J.P. Morgan Sec., Inc. v Ader
2013 NY Slip Op 31190(U)
May 30, 2013
Sup Ct, New York County
Docket Number: 650005/09
Judge: Melvin L. Schweitzer
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER
Justice

PART 45

J.P. MORGAN SECURITIES INC.

-v-

JASON ADER, HAYGROUND COVE ASSOCIATES, LP et al

INDEX NO. 650005/09

MOTION DATE ______

MOTION SEQ. NO. 003

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits ______ | No(s). ______

Answering Affidavits — Exhibits ______ | No(s). ______

Replying Affidavits ______ | No(s). ______

Upon the foregoing papers, it is ordered that this motion by plaintiff for summary judgment is GRANTED to the extent of dismissing all counterclaims but is otherwise DENIED per the attached Decision and Order.

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

Dated: May 30, 2013

[signature], J.S.C.
MELVIN L. SCHWEITZER

1. CHECK ONE: .... ☐ CASE DISPOSED ☑ NON-FINAL DISPOSITION

2. CHECK AS APPROPRIATE: ....MOTION IS: ☐ GRANTED ☐ DENIED ☑ GRANTED IN PART ☐ OTHER

3. CHECK IF APPROPRIATE: .... ☐ SETTLE ORDER ☐ SUBMIT ORDER

☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

J.P. MORGAN SECURITIES INC.,

Plaintiff/Counterclaim Defendant,

-against-

JASON ADER, HAYGROUND COVE ASSOCIATES LP, HAYGROUND COVE FUND MANAGEMENT LLC, HAYGROUND COVE ASSET MANAGEMENT LLC, HAYGROUND COVE INSTITUTIONAL PARTNERS LP, HAYGROUND COVE CAPITAL PARTNERS LP, HAYGROUND COVE OVERSEAS PARTNERS, LTD., HAYGROUND COVE LOW BETA FUND LP, HAYGROUND COVE LOW BETA FUND LTD., HAYGROUND COVE TURBO FUND LP, HAYGROUND COVE TURBO FUND LTD., HAYGROUND COVE ACQUISITION STRATEGIES FUND LP, and HAYGROUND COVE ACQUISITION STRATEGIES FUND LTD.,

Defendants/Counterclaim Plaintiffs.

Index No. 650005/09

DECISION AND ORDER

Motion Sequence No. 003

MELVIN L. SCHWEITZER, J.:

Plaintiff J.P. Morgan Securities LLC (formerly known as J.P. Morgan Securities Inc.) (JPM) moves, pursuant to CPLR 3212, for summary judgment on all of its claims and to dismiss all of defendants' counterclaims.

Background

Amended Complaint

Below is a summary of the allegations of plaintiff's amended complaint.

JPM is a broker-dealer and investment banking firm. Bear Stearns & Co. Inc. (Bear Stearns) is the surviving entity in a merger with JPM that occurred in late 2008. After the

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merger, Bear Stearns changed its name to J.P. Morgan Securities Inc. (i.e., the plaintiff herein). The amended complaint refers to JPM and Bear Stearns, interchangeably, as the same entity.

Defendant Jason Ader is the sole member, president, and chief executive officer of defendant Hayground Cove Asset Management LLC (HC Asset). The various Hayground Cove defendants are referred to as the Hayground Cove entities.

Ader, a former analyst at Bear Stearns, ceased employment at that entity on February 10, 2003 to form his own hedge fund. In July and August 2003, Ader and Bear Stearns entered into a series of preliminary agreements by which Bear Stearns agreed to invest in Ader's hedge funds (now called Hayground Cove) subject to negotiation of a definitive set of agreements. The parties contemplated a revenue sharing arrangement entitling Bear Stearns to 25% of revenues earned by the Hayground Cove entities adjusted for shared expenses according to a specified calculation method.

Bear HGC Holdings, Inc. (Bear HGC), a Bear Stearns affiliate, agreed to make an initial investment of $10 million in Hayground Cove Institutional Partners LP (HC Partners) by way of a letter agreement dated August 4, 2003 (August 2003 Letter Agreement). On November 24, 2004, Bear Stearns entered into two definitive agreements with Ader and the Hayground Cove entities, finalizing and restating the terms of Bear Stearns' investment. In the first agreement (2003 Investment Agreement), among Bear Stearns, Bear HGC, Ader, HC Partners, and Hayground Cove Fund Management LLC (HC Fund), the parties agreed that Bear HGC's limited partner interest in HC Partners would be transferred to Bear Stearns, and that Bear Stearns would maintain its investment in HC Partners for the time and under the conditions stated in the 2003 Investment Agreement.

