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

PRESENT: Bransten Justice

PART 3M

Merrill Lynch

- v -

BLF Asset Management

INDEX NO. 602069/07

MOTION DATE 4/30/09

MOTION SEQ. NO. 002

MOTION CAL. NO. ____

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

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

Cross-Motion: ☐ Yes ☑ No

Upon the foregoing papers, it is ordered that this motion

NYS SUPREME COURT RECEIVED
OCT 15 2009
IAS MOTION SUPPORT OFFICE

MOTION IS DECIDED IN ACCORDANCE WITH THE ACCOMPANYING MEMORANDUM DECISION.

FILED
OCT 16 2009
COUNTY CLERK'S OFFICE
NEW YORK

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

Dated: 10-14-09

HON. EILEEN BRANSTEN J.S.C.

Check one: FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST MDAI

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

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MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED,

Plaintiff,

-against-

BKF ASSET MANAGEMENT, INC.,

Defendant.

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Index No. 602069/2007
Motions Date: 4/30/09
Motions Seq. Nos: 002, 003

BRANSTEN, J.:

Motion sequence numbers 002 and 003 are consolidated for disposition.

In motion sequence number 002, plaintiff Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") moves, pursuant to CPLR 3212, for summary judgment in its favor. In motion sequence number 003, defendant BKF Asset Management, Inc. ("BKF") moves, pursuant to CPLR 3212, for summary judgment in its favor, and for attorneys' fees, costs and expenses.

Background

This case involves a dispute between an investment advisor, BKF, and a broker-dealer, Merrill Lynch, regarding an agreement known in the industry as a Soft Dollar Arrangement ("SDA"). Under an SDA, a specified percentage of the commissions paid to a broker-dealer to execute a trade on behalf of the client of an investment advisor is allocated

to cover the cost of third-party research services provided to the investment advisor. Under securities law, investment advisors are required to obtain the best execution of trades for their clients. The Safe Harbor Provision, however, permits an investment advisor, such as BKF, to pay a broker-dealer at a higher rate of commission, if the excess commission is used to purchase research services for the client (*see* Section 28 [e] of the Securities and Exchange Act of 1934, 15 USC § 78bb [e] ["Safe Harbor Provision"]).

Under the SDA involved in this case, Merrill Lynch established accounts with numerous providers of research and information services such as the American Stock Exchange, Bloomberg Financial Markets ("Bloomberg"), Dow Jones & Co. and others, which delivered their services to BKF. Merrill Lynch was directly accountable to the third-party research providers and paid them for the services that they delivered to BKF, after receiving approval for payment from BKF.

From approximately September 1996 to June 2006, BKF placed securities trades with Merrill Lynch for BKF's clients. Merrill Lynch earned brokerage commissions from those trades, and, under the SDA, as memorialized in a "Welcome Letter," welcoming BKF's predecessor company to the SDA, a certain specified portion of the commissions were earmarked to reimburse Merrill Lynch for the research services it had paid on BKF's behalf.[1]

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[1] Initially that ratio was 1.6 to 1 (or, for every $1.60 earned in commissions, $1 was credited to cover research services for BKF). Later, the ratio became 1.3 to 1 (or, for every $1.30 earned in commissions, $1 would be credited to BKF's account for research services).

In or about June 2006, BKF ceased the active business of asset management, and stopped placing such trades with Merrill Lynch. At that point, the account that Merrill Lynch maintained to track the research services it obtained for BKF reflected a debit balance of $608,730.06 - that is, all of the commission dollars earmarked to pay for research for BKF had been expended, and Merrill Lynch remained un-reimbursed for $608,730.06 in bills that it had paid on BKF's behalf.

