Public Sector Pension Inv. Bd. v Saba Capital Mgt., L.P.
2016 NY Slip Op 30215(U)
February 8, 2016
Supreme Court, New York County
Docket Number: 653216/2015
Judge: Anil C. Singh

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

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PUBLIC SECTOR PENSION INVESTMENT BOARD,

Plaintiff,

-against-

SABA CAPITAL MANAGEMENT, L.P.,
SABA CAPITAL OFFSHORE FUND, LTD.,
SABA CAPITAL, LLC and BOAZ WEINSTEIN

Defendants.

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DECISION AND ORDER

Index No.653216/2015
Mot. Seq. 001

HON. ANIL C. SINGH, J.

In this action for, *inter alia*, breach of contract and fiduciary duty, defendants move pursuant to CPLR 3211(a) (1) and (7) for an order dismissing the complaint. Plaintiff opposes.

Facts

Plaintiff Public Sector Pension Investment Board ("PSP") is a Canadian Crown Corporation and pension investment manager based in Montreal that invests the pension assets of various Canadian public employees. A structure commonly used by hedge funds in order to pool investment capital allows investors to invest in feeder funds, which in turn invests their assets in a master fund.[1]

In the period 2012-2013, PSP became a shareholder and investor of an offshore investment vehicle based in the Cayman Islands, defendant Saba Capital Offshore Fund, Ltd. (the "Feeder Fund" or the "Fund"). PSP's share of the Fund were Class A shares. The Fund is managed by investment adviser Saba Capital Management, L.P. ("Saba Management" or

[1] http://www.investopedia.com/terms/m/master-feeder-fund.asp

"Investment Manager"), and its managing member is defendant Weinstein. Saba Management also advises the master fund, Saba Capital Master Fund, Ltd. (the "Master Fund").

The terms of PSP's investment in the Fund are set forth in the Subscription Agreement, a confidential offering memorandum ("OM"), the corporate charter of the fund, the Amended and Restated Memorandum and Articles of Association of Saba Capital Fund, Ltd, (together "Fund Documents"). Pursuant to the Fund Documents, the directors of the feeder fund and Master Fund are responsible for determining the net asset value ("NAV") of both funds. The directors delegated that responsibility to Saba Management which as disclosed in the OM agreed to value the securities held by the Master Fund in accordance with the valuation guidelines set forth in the OM. The fund and the Master fund entered into individual Investment Management Agreements with Saba Management where Saba Management agreed to discharge its responsibilities involving the exercise of discretion "consistent with its fiduciary duties to the Fund and the investors in the Fund." (¶22 of the Investment Management Agreement).

Additionally, the Fund Documents delineated the redemption process for PSP to exercise its right of redemption. PSP would, (a) provide written notice to the Fund 65 days prior to the redemption, (b) be notified of the utilized redemption price within 30 days of the redemption date, and (c) be entitled to interest which would start to accrue at that point in favor of PSP.

After experiencing losses, PSP informed the Fund on January 23, 2015 that it wished to liquidate its investment as of March 31, 2015. Part of the Fund's investment was in a particularly illiquid MNI Bond. The Fund used Saba Management as its agent to calculate the redemption price. In anticipation of the redemption, Saba Management used a bid-wanted-in-competition ("BWIC") auction to liquidate or value thirty-one bonds, for their NAV instead of the External Pricing Source method, which Saba Management had previously used. PSP has no issue with the

value assigned to twenty-nine of the bonds however, contested the value of two MNI Bonds. Plaintiff contends the BWIC method depressed the value of the subject bonds and likewise the amount allocated for PSP's redemption. Ultimately, Saba Management did not sell the MNI Bonds held by the Master Fund in order to satisfy the Feeder Fund's pending request from PSP but honored the request based upon the price obtained by the BWIC method.

Less than one month later, in April 2015, Saba Management once again used External Pricing Sources to mark the bonds back up to prices in the 50s, even though, according to PSP, nothing had changed in the markets warranting an adjustment at that time.

