

Capone v Castleton Commodities Intl. LLC
2022 NY Slip Op 34093(U)
December 2, 2022
Supreme Court, New York County
Docket Number: Index No. 651794/2015
Judge: Jennifer Schechter
Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op <u>30001</u> (U), are republished from various New York State and local government sources, including the New York State Unified Court System's eCourts Service.
This opinion is uncorrected and not selected for official publication.

**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY: COMMERCIAL DIVISION**

PRESENT: HON. JENNIFER SCHECTERPART 54*Justice*

-----X

KEVIN CAPONE, STEVEN SCHEINMAN,

INDEX NO. 651794/2015

Plaintiffs,

- v -

DECISION AFTER TRIAL

CASTLETON COMMODITIES INTERNATIONAL LLC (F/K/A
LOUIS DREYFUS HIGHBRIDGE ENERGY LLC), LDH
MANAGEMENT HOLDINGS LLC, LDHMMH MM, LLC, TODD
BUILIONE, GLENN DUBIN, GEORGE FERRIS, WILLIAM
REED, JACQUES VEYRAT, JOHN DOES,

Defendants.

-----X

This case concerns whether defendants redeemed plaintiffs' units based on a good-faith determination of their Fair Market Value (FMV) as of December 31, 2010 (*see* Dkt. 510 at 11, 49). Plaintiffs' units were redeemed on April 12, 2011 based on a \$1.744 billion valuation, calculated on December 23, 2010, predicated on the Midstream Assets being worth \$1.43 billion, the merchant business being worth its \$569 million book value, and the company having \$255 million of debt (the December 23 Valuation). Yet, mere weeks earlier, on March 22, 2011, defendants sold the Midstream Assets for \$1.925 billion. At trial, plaintiffs had to prove that the December 23 Valuation was the product of bad faith (*see DV Realty Advisors LLC v Policemen's Annuity & Ben. Fund of Chicago*, 75 A3d 101, 110 [Del 2013]). They did. Ample credible evidence established that the market valued the Midstream Assets by half a billion dollars more than defendants' FMV, that defendants knew it, and that defendants nonetheless stuck with a lowball valuation anyway. That was bad faith.

The FMV was recalculated at Ferris' direction in a manner inconsistent with the company's past valuation approach. As plaintiffs explain:

Despite the ongoing bidding process and the \$2 billion ETP indication, Defendants manipulated the DCF metrics in the December valuation to produce a materially lower value. For example, in a December 17, 2010 DCF analysis, LDH used a discount rate of 8% to 10% and an EBITDA multiple of 9.5 to 10.5 to value Mont Belvieu, the largest piece of the Assets. PX50 at 21. As a result, that December 17 DCF analysis valued the Assets at between \$1.65 billion and \$1.96 billion. *Id.* **But a few days later, in the December 23 DCF analysis, LDH lowered the EBITDA multiple and raised the discount rates, thus reducing by hundreds of millions of dollars the DCF valuation of the Assets to between \$1.33 billion and \$1.61 billion.** PX58 at 7. At trial, Ferris claimed he told Quan to depart from discount

DECISION AFTER TRIAL

rates and multiples that LDH had used in the past because LDH had “fluffed and elevated” the projected cash flow numbers “to try to motivate buyers to pay more,” but “there was no expectation that those were believable numbers.” Tr. 194. This testimony implicates the “double-liar” problem ... because LDH still used these “fluffed” numbers in the December 23 DCF valuation; it just heavily discounted them, which makes the entire process outcome-oriented and unreliable (Dkt. 720 at 13 [*italics in original; bold added for emphasis*]).

The court does not find Ferris' explanations for the low valuation credible. Given the timing, it is clear that Ferris was motivated to suppress the FMV that would be used for plaintiffs' buyout in 2011 (*see also Capone v LDH Mgt. Holdings LLC*, 2018 WL 1956282, at *14 [Del Ch Apr. 25, 2018] [“I also note that the Plaintiffs point out that the Defendants relied on a valuation performed over a week before the LLC agreement contemplated such an exercise being conducted. That in itself may have been a breach of the agreement. In any event, it supports a reasonable inference that the Defendants, knowing that bids for the Midstream Assets would arrive in a few weeks, rushed the valuation so that the Plaintiffs' Units could be redeemed at below fair market value. Such conduct could potentially constitute a violation of the contractual obligation to adjust the valuation in good faith”]; *see also* Dkt. 720 at 12-13 [“Wallace and Ferris gave Quan 'explicit direction' to finalize the valuation by December 23, 2010. This deviated from LDH's past valuations, which were routinely conducted after the 'as of' date”]).*