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The Revenue Sharing Agreement (RSA), also dated November 24, 2003, among Bear Stearns, Ader, Hayground Cove Partners Ltd., Hayground Cove Overseas Partners, Ltd., HC Capital Partners LP, HC Fund, and Hayground Cove Associates LP, specified the terms by which Bear Stearns was entitled to share in the revenue of the Hayground Cove entities. The parties to the agreement entered into the First Amendment to the RSA, dated February 5, 2005 (First Amendment), by which the parties chiefly amended the calculation of the maximum operating expenses that the Hayground Cove entities would be entitled to deduct from revenue for purposes of calculating Bear Stearns' share.

This action is based on the allegation that, beginning in 2004, defendants have deprived JPM of the "Revenue Share" to which it is entitled under the RSA, and that defendants intend to continue to apply their erroneous calculation inputs and methods to future Revenue Shares. Specifically, defendants have deducted from gross revenues an amount exceeding what they actually paid in marketing fees pursuant to allowable contracts with third parties, which reduced JPM's revenue entitlement.

Moreover, defendants have improperly taken the "Expense Cap deduction" thereby reducing JPM's revenue share by an amount that is not in accord with the parties' agreements. In addition, despite the plain language of the RSA and the well-understood meaning of "assets under management" (AUM) in the industry, defendants have improperly included leverage and short positions (i.e., borrowings) within their calculation of AUM. When defendants calculate the management fees earned for purposes of calculating the revenues, however, defendants do not include such borrowing in determining AUM. Inclusion of such borrowing would increase the revenues and, therefore, the Revenue Share owed to JPM. Defendants have thereby

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improperly increased the "Maximum Eligible Operating Expenses" over that allowed under the RSA and, accordingly, reduced the revenues and Revenue Share paid to JPM below the amount actually due.

Furthermore, in calculating the Revenue Share for calendar years 2006 and 2007, defendants have taken a legal and organizational expense deduction after applying the 25% Revenue Share percentage, thus improperly reducing JPM's Revenue Share by the entire amount of such expenses, rather than by 25%. In addition, the RSA caps at $75,000 the total amount of such legal and organizational expenses. Defendants have deducted $24,000 per year for each of the years 2003-2007, for a total of $120,000 in legal and organizational expenses.

The complaint contains two causes of action. The first cause of action alleges that defendants breached the RSA by failing to pay JPM the full amount of the Revenue Share to which it is entitled under that agreement.

The second cause of action is for a declaratory judgment. JPM seeks a determination as to the correct interpretation of the RSA, asserting that this will affect future Revenue Share payments due to it.

JPM seeks: (1) damages of not less than $8,000,000, with interest; (2) a declaration of the rights of the parties under the RSA, specifically: (a) that only customary marketing fees actually paid to eligible third parties pursuant to arm's length contracts may be deducted from gross revenues for determining revenue under sections 2.1 and 6.1 (t) of the RSA; (b) that deduction of the Expense Cap under sections 2.1 and 6.1 (t) of the RSA must be taken from gross revenues before applying the 25% Revenue Share percentage, not after; (c) that AUM, for purposes of calculating the Maximum Eligible Operating Expenses under section 6.1 (n) of the RSA, does

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not include leverage, short positions, or other debt; (d) that deduction of legal and organizational expenses under sections 2.1 and 6.1 (t) of the RSA must be taken from gross revenues before applying the 25% Revenue Share percentage, and that the total amount of such expenses is capped at $75,000, and, thus, may not be deducted in the future.

Second Amended Answer

Below is a summary of defendants' second amended answer.

To induce Ader (the leading gaming and lodging industry analyst at Bear Stearns) to stay at Bear Stearns through completion of the "Wynn IPO," Bear Stearns vice-chairman Mickey Tarnopol represented to Ader that Bear Stearns intended to provide Ader with a range of financing, and other support necessary for his planned investment management firm. Ader agreed, and elected to forego alternative seeding offers from other investors.

After the Wynn IPO announcement in October 25, 2002, Barry Cohen, a Bear Stearns partner specializing in hedge funds and investment management, along with Bear Stearns chief financial officer, Samuel Molinaro, and Steven Begleiter represented to Ader that Bear Stearns would support Ader in either starting an independent investment management firm or operating an affiliated fund within Bear Stearns Asset Management (BSAM). All three advocated the BSAM option, telling Ader that working within BSAM would allow him to keep his unvested shares of Bear Stearns stock, own half of his business, and afford him direct access to Bear Stearns' large team of brokers and sales people to generate investment in his business. Bear Stearns subsequently advised Ader that it would no longer support the BSAM option, however, because of concern that a successful venture by Ader would encourage other star analysts to leave Bear Stearns' investment bank to pursue investment management ventures.

