

**Ferguson v Octagon Credit Inv., LLC**

2013 NY Slip Op 33370(U)

May 20, 2013

Sup Ct, New York County

Docket Number: 650525/12

Judge: Eileen Bransten

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SUPREME COURT OF THE STATE OF NEW YORK – NEW YORK COUNTY  
PRESENT: Hon. Eileen Bransten, Justice  
PART 3

JAMES FERGUSON,

Plaintiff,

-against-

OCTAGON CREDIT INVESTORS, LLC,

Defendant.


Index No.: 650525/12  
Motion Date: 12/11/12  
Motion Seq. No.: 002

The following papers, numbered 1 to 3, were read on this motion to dismiss.

	<u>Papers Numbered</u>
Notice of Motion/Order to Show Cause - Affidavits - Exhibits	1
Answering Affidavits - Exhibits	2
Replying Affidavits	3
Cross-Motion: <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	

Upon the foregoing papers, it is ordered that this motion is decided in accordance with the accompanying memorandum decision.

Dated: May 20, 2013

  
Hon. Eileen Bransten, J.S.C.

Check One:  FINAL DISPOSITION  NON-FINAL DISPOSITION  
Check if appropriate:  DO NOT POST  REFERENCE  SETTLE/SUBMITORDER/JUDG.

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

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

-----X  
JAMES FERGUSON,

Plaintiff,

-against-

OCTAGON CREDIT INVESTORS, LLC,

Defendants.

-----X

BRANSTEN, J.

Index No.: 650525/12  
Motion Date: 12/11/12  
Motion Seq. No.: 002

In motion sequence number 002, defendant Octagon Credit Investors LLC (“Defendant” or “Octagon”) moves pursuant to CPLR 3211(a)(1) and (a)(7) to dismiss plaintiff James Ferguson’s (“Plaintiff” or “Ferguson”) complaint (the “Complaint”) in this action. Plaintiff opposes.

**I. Background**

Ferguson is the founder of Octagon, an asset management company. (Compl. ¶¶ 6-7.) He served as Octagon’s chief executive officer and chief investment officer until his retirement in 2011. *Id.* at ¶ 7. On June 30, 2008, Octagon’s stockholders sold a majority equity stake in Octagon to CCMP Capital, LLC (“CCMP”). *Id.* at ¶ 8. At that time, Ferguson sold approximately 60% of his membership units in Octagon to CCMP. *Id.* On July 2, 2008, he also executed a Put and Call Agreement, whereby he secured the right to sell his remaining membership units to Octagon at a later date. *Id.* at ¶ 9; Compl., Ex. A (“Put Agreement”).

**A. The Put Agreement**

Under the Put Agreement, by December 15 of any year through 2013, Octagon's management is to deliver a "Proposed Budget" for the following calendar/fiscal year to Octagon's five member Board of Managers (comprised of three CCMP representatives, Ferguson as Chairman, and Octagon's Chief Executive Officer), and to Plaintiff. (Put Agreement, § 2(a).)

Under Section 2(b)(ii) of the Put Agreement, if Ferguson wishes to sell all or some of his remaining units to Octagon, he must notify Octagon in writing of his desire to exercise his put rights by December 15 of the applicable year:

To the extent [Ferguson] desires to exercise an Annual Put<sup>1</sup>, on or before any Annual Put Exercise Date [i.e., December 15], [Ferguson] must deliver to [Octagon] an irrevocable notice (the "Annual Put Notice"), subject to Sections 2(a) and 2(b)(iii) hereof, setting forth the Retained Units with respect to which the Annual Put is being exercised (an "Annual Put Exercise") . . .

*Id.* at § 2(b)(ii). The price to be paid by Octagon for Ferguson's membership units may be calculated either based on the Proposed Budget or based on a fair market appraisal. The Put Agreement provides:

[o]n or prior to the January 15 immediately following any such Proposed Budget Delivery Date, the Company shall notify (the "Approved Put/Call Budget Notice") [Ferguson] if the Proposed Budget or Revised Budget, as the case may be, has been approved by the Board of Managers and/or approved by the CCMP Members for the purpose of determining the applicable Put Exercise Price or Call Exercise Price (such approved budget

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<sup>1</sup> Capitalized terms not otherwise defined herein are defined in the Put Agreement.

(whether a Proposed Budget or a Revised Budget), the “Approved Put/Call Budget”).

*Id.* at § 2(a). If, the budget is approved for the purpose of determining the applicable Put Exercise Price, the price to be paid to Ferguson for his units will be derived from a formula based on earnings before interest and taxes (“EBIT Formula”). *Id.* at § 2(b)(vi).

