Elmrock Opportunity Master Fund I, L.P. v Citicorp N. Am., Inc.
2016 NY Slip Op 32508(U)
December 19, 2016
Supreme Court, New York County
Docket Number: 653300/16
Judge: Barry Ostrager
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 61

_____X

ELMROCK OPPORTUNITY MASTER FUND I, L.P.,

Plaintiff,

-against-

CITICORP NORTH AMERICA, INC., ESSL 2, INC., and CITIGROUP INC.,

Defendants.

_____X

INDEX NO. 653300/16

Motion Seq. No. 001

OSTRAGER, J:

Presently before the Court is a motion by the defendants Citicorp North America, Inc., ESSL 2, Inc. and Citigroup Inc. (collectively "Citi") to dismiss the complaint pursuant to CPLR §3211(a)(1) and (7). Plaintiff Elmrock Opportunity Master Fund I, L.P. ("Elmrock") is a hedge fund that purchased from Citi in 2010 options for $7,250,000 relating to a complex, multi-party transaction involving a nuclear power plant in Louisiana, the Waterford Steam Electric Generating Station, Unit 3 ("Waterford 3" or "Plant"). In this action, plaintiff Elmrock seeks $99,636,317.62 in compensatory damages and $100,000,000 in punitive damages for Citi's alleged breach of contract, breach of fiduciary duty, and fraud.

In brief, Citi owned approximately 10% of the plant by virtue of a sale and leaseback transaction Citi entered into with the Plant's owner in 1989. In 2010, Citi sold to Elmrock options in the Plant's expected income stream for $7,250,000. The Elmrock purchase contemplated that Elmrock would receive a return on its investment if the income stream in the Plant, from either the re-purchase or re-lease of Citi's interest by the owner of the Plant in 2017, exceeded $72 million. The income stream did not reach the mark, and Elmrock is now "out of the money." The issue in this case is complicated by a contested appraisal of Citi's interest in the Plant in 2014 and 2015 and a settlement between Citi and the

Plant's owner in connection with the disputed appraisal. Nevertheless, for the reasons stated below, Citi's motion is granted in part and denied in part.

Background

In 1989, Citi entered into a sale and leaseback transaction with Entergy Louisiana LLC ("Entergy"), the Plant's successor in interest (Complaint, ¶8). Entergy sold three 10.47% undivided interests to First National Bank of Commerce ("First National"), as owner trustee for the benefit of ESSL 2, a Citi subsidiary (¶¶10-11). Entergy then leased back the property from ESSL 2, to the extent of the undivided interests, and retained the option to re-purchase or re-lease the undivided interest at the expiration of the initial lease term in July 1, 2017 (¶¶13, 19).

In 2005, ESSL 2 entered into three Option Purchase and Sale Agreements dated July 25, 2005 with Fortress Investment Group LLC ("Fortress"). Under these Agreements, Fortress exercised its right to purchase at a strike price of $1 each an interest in the income stream from any re-lease commencing after July 2, 2017, or any sale of the undivided interests in Waterford 3 (¶21). In 2010, Citi offered Elmrock a similar deal.

In January 2010, Citi's Vice President Brian Whalen emailed Elmrock's David Elliman and Margot Rubin about the possibility of purchasing "a lease residual option in the prospective cash proceeds of a sale or re-lease of the undivided interests in Waterford [3]" following the expiration of the initial lease term (¶22). Relevant portions of the emails are quoted by plaintiff in the Complaint (at ¶22 and ¶23) which provide in part:

> [N]uclear power generating facilities were originally licensed by the NRC [Nuclear Regulatory Commission] for forty years. In March 2000, the NRC approved the first license extension of a nuclear plant, extending by twenty years the initial forty-year license. Because of the substantial cost involved in construction of new facilities (as well as the political and regulatory impediments to new nuclear power generation facilities), license extension is a relatively inexpensive way to maintain capacity. License extension is also a means of deferring decommissioning activity and the associated expense. Our understanding is that the vast majority of operating U.S. nuclear facilities are expected to be granted license extensions, and Entergy has stated its intent to submit a license renewal application for Waterford 3 in January 2013.... With

> a 40-year NRC license plus a 20-year anticipated license renewal, the expected economic useful life may be viewed as ending in 2044 ... Of course, we don't know what the lessee will do.

In addition, on February 3, 2010, Whalen transmitted another email to Elmrock with a revised Valuation Analysis of Waterford 3 prepared by DAI Management Consultants for Citi, which stated in pertinent part:

> The facility's [Waterford 3] current NRC operating license expires [on] December 18, 2024. Although Entergy has not yet submitted an application for extension of the operating license, DAI expects that they will eventually apply for, and receive, a twenty-year license extension for Waterford 3 ... As of 2005, the remaining economic useful life of the facility is estimated to be forty years, through December 2045.

