Zeno Inv., LLC v Merrill Lynch & Co., Inc.
2009 NY Slip Op 30178(U)
January 21, 2009
Supreme Court, New York County
Docket Number: 600121/08
Judge: Charles E. Ramos
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SCANNED ON 1/28/2009

[* 1]

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

PRESENT: _______________ *Justice* PART _______

Index Number : 600121/2008
ZENO INVESTMENTS, LLC
VS.
MERRILL LYNCH & CO. INC.,
SEQUENCE NUMBER : # 001
DISMISS

INDEX NO. 600121-08

MOTION DATE

MOTION SEQ. NO. #007

MOTION CAL. NO. __________

were read on this motion to/for __________

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

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

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

FILED
JAN 28 2009
COUNTY CLERK'S OFFICE
NEW YORK

Motion is decided in accordance with accompanying Memorandum Decision.

Dated: 1/21/09

J.S.C.

HON. CHARLES E. RAMOS

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION
---------------------------------------x
ZENO INVESTMENTS, LLC,

Index No. 600121/08

Plaintiff,

-against-

MERRILL LYNCH & CO., INC. and MICHAEL, STEWART,

Defendants.
---------------------------------------x

FILED
JAN 28 2009
COUNTY CLERK'S OFFICE
NEW YORK

Charles Edward Ramos, J.S.C.:

Defendants Merrill Lynch & Co. (Merrill) and Michael Stewart (together, Defendants) move to dismiss the amended complaint (CPLR 3016 [b], 2311 [1] [3], [7]). Defendants additionally seek costs and sanctions pursuant to 22 NYCRR 130.1-1.

Background[1]

This action involves Defendants' purported improper conduct amounting to alleged fraud, tortious interference, misappropriation of trade secrets, unfair competition, breach of contract and bad faith with respect to plaintiff Zeno Investments, LLC's (Zeno) sale of its majority-owned corporation ESP Technologies, LLC (ESP). According to Zeno, Defendants improperly sabotaged the sale of ESP on three separate occasions.

Zeno is a Delaware limited liability corporation that invests in private equity companies. In 2005, it acquired a 98% interest in ESP. ESP develops software for the purpose of increasing the speed and efficiency of trading securities through a proprietary electronic trading platform.

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[1] The allegations are taken from the amended complaint, and are assumed to be true for the purposes of this motion.

Zeno alleges that ESP and Defendants had a close relationship (beyond that of a traditional arms-length relationship) that spanned a long period of time. In 2002, Merrill's prime brokerage division became one of ESP's clients. Further, one of Merrill's subsidiaries extended a $2.8 million note (Note) to ESP.

In late 2005 to early 2006, ESP and non-party Credit Suisse were negotiating ESP's acquisition. Upon learning of these negotiations, Defendants allegedly took a series of actions to thwart any possible deal, including threatening to use Merrill's ability to drive ESP out of business because it could call the Note due at any time. Further, Defendants allegedly misrepresented that Merrill was genuinely interested in acquiring ESP. In reliance upon Defendants' representations, ESP terminated negotiations with Credit Suisse and entered into exclusive negotiations with Merrill.

At a meeting attended by Zeno, ESP and Defendants, Merrill allegedly agreed to purchase ESP for $17.8 million, that included a $15 million cash payment, conversion of the Note to equity, and a salaried position for a senior executive of ESP. Merrill and ESP allegedly executed a letter agreement (Letter Agreement) memorializing the oral agreement, followed by the preparation of a written proposal for ESP's acquisition by Merrill (February Term Sheet).

Zeno alleges that Defendants did not negotiate in good faith toward an acquisition of ESP. Defendants were allegedly seeking

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to cause a break off of ESP's negotiations with Credit Suisse by appearing to be in exclusive acquisition negotiations with ESP. Defendants' motivation was to misappropriate ESP's trade secrets.