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In early 2003, Bear Stearns, through Barry Cohen, shifted its efforts toward convincing Ader to accept seed financing for an independent investment management firm from Bear Stearns, rather than competing investors, including "Larch Lane," "Reservoir," "Man Group," and "CZAM," with whom Ader had discussions. To induce him to do so, Cohen represented to Ader that Bear Stearns was able to and intended to provide him with marketing assistance, including access to Bear Stearns' institutional clients, a strong prime brokerage operation, a strong team of retail brokers and sales people, and full "capital introduction" or "cap intro" support (i.e., introducing Ader to potential investors of capital).

HC Asset was launched in February 2003. In August 2003, Ader and the Hayground Cove entities – in reliance on Bear Stearns' representations – selected Bear Stearns' seeding offer over alternative and more favorable offers, which led to the signing of the RSA. Only well after the signing of the RSA on November 24, 2003, did Ader and the Hayground Cove entities begin to learn that Bear Stearns' representations, on which they relied in entering into the RSA and turning down other offers, allegedly had been false.

Notwithstanding continuing alleged false assurances from Barry Cohen beginning in late 2003, by late March or early April of 2004, it became clear that, as Cohen finally admitted, Bear Stearns would not (and did not) fulfill its representations to defendants, ostensibly due to various regulatory and legal obstacles to its doing so. Thus, as it had intended all along, Bear Stearns failed to provide Ader and the Hayground Cove entities with the promised marketing assistance and cap intro services.

The answer thus contains three counterclaims. The first, for fraudulent inducement, contains allegations that defendants chose Bear Stearns' seeding offer over alternative seeding

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offers based on its alleged false representations described above, and upon which they reasonably and justifiably relied. When Bear Stearns refused to provide the services that it had falsely represented it would provide, defendants were forced to spend their own resources in an attempt to replace Bear Stearns' assistance and defendants failed to realize additional profits.

The second counterclaim, for negligent misrepresentation, alleges that Bear Stearns had a duty of care to provide accurate information to defendants, and that Bear Stearns negligently breached this duty by making false representations concerning the support and services it would provide to defendants.

The third counterclaim, for reformation based on mutual mistake, alleges that the parties agreed that the Hayground Cove entities would deduct certain eligible operating expenses, up to the specified Expense Cap deduction, reflecting a portion of the total management expenses. The RSA contains a drafting error (mutual mistake) or unilateral mistake by defendants and improper conduct by Bear Stearns in seeking to conceal the mistake. To the extent that the RSA is inconsistent, it must be reformed to reflect the terms of the actual agreement on revenue-sharing set forth on "Attachment A" (Term Sheet) to the August 2003 Letter Agreement.

Arguments

JPM argues that: (1) defendants breached the RSA by (a) deducting operating expenses from Bear Stearns' Revenue Share instead of gross revenues, (b) deducting third-party marketing expenses not actually incurred, and (c) applying an operating expense cap improperly based on notional AUM; (2) defendants' counterclaims are without evidentiary support; and (3) it is entitled to an award of interest and attorney's fees.

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Defendants argue that JPM is not entitled to summary judgment: (1) on defendants' counterclaims for fraud and negligent misrepresentation, as well as its claim concerning the deduction of marketing fees; (2) on its contract claims, or their reformation counterclaim concerning treatment of the Expense Cap deduction under the RSA; (3) on its claim concerning revenue-generating AUM; and (4) on its claim for attorney's fees.

Determination

The motion is granted to the extent of dismissing the counterclaims. The issue of the 25% Expense Cap deduction is resolved in JPM's favor, i.e., that eligible operating expenses up to a defined maximum must be taken from gross revenues before applying the 25% Revenue Share percentage, not after; but summary judgment on the complaint is denied because of material factual issues as to the other branches of the complaint.

Discussion

Amended Complaint

1. First Cause of Action.

JPM contends that defendants breached the RSA by failing to pay its entitled amount of the Revenue Share. According to JPM, the "basic outline of the RSA" was for Bear Stearns to receive 25% of all Hayground's revenues for the prior calendar year, defined as Hayground's gross revenues minus certain allowable expenses, namely (1) customary marketing fees paid to third parties, and (2) eligible operating expenses up to the Expense Cap (Revenue Share) (memorandum in support at 5). The Expense Cap is defined as "the lesser of (a) Eligible Operating Expenses for the applicable period and (b) the Maximum Eligible Operating Expenses

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for such period" (RSA, § 6.1 [I]. Thus, the Revenue Share due to Bear Stearns is calculated as Revenue Share = 25% x (gross revenues – Expense Cap).