Plaintiff entered into the three Option Purchase and Sale Agreements ("Agreements") dated June 30, 2010 with Citi by relying, allegedly, on representations concerning the economic useful life of Waterford 3 until at least 2044 (¶25). Elmrock paid $7,250,000 for these options (¶26).

Under the Agreements, the first $70,720,000 of the income stream expected from either the lease payments after July 2, 2017 or sale of the undivided interests in Waterford 3 would go 100% to Fortress as a preferred option holder in the 2010 deal. Any amounts from $70,720,000 to $123,760,000 would go 25% to Fortress and 75% to Elmrock; any amounts from $123,760,000 to $176,800,000 would go 25% to Fortress, 54.9975% to Elmrock, and 20.0025% to ESSL 2; any amounts from $176,800,000 to $230,770,321.60 would go 25% to Fortress and 75% to Elmrock; any amounts from $230,770,321.60 to $266,130,321.60 would go 25% to Fortress and 75% to ESSL 2; and any amount above $266,130,321.60 would go 25% to Fortress, 18.75% to Elmrock, and 56.25% to ESSL 2. This payout schedule is set forth in the Agreements (¶26). Simply stated, Elmrock was to receive nothing if the income stream from re-sale or re-lease of the undivided interest in Waterford 3 did not exceed $70,720,000, but was entitled to receive various percentages thereafter.

Furthermore, under the facility leases governing the lessor-lessee relationship between ESSL 2 (Citi's subsidiary) and Entergy, Entergy could notify ESSL 2 in writing several years prior to the

expiration of the initial lease term in July 2017 of Entergy's election to (i) return the undivided interests it was leasing, (ii) exercise lease renewal options, or (iii) purchase the undivided interest at the end of the initial term for their Fair Market Sales Value. In connection with the latter option, if ESSL 2 and Entergy disagreed on the Fair Market Sales Value, then an appraisal procedure contained in the facility leases governed, i.e. each of Entergy and ESSL 2 were to select an appraiser, and if the two appraisers disagreed, *inter alia*, as to the value, period, or amount, they would select a third appraiser and the average of the three appraisers' determination was to be conclusive (¶¶17-20).

On July 23, 2014, Entergy informed ESSL 2 that it was prepared to move forward with either the re-purchase or re-lease of ESSL 2's undivided interest in Waterford 3 (¶40). Entergy valued the Fair Market Sales Value of the Plant's undivided interest at $39,700,000 dollars, predicated upon an assumed reversion of the undivided interest back to Entergy at the end of the ground lease term in December 2024 (¶40). Citi disagreed and argued that the Plant's expected useful life was through 2044, predicated on Entergy's anticipated license extension from NRC (¶52-53). As Entergy and Citi disagreed on the assumptions underpinning the valuation of the undivided interests, they resorted to the appraisal procedures contained in the facility leases.

ESSL 2 appointed Lummus Consultants International, Inc. as its appraiser on August 14, 2014 (¶41). Entergy appointed PA Consulting Group, Inc. as its appraiser on January 5, 2015. The two consultants disagreed on the valuation of the undivided interests as well. Subsequently, ESSL 2 and Entergy entered into a Supplemental Appraisal Protocol dated March 2, 2015 (*see* moving papers, Whalen Aff., Exh. 6).

The Supplemental Appraisal Protocol ("Protocol") provided that, after the appointment of a third appraiser, if the three appraisers could not agree on the underlying assumptions, then either Entergy or ESSL 2 could seek judicial review in the U.S. District Court for the Eastern District of Louisiana within 30 days of receipt of all reports by ESSL 2 and Entergy (*Id.* at 12) (Complaint ¶49). Notably, the

Protocol provides that any "Transaction Party" may seek judicial review of unresolved valuation assumptions (Whelan Aff., Exh. 6 at 12), and only ESSL 2 and Entergy are defined as "Transaction Parties" (at 3).

By March 31, 2015, a third appraiser, Concentric Energy Advisors, Inc., was chosen (¶50), and on July 24, 2015, the three appraisers issued their reports. All three appraisers agreed that the *economic useful life* of Waterford 3 was through the end of 2044, but two of the three appraisers agreed that the *valuation* period ended in 2024 (¶ 54). As a result, in accordance with the modified appraisal procedures, the appraisers determined that for a valuation period ending in 2024, the Fair Market Sales Value was under $40 million, and for valuation period ending in 2044, the Fair Market Sales Value was just over $167 million (¶54). In short, Elmrock is "out of the money" if the valuation period through 2024 controls or Elmrock is "in the money" if the valuation period through 2044 controls.