Merrill Lynch and BKF agree on the facts as stated above, which are based on their Stipulation of Undisputed Material Facts. Their major area of factual disagreement relates to the intention or expectation of the parties regarding whether and how Merrill Lynch would be reimbursed, if there were insufficient credits to cover research services delivered to BKF for which Merrill Lynch had paid. According to Merrill Lynch, in entering into the SDA, it expected that it would be fully compensated and reimbursed for those research services even if there were insufficient commission-credits. As support for its expectation, Merrill Lynch points to the Service Cancellation Policy signed by BKF (under the name of its predecessor, John A. Levin & Co., Inc.), pursuant to which BKF agreed to reimburse Merrill Lynch if Merrill Lynch were compelled to pay cancellation penalties to Bloomberg for its research services obtained for BKF.

Although BKF does not submit the affidavit of anyone with personal knowledge of its understanding and intention in entering into the SDA, BKF contends that the parties knew

that there would be no cash exchanges between them. BKF quotes the deposition testimony of Stephen Kane, identified by BKF as a Merrill Lynch employee, stating that it was his understanding that, if a client's account had a balance favoring the client, the client would not be entitled to cash, rather than working off that balance by means of obtaining research services. Kane states in deposition, "[i]f I recall, it was an SEC rule about the firms not contemplating cash being passed to the clients ... and that's why it is not allowed" (Deposition of Stephen Kane, at 16-17). Neither Kane nor BKF, however, cite any particular SEC rule prohibiting cash payments, or any written policy of Merrill Lynch to that effect.

BKF also quotes the deposition of William B. Keena, identified by BKF as Merrill Lynch's expert,[2] who states that "the commissions were never the money manager's to begin with. So in an excess overage type of position you could never return the money back to the money manager. That would be a breach because you couldn't return money to someone it never belonged to" (Deposition of William B. Keener, at 33). Thus, according to BKF, if it was not entitled to the return of any commissions that were earmarked for research, but not spent, Merrill Lynch was not entitled to reimbursement for research bills it had paid, but for which there were no funds in the earmarked account.

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[2] Because only small portions of the Keener and Kane transcripts are annexed to BKF's motion papers, the court is not in a position to verify BKF's identification of those two individuals; however, Merrill Lynch does not dispute the respective identifications.

BKF further contends that Merrill Lynch knew that the commissions generated by trades would fluctuate, that Merrill Lynch could terminate the relationship under the SDA at any time and should have monitored the shortfall more carefully, and that the SDA would be eviscerated if BKF were directly liable for the research services provided pursuant to the SDA. On the other hand, as Merrill Lynch argues, only BKF knew that after 10 years of trading with Merrill Lynch that it planned to cease the active business of asset management. Nonetheless, it presumably continued to request the engagement of research services and approve the payment of bills by Merrill Lynch.

Analysis

Merrill Lynch asserts a single cause of action for unjust enrichment. Quoting *Joan Hansen & Co., Inc. v Everlast World's Boxing Headquarters Corp.* (296 AD2d 103, 108 [1st Dept 2002]), Merrill Lynch contends that it has met the following criteria for recovery under the theory of unjust enrichment:

> "(1) the performance of the services in good faith, (2) the acceptance of the services by the person to whom they are rendered, (3) an expectation of compensation therefor, and (4) the reasonable value of the services" (internal citation and quotation marks omitted).

According to Merrill Lynch, it obtained the research services for BKF in good faith, those services were accepted by BKF, Merrill Lynch had an expectation that it would be

reimbursed for the research services it paid for and there is no dispute regarding the reasonable value of those services.

Questions of fact exist, however, regarding the third requirement, the expectation of compensation, that preclude summary judgment. Merrill Lynch asserts that it expected to be compensated in cash where there was a shortfall in BKF's research account. The testimony cited by BKF suggesting that it would not have been reimbursed had there been a surplus in the "research account," however, at least raises serious questions as to whether there was a reasonable basis for Merrill Lynch's alleged expectation of cash reimbursement. Furthermore, the provision for cash payments in connection with the Bloomberg Service Cancellation Policy, relied on by Merrill Lynch, could also support the conclusion that the parties knew how to provide in writing for cash reimbursement and did not do so with respect to the situation in which Merrill Lynch now finds itself; therefore, it is unlikely that such expectation existed.