It is clear that by mid-December 2010, defendants knew that there was robust market interest in the assets (*see* Dkt. 720 at 11-12). Based on internal data defendants had provided, on January 14, 2011, 23 sophisticated companies submitted bids for the assets ranging “from \$1.1 billion to \$2.5 billion, with a median bid of \$1.9 billion” (*id.* at 13, citing Dkt. 580 at 6). “These bids—**which were based on information LDH provided to bidders before December 31, 2010**,—are strong evidence that the December 23 valuation did not reflect ‘the amount that would be distributed’ if the Assets had been sold on December 31” (*id.* at 14 [*emphasis added*]). It is implausible that so many firms would overbid by hundreds of millions of dollars if there really was a good-faith basis justifying the company's FMV.

There is no credible evidence, moreover, that between December 2010 and March 2011, the assets materially increased in value. Nor was there credible evidence that their value materially changed between December 23, 2010 and January 14, 2011. There is no evidence of anything occurring in the market during the two months between when the initial bids were submitted and when the final agreement was reached that suggests the assets' value materially changed during that time. Had the sale process occurred in 2010, the same opportunity to submit second-round bids would presumably have occurred. That the final purchase price of \$1.925 billion is so close to the median first-

* The evidence further established that between the December 17 higher valuation and the December 23 lower valuation “a buy-out of certain members” was on LDH's radar (Dkt. 275 at 2).

round bid suggests that, if the sale process had fully played out and closed by the end of 2010, the price would still have been around \$1.925 billion.

Valuation, of course, is not an exact science, and it would be one thing if just one or two firms valued the assets differently. But when so many did based on the very same data that defendants themselves purportedly used to come up with their FMV, that creates a strong inference that defendants' FMV is suspect. Defendants do not credibly explain the staggering spread between the valuations. After all, "the evidence is only more compelling considering the second round of bids, which ranged from \$1.55 to \$2 billion" (*see id.*).

The parties' dispute over the propriety of considering data after the "as-of" date is inapposite because plaintiffs are not relying on hindsight bias. While the January 2011 bids were submitted after the as-of date, the data on which they were based predated the as-of date. Thus, the bids are compelling proof that the FMV calculated by defendants using the same data from 2010 was not the product of good faith.

Additionally, while the FMV was to be calculated as of the end of 2010, that calculation did not need to occur until April 2011. Had there been no FMV calculation in December 2010, defendants, in 2011, would have had to assess FMV based on 2010 data just as the bidders did in January 2011. There is nothing in the contract that obligated defendants to rely on the December 23 Valuation and there is nothing in the contract that prohibited them, in April 2011, from realizing that their FMV from December was clearly not reflective of fair market value. Indeed, even if there was no bad faith intended in December 2010--and the fact that defendants unjustifiably played with the numbers while a member buy-out was anticipated shows that there was--defendants unquestionably knew in April 2011 that based on 2010 data the market actually valued the Midstream Assets at \$500 million more than defendants had previously calculated. The evidence established that in April 2011, defendants knew that had there been a sale in December 2010, the price would have been materially greater than \$1.43 billion (to be sure though, the court is convinced, based on the evidence, that defendants knew that in December 2010 too). Nothing stopped them then from recognizing the Assets' actual December 2010 FMV. Instead, they chose to rely on a valuation that they knew was not reflective of the actual market. That defendants elected to rely on the December 23 Valuation proves that they were less interested in a good-faith FMV assessment and instead opted to rely on one that was inexplicably low and minimized what plaintiffs were owed (*see also Capone*, 2018 WL 1956282, at *14 ["nothing in the LLC agreement unequivocally states that information learned after December 31, and relevant to value as of the time immediately preceding the 'deemed sale,' cannot be considered in determining the fair market value of the Plaintiffs' Units" or that it was not necessary to make "a good-faith adjustment of the LDH assets' gross asset value immediately before redeeming a terminated employee's Units"]). That was bad faith.