According to defendants, "compelling evidence" establishes that: (a) the parties originally agreed, as set forth in the Term Sheet, that Bear Stearns would reduce its 25% Revenue Share by an Expense Cap of up to $600,000; (b) the parties never intended or agreed to alter that treatment in the final RSA; and (c) the RSA, as drafted, changed the order of operations so that Bear Stearns' Revenue Share is only reduced by 25% of the Expense Cap, or $150,000 (memorandum in opposition at 25).

Defendants contend further that, by defining "25% annually of all gross revenues" as the "Revenue Share," and by providing for payment of the "Revenue Share," "less the Expense Cap," the Term Sheet makes clear that the Expense Cap is subtracted from Bear's 25% Revenue Share. That treatment is distinguished in the very next sentence from marketing expenses, which are deducted "from revenues" – unlike the RSA, which treats both deductions alike (memorandum in opposition at 27). Defendants also contend that, by providing for Bear Stearns "to reduce its Revenue Share by 25% of Eligible Operating Expenses," capped at a maximum, the entire Expense Cap is deducted from the 25% Revenue Share. The next sentence distinguishes repayment of affiliate loans, which are "excluded from the Expense Cap, but will be deductible from gross revenues before [Bear Stearns'] Revenue Share is calculated." In contrast, the RSA takes both deductions from gross revenues (*id.* at 28).

Defendants' interpretation is untenable. "It is well settled that our role in interpreting a contract is to ascertain the intention of the parties at the time they entered into the contract. If

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that intent is discernible from the plain meaning of the language of the contract, there is no need to look further" (*Evans v Famous Music Corp.*, 1 NY3d 452, 458 [2004]). Such is the case here.

Contrary to defendants' contention, the Term Sheet and the RSA provide for the same result, which is consistent with JPM's interpretation. Under the Term Sheet, the Revenue Share is "25% annually of all gross revenues from the Fund and all revenues derived by the Principal or any Affiliate (to be defined) from any Related Activities ('Revenue Share') less the Expense Cap" (Term Sheet at 5). In the section entitled "Expense Cap," "Bear HGC agrees to reduce its Revenue Share *by 25% of Eligible Operating Expenses* . . . up to a maximum of $400,000 of Eligible Operating Expenses in year one . . . and $600,000 of Eligible Operating Expenses in year two and thereafter . . ." (emphasis added) (Term Sheet at 6). Hence, based on the plain language of the Term Sheet, the reduced amount of Bear Stearns' Revenue Share is *25% of Eligible Operating Expenses,* not 100% of the expenses, up to the cap, as defendants contend.

For example, if the revenues totaled $10,000,000 and the eligible expenses totaled $2,000,000, then Bear Stearns would be entitled to 25% of $10,000,000 after deducting eligible expenses. Thus, $10,000,000 minus expenses up to the $400,000 cap (in year 1), amounts to $9,600,000, which would yield $2,400,000 as Bear Stearns' 25% portion. According to defendants, however, the Term Sheet provides that the entire Expense Cap is subtracted from Bear Stearns' 25% Revenue Share (memorandum in opposition at 27-28). Thus, assuming again, that the revenues totaled $10,000,000 and the eligible expenses totaled $2,000,000, then, defendants argue, Bear Stearns would be entitled to 25% of $10,000,000 or $2,500,000, minus expenses up to the Expense Cap of $400,000 (in year 1), amounting to $2,100,000.

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To construe the provisions in the manner proffered by defendants would ignore the clear provisions of the Term Sheet which the court declines to do (*Diamond Castle Partners IV PRC, L.P. v IAC/InterActiveCorp*, 82 AD3d 421, 422 [1st Dept 2011]). Moreover, defendants' interpretation fails to take into account the provision defining Expense Cap. In so doing, it violates the rule that an agreement should not be interpreted in a manner that renders a provision meaningless (*Beal Sav. Bank v Sommer*, 8 NY3d 318, 324 [2007]).

Defendants argue that the "next sentence distinguishes repayment of affiliate loans, which are "*excluded* from the Expense Cap, *but* will be deductible from gross revenues *before* [Bear Stearns'] Revenue Share is calculated" *id.* (emphasis added). The RSA, by contrast, takes both deductions from gross revenues" (memorandum in opposition at 28). Defendants have not persuasively shown how JPM's construction of the Expense Cap deduction is dependent upon the sentence about repayment of loans. They operate independently of one another.