Discussion

On a motion to dismiss a complaint for failure to state a cause of action, a court should accept the facts pleaded in the complaint as true and, affording the plaintiff the benefit of every possible favorable inference, should determine whether such facts state a cognizable cause of action (Sokoloff v Harriman Estates Dev. Corp., 96 NY2d 409, 414 [2001]).

First Cause of Action for Breach of Contract against the Fund[2]

PSP claims the Fund Documents operated as a valid and binding contract which required the Fund to redeem its Class A shares at a price equal to the properly calculated NAV of those shares. Furthermore, PSP claims the Fund breached this requirement when, through Saba Management, it failed to adequately determine the Fund's NAV as of March 31, 2015 with the procedure set forth in the Fund Documents. This improper procedure according to PSP ultimately reduced its redemption proceeds. On the other hand, defendants argue that the OM set forth the obligations of the Investment Manager and gave broad discretion to determine the

[2] While this motion was *sub judice*, plaintiff discontinued the First Cause of Action for breach of contract claim asserted against Saba Capital Management, L.P. in the Notice of Partial Discontinuance of Claims dated December 8, 2015.

NAV. Specifically, they contend they were justified in using the BWIC process since the OM stated in part, the Investment Manager may "*consider*[], *among other factors,* such External Pricing Sources," in addition to "recent trading activity or other information that, *in the opinion of the Investment Manager*, may not have been reflected in the pricing obtained from such external sources." (OM at 83 (emphasis added).) Additionally, the Investment Manager is entitled to "value such securities *as it reasonably determines.*" (id.) (emphasis added). PSP contends that defendants utilized the BWIC process and completely disregarded any prices available from External Pricing sources.

First, defendants argue that the BWIC method could arguably be seen as an External Pricing source since Saba Management interacted with third parties in order to conduct the auction and determine the price in which the bonds could be bought. An External Pricing Source is defined in the Fund Documents as "independent pricing services or dealer quotations from a market maker or financial institution regularly engaged in the practice of trading in or pricing such securities." Conversely, the BWIC process has no defined parameters. Defendants have not set forth any documents that clearly contradict PSP's assertion that BWIC is not an external pricing source. "[A]any fact that can be fairly implied from the pleadings will be deemed alleged" L. Magarian & Co., Inc. v Timberland Co., 245 AD2d 69, 69 [1st Dept 1997]). Assuming the truth of PSP's allegation, which we must at this juncture PSP has sufficiently alleged that BWIC is not an external pricing source.

Second, PSP contends that while the Fund Documents may allow Saba Management to utilize "other factors," the Fund Documents do not on the other hand authorize defendants to completely ignore quotes available from the External Pricing Sources. PSP further posits that defendants turned a blind eye to the External Sources in order to manipulate the price downward.

If Saba Management conducted the valuation in bad faith then liability may attach regardless if BWIC is considered, "other factors" under the Fund Documents. Where a contract contemplates exercise of discretion, the covenant of good faith and fair dealing is implicit in the contract, which includes the promise not to act arbitrarily or irrationally in exercising that discretion (Dalton v Educ. Testing Serv., 87 NY2d 384, 389 [1995]). Here, Saba Management had a duty to "value such securities as it reasonably determines" (OM at 83), therefore was obligated to execute this discretionary feature in good faith (see Bullmore v. Ernst & Young Cayman Islands, 2006 WL 4682212) (finding duty on investment manager to value securities in good faith even in the absence of the Agreement's express contractual obligation). As of March 31, 2015 the External Pricing Sources returned price quotes of 50-60, opposed to the BWIC process which determined the price to be 31. Defendants argue that the duty to consider must also include the ability to reject the External Pricing Source. Nonetheless, the ambit of that discretion to reject must not be exercised arbitrarily. At this juncture, PSP has alleged the valuation method was not performed in good faith thus PSP has sufficiently a cause of action for breach of contract against the Fund (Dalton v Educ. Testing Serv., at 392-93) (finding defendant did not consider relevant information and by doing so, failed to comply in good faith with its own procedures, thereby breaching its contract with plaintiff).