About a week later, on July 31, 2015, Citi informed Elmrock of the appraisal values and provided it with copies of the appraisal reports (¶56). Several days later, Elmrock requested Citi, by phone and in writing, to commence litigation proceedings to challenge the outcome of the appraisals (¶57). In a letter dated August 6, 2015, Elmrock's counsel wrote to Citi's counsel as follows:

> I am writing to confirm that, in our telephone conversation yesterday and today, I advised you that my client [Elmrock], as Buyer, directed (and is hereby again directing) your client [Citi], as Seller, under the [Option Purchase and Sales] Agreements to: (i) commence litigation (or to cause ESSL 2, Inc. to do so) in accordance with Section 10(d) of the Supplemental Appraisal Protocol dated March 2, 2015 between ESSL 2, Inc. and Entergy Louisiana, LLC within the 30-day time frame provided therein...[1]

The complaint alleges that Citi did not comply with Elmrock's "reasonable request" and "stopped transmitting documents and keeping Elmrock informed of the contents of any negotiations" between Entergy and/or Fortress (¶58). Plaintiff further alleges that Citi informed Elmrock of a potential settlement with Entergy months later, in November 2015. However, Citi provided a series of

[1] *See* moving papers, Rubin Aff., Exh. 1.

letters from August to November 2015 showing a different string of communications between Citi and Elmrock (*see* opposition papers, Rubin Aff, Exhs. 2-10). For example, in a letter dated August 12, 2015 (Rubin Aff., Exh. 2) Citi's counsel wrote to Elmrock's counsel:

> As you have been advised, Citi is committed to achieving a commercially reasonable solution to the appraisal dispute. To that end, Citi is prepared [to] assign Elmrock ... and Fortress the right to control any anticipated litigation seeking judicial review pursuant to the appraisal protocol between ESSL 2... and Entergy.
>
> As you were advised and as your client is aware, Citi divested substantially all of its interest in the Facility Lease pursuant to the 2010 transaction with Elmrock. It is not reasonable (or required by the Option Purchase and Sale Agreements between Citi and Elmrock) for Elmrock to direct Citi to prosecute a claim for which Elmrock and Fortress are the real parties in interest.

Additional letters from Citi from this time period indicate that Elmrock refused to pursue such litigation and further refused to allow Citi to reveal Elmrock's identity and role in the transaction to Fortress, the preferred equity holder in the 2010 deal (Rubin Aff., Exhs. 2, 3). The letters also indicate that Citi offered to request a 45-day extension of the deadline to commence judicial challenge of the appraisal to help Elmrock and Fortress preserve their rights. (Rubin Aff., Exh. 2).

Finally, in an email dated November 10, 2015, Citi informed Elmrock that Entergy agreed to settle the dispute over the residual value of the undivided interest in Waterford 3 for $60 million dollars (Rubin Aff., Exh. 8). Accordingly, Citi and Entergy entered into a purchase agreement dated December 18, 2015 (*Id.*, Exh. 10) (Complaint, ¶62).

At some point in 2016, Elmrock retrieved from the Securities and Exchange Commission website Entergy's 10-K Form for the year ending in December 31, 2015 (Rubin Aff., Exh. 13). Elmrock alleges that the 10-K Form shows that Entergy purchased the undivided interests in Waterford 3 for $183,273,000, contrary to Citi's representations that the interests were purchased for $60 million (¶63). In its complaint against Citi, plaintiff Elmrock asserts four causes of action: (1) breach of contract, (2) breach of fiduciary duty, (3) fraud in the inducement, (4) fraud, and also seeks punitive damages.

Analysis

On a pre-answer motion to dismiss pursuant to CPLR 3211(a)(1) and (7), the Court must "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory.... Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law...." *Leon v Martinez*, 84 NY2d 83, 87 (1994) (citations omitted).

The First Cause of Action: Breach of Contract

A breach of contract claim requires the existence of a contract, the plaintiff's performance thereunder, the defendant's breach thereof, and resulting damages. *Harris v Seward Park Hous. Corp.*, 79 AD3d 425, 426 (1st Dept 2010). It is undisputed that three Option Purchase and Sale Agreements existed between plaintiff and defendants and that plaintiff performed by paying $7,250,000. As for breach and resulting damages, Elmrock alleges Citi breached several affirmative and negative covenants contained in Articles 9 and 10, respectively, in the Agreements at issue.