The operative language in the Term Sheet is not ambiguous, because it is not "susceptible of two reasonable interpretations" (*DMP Contr. Corp. v Essex Ins. Co.*, 76 AD3d 844, 846 [1st Dept 2010]). But even if it were, the ambiguity is resolved by the RSA, which is the controlling document. It is undisputed that the RSA entitles Bear Stearns to 25% of the revenues for the prior calendar year (RSA, § 2.1), which, in turn, is defined as "all gross revenues" less the "Expense Cap for the applicable period" (RSA, § 6.1 [t]). The "Expense Cap" is defined as "the lesser of (a) Eligible Operating Expenses for the applicable period and (b) the Maximum Eligible Operating Expenses for such period" (RSA, § 6.1 (I). Hence, the Expense Cap is taken from gross revenues prior to the calculation of Bear Stearns' 25% share. The parties do not disagree

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as to JPM's interpretation of the RSA formula. Resort to defendants' proffered extrinsic evidence is not warranted.

JPM also alleges, in the first cause of action, that defendants breached the RSA by deducting third-party marketing expenses that were not actually incurred. It claims that, over the course of the relationship, Hayground deducted a flat 20% of its fees (totaling $21 million) from revenue as "marketing fees" although the only evidence of any appropriate deductible marketing expenses was $50,000 in early 2004 (memorandum in support at 22). Defendants allege that the 20% deduction was done in accordance with the parties' agreement to amend the provision pertaining to third-party marketing expenses. The motion is denied as to this claim because of the existence of material factual issues.

It is undisputed that the RSA was not amended to reflect this alleged change in marketing expenses. Defendants allege, however, that the parties orally agreed to the modification and subsequently performed in accordance with the agreed-upon change. Although JPM argues that the defense is waived, because defendants failed to plead it as an affirmative defense, this assertion is itself improper, because JPM raised it for the first time in its reply papers (*Agress v Clarkstown Cent. School Dist.*, 69 AD3d 769, 772 [2d Dept 2010]).

Defendants' cited evidence in the record (testimony of Ader and Laura Conover, chief operating officer of the Hayground Cove entities) is inconclusive on this point, and raises issues of credibility. For example, Ader was equivocal as to the alleged modification:

> "Q. Did Barry say to you that I agree with you Jason, you may deduct a portion of the commissions that you paid to the street as marketing expenses?
>
> A. Not in those words, no.

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Q. Tell me everything that you can recall about your first discussion with Barry regarding brokerage commissions as marketing fees?

A. Well, this issue came up after it became very clear that Bear Stearns, despite strong indications of their desire and intent to market the fund, that they were no longer going to be able to fulfill those promises in any way for various compliance reasons. So, we talked about different ways that funds go about getting marketed by various relationships at other investment banks, brokers, private client brokers, and we talked about what one would pay various fee arrangements. Does it make sense to just do a percentage of management fees, does it make sense to do a percentage of incentive fees or a combination of both. What I suggested to Barry in that conversation is what I had seen typically and what I was hearing other managers were doing where they were offering 20 percent of their management fees and 20 percent of their incentive fees to brokers in commissions for the benefit of helping the fund raise assets. And the brokers would have a strong interest in pursuing that opportunity because it meant more direct commissions to them as well. That was really my recollection of the substance of the discussion. Obviously it was several years ago.

Q. Do you recall any other discussions with Barry Cohen on this topic other than the one that you have just testified to?

A. Well, no. I mean we – after we had that conversation we really started to step up our commissions and had been operating very transparently that we would take – to the extent that we were paying commissions and we were paying them a deduction of 20 percent of our management fees and 20 percent of our incentive fees to various brokerage firms like Deutsche Bank and UBS and others who had been helpful and really working with our counterparties to try to help the firm raise assets and get visibility and have meetings and go on road shows and do all the things necessary and where banks like that could be helpful. Every month we reported it as we understood the deal to be.

Q. I think at the beginning of your answer you did answer this, so I apologize but I want to make it clear. Other than that discussion, you don't have a recollection of any other discussions with Barry on this topic other than what you just testified to?

A. That is my general understanding"

(Ader dep tr at 476:9-478:20)

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"Q. I know you testified that you're not the person that did it, but do you have an understanding of how the person who was responsible for figuring out deductions would go about that task and what documents they would rely on, etc.?