Citing an alternate standard for unjust enrichment, BKF contends that Merrill Lynch cannot establish the following elements articulated by the Court in *Beth Israel Med. Ctr. v Horizon Blue Cross & Blue Shield of N.J., Inc.* (448 F3d 573, 586 [2d Cir 2006]): "'(1) that the defendant benefitted; (2) at the plaintiff's expense; and (3) that equity and good conscience require restitution,'(citation omitted)" and that summary judgment should be granted in favor of BKF. According to BKF, the clients of BKF, not BKF itself, both paid

for and benefitted from the research services, which were delivered to BKF merely as an agent for its clients and not for the benefit of BKF itself. Therefore, according to BKF, the very first requirement of unjust enrichment is not and cannot be met. BKF, however, has not submitted any affidavits from persons with direct knowledge of how the research accounts are actually structured, and whether particular research services contracted for on BKF's account are used only for the particular client whose commissions paid for the service, or whether the commissions are pooled, and the research services are generally used by BKF for all clients and, therefore, are really general resources of BKF, as the investment advisor.

Using either legal standard for unjust enrichment, there are questions of fact that preclude summary judgment to either party.

BKF further argues that a claim for unjust enrichment is not available where there is a contract covering the subject matter of the services involved (*see Goldman v Metropolitan Life Ins. Co.*, 5 NY3d 561, 572 [2005], quoting *Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 388 [1987] [the "'existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter'"]). BKF contends that, although the SDA, as articulated in the Welcome Letter, was not a traditional contract, it constituted a contractual arrangement when read in the context of Section 28 (e) of the Securities and Exchange Act of 1934, and precludes a cause of action in quasi contract for research services which, BKF

argues, arise out of the same subject matter as the SDA. However, given both that the questions of fact that exist regarding how the parties operated under the SDA, it would be difficult for this court to conclude, as the Court did in *Goldman,* that "the disputed terms and conditions fall entirely within the insurance contract" (*id.* at 572), and it would be inappropriate to conclude that the existence of the SDA precludes a possible cause of action in quasi contract.

Citing *In re Ades & Berg Group Investors v Breeden* (550 F3d 240, 245 [2d Cir 2008]), BKF also argues that where the defendant's actions are consistent with law (here, the Safe Harbor provisions of the Securities and Exchange Act), there can be no unjust enrichment. However, as the Court pointed out in *Ades*, "the equities of bankruptcy are not the equities of the common law," and there it was applying New York law governing unjust enrichment "in light of the special equities of bankruptcy" (*id.* at 244, 245 [internal quotation marks and citation omitted]). Furthermore, the Safe Harbor provision does not address what occurs when there is either a shortfall or surplus of those commissions, but rather, merely makes permissible the use of commissions to finance research in order to enable investment advisors to use their reasonable business judgment in selecting a broker-dealer under the system of competitive commission rates.

There appears to be no case law regarding the situation at issue. Nor have the parties presented any evidence concerning the general industry practices governing SDAs with respect to possible shortfalls in accounts earmarked for the purchase of research services.

Under these circumstances, given the questions of fact raised by the papers of the parties, summary judgment is inappropriate.

Accordingly, it is

ORDERED that the motion of plaintiff in motion sequence 002 and the motion of defendant in motion sequence 003 are both denied.

This constitutes the Decision and Order of the Court.

Dated: New York, New York
October 14, 2009

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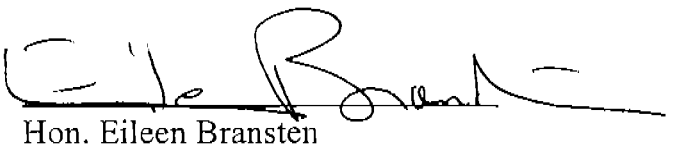

Hon. Eileen Bransten