Backus v Aeroflex Holding Corp.
2014 NY Slip Op 30468(U)
February 18, 2014
Supreme Court, New York County
Docket Number: 651515/12
Judge: Eileen Bransten
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 3

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ALEX BACKUS, FRANCIS EUGENE HINKLE, JR., WILLIAM F. ROSS, THOMAS U. LEUSCHEN, JR., RICHARD TSUKANO, CESAR GAMEZ, GRICHA RAETHER, and RICHARD HOUSE,

Plaintiffs,

Index No.: 651515/12
Motion Sequence No.: 004
Motion Date: 11/7/2013

-against-

AEROFLEX HOLDING CORP. and VGG HOLDINGS LLC,

Defendants.

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EILEEN BRANSTEN, J.:

Presently before the Court is the motion to dismiss filed by defendants Aeroflex Holding Corp. ("Aeroflex") and VGG Holdings LLC ("VGG").[1] Defendants seek dismissal of the First Amended Complaint ("Amended Complaint"), pursuant to CPLR 3211(a)(1) and (7). For the reasons that follow, defendants' motion is granted.

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[1] On June 10, 2013, the Court so-ordered the parties' stipulation to amend the caption. This Order removed defendants Veritas Capital Fund III, LP ("Veritas"), AX Holding LLC, Golden Gate Capital Investment Fund II, L.P. ("Golden Gate"), GS Direct, L.L.C., John Adamovich, Leonard Borow, Andrew Kaminsky, Robert McKeon, Edward Wactlar and John Does 1-10 from the caption of the First Amended Complaint.

I. Background

The Amended Complaint alleges that plaintiffs Alex Backus, Francis Eugene Hinkle, Jr., William F. Ross, Thomas U. Leuschen, Jr., Richard Tsukano, Cesar Gamez, Gricha Raether and Richard House (collectively "plaintiffs"), are the former owners of VI Technology, Inc. VI Technology, Inc. was acquired by defendant VGG in March 2009 for $5 million in cash and $12 million in Class A membership interests ("Membership Interests") in VGG. *See* Am. Compl. ¶¶ 15, 18-22. Plaintiffs collectively hold approximately 1.5 percent of the VGG Class A Membership Interests.

VGG is the holding company for Aeroflex. *Id.* ¶ 17. VGG's equity owners are defendants Veritas, Golden Gate, and Goldman (collectively the "Investors"). *Id.* Pursuant to the VGG operating agreement ("Operating Agreement"), the Investors and certain Aeroflex employees, including defendants Adamovich and Borow, also hold VGG Class A Membership Interests. In addition, the VGG Operating Agreement designates certain employees as "Special Members" who also hold Class A Membership Interests. *Id.* ¶ 27; *see also* Affirmation of Brian T. Kohn ("Kohn Affirm.") Ex. 2 at 1, 9 (VGG Operating Agreement). Together, the Special Members and Investors hold more than 90 percent of the Class A Membership Interests in VGG.

When plaintiffs became holders of Class A Membership Interests, Section 3.8 of the VGG Operating Agreement permitted any Class A Member to redeem all of his or her

Class A Membership Interests in VGG for Aeroflex shares, at any time from and after the occurrence of an Aeroflex initial public offering ("IPO"). *See* VGG Operating Agreement § 3.8. However, that right was modified by the Registration Rights Agreement, attached to the Operating Agreement as exhibit B and incorporated into that document, which restricted the sale of Aeroflex stock for six months following the date of the Aeroflex IPO. *See* Kohn Affirm. Ex. 11 § 4.