A. I believe I do.

Q. Can you explain that to me?

A. My understanding is that the amounts paid to the brokerage firms would be aggregated and I think my understanding is that Barry had agreed to the 20 and 20 amount – on the phone with Barry Cohen had agreed to a 20/20 amount on management fees and incentive fees to both Laura and I and in almost all instances every year our commissions were so far in excess of that that there was a number far greater than we would have to produce in detail. So that it was – at least my recollection of the audit was that it was very sufficient to support the third-party marketing language"

(Ader dep tr at 551:7-552:4)

Conover's deposition testimony is also inconclusive.

"Q. Do you have any reason to believe that in the months between October – September of '04 and October of '05 that Hayground changed the way it was calculating the revenue share?

Mr. Greenblatt: Objection to form.

A. Yes.

Q. What is the basis for that?

A. It appears to be that the marketing fees are being calculated different based on a conversation that I know Jason had with Barry Cohen.

. . . .

Q. Tell me everything that you can recall about the conversation. What exactly did Jason say to Barry?

A. I don't remember exactly word for word, however I do explicitly remember Barry saying that it would be reasonable and customary to take a 20 percent marketing fee deduction off your total management fees and total performance fees.

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. . .

Q. Anything else, anything else Barry said specifically?

A. No.

Q. You can't recall a single other thing that he said?

A. I don't remember. I don't remember him saying anything with respect to, you know, you must incur or up to or any of the words that you're implying. I know what I heard and he said 20 percent of management fees and 20 percent of performance fees we could deduct for marketing.

. . .

"Q. After you had this conversation, did Jason tell you in words or substance from now on we should put a flat 20 percent for marketing expenses?

Mr. Greenblatt: Objection to form.

A. We discussed it as I was on the call and I heard Barry say that, so of course I'm sure"

(Conover dep tr at 92:9-97:25).

To be sure, the RSA contains a provision that requires amendments to be in a writing executed by all parties (RSA, § 8.5), and defendants are relying upon an alleged oral modification to the RSA.

Defendants argue that the parties' performance proves the terms of the alleged oral amendment (*Rose v Spa Realty Assoc.*, 42 NY2d 338, 343 [1977]). This is difficult to prove inasmuch as the "performance must be unequivocally referable to the modification" (*Nassau Beekman, LLC v Ann/Nassau Realty*, LLC, 105 AD3d 33, 40 [1st Dept 2013]). They also contend, however, that, under Section 5.1 of the RSA, Bear Stearns had the right to retain an accounting firm to "verify the accuracy of all calculations (and their respective components) required pursuant to this Agreement," the results of which are "final and binding with respect to

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the matters contained therein." Defendants assert that, on October 27, 2005, Bear Stearns exercised this right to retain an outside auditor, "Deloitte." The Deloitte "Agreed Upon Procedures" "repeatedly confirmed that Hayground was taking a 20% deduction for marketing fees," and that commission expenses were included as part of marketing expenses (defendants Rule 19-a response, §§ 307-313). They contend that a report that Deloitte issued in 2005 accepted the 20% marketing deduction, and that this is dispositive of the marketing expenses issue as a matter of law. JPM does not address this defense in its reply papers. However, the report that defendants submitted is an unsigned "Preliminary Draft" (exhibit 120 to affirmation of Jed I. Bergman, Esq.). Hence, although the assertion is insufficient to resolve the matter in defendants' favor, it militates in favor of denying the motion.

The third alleged breach of the RSA is that defendants applied an operating expense cap improperly based on gross or notional AUM rather than revenue-generating assets. As with the third-party marketing expenses, here, too, material issues of fact exist.

According to JPM, it agreed to increase the Expense Cap as reflected in the First Amendment to the RSA, which provides that "Maximum Eligible Operating Expenses" (i.e., the Expense Cap) for 2005 and beyond would increase by $300,000 for every $500,000,000 increase in "average assets under management" (i.e. AUM) for a given year, which was defined to be the average of the four quarter-end "sum of the collective Revenue-generating assets under management of Management Entities" (First Amendment, § 1). JPM argues that, in calculating the AUM, defendants improperly inflated the amount by using notional or gross assets – not only the actual investor capital accounts but also leveraged assets which increased the Maximum

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Eligible Operating Expenses for 2005-08 and decreased the Revenue Share. However, only assets that generate fees count.

According to defendants: (1) from 2005 to 2008, the AUM was calculated for purposes of the First Amendment by multiplying net assets by gross exposure, thus including leveraged and short positions, and this course of performance is the most persuasive evidence of the agreed intention of the parties; (2) JPM's interpretation is contradicted by record evidence that Bear Stearns understood and agreed that the First Amendment applies to gross AUM; (3) it is undisputed that the purpose of the First Amendment was to afford defendants some relief on the Expense Cap as the fund expenses grew, but JPM's interpretation would have provided them with no relief at all; and (4) expert testimony and evidence of industry custom and usage also support defendants' position that leverage and short positions can be included in a fund's AUM. These conflicting assertions raise material factual issues, and the language itself contained in the First Amendment is not dispositive as to whether leveraged assets may not be included in the calculation.