If Octagon notifies Ferguson on or prior to the applicable date that the CCMP members on the Board of Managers (the “CCMP Members”) did not approve the Proposed Budget for the purpose of determining the applicable Put Exercise Price (“Proposed Budget Rejection”), then Ferguson has two options under the Put Agreement. *See* Put Agreement § 2(b)(iii). Under section 2(b)(iii) of the Put Agreement:

In connection with the Annual Put Exercise, (a) if [Octagon] notifies [Ferguson] on or prior to the applicable Budget Notification Date that a Proposed Budget Rejection has occurred . . . [Ferguson] may irrevocably elect, by written notice (the “Alternative Put Notice”) to [Octagon], to either (x) withdraw such applicable Annual Put Exercise, or (y) have the Put Exercise Price for the Retained Units subject to such Annual Put Exercise be determined pursuant to an Appraisal Value (the “Appraised Put Exercise Price”) (such election, a “Put Valuation Election”);

Accordingly, if Octagon notifies Ferguson that there was a Proposed Budget Rejection, Ferguson can either withdraw his Annual Put Exercise or have the Put Exercise Price determined by a fair market appraisal.

***B. Ferguson’s Put Exercise***

On December 7, 2011, Octagon’s management submitted a Proposed Budget for 2012 to Ferguson. (Compl. ¶ 19.) Based on the EBIT figure in the Proposed Budget, Ferguson

elected to exercise his put right. *Id.* at ¶ 20. On December 15, 2011, Ferguson sent formal notice of his put exercise for all of his remaining units of Octagon to Octagon's chief executive officer. *Id.*

On December 16, 2011, Octagon notified Ferguson by letter (the "Budget Rejection Letter") that the CCMP Members in control of the Board of Managers rejected the Proposed Budget for the purpose of determining the Put Exercise Price. *Id.* at ¶ 21. If Ferguson still desired to exercise his put right, his Put Exercise Price would be an appraisal-based price rather than the EBIT Formula price. *Id.* Octagon did not specify a reason for rejecting the budget in the Budget Rejection Letter. *Id.* at ¶ 22. Ferguson neither withdrew his put nor opted for an appraisal-based Put Exercise Price. Instead, he commenced this action for breach of the implied covenant of good faith and fair dealing and breach of an express covenant of good faith and fair dealing against Octagon on February 24, 2012.

***C. Express Covenant of Good Faith and Fair Dealing***

Ferguson brings a claim against Octagon under Section 4.01(j) (the "Express Covenant") of the Second Amended and Restated Limited Liability Company Agreement of Octagon (the "LLC Agreement"). On July 2, 2008, the same day that Ferguson and Octagon executed the Put Agreement, Octagon entered into the LLC Agreement with each of its members, including Ferguson. *See* Affirmation of John M. Callagy in Support of Octagon Credit Investors, LLC's Motion to Dismiss the Complaint ("Callagy Affirm."), Ex. C ("LLC Agreement").

The LLC Agreement defines “Agreement” as “this Second Amended and Restated Limited Liability Company Agreement, including all exhibits and schedules hereto, as it may be amended or restated from time to time,” and provides that:

Subject to Section 12.11,<sup>2</sup> any action, consent, approval, election, decision or determination to be made by the Board of Managers under or in connection with this Agreement (including any act by the Board of Managers within its “discretion” under this Agreement and the execution and delivery of any documents or agreements on behalf of [Octagon],) (i) shall be in the sole and absolute discretion of the majority of the Board of Managers and (ii) shall be made in good faith and on a reasonable basis.

(LLC Agreement § 4.01(j).) Although this Express Covenant is not contained within the Put Agreement, Ferguson bases his first cause of action thereon. Ferguson contends that this Express Covenant applies to the Put Agreement by virtue of Put Agreement Section 8 (the “Merger Clause”).

The Merger Clause provides, in pertinent part, that:

This [Put] Agreement, together with . . . the LLC Agreement . . . is the entire agreement and understanding between and among the Parties with respect to the subject matter hereof . . . No Party has relied upon any other communication whatsoever in entering into this [Put] Agreement.

Plaintiff maintains that the LLC Agreement and the Put Agreement should therefore be read and interpreted together, and that the Express Covenant applies to both agreements.

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<sup>2</sup> Section 12.11 is a disclaimer of all implied covenants other than the implied covenant of good faith and fair dealing.

## II. Analysis

### A. *Motion to Dismiss Standard*

On a motion to dismiss for failure to state a cause of action, the court must accept each and every allegation as true and liberally construe the allegations in the light most favorable to the pleading party. *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268, 275 (1977); see CPLR 3211(a)(7). “We . . . determine only whether the facts as alleged fit within any cognizable legal theory.” *Leon v. Martinez*, 84 N.Y.2d 83, 87-88 (1994).