On November 19, 2010, Aeroflex consummated its IPO, and in or about July 2011, plaintiffs attempted to redeem their shares. *See* Am. Compl. ¶¶ 39, 75. Unbeknownst to plaintiffs, defendants adopted an amendment to the Operating Agreement on November 24, 2010 ("Amendment 7") that revised Section 3.8 of the Operating Agreement to allow Class A Members to redeem their shares only after the second anniversary of the IPO. Additionally, the revised Section 3.8 permitted Investors to redeem their shares before the two years expired if all three Investors, Veritas, Golden Gate and Goldman, approved the redemption of the shares in writing. *Id.* ¶¶ 38-43. The revised Section 3.8 states, in pertinent part, that shares can be redeemed:

> (i) at any time from and after the earlier to occur of (A) the second anniversary of the consummation of an IPO or . . . (ii) with the prior written approval of each of the Veritas Fund . . ., Golden Gate . . . and Goldman . . ., at any time from and after the consummation of an IPO.

See Kohn Affirm. Ex. 9 (Amendment No. 7) at § 5(b).

A. *The Instant Action*

Thereafter, plaintiffs commenced this breach of contract action, alleging, among other things, that the Amendment 7 is void to the extent that it revised Section 3.8 without plaintiffs' consent. Plaintiffs contend that Amendment 7 violates Section 12.1(F)(ii) and (iii) of the Operating Agreement,[2] which provide, in pertinent part, that the Operating Agreement may not be amended without the prior written consent of each Class A Member if the amendment:

> (ii) adversely affects any payments to which a Class A Member other than an Investor or Special Member has become entitled to pursuant to this Agreement or (iii) adversely affects the rights of a Class A Member other than an Investor or a Special Member under Article III, Article VIII, Section 5.1, Section 9.2 and this Section 12.1 (F) . . . in a manner that is adverse materially and disproportionately to such Class A Member as compared to other Class A Members.

(Kohn Affirm. Ex. 4 § 4.)

Plaintiffs assert that Amendment 7 had a "material and disproportionate" effect on their redemption rights because they had no ability to divest themselves of Class A Membership Interests, which have declined in value since they first sought to redeem their holdings in July 2011. Plaintiffs note as well that the Investors were granted an exemption from the two-year lock-up period.

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[2] As modified by Amendment 2 to the Operating Agreement.

In addition, Plaintiffs argue that Amendment 7 affected payments to which they were entitled under Section 4.4 of the Operating Agreement (the "Distribution Clause") because Special Members accrue a 12 percent annual return on a guaranteed distribution of $3,175,000 ("Special Distribution") – a distribution that is not available to any other Class A Member. Plaintiffs argue that because Special Members cannot divest their shares for an additional 18 months, they earn an additional 18 months of interest on the Special Distribution. Plaintiffs allege that the Special Members accrue this additional interest at the expense of other Class A Members because the 12 percent interest accrual on the Special Distribution directly reduces the cash available to pay plaintiffs the return on their investment. They also contend that their payments under the fifth step of the distribution provision will be reduced by the additional interest accrual on the Special Distribution during the two-year lockup period.

Plaintiffs also contend that they were entitled to payments under the Distribution Clause before Amendment 7 became effective. The IPO occurred on November 19, 2010, and Amendment 7 did not become effective until five days later on November 19, 2010. Plaintiffs assert that they became entitled to payments under the Distribution Clause during that five day interval between the IPO and the effective date of Amendment 7.

II. Discussion

On a CPLR 3211(a)(7) 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). A motion to dismiss must be denied, "if from the pleadings' four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law." *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 152 (2002).

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. *Matter of Sud v. Sud*, 211 A.D.2d 423, 424 (1st Dep't 1995).

Moreover, where the motion to dismiss is based on documentary evidence under 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). Where, as here, the defendants have presented documentary evidence, the court is required to determine "whether the proponent of the

pleading has a cause of action, not whether he has stated one." *Ark Bryant Park Corp. v. Bryant Park Restoration Corp.*, 285 A.D.2d 143, 150 (1st Dep't 2001).