For these reasons, the court finds that defendants could not have believed in good faith that had a sale of the Midstream Assets occurred on December 31, 2010, the price would only have been \$1.43 billion. Though this is not an appraisal proceeding requiring an independent determination of value, defendants wrongly suggest that this court should not draw on the Delaware Supreme Court's guidance regarding how to assess value in this

context. Unlike in many appraisal proceedings, the court here need not assess drastically divergent outcome-oriented expert valuations. Having found the December 23 Valuation to be the product of bad faith, the court can rely on the best evidence of value--a purchase price that resulted from a robust sale process in an efficient market (*see Fir Tree Value Master Fund, LP v Jarden Corp.*, 236 A3d 313, 324 [Del 2020]). After all, "a buyer in possession of material nonpublic information about the seller is in a strong position (and is uniquely incentivized) to properly value the seller when agreeing to buy the company at a particular deal price, and that view of value should be given considerable weight by the [court] absent deficiencies in the deal process" (*Verition Partners Master Fund Ltd. v Aruba Networks, Inc.*, 210 A3d 128, 137 [Del 2019]). Given the robust and competitive sale process, there is good reason here to rely on "the price that results from that process" (*id.* at 138, citing *Dell, Inc. v Magnetar Glob. Event Driven Master Fund Ltd*, 177 A3d 1, 35 [Del 2017] ["When the evidence of market efficiency, fair play, low barriers to entry, outreach to all logical buyers, and the chance for any topping bidder ... is so compelling, then failure to give the resulting price heavy weight because the trial judge believes there was mispricing missed by all [] stockholders, analysts, and potential buyers abuses even the wide discretion afforded the Court of Chancery in these difficult cases"]).

Had defendants actually arrived at a good-faith FMV there is no reason to believe their assessment of the Midstream Assets' worth would have been materially different than the market consensus. And that is why the market's assessment is the proper metric on which to base plaintiffs' damages. Plaintiffs are therefore entitled to damages based on defendants' undervaluation of the Midstream Assets by \$495 million (\$1.925 billion - \$1.43 billion).

The court also finds that it was bad faith for defendants to value the merchant business at book value (*see* Dkt. 688 at 39-41). In 2009, the company itself rejected that it would sell for book value; it thought the merchant business would sell for 1.2 times book value (Dkt. 511 at 25). In October 2010, two banks also thought that in a sale process targeted to the right type of buyer it could be sold above book value (Dkt. 537 at 16-17; Dkt. 538 at 29-31). The court further credits Capone's testimony, given his role at the company, about the state of the trading book and does not credit defendants' testimony about the effect of the financial crisis on the market's willingness to pay more than book value since, after all, the company itself thought in 2009 that the merchant business would sell above book value. The court therefore does not find that defendants made a good-faith assessment that the merchant business would only sell for book value. While plaintiffs have taken somewhat inconsistent positions on the proper multiple, the court finds that a good-faith assessment of the value of the merchant business as of the end of 2010 would have concluded that it would sell for at least 1.1 times book value (\$625.9 million). Thus, the court finds that plaintiffs are entitled to damages based on defendants having undervalued the merchant business by \$56.9 million (\$625.9 million - \$569 million).

The court is unpersuaded by the parties' other arguments about the proper measure of damages and only awards damages on categories addressed in plaintiffs' post-trial brief (*see* Dkt. 720 at 23-26). Plaintiffs are therefore entitled to recover their pro rata share of

\$551.9 million (\$495 million + \$56.9 million). Capone is owed \$8,278,500 based on his 1.5% interest and Scheinman is owed \$3,863,300 based on his 0.7% interest.

The court rejects defendants' arguments about why Scheinman's recovery should be reduced. The court has already rejected defendants' argument that Scheinman's conduct may be used to set off their liability (*see* Dkt. 157 at 5-6), and the court further rejects defendants' argument that Scheinman's conduct, whether viewed as disloyal or a breach of contract, is a valid defense to defendants' bad-faith breach. Defendants complain that it was Scheinman's fault that § 7.6 was "broken" due to the drafting of § 7.4(c)(i), and thus it was his fault that the parties' agreement does not reflect their intent that the value of a 2011 sale should have been factored into plaintiffs' buyout. This is cynical. The very reason why defendants could be impelled to lowball plaintiffs was due to Scheinman's mistake. Having to pay plaintiffs based on the sale price can hardly be viewed as inequitable since that, according to defendants, is consistent with their real intent from the outset. Their litigation strategy was an attempt to capitalize on Scheinman's mistake so their complaints about it ring hollow. Likewise, the court is not at all moved by defendants' complaints about what Scheinman told Capone. Scheinman telling Capone about § 7.6 has nothing to do with whether Capone was aggrieved by defendants' bad-faith FMV and is not a credible basis to let defendants off the hook for their bad faith.