2. Second Cause of Action.

Based on the existence of material issues of fact, discussed above, JPM is not presently entitled to the request for a declaratory judgment.

3. Costs and Attorney's fees.

JPM seeks an award of attorney's fees pursuant to section 11of the 2003 Investment Agreement, and section 9 of the Investment Agreement, dated July 1, 2005. Both provisions are substantially the same. Section 11 (Indemnification) of the 2003 Investment Agreement provides:

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(a) The Subscriber understands the meaning and legal consequences of the representations, warranties, agreements, covenants and confirmations set forth herein and agrees that the subscription continued hereby, will be accepted in reliance thereon. The Subscriber agrees to indemnify and hold harmless the Partnership, the General Partner and their Affiliates, and the officers and directors of any of the foregoing (collectively, the "Partnership Indemnified Persons") from and against any and all loss, damage, liability or expense, including reasonable costs and attorneys' fees and disbursements, which a Partnership Indemnified Person may incur by reason of, or in connection with, any representation or warranty made herein by the Subscriber not having been true when made, or any failure by the Subscriber to fulfill any of the covenants or agreements set forth herein.

(b) The Principal and the General Partner, jointly and severally, agree to indemnify and hold harmless the Subscriber and its Affiliates, and the officers and directors of any of the foregoing (collectively, the "Subscriber Indemnified Persons") from and against any and all loss, damage, liability or expense, including reasonable costs and attorneys' fees and disbursements (collectively, "Damages"), which a Subscriber Indemnified Person may incur by reason of, or in connection with, any representation or warranty made herein or in the Revenue Sharing Agreement by the Principal, the General Partner, the Investment Manager, the Partnership, the 3(c)(1) Partnership, and/or the Offshore Fund not having been true when made, any misrepresentation made by the Principal, the General Partner, the Investment Manager, the Partnership, the 3(c)(1) Partnership, and/or the Offshore Fund or any failure by the Principal, the General Partner, the Investment Manager, the Partnership, the 3(c)(1) Partnership, and/or the Offshore Fund to fulfill any of the covenants or agreements set forth herein, in the Revenue Sharing Agreement or in any other document provided by the Principal, the General Partner, the Investment Manager, the Partnership, the 3(c)(1) Partnership, and/or the Offshore Fund to the Subscriber; provided, however, that in no event shall the Principal's personal liability pursuant to this Section 11(b) exceed, in the aggregate, one million dollars ($1,000,000), except with respect to Damages arising out of the Principal's willful breach of a material term of this Agreement or the Revenue Share Agreement. For the avoidance of doubt, it is agreed and understood that the material provisions of the Revenue Sharing Agreement shall include, without limitation. Section 2. 1 and Article III thereof.

JPM has not demonstrated its entitlement to an award of attorney's fees pursuant to these provisions, because they do not "contain language clearly permitting plaintiff to recover from defendant the attorney's fees incurred in a suit against defendant" and they are "typical of those

[* 20]

which contemplate reimbursement when the indemnitee is required to pay damages on a third-party claim" (*Hooper Assoc. v AGS Computers,* 74 NY2d 487, 492 [1989]). The provision must "*unequivocally* be meant to cover claims between the contracting parties rather than third-party claims" (*Gotham Partners, L.P. v High Riv. Ltd. Partnership*, 76 AD3d 203, 207 [1st Dept 2010], *lv denied* 17 NY3d 713 [2011]). JPM argues that the Hayground Cove entities' obligations under the RSA (to which the provisions of the Investment Agreements refer) effectively relate only to payment of the required revenue share, and "it is difficult to imagine how a breach could ever rise to third-party claims." Even if so, breach of the covenants contained in the Investment Agreements, the document that contains the provisions, could give rise to third-party claims.

Second amended answer

1. First Counterclaim (fraudulent inducement).

Defendants allege that, "as it had intended all along, Bear Stearns failed to provide Ader and Hayground with the promised marketing assistance, 'cap intro' services or the level of access to Bear Stearns's then-strong team of retail brokers and salespeople – all of which were explicitly promised to Ader and Hayground, and on which they relied, to their detriment, in foregoing alternative seeding offers" (second amended answer, ¶ 29). As Bear Stearns intended, defendants reasonably and justifiably relied on Bear Stearns' false representations in foregoing alternative seeding offers. When Bear Stearns refused to provide the services that it had falsely represented it would provide, defendants were forced to spend their own resources in an attempt to replace Bear Stearns' assistance.

