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COMMERCIAL DIVISION UPDATE

Expert Analysis

The Hurdle to Pleading Fiduciary Duty Claims in Arm's Length Relations

Under New York law, business relationships can give rise to fiduciary duties in certain factual settings. As explained by the New York Court of Appeals in *EBC I Inc. v. Goldman, Sachs & Co.*, “[a] fiduciary relationship exists between two persons [whenever] 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 relation.”¹ Such a relationship “is grounded in a higher level of trust than normally present in the marketplace between those involved in arm’s length business transactions.”²

The Court of Appeals further advised that the determination of whether such a relationship exists is “necessarily fact-specific,” and that although the courts may look to a contract between the parties to discover the nature of the parties’ relationship, it is “fundamental” that the existence of a fiduciary duty does not depend solely on the language of that contract.³

Thus, in *EBC I Inc.*, the Court of Appeals found that the complaint stated a claim for breach of fiduciary duty where plaintiff alleged the relationship of the parties went beyond arm’s length to one of higher trust and confidence as the plaintiff allegedly relied on Goldman Sachs’ expert advice in pricing plaintiff’s public offering of securities. Likewise, in *AHA Sales Inc. v. Creative Bath Products Inc.*, the Appellate Division, Second Department, found a claim for breach of fiduciary duty had been stated where plaintiff sales representative alleged a long-established and dependent relationship with the defendant manufacturer giving rise to a special relationship of trust and confidence.⁴

Two recent Commercial Division opinions, one involving the relationship between a borrower and lender and the second a



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relationship between a contractor and property owner, illustrate the application of these principles to common business relations. These opinions demonstrate that New York courts are generally loath to recognize the existence of a fiduciary duty where the relationship of the parties is in the nature of an arm’s length business transaction without more.

‘Twin Holdings’

In *Twin Holdings of Del. LLC v. CW Capital, LLC*,⁵ the plaintiffs filed suit in Nassau County Supreme Court asserting nine causes of action, including breach of fiduciary duty, relating

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to the parties’ loan agreement. On March 20, 2007, the plaintiff-borrowers had entered into a contract to purchase a commercial building from defendants for the price of \$30 million. In addition to being the seller, the defendants agreed to act as lenders and to “extend short term financing for plaintiffs to acquire title and to renovate the property,” which financing would be secured by a mortgage on the property.⁶

Pursuant to the loan agreement, the defendants had an obligation to extend additional advances of up to \$2.1 million to be used for “tenant improvement and leasing commission obligations.”⁷ The loan agreement

obligated plaintiffs to maintain a certain minimum ratio of cash flow to debt service payment, and whenever that minimum was not met, “to make a ‘balancing prepayment’ of principal to [defendants to] maintain the required ratio of cash flow to debt service payment.”⁸

On Feb. 27, 2009, the defendants notified plaintiffs that plaintiffs had failed to achieve the required minimum ratio of cash flow to debt service payment and that a “balancing repayment” was necessary to avoid default under the loan. Plaintiffs disagreed and commenced the instant lawsuit, alleging that defendants had miscalculated the debt service ratio. The plaintiffs also asserted that defendants had breached their fiduciary duty to plaintiffs by “refusing to advance additional sums to reimburse plaintiffs for improvements to the building unless plaintiffs made the demanded balancing payment.”⁹

Plaintiffs moved for a preliminary injunction directing defendants to continue funding the loan during the pendency of the action. Defendants moved for dismissal of the complaint arguing, among other things, that plaintiffs’ breach of fiduciary duty claim failed to state a cause of action.

Justice Stephen A. Bucaria of the Nassau County Commercial Division denied plaintiffs’ motion for a preliminary injunction and granted defendants’ motion to dismiss as to the breach of fiduciary duty claim.¹⁰ Plaintiffs had argued that defendants were in a “position of control” which gave rise to a fiduciary relationship, pointing to a provision of the loan agreement that required defendants’ consent before plaintiffs could “enter into a lease of more than 7,800 rentable square feet or for a term longer than five years” with a prospective tenant of the building.¹¹ Justice Bucaria rejected this argument, explaining:

While a major lease approval provision may give the mortgagee [i.e., defendants] additional security with respect to its investment, such a provision does not give the mortgagee the obligation to act for or give advice to the borrower [i.e., plaintiffs] with respect to the loan or the operation of the building.