Second Cause of Action for Tortious Interference with Contract against Weinstein

PSP claims defendant Weinstein as the managing member of the investment manager intentionally, without justification and to further his own personal interests, induced the Fund to breach its contractual obligations owed to PSP. A party to a contract has a right of action against a person who has procured a breach by the other party thereto (Lama Holding Co. v Smith

Barney Inc., 88 NY2d 413, 424 [1996]). "Tortious interference with contract requires the existence of a valid contract between the plaintiff and a third party, defendant's knowledge of that contract, defendant's intentional procurement of the third-party's breach of the contract without justification, actual breach of the contract, and damages resulting therefrom." (Id.).

Defendants argue defendant Weinstein may not be found liable for tortious interference because he was not a stranger to the contract. A corporate officer is not liable for tortuously interfering with a corporate contract when he is considered a party to the contract (Burdett Radiology Consultants, P.C. v Samaritan Hosp., 158 AD2d 132, 136 [3d Dept 1990]). PSP is alleging breach of contract between itself and the Fund. While Weinstein is an insider to the investment manager, he is not an insider to any entity that is a member of the agreement thus, he is a third party to the contract. The extent of Weinstein's control over the investment manager or the Fund is a non sequitur (C.f. Solow v Stone, 994 F Supp 173, 182 [SDNY 1998]] (stating in dicta, defendant could not be liable for tortious interference when he was an insider of the *contracting* corporation in which he exercised control). Accordingly, a claim against Weinstein may be actionable.

Ordinarily a corporate officer acting in good faith is immune from liability for the acts of its corporation (Buckley v 112 Cent. Park S., Inc., 285 AD 331, 334 [1st Dept 1954]). However, under a heightened pleading standard, a corporate official may be found personally liable for his or her acts if their actions constitute independent tortious conduct (Intl. Credit Brokerage Co., Inc. v Agapov, 249 AD2d 77, 77 [1st Dept 1998]). Plaintiffs must claim the individual either acted beyond the scope of his employment or, if not, was motivated by his personal gain (Am.-Eur. Art Assoc., Inc. v Trend Galleries, Inc., 227 AD2d 170, 172 [1st Dept 1996]). The parties agree that defendant Weinstein was acting within the scope of his employment.

Conversely, the parties disagree on whether Weinstein's acts must elicit any personal gain or whether the personal gain must be separate and apart from the corporation. Plaintiff cites to Herald Hotel Assoc. to stand for the proposition that a corporate insider could be held liable for tortious interference of contract "regardless of whether he acted in furtherance of the interests of either corporation" (Herald Hotel Assoc. v Ramada Franchise Sys., Inc., 191 AD2d 288, 288 [1st Dept 1993]). However, recent case law has clarified that the pleadings must allege that the individual defendant corporate officer must have been acting for his or her own personal interests *rather than* for the corporate interest" (Petkanas v Kooyman, 303 AD2d 303, 305 [1st Dept 2003]) (emphasis added).

PSP contends that Weinstein derived personal gain as a non-redeeming shareholder in the Fund because the Fund paid PSP an artificially low price for their redemption of shares then retained the shares of the subject bonds which were actually worth much more as indicated in the April valuation.[3] Thus, the personal benefit allegedly received by Weinstein was also bestowed upon the corporation and all non-redeeming shareholders. From a policy perspective, corporate officers and directors should not be dis-incentivized from furthering the interest of their corporation when they tangentially might receive a benefit as well. PSP has not sufficiently alleged a cause of action of tortious interference with contract against Weinstein and accordingly that claim is dismissed without leave to replead.

Third Cause of Action for Breach of Fiduciary Duty against Saba Management

PSP brings this claim against Saba Management for breaching a separate fiduciary duty owed directly to PSP for failing to protect PSP's interest as an investor.

[3] Specifically, the investment structure is as follows: Weinstein owns shares in the intermediate fund whose assets are invested in the same Master Fund that the Fund's assets are invested.