On the other hand, while factual allegations contained in a complaint should be accorded a favorable inference, bare legal conclusions and inherently incredible facts are not entitled to preferential consideration. *Sud v. Sud*, 211 A.D.2d 423, 424 (1st Dep’t 1995).

Moreover, where the motion to dismiss is based on documentary evidence (CPLR 3211(a)(1)), the claim will be dismissed “if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law.” *Leon v. Martinez*, 84 N.Y.2d at 88; see also *150 Broadway N.Y. Assoc., L.P. v. Bodner*, 14 A.D.3d 1, 5 (1st Dep’t 2004).

### B. *Octagon As Defendant in this Action*

As a threshold matter, this Court finds that Octagon is the proper defendant in this action. Octagon contends that, because it was the CCMP Members, not Octagon, that rejected the Proposed Budget, Ferguson’s complaint is properly brought against the CCMP Members. (Defendant Octagon Credit Investors, LLC’s Memorandum of Law in Support of its Motion to Dismiss the Complaint (“Octagon’s Memo”), p. 12.)

Ferguson correctly points out, however, that it was Octagon that was the signatory and had the duty to repurchase under the Put Agreement. (Plaintiff's Memorandum of Law in Opposition to Defendant's Motion to Dismiss the Complaint ("Ferguson's Memo"), p. 22.) Further, though it may ultimately have been the CCMP Members that opted to reject the Proposed Budget by virtue of their majority representation on Octagon's Board of Managers, they were doing so in their capacity as the managers of Octagon, and not in any other capacity. Accordingly, because Octagon is the signatory under the Put Agreement with the obligation to repurchase Ferguson's shares, and because the CCMP Members were acting in their capacity as managers of Octagon, Octagon is a proper defendant in this action.

***C. Breach of Express Covenant in LLC Agreement***

Octagon contends that Ferguson's first cause of action for breach of the LLC Agreement's Express Covenant should be dismissed because the Express Covenant is found in the LLC Agreement and not in the Put Agreement. (Octagon's Memo, p. 14). Octagon argues that, as a result, the Express Covenant does not apply to decisions regarding Ferguson's put exercise. *Id.* at p. 15. Octagon also maintains that the Put Agreement's Merger Clause does not make the Express Covenant applicable to the Put Agreement. (Defendant Octagon Credit Investors, LLC's Reply Memorandum of Law in Support of its Motion to Dismiss the Complaint ("Octagon's Reply Memo"), p. 11.)

Ferguson contends that the Put Agreement's Merger Clause does make the Express Covenant of good faith and fair dealing applicable to the Put Agreement, and therefore, that

he has properly brought a claim under the Express Covenant. (Ferguson's Memo, p. 12.) Ferguson further argues that the Express Covenant applies to decisions made "in connection with" the LLC Agreement and not merely under that agreement. Ferguson contends that the Put Agreement is connected to the LLC Agreement, thus any decision made under the Put Agreement is one that is made in connection with the LLC Agreement. (Octagon's Memo, p. 12.)

To begin, Ferguson's reliance on the Merger Clause is misplaced. "The purpose of a merger clause is to require the full application of the parol evidence rule in order to bar the introduction of extrinsic evidence to alter, vary or contradict the terms of the writing." *Jarecki v. Shung Moo Louie*, 95 N.Y.2d 665 (2001). It does not necessarily follow that a merger clause in one agreement incorporates the terms of another agreement into the original agreement.

It is true that under New York law, "[w]here several instruments constitute part of the same transaction, they must be interpreted together." *BWA Corp. V. Alltrans Express U.S.A., Inc.*, 112 A.D.2d 850, 852. However, the Court finds that *Rosen v. Mega Bloks Inc.*, 2007 WL 1958968; 2007 U.S. Dist. LEXIS 48469 (S.D.N.Y. 2007) is here instructive and supports this Court's finding that the Express Covenant was not incorporated into the Put Agreement.

In *Rosen*, a Magistrate Judge<sup>3</sup> for the Southern District court, applying New York contract interpretation principles, held that “[t]he mere fact that a document is an ‘integral part’ of a larger transaction does not mean that any provision contained in that document must be applied to all other documents that are part of the same transaction.” *Rosen*, 2007 U.S. Dist. LEXIS 48479 at \*12. The court in *Rosen* further noted that:

[e]ven though several instruments relating to the same subject and executed at the same time should be construed together to ascertain the intention of the parties, it does not necessarily follow that those instruments constitute one contract or that one contract was accordingly merged in or unified with another so that every provision in one becomes a part of every other[.]