Although recognizing that the determination

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of whether a fiduciary relationship exists remained “necessarily fact-specific,”¹² the court concluded that “a mere debtor and creditor relationship does not give rise to a fiduciary obligation.”¹³ The court went on: “If the parties do not create their own relationship of higher trust, courts should not ordinarily do it for them.”¹⁴

‘Rakus’

In *Rakus Inc. v. 3 Red G, LLC*,¹⁵ the plaintiff building contractor brought suit in Kings County Supreme Court asserting five causes of action, including breach of fiduciary duty, against defendants, the owners of a commercial condominium in Brooklyn. On Jan. 29, 2008, the parties had entered into a written agreement whereby plaintiff was to renovate the second floor of the condominium for use as a medical office by defendants for the price of \$357,000. The plaintiff alleged that the defendants improperly modified the scope from that set forth in the agreement causing plaintiff to perform an additional \$799,454 in work. Upon completion of the work, defendants allegedly paid only \$611,454 to plaintiff leaving \$188,000 outstanding. Plaintiff filed a mechanic’s lien against the condominium and commenced the instant lawsuit on July 2, 2009.

Defendants moved to dismiss four out of plaintiff’s five claims, including plaintiff’s breach of fiduciary duty claim. Justice Carolyn E. Demarest of the Kings County Commercial Division granted defendants’ motion in its entirety.

The court first noted the general rule that an arm’s length business relationship between parties to a contract generally does not give rise to a fiduciary relationship. The court then turned to the allegations of the complaint and the terms of the parties’ contract to discern “the details of the relationship between plaintiff and defendants.” The court concluded “that it was a simple contractor-owner relationship whereby [plaintiff] was to perform renovation work on [defendants’] property.”

The court found that “plaintiff’s complaint merely recites that ‘Defendants’ actions in not paying the monies due to the plaintiff have caused them to breach their fiduciary duty,’” failing to “plead a preexisting or special relationship or that the contract for renovation work was anything more than a one-time arm’s length transaction.” The court distinguished the Court of Appeals’ decision in *EBC I*, explaining that, unlike in the instant case, the parties’ relationship in *EBC I* “went beyond an ordinary business relationship to one of higher trust and confidence since plaintiff relied on defendant Goldman Sachs’ expert advice.”

The practitioner, in pleading a cause of action for breach of fiduciary duty, should be careful to allege, and be prepared to prove, specific facts establishing the existence of a relationship of trust and confidence beyond that found in everyday commercial relationships.

The court concluded that plaintiff’s breach of fiduciary duty claim had not been “pled with sufficient detail,” and accordingly granted defendants’ motion to dismiss for failure to state a claim.

Conclusion

These recent decisions in *Twin Holdings* and *Rakus* are sound reminders of the difficulties plaintiffs have in New York courts in adequately pleading facts to support a claim for breach of fiduciary duty in business disputes. To plead a fiduciary duty claim, more is generally required than an arm’s length business transaction or conclusory allegations that the defendant owed a fiduciary duty to, or had a special relationship with, the plaintiff. The practitioner, in pleading a cause of action for breach of fiduciary duty,

should be careful to allege, and be prepared to prove, specific facts establishing the existence of a relationship of trust and confidence beyond that found in everyday commercial relationships.



1. *EBC I Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 19, 832 N.E.2d 26, 31, 799 N.Y.S.2d 170, 175 (2005) (citation and quotation marks omitted).
2. *Id.*
3. See *id.*
4. 58 A.D.3d 6, 22, 867 N.Y.S.2d 169, 181-82 (2d Dept. 2008).
5. *Twin Holdings of Del. LLC v. CW Capital, LLC*, 26 Misc.3d 1214(A), 2010 N.Y. Misc. LEXIS 112, 2010 WL 309022 (Nassau Co. Jan 19, 2010) (Bucaria, J.).
6. *Twin Holdings of Del. LLC*, 2010 N.Y. Misc. LEXIS 112, at *1-3.
7. *Id.* at *2.
8. *Id.* at *3.
9. *Id.* at *4-6.
10. *Id.* at *20-21, 26. However, the court did not dismiss plaintiffs’ complaint in its entirety, allowing plaintiffs’ breach of contract claim (among others) to move forward. *Id.* at *12.
11. *Twin Holdings of Del. LLC*, 2010 N.Y. Misc. LEXIS 112, at *20-21.
12. *Id.* at *20 (quoting *EBC I*, 5 N.Y.3d at 19, 832 N.E.2d at 31, 799 N.Y.S.2d at 175).
13. *Twin Holdings of Del. LLC*, 2010 N.Y. Misc. LEXIS 112, at *20.
14. *Id.* at *20.
15. *Rakus Inc. v. 3 Red G, LLC*, 26 Misc. 3d 1206(A), 2010 N.Y. Misc. LEXIS 5, 2010 WL 26252 (Kings Co. Jan. 5, 2010) (Demarest, J.).

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