After nothing transpired, in the spring of 2006 ESP renewed acquisition negotiations with Credit Suisse and other investors. Credit Suisse purportedly contacted Defendants in order to assess their interest in participating in ESP's acquisition as an additional investor. While Defendants represented that Merrill had a genuine interest in participating as an investor in ESP's acquisition, Merrill purportedly did not. Credit Suisse executed a term sheet (May Term Sheet), that provided that investors, including Credit Suisse and Merrill, would purchase at least $25 million of newly issued LLC units in ESP. On the eve of finalizing the transaction, Defendants allegedly refused to proceed in order to sabotage any sale of ESP, thereby causing the deal to collapse.

In the fall of 2006, ESP, Zeno, Credit Suisse, and other investors reached a deal for the sale of ESP (November Term Sheet). Defendants allegedly attempted to sabotage the third attempt to sell ESP, by representing that they were willing to convert the Note as part of the transaction and that they were "on board" with participating as an investor. However, they backed out of the deal at the last moment, thereby sabotaging it.

More than a year later and finally without Defendants' interference, Zeno succeeded in selling ESP. However, the pre-financing valuation was substantially less than either the $22

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million or $20 million provided under the May and November Term Sheets, resulting in the commencement of this action against Defendants.

Zeno asserts nine causes of action for tortious interference with prospective contract, tortious interference with contract, promissory fraud, fraud/fraudulent inducement, negligent misrepresentation, misappropriation of trade secrets, unfair competition, breach of the covenant of good faith and fair dealing, and prima face tort.

Discussion

Defendants move to dismiss the amended complaint on several grounds, including that Zeno lacks standing to pursue most of the causes of action contained in the complaint, contending that they are effectively derivative claims that seek relief on behalf of ESP. Further, Defendants assert that Zeno otherwise fails to sufficiently plead its causes of action, and that documentary evidence establishes that the agreements at issue were not binding.

At the outset, the Court must address the threshold issue of Zeno's standing to pursue causes of action that on their face, appear to be seeking recovery for harm to ESP.[2]

Where the remedy sought by a shareholder is for a wrong to the corporation, any claims must be brought derivatively, for the benefit of the corporation (*In re Comverse Technology, Inc.*, 56 AD3d 49 [1st Dept 2008]). However, where a shareholder is

[2] Zeno is a 98 % shareholder of ESP.

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seeking to redress harm independent of harm suffered by the corporation, it may pursue a direct cause of action (*Id.*).

The gravamen of Zeno's amended complaint is that, upon learning that Zeno might sell ESP to Credit Suisse, Defendants wrongfully feigned interest in purchasing ESP in order to scuttle any sale. The ultimate harm stemming from this conduct is that ESP was ultimately acquired for millions of dollars less than it had previously been valued for under prior term sheets. In addition, the harm suffered is the misappropriation of ESP's proprietary technology that purportedly constitutes protected trade secrets (Amended Complaint, ¶¶ 26, 47, 57, 66, 69-71, 78, 89, 93).

Because the recovery sought by Zeno in the causes of action for tortious interference with contract, promissory fraud, fraud/fraudulent inducement, negligent misrepresentation, misappropriation of trade secrets, unfair competition, and prima facie tort, would flow in the first instance to the benefit of ESP and not directly to the benefit of Zeno, the Court concludes that these causes of action are derivative in nature (*see O'Neill v Warburg, Pincus & Co.*, 39 AD3d 281, 281-82 [1st Dept 2007]). Consequently, Zeno, as a majority shareholder, lacks standing to bring an action in its own name for recovery sought for the benefit of the corporation, ESP. The second through seventh and ninth causes of action are dismissed without prejudice to be re-plead derivatively, if so advised.

Nonetheless, Zeno asserts that it has standing to plead causes of action for breach of the implied covenant of good faith and fair dealing and tortious interference with prospective contract relations as a third-party beneficiary of those agreements and/or prospective agreements. Zeno asserts that, although it is not a signatory to the Letter Agreement or the February Term Sheet, it was an intended third party beneficiary of those agreements. Further, it asserts that, to the extent that these agreements are preliminary in nature, they are binding insofar as they obligate Defendants to negotiate toward a final agreement in good faith.