[* 21]

Notwithstanding these allegations, defendants have not shown that, when Bear Stearns made the alleged false promissory representations, it had no intention at that time of fulfilling the promises. Defendants provide no facts to support the conclusory assertions as to present intent. A claim 'based upon a statement of future intention must allege facts to show that the defendant, at the time the promissory representation was made, never intended to honor or act on his statement'" (*Laura Corio, M.D., PLLC v R. Lewin Interior Design, Inc.*, 49 AD3d 411, 412 [1st Dept 2008] quoting *Non–Linear Trading Co. v Braddis Assoc.*, 243 AD2d 107, 118 [1st Dept 1998]). A "mere statement of an intention, even if expressed unconditionally and unequivocally does not, on its own, give rise to a binding contract" (*Smith v Smith*, 66 AD3d 584, 585 [1st Dept 2009]).

2. Second counterclaim (negligent misrepresentation).

Allegedly, Bear Stearns negligently breached its duty of care by making false representations of fact, knowing that defendants were relying on these representations about support services for Ader's planned investment management firm.

A claim for negligent misrepresentation requires the party asserting it to demonstrate: "(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information" (*J.A.O. Acquisition Corp. v Stavitsky*, 8 NY3d 144, 148, *rearg denied* 8 NY3d 939 [2007]). "Generally, a special relationship does not arise out of an ordinary arm's length business transaction between two parties" (*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 296 [1st Dept 2011). Defendants do not satisfy these requirements.

[* 22]

Defendants contend that Bear Stearns had a duty of care because of the "longstanding employment, advisory and business relationship with Ader, its specialized knowledge of the investment management industry, and its knowledge and evaluation of Ader's and Hayground's needs." Nevertheless, defendants failed to demonstrate the existence of a special or privity-like relationship imposing a duty on Bear Stearns to impart correct information to them, because this was essentially an "arms-length business relationship" and Ader was an experienced financial analyst (*see Greentech Research LLC v Wissman*, 104 AD3d 540, 540-541 [1st Dept 2013]). Indeed, the answer itself states that, "[p]rior to deciding to enter the investment management business and forming Hayground, Ader was the leading gaming and lodging industry analyst at Bear Stearns for nearly a decade and was made one of the youngest senior managing directors in Bear Stearns history" (second amended answer, ¶ 11).

Although Ader claims that he lacked experience in managing a hedge fund, the allegations do not support the assertion that Bear Stearns owed a duty of care to defendants, which is required to assert such a claim (*see Korea First Bank of N.Y. v Noah Enters., Ltd.*, 12 AD3d 321, 323 [1st Dept 2004], *lv denied* 4 NY3d 710 [2005]). Moreover, the essence of the complaint is not that Bear Stearns negligently rendered advice or information to defendants' detriment. Rather, it is that it failed to do that which it promised to do. It alleges that "Ader and Hayground – in reliance on Bear Stearns' representations concerning marketing assistance, access to Bear Stearns' strong prime brokerage operation, and full 'cap intro'– selected Bear Stearns' seeding offer over alternative and more favorable seeding offers" which led to the signing of the RSA and "well after the signing of the RSA on November 24, 2003, did Ader and Hayground begin to learn that Bear Stearns' representations, on which Ader and Hayground had

relied in entering into the RSA and turning down other offers, had been false" (second amended answer, ¶¶ 26-27).

3. Third counterclaim (reformation).

Based on the foregoing, the third counterclaim for reformation of the RSA is also dismissed.

Accordingly, it is

ORDERED that the motion for summary judgment is granted to the extent of dismissing the counterclaims and is otherwise denied.

Dated: May 30, 2013

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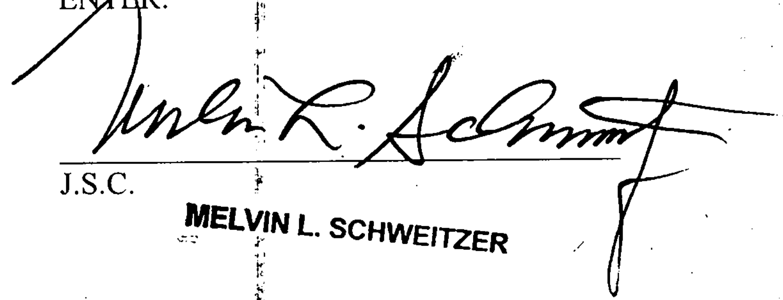

J.S.C.

MELVIN L. SCHWEITZER