

**Mercantile Capital Partners Fund, LP v Morrison
Cohen LLP**

2008 NY Slip Op 30674(U)

March 4, 2008

Supreme Court, New York County

Docket Number: 0601596/2007

Judge: Doris Ling-Cohan

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. Doris Ling-Cohan
Index Number : 601596/2007

PART 36

MERCANTILE CAPITAL PARTNERS

vs

MORRISON COHEN LLP

Sequence Number : 001

DISMISS ACTION

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

The following papers, numbered 1 to 4 were read on this motion to/for dismiss

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

1, 2
3
4

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion to dismiss is decided
in accordance with the attached memorandum
decisions.

FILED
MAR 11 2008
NEW YORK
COUNTY CLERK'S OFFICE

HON. DORIS LING-COHAN

Dated: 3/4/08

[Signature]

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 36

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MERCANTILE CAPITAL PARTNERS FUND, LP.,
Plaintiff,

Index No. 601596/07
Motion Seq. No.: 001

-against-

MORRISON COHEN LLP and LAWRENCE B. RODMAN,
Defendants

FILED
MAR 14 2008
NEW YORK
COUNTY CLERK'S OFFICE

LING-COHAN J.:

Defendants move pursuant to CPLR 3211 (a) (7) for an order dismissing the complaint.

Defendant Morrison Cohen LLP (Morrison) is a New York law firm and defendant Lawrence B. Rodman is a member of that firm.

Background

Plaintiff Mercantile Capital Partners Fund LLP. (MCPF) is an entity created to make equity and debt investments in various portfolio companies on behalf of its limited partners. According to plaintiff's complaint, in June 2001 MCPF retained Morrison to advise and represent it in connection with several investments in its portfolio companies, including Dry Ice, a retailer of children's furniture. In 2005 Morrison, and particularly defendant Rodman, served as counsel in connection with several significant loans from MCPF to Dry Ice, intended to be structured in the form of subordinated secured promissory notes (the Notes), in connection with which MCPF was to receive security interests in the assets of Dry Ice. The terms of MCPF's purchase of the Notes from Dry Ice were memorialized in an agreement dated February 14, 2005, entitled Note Purchase Agreement (Note Agreement).

During this time, defendants negotiated, drafted and prepared certain loan agreements documenting MCPF's obligation to purchase notes and Dry Ice's granting a security interest in the collateral to MCPF (Loan Agreements). The security interests created by these Loan Agreements were to be subordinate to the security interests granted by Dry Ice to the CIT Group/Business Credit, Inc., (CIT or Senior Lender) pursuant to a security agreement drafted in May 2005. During February 2005 through May 2005, in accordance with the Loan Agreements, MCPF made loans to Dry Ice through the purchase of notes having a combined principal value of \$1,220,338.39. At all times, it is alleged, Morrison knew that one of the most critical elements of MCPF's purchase of the Notes was the perfection of the security interests because it would afford MCPF the status of a secured and perfected creditor with Dry Ice. Plaintiff alleges that Morrison knew or should have known that proper perfection of the Security Interest was necessary to protect MCPF's position as a secured creditor of Dry Ice and give it the ability to protect itself in the event Dry Ice experienced financial difficulties and faced the prospect of filing a bankruptcy petition.

Plaintiff alleges that on April 7, 2005, Rodman advised MCPF that defendants failed to timely file the perfection documents and stated that the documents were only in fact filed on that day. Rodman allegedly advised MCPF, based upon an analysis that Morrison conducted, that the security interests were not affected by the untimely filing of the perfection documents.

On May 5, 2005, relying upon Rodman's advice, it is alleged that MCPF loaned Dry Ice an additional \$300,000. Plaintiff maintains that, had it been advised that the security interests were subject to avoidance as a result of the untimely filing, MCPF would not have made the additional investment, nor would it have continued on its course.