A. *Breach of Contract*

Section 13.18 of the Operating Agreement states "[t]he laws of the State of Delaware (without reference to its choice of laws principles) shall govern the validity of this Agreement, the construction of its terms, and the interpretation of the rights and duties of the Members." VGG Operating Agreement at § 13.18. Because the parties have elected to have Delaware law apply to the construction of the Operating Agreement, the court will apply Delaware law to the breach of contract claims.

Dismissal of a claim for breach of contract is warranted where the language of the contract contradicts the allegations underlying plaintiffs' claim. *See Lorilard Tobacco Co. v. American Legacy Found.*, 903 A.2d 728, 739 (Del. 2006) (stating that Delaware courts interpret clear and unambiguous contract terms according to their plain meaning). "When the language of a contract is clear and unequivocal, a party will be bound by its plain meaning." *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1030 (Del. Ch. 2006).

1. <u>Consent to Amendment 7 Pursuant to Section 12.1(F)(iii)</u>

Accepting all facts pled by plaintiffs as true, the Court concludes that plaintiffs' consent to Amendment 7 was not required under Section 12.1(F)(iii) of the Operating Agreement because Amendment 7 did not adversely affect plaintiffs' rights in a manner that is "adverse materially and disproportionately" as compared to other Class A Members." Instead, Amendment 7, which amended Section 3.8 to impose a two-year "lock-up period" on Class A Members' redemption rights, adversely affected *all* Class A Members.

However, plaintiffs maintain that Section 3.8(ii), which provided an exception to the lock-up period in Amendment 7, affected its rights "materially and disproportionately" because that exception permits the Investors – Veritas, Golden Gate and Goldman – to voluntarily agree among themselves to redeem their shares and leave the company while plaintiffs were denied a similar right.

By its terms, the exception delineated in Section 3.8(ii) applied to all Class A Members. That is, if any Class A Member, including Plaintiffs, wanted to redeem their shares during the lock-up period, they could seek the approval for such redemption from Veritas, Golden Gate and Goldman. Redemption would be permitted if each of those entities agreed to such redemption in writing. Plaintiffs are included in the exception. Although plaintiffs are not included in the group that makes the decision, they are Class A

Members who can seek prior written approval, like any other Class A Member, including the investors. They are not singled out by this exception and their rights are not affected materially and disproportionately by this exception as compared to other Class A Members.

Accordingly, plaintiffs' cause of action alleging breach of Section 12.1(F)(iii) of the Operating Agreement is dismissed.

2. Consent to Amendment 7 Pursuant to Section 12.1(F)(ii)

Class A Members' consent to an amendment is required under Section 12.1(F)(ii) of the Operating Agreement if the amendment "adversely affects any payments to which a Class A Member . . . has become entitled to pursuant to this Agreement . . ." (Kohn Affirm. Ex. 9.) Plaintiffs contend that their consent was required pursuant to Section 12.1 (F)(ii) because Amendment 7 adversely affected distribution payments due under Section 4.4 and plaintiffs' redemption payments under Section 3.8.

(a) **Redemption Payments**

Citing to the language of Section 12.1(F)(ii), defendants argue that plaintiffs had not become entitled to any redemption payments under the Operating Agreement at the

time Amendment 7 became effective. In support, defendants note that plaintiffs' admission in the original complaint that they did not have a right to redeem their shares because the Registration Rights Agreement, which was attached to the Operating Agreement as exhibit B, imposed a 180-day lock-up period upon the occurrence of the IPO. Further, defendants contend that plaintiffs failed to submit a written notice of redemption to Aeroflex.

Plaintiffs, on the other hand, argue that they were entitled to redeem their shares during the 5-day period between when the IPO was consummated (November 19, 2010) and when Amendment 7 was adopted (November 24, 2010).

In this instance, the documentary evidence demonstrates that, pursuant to the Registration Rights Agreement, neither plaintiffs, nor any other members of Aeroflex, had the right to redeem their shares during the 180-day period following the IPO. *See* Kohn Affirm. Ex. 11 § 4. Therefore, plaintiffs' redemption right had not accrued when Amendment 7 became effective, and they were not entitled to redemption payments. Accordingly, Plaintiffs' claim for alleging breach of Section 12.1(f)(ii) fails on this basis.