The court first must determine which law to apply to this controversy. In analyzing the standing of a breach of fiduciary duty claim, the choice of law is between the application of New York or Cayman Islands law. New York courts apply the internal affairs doctrine, which dictates that the internal affairs of a corporation will be governed by the state in which the corporation is incorporated (Hart v Gen. Motors Corp., 129 AD2d 179, 184 [1st Dept 1987]). Defendants have vacillated on their position on which law applies but it is of no consequence. The issue of valuing fund assets is squarely within the internal affairs of the Fund and since the Fund was incorporated in the Cayman Islands, then Cayman law applies.

The court may take judicial notice of the laws of foreign countries (CPLR 4511(b))[4]. "The Cayman Islands modeled its laws predominantly on English common law, which prohibits shareholder derivative actions" (Shenwick v HM Ruby Fund, L.P., 106 AD3d 638, 639 [1st Dept 2013]). Under Cayman Law, the proper plaintiff in an action with respect to a wrong allegedly done to a company (whether by management or otherwise) generally is the company itself. (Svanstrom & Ors v. Jonasson, 1997 CILR192 at 195-196; Hatfield First Aff.). Defendants argue that PSP does not have standing to bring a cause of action for improper valuation since it must be brought by the Fund itself against, its own investor manager, Saba Management. Defendants reason that PSP is asserting a derivative claim because the March NAV calculation was the same for PSP as it was for every other investor in the Fund. On the other hand, PSP contends the injury only occurred to the redeeming shareholders.

The Cayman Islands Court of Appeals incorporated the following principle into the law of the Cayman Islands:

[4] PSP has submitted three affidavits by Laura Hatfield and defendants have submitted two affidavits by Mac Webster Imrie. Both are practicing attorneys in the Cayman Islands and have attested to their knowledge of the law in the Cayman Islands and referenced supporting case law.

> "What [a shareholder] cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company, in which he has (say) a 3 per cent shareholding." (Prudential Assurance Co Ltd v. Newman Indus. Ltd. (No 2) [1982] Ch 2046)

In order to ascertain whether the claim is direct, Cayman law dictates, like New York law, an analysis on whether the company has suffered a harm and consequently the shareholder has suffered a reflective loss through its company or, rather, the shareholder has suffered a direct loss constituting a direct claim[5]. A "shareholder may bring a direct claim where he or she has suffered harm not suffered by the corporation generally, and will be individually entitled to the benefit of the remedy obtained (Brinckerhoff v JAC Holding Corp., 10 AD3d 520, 521 [1st Dept 2004]). "[T]he proper inquiry in distinguishing between a direct and derivative claim is what is the nature of the harm alleged and who is principally harmed: the corporation or the individual shareholders." (Higgins v New York Stock Exch., Inc., 10 Misc 3d 257, 266 [Sup Ct 2005]).

All of the shareholders of the Fund were in fact subject to the alleged improper valuation of their shares. Ultimately, however, only the redeeming shareholders suffered a tangible harm. There is no harm that could be remedied for the Fund since it did not suffer a monetary loss for redeeming their shares at an improper price (see Brinckerhoff v JAC Holding Corp., 10 AD3d 520, 521 [1st Dept 2004]). On the contrary, taking plaintiffs allegations as true, PSP has alleged the undervaluation benefited the Fund because the amount of the Fund's redemption liability to the plaintiff was reduced (Higgins v New York Stock Exch., Inc., 10 Misc 3d 257, 272 [Sup Ct , NY Cty, 2005]) ("In contrast, the NYSE is being benefitted, or, put differently, is not injured; by

[5] The injury analysis is the same between Cayman law and New York law, therefore New York law will be referenced for convenience.

paying less equity out to the seatholders, the NYSE retains more shareholders' equity, translating into more assets appearing on the NYSE balance sheet"). PSP has asserted a direct claim against Saba Management.

Defendants also argue that the claim for fiduciary duty should be dismissed as duplicative of the breach of contract claim. PSP posits that shortly after PSP tendered its redemption notice, Saba Management undertook an extra contractual duty by stating that it would work directly with PSP to maximize the value of its redemption. Defendants allege that that duty, is the same duty that Saba Management owed to all investors.

Upon review of the expert affidavits submitted by both plaintiff and defendants on Cayman Law there is no substantial difference between New York and Cayman law and such under choice of law principles, this Court will refer to New York law for convenience.

