." *Robinson v Robinson*, 303 AD2d 234, 235 (1st Dep't 2003). Thus, and for dismissal under CPLR 3211(a)(1), a defendant must demonstrate that the documentary evidence "resolves all factual issues as a matter of law, and conclusively disposes of the plaintiff's claim." *Scadura v Robillard*, 256 AD2d 567 (2d Dep't 1998).

A motion to dismiss may also be granted under CPLR 3211(a)(7) when the complaint fails to state a claim at law. On a motion to dismiss pursuant to CPLR 3211(a)(7), the facts alleged in the complaint are taken as true and the plaintiff receives the benefit of every possible inference. *Leon v Martinez*, 84 NY2d 83, 88 (1994). Accordingly, the test for dismissal for "insufficiency of pleadings is not whether the plaintiff has artfully drafted the complaint but whether, deeming the complaint to allege whatever can be reasonably implied from its statements, a cause of action can be sustained." *Stendig, Inc. v Thom Rock Realty Co.*, 163 AD2d 46, 48 (1st Dep't 1990). Courts look to the "four-corners" of the complaint to find any cause of action recognizable at law. *Guggenheimer v Ginzburg*, 43

NY2d 268, 275 (1977).

Breach of Contract Against All Defendants

Defendants argue that plaintiffs' claim for breach of contract must be dismissed because it fails to allege damages, as required by Delaware law, and fails to identify any LLC Agreement obligations that either corporate or individual defendants breached.

To state a claim for breach of contract in Delaware, a plaintiff must demonstrate, among other undisputed elements, "resultant damages" arising from breach of an existing contract. *VLIW Tech., LLC. v Hewlett-Packard Co.*, 840 A2d 606, 612 (Del. 2003). Defendants argue that plaintiffs' complaint fails as a matter of law under CPLR 3211(a)(7) because it neglects to plead any compensable "resultant damages" arising from defendants' refusal provide plaintiff with FrontPoint information. In defendants' view, plaintiffs plead an amorphous concept of alleged loss not recognized by the courts. Defendants rely on New York and Delaware cases dismissing actions upon summary judgment motions where plaintiffs have had an opportunity for discovery and have no proof of damages.

Damages are a required ingredient for a breach of contract claim in both New York and Delaware. *VLIW Tech., LLC.*, supra; *Furia v Furia*, 116 AD2d 694, 695 (2d Dep't 1986). Here, plaintiffs have pled damages and defendants' demand for evidence of damages is premature. Plaintiffs are not required to plead and prove the amount of damages at the pleading stage of

litigation. Plaintiffs are entitled to conduct discovery as any evidence of "resultant damages" is in the hands of the defendants.

Alternatively, defendants argue for dismissal of the breach of contract claim based on the LLC Agreement. Defendants maintain that § 3.06 of the LLC Agreement affords plaintiffs no right to vote or to participate in Board decisions concerning FrontPoint's restructuring or its acquisition by Morgan Stanley. In support of this contention, defendants cite § 5.06, which vests FrontPoint's Board with the discretion to merge or consolidate upon a favorable vote of 65% of the firm's voting members.

Moreover, defendants challenge plaintiffs' allegations that the purported delay in gaining access to FrontPoint's books and records, financial statements and third-party reports constitute any breach of the LLC Agreement under § 6.04. Defendants assert that the right to inspect FrontPoint books and records is limited to "purpose[s] reasonably related to a Member's Interest." (LLC Agreement § 6.04(a)) Defendants maintain that plaintiffs failed to identify the purpose for their inspection in their requests. Additionally, defendants maintain that there is no breach of contract with regard to § 6.04(b) because the financial statements were in fact "provided as soon as [was] reasonably practicable." FrontPoint's auditors did not issue the financial statements until November 20, 2006, eight days before commencement of this suit. After the statements were approved by

the Board of Managers, defendants' counsel sent the financial data to plaintiffs' counsel.