There is no other basis to reduce Scheinman's recovery. To be sure, the court previously held that if Scheinman prevailed "on his claim for being underpaid for his Units" his recovery could be subject to a set-off for being overpaid under the Separation Agreement (Dkt. 157 at 7; *see id.* n 9, citing Dkt. 78 at 19-20). But defendants have the burden of proving affirmative defenses, including entitlement to offsets (*Brignoli v Balch, Hardy & Scheinman, Inc.*, 178 AD2d 290 [1st Dept 1991]; *see Oden v Chemung Cty. Indus. Dev. Agency*, 87 NY2d 81, 89 [1995]). They have not come close to carrying that burden. The court's prior decisions clearly identified the questions necessary to determine if, and how much, of a set-off is appropriate. Defendants' terse treatment of this topic fails to address these issues (*see* Dkt. 719 at 30) or to rebut Scheinman's testimony (Dkt. 689 ¶¶ 81-82). The court therefore lacks the requisite answers to the questions necessary to find that a set-off is warranted or how to calculate it. Scheinman's recovery will therefore not be decreased by any alleged overpayment under the Separation Agreement.

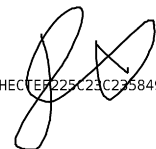
Finally, both in New York and Delaware, pre-judgment interest is considered a substantive rather than a procedural issue (*Davenport v Webb*, 11 NY2d 392, 395 [1962]; *see J.P. Morgan Sec. Inc. v Vigilant Ins. Co.*, 203 AD3d 541 [1st Dept 2022], citing *TIAA-CREF Individual & Institutional Servs., LLC v Illinois Natl. Ins. Co.*, 2017 WL 5197860, at *6 [Del Super Ct Oct. 23, 2017], *affd* 192 A3d 554 [Del 2018]). Substantive issues are governed by contractual choice-of-law clauses (*Frankel v Citicorp Ins. Servs., Inc.*, 80 ADD3d 280, 286 [2d Dept 2010], citing *Tanges v Heidelberg N. Am., Inc.*, 93 NY2d 48, 53 [1999]). Because the parties' agreement is governed by Delaware law (Dkt. 510 at 60), the amount of pre-judgment interest on plaintiffs' breach-of-contract claim is governed by Delaware law (*Cricket Stockholder Rep, LLC v Project Cricket Acquisition, Inc.*, 2019 WL 3944488, at *2 [Sup Ct, NY County Aug. 21, 2019]; *see Schwimmer v Allstate Ins. Co.*, 176 F3d 648, 650 [2d Cir 1999])

Under Delaware law, "where there is no expressed contract rate, the legal rate of interest shall be 5% over the Federal Reserve discount rate including any surcharge as of the time from which interest is due" (6 Del C § 2301[a]). The Holdback Amount is not at issue here so the interest rate in § 7.7(b) is inapplicable (see Dkt. 510 at 53). Defendants do not identify any other expressed contract rate.

"The general rule is that interest starts on the date when payment should have been made" (Watkins v Beatrice Cos., 560 A2d 1016, 1020 [Del 1989]). While "prejudgment interest is awarded as a matter of right ... the trial court has some discretion in fixing the amount of interest where there has been inordinate delay caused by one of the parties" (Citadel Holding Corp. v Roven, 603 A2d 818, 826 [Del 1992]). Though defendants complain that plaintiffs caused inordinate delay by waiting years to sue, defendants themselves bear much of the blame for how long this case took since a massive detour to Delaware was needed because despite their awareness "at the time of dissolution of the Plaintiffs' non-frivolous claims against the LLCs for breach of contract" they canceled the LLCs without maintaining proper reserves "to cover the Plaintiffs' claims" (Capone, 2018 WL 1956282, at *14).

In the end, this was a complex case litigated in a complex manner by highly capable counsel with a substantial amount of money at stake. While each side made aggressive litigation decisions, the court cannot conclude that plaintiffs' timing in commencement of this action constitutes "inordinate delay" with which they should be faulted.

Accordingly, it is ORDERED that the Clerk is directed to enter judgment (1) in favor of plaintiff Kevin Capone and against defendants LDH Management Holdings LLC and LDHMH MM, LLC, jointly and severally, in the amount of \$8,278,500 plus pre-judgment interest in accordance with 6 Del C § 2301(a) from April 12, 2011 to the date judgment is entered; and (2) in favor of plaintiff Steven Scheinman and against defendants LDH Management Holdings LLC and LDHMH MM, LLC, jointly and severally, in the amount of \$3,863,300 plus pre-judgment interest in accordance with 6 Del C § 2301(a) from April 12, 2011 to the date judgment is entered; and plaintiffs shall e-file a proposed judgment to the Clerk consistent with this order.

20221202134357JJSCHECTER225C23C275849C3AE6868EDF3FCBAEA


JENNIFER SCHECTER, JSC

DATE: 12/2/2022

Check One:

Case Disposed

Non-Final Disposition