Certain preliminary agreements may be the basis for a cause of action for breach of the implied covenant of good faith and fair dealing (*Network Enterprises, Inc. v APBA Offshore Productions, Inc.*, 483 [SD NY 2006], *affirmed* 264 Fed Appx 36 [2d Cir 2008]). Nonetheless, documentary evidence, namely the agreements themselves, demonstrate that the Letter Agreement or the February Term Sheet are not binding preliminary agreements to either acquire ESP, or to negotiate open issues in good faith in an attempt to reach agreement as to the acquisition of ESP in the future (*see Brown v Cara*, 420 F 3d 148, 153 [2nd Cir 2005]).

The intent of the parties not to be bound is explicit from the language of the agreements themselves. The Letter Agreement expressly states that Merrill and ESP,

> "propose to continue discussions concerning a possible strategic relationship ... Each party also understands that <u>no contract or agreement providing for a Transaction shall be deemed to exist between the parties unless and until a final definitive agreement has been executed and delivered</u> ... neither of the parties will be under any legal

> obligation of any kind whatsoever with respect to such Transaction by virtue of this letter agreement" (emphasis added) (Letter Agreement, Exhibit B, annexed to the Aff. of John Gueli, Esq.).

Similarly, the February Term Sheet expressly disavows that it creates binding obligations. It states that Merrill "is pleased to submit this Non-Binding Indication of Interest .... As this Proposal is non-binding (...) any and all terms discussed relating to this Proposal are subject to change" (emphasis added) (February Term Sheet, Exhibit C, *Id.*).

The express language of the Letter Agreement and the February Term Sheet demonstrate an unmistakable intent by ESP and Merrill not to be bound either to the sale of ESP or to continue to negotiate in good faith in the future towards a final agreement for ESP's sale. Otherwise, the implied covenant of good faith and fair dealing cannot be used to create new contractual obligations that negate the parties' explicit and bargained-for intentions (*Madison Apparel Group Ltd. v Hachette Filipacchi Presse, S.A.*, 52 AD3d 385, 386 [1st Dept 2008]).

For these reasons, the Court concludes that Zeno has failed to allege any agreement that would give rise to a duty on Merrill's part to act in good faith (and upon which Zeno can claim entitlement to third party beneficiary status). Therefore, Defendants' motion to dismiss the eighth cause of action for breach of the covenant of good faith and fair dealing is granted.

Zeno's cause of action for tortious interference with prospective contractual relations premised upon Zeno's status as intended third party beneficiary of any contract between ESP and Credit Suisse, also fails.

In order to plead a cause of action for tortious interference with prospective contractual relations, a party must allege that the wrongful conduct is directed, not at the plaintiff itself, but at the party with which the plaintiff has, or seeks to have, a relationship with (*Carvel Corp. v Noonan*, 3 NY3d 182, 190-92 [2004]). In other words, what is required is the allegation that Defendants used wrongful means to drive away Credit Suisse (*Id.*), unless Zeno alleges that the Defendants' sole motivation was to harm Zeno (*NBT Bancorp., Inc. v Fleet/Norstar Fin. Group, Inc.*, 215 AD2d 990, 990-91 [3d Dept 1995], *affirmed* 87 NY2d 614 [1996]).

However, Zeno does not allege that Defendants' purported wrongful conduct was directed at Credit Suisse, but at ESP. Otherwise, Zeno does not allege that Defendants' sole motivation was to harm Zeno or even ESP, for that matter. Rather, Zeno alleges that Defendants were motivated by a desire to procure ESP's proprietary material in order to conduct due diligence on ESP (Amended Complaint, ¶ 28).

For these reasons, Zeno fails to sufficiently state that it is entitled to third beneficiary status in order to recover for tortious interference with prospective contractual relations.

Finally, the Court declines to exercise its discretion to grant Defendants' request for costs, pursuant to 22 NYCRR 130.1-1. Defendants have not demonstrated that this action is so frivolous as to warrant the imposition of sanctions.

Accordingly, it is

ORDERED that the motion to dismiss the amended complaint is granted; and it is further

ORDERED that the request for costs is denied.

Dated: January 21, 2009

ENTER:

J.S.C.

HON. CHARLES E. RAMOS

FILED
JAN 28 2009
COUNTY CLERK'S OFFICE
NEW YORK