Defendants argue that there was no breach of § 6.04(c)(iii) of the LLC Agreement because plaintiffs were entitled to receive only a "brief description" of any third-party appraisal, not the complete valuation. Accordingly, defendants assail the notion that plaintiffs have stated a valid cause of action based on the cited contract provisions.

The Court also rejects defendants' arguments based on documentary evidence. The LLC Agreement requires FrontPoint to give its members access to the company's books and records (§ 6.04(a)), and to its annual (§ 6.04(b)), quarterly (§ 6.04(c)), and third-party reports (§ 6.04(c)(iii)). Plaintiffs' claims for breach under § 6.04(b) and (c) were not mooted by defendants' document production in response to plaintiffs' complaint. Moreover, FrontPoint's restructuring efforts could constitute a "modification of the [LLC] agreement" under § 11.02(b), triggering plaintiffs' contractual rights pursuant to this provision. To succeed on a motion to dismiss based upon documentary evidence, the documentary evidence must be of such a nature and scope as to substantially negate plaintiffs' complaint. *Robinson v Robinson*, 303 AD2d 234, 235 (1st Dep't 2003). Defendants' documentary evidence fails to negate plaintiffs' claim.

Lastly, defendants argue that the breach of contract claim should be dismissed against the individual defendants because

they did not bind themselves individually in the LLC Agreement. The documentary evidence is not conclusive on whether the defendants executed the LLC Agreement as individual signatories or were acting on behalf of the company. Therefore, the motion to dismiss the breach of contract cause of action is denied.

Breach of Fiduciary Duty Against the Individual Defendants

Defendants move to dismiss plaintiffs' breach of fiduciary duty claim arguing, based on CPLR 3013,¹ that the pleading is insufficiently vague and is barred by the LLC Agreement. Defendants contend that plaintiffs' pleading fails to give an adequate account of "how the individual defendants mismanaged the company" or "how they preferred their own interests to those of plaintiffs." (Verified Complaint ¶ 60).

The elements of a properly pled claim for breach of fiduciary duty are: the existence of a fiduciary duty and defendants' breach of that duty. *Briarpatch Ltd., L.P. v Frankfurt, Garbus, Klien & Selz, P.C.*, 13 AD3d 296, 297 (1st Dep't 2004), appeal denied, 4 NY3d 707 (2005). Here, plaintiffs' complaint alleges that:

"In violation of their fiduciary duties to the Plaintiffs, the Individual Defendants benefitted personally at the expense of the Plaintiffs, depriving them of benefits that, but for the Individual

¹CPLR 3013 provides that:

"statements in a pleading shall be sufficiently particular to give the court and the parties notice of the transactions, occurrences, or series of transactions or occurrences intended to be proved and the material elements of each cause of action or defense."

Defendants wrongful conduct, the Plaintiffs would have enjoyed. Moreover, in violation of the duty of care that they owed the Plaintiffs, the Individual Defendants mismanaged FrontPoint, preferring their self-interest over the interests of FrontPoint and the interests of the Plaintiffs, in violation of the duty of care that they owed. The Individual Defendants also wasted corporate assets" (Verified Complaint ¶ 59, 60).

Plaintiffs' pleading is sufficient to give the court and the parties notice of the cause of action pled. Again, as there has been no discovery, defendants' motion is premature. Plaintiffs cannot be expected to plead with any real degree of specificity.

Further, defendants move to dismiss plaintiffs' complaint on grounds that it is so ambiguous that defendants do not know whether plaintiffs are asserting direct or derivative claims against them. Defendants contend that since plaintiffs are no longer FrontPoint unit holders, they lack the standing to bring a derivative action on behalf of the company.

Plaintiffs' failure to delineate between direct and derivative claims is not fatal. In fact, in the complaint, plaintiffs make no mention nor any attempt to plead the heightened standards required for a derivative claim. Plaintiffs' complaint states a recognizable claim only for direct breach of fiduciary duty. The court will not grant a motion to dismiss a claim that is not even pled or asserted.