"[W]hile causes of action for breach of fiduciary duty that merely restate contract claims must be dismissed, conduct amounting to breach of a contractual obligation may also constitute the breach of a duty arising out of the relationship created by contract which is nonetheless independent of such contract" (Bullmore v Ernst & Young Cayman Is., 45 AD3d 461, 463 [1st Dept 2007]) (internal citations omitted)).

PSP has discontinued its breach of contract claim against Saba Management thus this claim for breach of fiduciary duty is the only remaining action asserted against Saba Management for the alleged marked down valuation. The Fund and the Master fund entered into individual Investment Management Agreements with Saba Management and under the OM was obligated to value the securities held by the Fund in accordance with the valuation guidelines. Conversely, there is no direct privity between PSP and the Saba Management.

Since Saba Management had no contractual requirement to act, specifically on behalf of PSP, Saba Management undertook an extra contractual duty when it affirmatively stated it would maximize PSP's redemption (Walnut Hous. Assoc. 2003 L.P. v MCAP Walnut Hous. LLC, 2016 NY Slip Op 00617 [1st Dept Feb. 2, 2016] (affirming sufficiently of breach of fiduciary duty claim as not duplicative against a defendant that did not have a contractual obligation directly to the plaintiff).

PSP has conceded it owed a fiduciary duty to PSP (Transcript of Oral Argument at 8) and the affirmative representation illuminates the scope of that duty. (see Gochberg v Sovereign Apartments, Inc., 119 AD3d 431, 432 [1st Dept 2014] (holding that contrary "to defendants' contention, plaintiffs' breach of fiduciary duty claim is not a breach of contract claim in disguise" since it was premised on different duties). Assuming the truth of PSP's allegation that Saba Management did not maximize PSP's redemption then, PSP has adequately alleged a breach of fiduciary duty claim against Saba Management

Fourth Cause of Action for Aiding and Abetting against Weinstein

PSP brings this claim against Weinstein for conspiring with Saba Management in improperly calculating the NAV of the subject bonds in order for Weinstein to personally benefit. Both parties concede that New York law applies to this claim since the tort occurred in New York which has the greatest interest (Transcript of Oral Argument at 13, 43).

A claim for aiding and abetting a breach of fiduciary duty will lie where there is: (1) a breach of fiduciary obligations; (2) a defendant who knowingly induced or participated in the breach; and (3) injury to the plaintiff as a result of the breach (Kaufman v Cohen, 307 AD2d 113, 125 [1st Dept 2003]).

Defendants argue that Weinstein may not be found liable for aiding and abetting since he is part of the same corporate structure as Saba Management thus he is not an independent actor in order to aid and abet another actor. Defendants rely solely upon the persuasive authority of Solow v Stone, whereby in the context of a bankruptcy, the court held… "a third-party relationship between the alleged aider and abettor and the corporation is a necessary element in any such action." (994 F Supp 173, 181 [SDNY 1998] affd, 163 F3d 151 [2d Cir 1998]). The court dismissed the claim finding the defendant was part of the corporate structure of the corporation alleged to have breached the fiduciary duty (id.). That case may be distinguished from the instant facts whereby defendant Weinstein is an *officer* of the alleged corporation alleged to have breached the fiduciary duty. The binding authority of the First Department has affirmatively held that an officer of a corporation who knowingly participates in a breach of the corporation's fiduciary duties may be held personally liable. (Talansky v Schulman, 2 AD3d 355, 360 [1st Dept 2003]).

On the other hand, plaintiff has failed to sufficiently allege in a non-conclusory matter that defendant Weinstein knowingly induced Saba Management to breach its fiduciary duty owed to PSP to maximize its redemption when Saba Management downgraded the valuation of the subject bonds (Kaufman v Cohen, 307 AD2d 113, 125 [1st Dept 2003]). PSP's cause of action for aiding and abetting a breach of fiduciary duty against Weinstein is dismissed without prejudice.

This constitutes the decision and order of the Court.

Date: February 8, 2016
New York, New York

Anil C. Singh