(b) **Distribution Payments**[3]

The Distribution Clause provides that "Available Cash" first will be distributed to the Class A Members, in proportion to their Unreturned Invested Capital. *See* VGG Operating Agreement at § 4.4(a). Thereafter, under the "waterfall payment structure" of Section 4.4, once all Unreturned Invested Capital was returned, Section 4.4(b) granted the Special Members a Special Distribution of $3,175,000, as defined in the Operating Agreement. *See id.* at 8. Special Members receive this fixed sum before plaintiffs, or any other Class A Members, receive their 12 priority returns on Unreturned Invested Capital under Section 4.4(c). Priority Returns are defined in the Operating Agreement as 12 percent compounded quarterly on the Unreturned Invested Capital of Class A Members,

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[3] Section 4.4 of the Operating Agreement (the Distribution Clause), which was part of the agreement before plaintiffs became members, states in pertinent part:

> 4.4 Distributions. Available Cash shall be distributed to the Members as follows:
>
> (a) first, to the Class A Members in proportion to their Unreturned Invested Capital until such time as they have received cumulative distributions . . . equal to all of their Invested Capital, and no distribution shall be made pursuant to paragraphs (b), (c), (d) or (e) below until Unreturned Invested Capital of the Class A Membership Interests is equal to zero;
>
> (b) second, to the Special Members in the amount of the Special Distribution pro rata in accordance with their respective Capital Contributions;
>
> (c) third, to Class A Members in proportion to their unpaid Priority Returns until such time as they have received cumulative distributions . . . equal to their Priority Return, and no distribution shall be made pursuant to paragraphs (d) or (e) below until the full amount of the Priority Return has been distributed to Class A Members;

and the "for the purposes of calculating the Priority Return, the Special Distribution shall, with respect to the Special Members, be considered Unreturned Invested Capital until it is distributed to the Special Members pursuant to Section 4.4 hereof." VGG Operating Agreement at 7-8. Therefore, under the terms of the Operating Agreement, Special Members receive their Priority Returns on the Special Distribution at the same time that Plaintiffs and other Class A Members receive their Priority Returns on their Unreturned Invested Capital.[4]

Accordingly, plaintiffs will receive their 12 percent Priority Return for the lock-up period, in proportion to their Unreturned Invested Capital at the same time and at the same rate that Special Members receive their priority return on their Unreturned Invested Capital. *See* VGG Operating Agreement at § 4.4(c). Since all Class A Members, including Special Members, are accruing their Priority Returns at the same rate, plaintiffs' proportional share of the Priority Returns will not be diminished. Thus, if Special Members are accruing 12 percent Priority Returns for an additional 18 months, then plaintiffs, and all other Class A Members, are likewise accruing an additional 18 months worth of priority return interest on their Unreturned Invested Capital. The distribution to

[4] This Court's decision dated March 6, 2013 is corrected to the extent that the decision suggested that Special Members received their Priority Returns on the Special Distribution before other Class A members receive their Priority Returns on Unreturned Invested Capital.

Special Members under Section 4.4(b) will not diminish plaintiffs' priority return under Section 4.4(c).

Moreover, there is nothing in the language of Section 4.4 that permits plaintiffs' priority returns to be disproportionately reduced as compared to the Special Members or any other Class A Members. Section 4.4(c) clearly states that no distributions shall be made pursuant to any other subsection "until the full amount of the priority return has been distributed to Class A Members."

Finally, plaintiffs' claim that Amendment 7 adversely affected payments to which they were entitled under the fifth step is without merit. Pursuant to Section 4.4(e), at the fifth step of the waterfall, remaining Available Cash, if any, is paid to all members "pro rata in accordance with their respective Percentage Interests. Plaintiffs' percentage interest was not changed by Amendment 7. Therefore, while plaintiffs and all other Class A Members may receive less at the fifth step, this is only because plaintiffs and all other Class A members will have received larger payments of priority returns at the third step under Section 4.4(c).