*Id.* at \*13 (citing 11 WILLISTON ON CONTRACTS § 30:26 (4th ed.)). Finally, the court in *Rosen* found that a merger clause is irrelevant to the question of whether one agreement’s provisions govern a related agreement. *Id.* at \*15 (citing to *Jarecki*, 95 N.Y.2d at 669 and to *Rosenblum v. Travelbyus.com Ltd.*, 299 F.3d 657, 665 (7th Cir. 2002) (holding that a merger clause does not incorporate other contracts by reference)).

Although the two agreements here at issue may be related and were executed on the same day, they each govern different situations. The LLC Agreement addresses the management and operation of Octagon and the Put Agreement addresses the right of Ferguson to require Octagon to purchase his remaining membership units in Octagon.

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<sup>3</sup> The Magistrate’s Report and Recommendation was subsequently adopted in part by United States District Judge Laura Swain at *Rosen v. Mega Bloks Inc.*, 2008 U.S. Dist. LEXIS 55035 (S.D.N.Y. 2008). The parties did not object to the portion of the Magistrate’s decision here analyzed by the Court. Accordingly, it is not addressed in Judge Swain’s opinion.

Further, the LLC Agreement does not evidence a clear manifestation of an intent by the parties thereto to be bound by any of the terms of the Put Agreement, let alone the Express Covenant. *See Federated Mut. Ins. Co. v. Woodstock '99 LLC*, 140 F. Supp. 2d 225, 228 (N.D.N.Y. 2001) (holding that “there must be a clear manifestation of an intent to be bound by the terms of an incorporated instrument,” and finding that there was no evidence of any intent to bind a party to one agreement to a waiver of subrogation provision in a separate agreement where there was no mention of such provision in the agreement, despite the fact that the agreement referenced the separate agreement); *see also Rosen*, 2007 U.S. Dist. LEXIS 48479 at \*16 (finding that there is no reason to conclude that the parties’ inclusion of an arbitration clause in one agreement indicates that they agreed to arbitrate claims arising under a separate agreement).

Finally, the Court finds no merit in Ferguson’s argument that the Board of Managers’ decision related to Ferguson’s put exercise was made “in connection” with the LLC Agreement and thus falls under the Express Covenant. Although the Put Agreement and the LLC Agreement are “connected” to one another, this action is based on Ferguson’s put exercise and the Board of Managers’ discretion related thereto. The Board of Managers’ decision to reject the Proposed Budget was made under and in connection with the Put Agreement and not the LLC Agreement. Accordingly, Ferguson’s claim for breach of the Express Covenant is dismissed.

***D. Breach of Implied Covenant of Good Faith and Fair Dealing***

Octagon argues that Ferguson's claim for breach of the implied covenant of good faith and fair dealing should be dismissed because "Ferguson received exactly what he bargained for under the express terms of the Put Agreement, and when the agreement is clear on its face, the court should not read into it a duty that does not otherwise exist." (Octagon's Memo, p. 8.)

Ferguson contends that, the Board of Managers exercised their discretion under the Put Agreement when they rejected the Proposed Budget for the purpose of determining Ferguson's Put Exercise Price. (Ferguson's Memo, p. 17.) Ferguson argues that where a contract contemplates one party's exercise of discretion, the implied covenant of good faith and fair dealing includes a promise not to act arbitrarily or irrationally in exercising that discretion. (Ferguson's Memo, p. 16.)

Ferguson also alleges that Octagon breached the covenant of good faith and fair dealing implied under Delaware law in the LLC Agreement. The Court has found *supra* that the exercise of Ferguson's Put right and Octagon's discretionary decisions related thereto fall under the Put Agreement, and not the LLC Agreement. For that reason, the Court dismisses Ferguson's claim for breach of the covenant of good faith and fair dealing implied in the LLC Agreement. The Court finds, however, that Ferguson has adequately pled his claim for breach of the implied covenant of good faith and fair dealing with respect to the Put Agreement.

Within every contract is an implied covenant of good faith and fair dealing. This covenant is breached when a party to a contract acts in a manner that, although not expressly forbidden by any contractual provision, would deprive the other party of the right to receive the benefits under their agreement. For a complaint to state a cause of action alleging breach of an implied covenant of good faith and fair dealing, the plaintiff must allege facts which tend to show that the defendant sought to prevent performance of the contract or to withhold its benefits from the plaintiff.