For example, Elmrock alleges that Citi breached, among others, paragraph 10(g) of the Agreements by agreeing with Entergy to modify the appraisal procedures without Elmrock's prior written consent. The provision provides in relevant part:

> Modification of Documents. Seller [Citicorp] shall not cause or permit ESSL 2 to cause the Owner Trustee to, without the written consent of Buyer [Elmrock] (which consent shall not be unreasonably withheld), amend, modify or waive any provisions of the Transaction Documents in effect on the date hereof, which could reasonably be expected to (i) have more than a de minimis impact on Buyer's rights with respect to the Option or the Option Property [as defined in paragraph 1(a)] or the value of the Buyer's interest therein...

In addition, Elmrock alleges that Citi breached paragraph 10(i) of the Agreements by settling with Entergy for $60 million dollars without obtaining Elmrock's written consent. The provision provides:

Decline Proceeds. Without the prior written consent of Buyer, which consent shall not be unreasonably withheld, Seller shall not cause or permit ESSL 2 to agree to any reduction in any Option Property.

Citi does not contest its failure to obtain Elmrock's written consent prior to modifying the appraisal procedures or prior to settling the value of the interests with Entergy for $60 million, which impacted Elmrock's options under the Agreements. Therefore, the First Cause of Action survives dismissal.

In its memorandum of law in support of the motion, Citi argues, *inter alia*, that the contract claim fails as a matter of law because the damages are too speculative. *Kantor v 75 Worth St.*, LLC, 95 AD3d 718 (1st Dept 2012). However, to survive a pre-answer motion to dismiss pursuant to CPLR §3211(a)(7), "a pleading need only state allegations from which damages attributable to the defendant's conduct may reasonably be inferred." *Lappin v Greenberg,* 34 AD2d 277 (2006). At this early stage of the proceedings, plaintiff is not obliged to show that it actually sustained damages but only that "damages attributable to [defendants' conduct] might be reasonably inferred." *InKine Pharm. Co. v Coleman,* 305 AD2d 151, 152 (2003). In that respect, plaintiff's allegations are sufficient to sustain its breach of contract claim which seeks $99 million in damages.

The Second Cause of Action: Breach of Fiduciary Duty

To establish a breach of fiduciary duty claim, plaintiff must prove (1) the existence of a fiduciary relationship, (2) misconduct by the defendants, and (3) damages directly caused by the defendants' misconduct. *Pokoik v Pokoik*, 115 AD3d 428, 429 (1st Dept 2014), *citing Kurtzman v Bergstol*, 40 AD3d 588, 590 (2d Dept 2007). A fiduciary relationship is "grounded in a higher level of trust than normally present in the marketplace between those involved in arm's length business transactions." *Oddo Asset Management v Barclays Bank PLC*, 19 NY3d 584, 593 (2012), *citing EBC I, Inc. v Goldman Sachs & Co.*, 5 NY3d 11, 19 (2005). The Court of Appeals has held that a fiduciary duty exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon

matters within the scope of the relationship. *Roni LLC v Arfa*, 18 NY3d 846, 848 (2011). Additionally, a fiduciary relationship *may* exist where one party reposes confidence in another and reasonably relies on the other's superior expertise or knowledge. *Id., quoting AG Capital Funding Partners, L.P. v State St. Bank & Trust Co.,* 11 NY3d 146, 158 (2008) ("A fiduciary relation exists when confidence is reposed on one side and there is resulting superiority and influence on the other").

The transactions at issue involved ground leases and facility leases between ESSL 2, Citi's subsidiary, as lessor, and Entergy, as lessee, as well as a deal between Citi and Elmrock for an expected income stream in the undivided interests in Waterford 3 after July 2, 2017. All the parties involved in these complex transactions were highly sophisticated; it cannot be said that any one party relied upon the superior expertise of the other or that any fiduciary relationship was created by the arm's length transaction beyond the terms of the contract. As such, the Second Cause of Action sounding in breach of fiduciary duty is duplicative of the breach of contract claim and cannot stand. *See, e.g., Celle v Barclays Bank P.L.C.*, 48 AD3d 301, 302 11st Dep't 2008).

The Third Cause of Action: Fraud in the Inducement

Plaintiff alleges that Elmrock was induced to purchase for $7,250,000 an expected income stream from either re-lease or re-sale of undivided interests in Waterford 3 after July 2, 2017 by relying on Citi's alleged false representation of the Plant's economic useful life at least through 2044 (Complaint, ¶82). To state a claim for fraudulent inducement, "there must be a knowing misrepresentation of material present fact, which is intended to deceive another party and induce that party to act on it, resulting in injury." *Wyle Inc. v ITT Corp.*, 130 AD3d 438, 438-39 (1st Dept 2015), *quoting Go Smile, Inc. v Levine,* 81 AD3d 77, 81 (1st Dept 2010), *lv dismissed* 17 NY3d 782 (2011).