Accordingly, plaintiffs' cause of action alleging breach of Section 12.1(F)(ii) of the Operating Agreement is dismissed.

B. *Tortious Interference with Contract*

To state a claim for tortious interference with contract under New York law,[5] a plaintiff must allege: (1) the existence of a valid contract between plaintiff and a third party; (2) defendant's knowledge of that contract; (3) defendants' intentional procurement of the third party's breach of that contract; and (4) damages. *See Burrowes v. Combs*, 25 A.D.3d 370, 373 (1st Dep't 2006).

Here, plaintiffs have failed to allege a viable cause of action against Aeroflex for tortious interference with Plaintiff's Operating Agreement with VGG. As a threshold matter, this court has dismissed plaintiffs' causes of action alleging breach of contract. This fact alone mandates dismissal of the tortious interference claim. *See, e.g., Murataj v. Dream Dragon Prods., Inc*, 72 A.D.3d 527, 527 (1st Dep't 2010) (where there is no breach of contract, the tortious interference with contract claim fails as a matter of law).

However, even assuming arguendo that there was a breach, plaintiff has failed to adequately allege a tortious interference with contract claim. To sustain this cause of

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[5] The Operating Agreement contains a choice-of-law provision mandating the application of Delaware law to plaintiffs' breach of contract claims. This provision does not apply to tort claims. To resolve a choice-of-law issue in tort cases, New York courts conduct an interest analysis to identify the state with the greatest interest in the litigation. *See Elmaliach v. Bank of China Ltd.*, 110 A.D.3d 192, 202 (1st Dep't 2013). Generally, when a choice-of-law issue relates to laws regulating conduct, the location of the alleged tort determines the applicable law. *Id.* In this case, both Aeroflex and VGG have their principal places of business in New York, and Aeroflex is alleged to have acted through its executive officers in New York. (Am. Compl. ¶ 106.) Thus, because the alleged tortious conduct occurred in New York, the court will apply New York law.

action, "the plaintiff must allege that the contract would not have been breached 'but for' the defendant's conduct." *Washington Ave. Assoc. v. Euclid Equip.*, 229 A.D.2d 486, 487 (2d Dep't 1996). Here, plaintiffs have not alleged that "but for" Aeroflex's actions the contract would not have been breached. Moreover, plaintiffs failed to allege specific conduct on Aeroflex's part that caused VGG to breach the contract. Plaintiffs' conclusory allegations of tortious conduct are insufficient to state a claim. *See Kickertz v. New York Univ.*, 110 A.D.3d 268, 275 (1st Dep't 2013). Moreover, plaintiffs also have failed to allege that Aeroflex acted intentionally to cause the breach which is an essential element of the claim. *See Murataj*, 72 A.D.3d at 527.

Therefore, the tortious interference with contract claim is dismissed for failure to state a cause of action.

C. *Declaratory Judgment*

The first cause of action seeks a declaratory judgment that Amendment 7 is null, void. As with their breach of contract claims, plaintiffs here contend that Amendment 7 was invalid because it purportedly adversely affected plaintiffs' rights under the Operating Agreement and was enacted without plaintiffs' prior consent. The Court already has rejected this argument, *see supra*. Accordingly, plaintiffs' declaratory judgment claim is likewise dismissed.

III. Conclusion

Accordingly, it is

ORDERED that defendants Aeroflex Holding Corp. and VGG Holding LLC's motion to dismiss the complaint is granted and the complaint is dismissed, with costs and disbursements to said defendants as taxed by the Clerk of the Court, and the Clerk is directed to enter judgment accordingly in favor of said defendants.

Dated: 2-18-14

ENTER:

J.S.C.

HON. EILEEN BRANSTEN
J.S.C.