*Aventine Inv. Mgmt., Inc. v. Canadian Imperial Bank of Commerce*, 265 A.D.2d 513, 513-14 (2d Dep't 1999) (internal citations omitted). The implied covenant "encompasses any promise which a reasonable person in the position of the promisee would be justified in understanding was included[.]" *Just-Irv Sales v. Air-Tite Bus. Ctr. LLC*, 237 A.D.2d 793, 794 (3d Dep't 1997).

"Courts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include." *Bazin v. Walsam 240 Owner, LLC*, 72 A.D.3d 190, 195 (1st Dep't 2010). However, "[e]ven when a contract confers decision-making power on a single party, the resulting discretion is nevertheless subject to an obligation that it be exercised in good faith." *Travellers Int'l, A.G. v. Trans World Airlines*, 41 F.3d 1570, 1575 (2d Cir. 1994) (analyzing an implied covenant of good faith and fair dealing claim under New York law).

Ferguson alleges that Octagon deprived him of the benefit of his bargain when it summarily rejected the Proposed Budget for determining his Put Exercise Price in bad faith and without any reasonable basis. (Compl. ¶ 38.) Ferguson maintains that Octagon

attempted to “manipulate the terms of the [a]greements” to either force Ferguson to withdraw his Put or to pay him a lower appraisal-based price for his membership units. *Id.* Ferguson contends that this was contrary to his reasonable expectations. *Id.* Based on these allegations, the Court finds that Ferguson has adequately pled his claim for breach of the implied covenant of good faith and fair dealing.

The cases cited by Octagon in support of their contention that a good faith requirement would here alter the Put Agreement’s terms are factually inapposite. In *Boudinot v. Shrader*, 2012 WL 489215 (S.D.N.Y. 2012), an employer had forced plaintiffs to redeem their shares in the company early, before a significant business transaction would have increased the value. Plaintiffs, however, conceded that they received the full contractual two year holding period to which they were entitled under the agreement after their retirement, and that after that time, the company had the explicit right to redeem the stock at any time. In *Fesseha v. TD Waterhouse Investor Serv. Inc.*, 193 Misc.2d 253 (Sup. Ct. N.Y. Cty 2002), the court refused to read a notice and opportunity provision into an agreement under the guise of the implied covenant of good faith and fair dealing. The remaining cases cited by plaintiff are similarly distinguishable in that the plaintiff in those cases sought to use the implied covenant of good faith and fair dealing to insert provisions into existing agreements that were not in the language of the agreements.

Although, here, the Put Agreement does not require Octagon to approve the Proposed Budget for the purpose of determining the Put Exercise Price, Octagon's management was required to act in good faith in its determination to reject the budget. When a contract confers decision-making power on one party, as is the case here with Octagon, the decision-making party is nevertheless subject to an obligation that its discretion be exercised in good faith." *Travellers Int'l, A.G. v. Trans World Airlines*, 41 F.3d 1570, 1575 (2d Cir. 1994).

Accordingly, taking all inferences in favor of Plaintiff, as this Court must on a motion to dismiss, the Court finds that Ferguson has adequately pled his claim for breach of the implied covenant of good faith and fair dealing with respect to the Put Agreement.

***E. Declaratory Relief***

In his third cause of action, Ferguson seeks an order declaring that, "until he is paid the full amount due to him for his ownership interest, Ferguson retains all of his rights under the LLC Agreement[,]" including his right to distributions, allocations and his voting rights. (Compl. ¶¶ 40-43.)

Octagon addresses Ferguson's claim for declaratory relief in a footnote that states that "[d]ismissal of the first and second causes of action in the Complaint moots Mr. Ferguson's third claim for declaratory relief[.] . . . That claim, therefore should also be dismissed." Octagon's Memo, p. 15, n.3. The Court has maintained Ferguson's second cause of action, accordingly, Ferguson's third claim is not mooted, and Octagon's motion to dismiss the third claim is denied.

**Order**

Accordingly it is hereby

**ORDERED** that Defendant's motion to dismiss is granted as to Plaintiff's first cause of action; and it is further

**ORDERED** that Defendant's motion to dismiss Plaintiff's second cause of action is granted insofar as Plaintiff's claim based on the LLC Agreement is dismissed; and it is further

**ORDERED** that Defendant's motion to dismiss Plaintiff's second cause of action is denied as to Plaintiff's claim based on the Put Agreement; and it is further

**ORDERED** that Defendant's motion to dismiss Plaintiff's third cause of action is denied; and it is further


**ORDERED** that counsel are directed to appear for a preliminary conference in Part 3, Room 442, 60 Centre Street, on June 18, 2013, at 10:00AM.

This constitutes the decision and order of the court.

Dated: New York, New York

May 20 2013

ENTER:



Hon. Eileen Bransten, J.S.C.