Plaintiff Elmrock quotes in its complaint email communications from Citi to Elmrock at the initial stages of the 2010 transaction where Citi predicted the Plant's expected useful economic life

through 2044 by anticipating a grant of a 20-year license extension by the Nuclear Regulatory Commission (NRC) (*see supra* at 2) ("... With a 40-year NRC license plus a 20-year anticipated license renewal, the expected economic useful life may be viewed as ending in 2044 ... Of course, we don't know what the lessee will do."). The complaint further concedes that the three appraisers retained in 2014 and 2015, more than 4 years after Elmrock entered into the Agreements with Citi, also grappled with the appropriate valuation assumptions of the undivided interest in the Plant. As there is no indication that Citi knowingly misrepresented the expected useful life of the Plant through 2044, nor that Citi had the intent to deceive Elmrock in so stating, the Third Cause of Action is hereby dismissed.

The Fourth Cause of Action: Fraud

To state a claim for fraud, the complaint must allege misrepresentation or concealment of a material fact, falsity, scienter on the part of the wrongdoer, justifiable reliance and resulting injury. *ACA Fin. Guar. Corp. v Goldman Sachs & Co.*, 131 AD3d 427, 428 (1st Dept 2015). Plaintiff alleges that Citi defrauded it by agreeing to Entergy's settlement offer of $60 million dollars for the undivided interests in Waterford 3. Plaintiff points to SEC 10-K Form submitted by Entergy in 2016 which allegedly reported the purchase of the undivided interests by Entergy for $183,273,000 (Rubin Aff., Exh. 13 at 166). In opposition, Citi argues that plaintiff is misreading the 10-K Form in that it represents $60,000,000 as the purchase price and an additional $123,273,000 for rent payments owed to ESSL 2 under the facility leases. Citi further argues that the Option Purchase and Sale Agreements between Citi and Elmrock specifically exclude payments of basic rent received prior to July 1, 2017 (Whalen Aff., Exh. 1 at 7) (Citi MOL at 10). However, even if a misrepresentation had been made, each sophisticated party was in a position to evaluate the information on its own, precluding justifiable reliance.

As with the fraudulent inducement claim, the Court finds that plaintiff has failed to allege the elements necessary to state a claim for fraud. Therefore, the Fourth Cause of Action is dismissed.

Punitive Damages

Plaintiff alleges that as a result of the defendants' actions, plaintiff is entitled to $100 million dollars in punitive damages. The following four elements must be pled to sustain a claim for punitive damages based on an alleged breach of contract: (1) conduct must be actionable as an independent tort; (2) the conduct must be egregious in nature; (3) the egregious conduct must be directed at plaintiff; and (4) the conduct must be a pattern directed at the public generally. *New York Univ. v. Continental Ins. Co.*, 87 NY2d 308, 316 (1995). Punitive damages are available only in those limited circumstances where the conduct is "morally reprehensible" and of "such wanton dishonesty as to imply a criminal indifference to civil obligations." *Rocanova v Equit. Life Assur. Soc. of U.S.*, 83 NY2d 603, 614 (1994), quoting *Walker v Sheldon*, 10 NY2d 401, 404–405 (1961).

Plaintiff alleges that Citi's actions toward Elmrock were "so egregious as to evidence a high degree of moral turpitude" (¶94). Plaintiff also alleges that Citi acted against Elmrock's interests in order to bolster its relationship with Fortress (¶95). Finally, plaintiff alleges that Citi's securitization of a future income stream of one investor and subsequent actions against the interests of such an investor is "consistent with its pattern of activity this century against numerous investors in securitized income streams, including investors in residential mortgage-backed securities" (¶98). The punitive damages claim is hereby dismissed as the alleged "egregious" conduct by Citi towards Elmrock is not directed at the public generally, and the plaintiff's attempt to link a commercial dispute between two entities to unrelated mortgage-backed securities is unavailing.

Accordingly, it is hereby

ORDERED that defendants' motion to dismiss is granted in part, and the Second, Third and Fourth causes of action of the complaint, as well as the request for Punitive Damages, are severed and dismissed, and the motion is otherwise denied; and it is further

ORDERED that defendants are directed to serve an answer to the remaining cause of action in the complaint within 20 days after service of a copy of this order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 341, 60 Centre Street, on January 17, 2017 at 9:30 a.m.

Dated: December 19, 2016

J.S.C.

BARRY R. OSTRAGER
JSC