Defendants also move to dismiss plaintiffs' claim for breach of fiduciary duty based on § 5.07 of the LLC Agreement which defendants argue limits the fiduciary duties of the individual defendants to FrontPoint as a corporation. Thus, defendants

maintain that any fiduciary duties owed are to FrontPoint and not to the individual members of the company.

The Court rejects defendants' attempt to dismiss the fiduciary duty claim based upon the documentary evidence. Section 5.07 of the LLC Agreement is not an exculpation of the individual defendants' fiduciary duties. Furthermore, § 10.01 of the LLC Agreement expressly provides for liability for "gross negligence, willful misconduct, criminal activity, bad faith or fraud," which contradicts defendants' assertions of immunity. Here, plaintiffs accuse defendants of "willful misconduct." Accordingly, defendants' motion to dismiss the third cause of action is denied.

Unjust Enrichment Against the Individual Defendants

Defendants argue that plaintiffs' claim for unjust enrichment is defective because it lacks any factual support.

To state a claim for unjust enrichment, plaintiffs must allege that they (1) conferred a benefit upon the defendant and that the (2) defendant retained that benefit without compensation to plaintiff. *Nakamura v Funjii*, 253 AD2d 387, 390 (1st Dep't 1998). Here, plaintiffs explicitly state that defendants, through their conduct, "wrongly and without justification favored holders of Class A Units and Class B Units in FrontPoint, including themselves, to the detriment of holders of the Plaintiffs." (Verified Complaint ¶ 64). At the pleading stage, plaintiffs need not demonstrate how the individual defendants

enriched themselves. *See, Wiener v Lazard Freres & Co.*, 241 AD2d 114, 120 (1st Dep't 1998) (Reversing lower court's dismissal of claims for unjust enrichment because plaintiffs failed to allege how defendants had been enriched). Therefore, defendants' first argument to dismiss unjust enrichment is denied.

Defendants also move to dismiss plaintiffs' claim for unjust enrichment on grounds that the LLC Agreement sanctioned defendants' behavior. Specifically, defendants contend that under § 3.12 of the LLC Agreement, plaintiffs had no pre-emptive rights as Class "C" unit-holders. In conjunction with § 3.03 and § 3.04, defendants argue that they had the right to restructure FrontPoint, to issue additional equity units and to pursue a buyout. Therefore, defendants maintain that plaintiffs' unjust enrichment claim be dismissed.

Defendants' argument that the LLC Agreement permits the individual defendants to act in a manner without regard to the interests of FrontPoint's other interest holders is flawed. While LLC Agreement § 3.03 vests no pre-emptive rights in Class "C" unit holders, it does not authorize the individual defendants to operate FrontPoint solely for their own benefit. Therefore, defendants' motion is denied.

Accounting

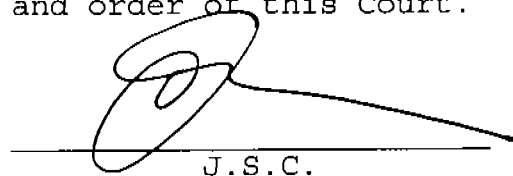
Defendants challenge plaintiffs' grounds for an accounting. Defendants maintain that § 5.07 of the LLC Agreement eliminated any fiduciary duty owed to plaintiff and that plaintiffs have not properly pled any wrongdoing on the part of the defendants.

The elements necessary for an accounting are a fiduciary relationship between plaintiff and defendant and alleged wrongdoing by defendant. *Brigham v McCabe*, 27 AD2d 100, 105 (3d Dep't 1966), affirmed, 20 NY2d 525 (1967). This is precisely what plaintiff alleges here.

Accordingly, it is ordered that defendants' motion to dismiss is denied.

This shall constitute the decision and order of this Court.

Dated: July 30, 2007



J.S.C.

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