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The Credit Bid Deal

By mid-June 2005, Hilco Trading Co., an entity allegedly well known for its expertise in evaluating and investing in companies with economic difficulties, made a proposal to MCPF allegedly based upon its belief that MCPF was a perfected secured creditor of Dry Ice. In an attempt to inject new capital and new senior management expertise into a company experiencing financial difficulties, and in order to realize a return on its investment, MCPF was asked to participate with Hilco in a transaction to acquire the assets of Dry Ice, known as a "credit bid" (Complaint at ¶ 25). According to plaintiff, the credit bid deal was going to be effected through what was essentially a pre-planned bankruptcy process in the third week of June. The complaint alleges that pursuant to the credit bid, Hilco was to buy out CIT's interest and position as the senior secured lender to Dry Ice, join with the MCPF Group as the junior secured lender, and in the context of a case filed by Dry Ice under Chapter 11 of the Bankruptcy Code, use the combination of the senior and junior security in the assets of Dry Ice, to purchase Dry Ice's assets outright and operate Dry Ice on a going forward basis outside of the bankruptcy proceeding (*Id.*). Plaintiff allegedly made this decision based upon projections and analysis based upon Dry Ice's sales and performance track record and projection.

The structure of the credit bid deal also provided that Hilco and MCPF would commit the aggregate of \$3,750,000 as operating capital to an acquisition vehicle, Dry Ice Acquisition Co., that would purchase the assets of Dry Ice out of bankruptcy through the credit bid transaction (*Id.* at ¶27). Hilco would provide Dry Ice Acquisition Co. with a term, interest bearing loan of \$1,175,000 and Hilco and MCPF would each provide Dry Ice Acquisition Co. with \$1,000,000 cash in exchange for \$1,000,000 in Series A notes of the company. MCPF was also to receive

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an additional \$750,000 in Series A notes as a credit for \$750,000 of MCPF's secured interest that had been in the credit bid. Hilco and MCPF further agreed that each would own a 50% equity interest in Dry Ice Acquisition Co. MCPF accepted the proposal based upon defendants' consistent representations to both MCPF and Hilco that MCPF's Security Interests were "in good order". (*Id.* at ¶¶ 29, 33-34).

On June 17, 2005, Hilco advised MCPF that they would not go forward with the credit bid deal solely because it had learned that the perfection status of the security interests was uncertain, as a result of defendant's failure to timely file the perfection documents, since there was now potential that the debt was avoidable in the context of a Dry Ice bankruptcy proceeding (*Id.* at ¶ 35).

According to plaintiff, the failure of the credit bid deal, derailed the implementation of the Dry Ice Asset purchase, which resulted in Dry Ice operating for a much greater period of time, with greater losses than would have been the case had the financing been provided and the fall and holiday inventory been ordered as planned (*Id.* at ¶ 41). Instead, the bankruptcy petition was not filed until July 10, 2005 (instead of the third week in June) and the need to fund what was an operating business dissipated (*Id.*). Plaintiff asserts that defendants had the ability to mitigate the effects of their negligence by coming forward with collateral for the value of the security interests that were not timely effected which would have avoided the Hilco liquidation sale, but refused.

Plaintiff commenced this action alleging two (2) cause of action against defendants: (1) legal malpractice; and (2) breach of fiduciary duty cause of action. Both claims arise from the allegation that Morrison's alleged failure to timely perfect plaintiff's security interest, caused

Hilco to withdraw from participating with plaintiff in the credit bid deal resulting in damages. The complaint specifically alleges that the failure of the credit bid deal impeded the implementation of the Dry Ice asset purchase with the ultimate result that Dry Ice operated for a longer period of time with greater losses than would have been the case had the credit deal proceeded and the contemplated financing been provided and the Fall and holiday inventory been ordered as planned. Plaintiff alleges that :

“[a]s a direct and proximate consequence of defendants’ failure to timely file the Perfection Documents, the Credit Bid deal failed and MCPF suffered monetary damage because, inter alia it did not realize the benefits of the Credit Bid Deal set forth above, that it would have realized but for Defendants’ negligence ... it loaned an additional \$300,000 to Dry Ice on or about May 5, 2005, which it would not have done [and] ... significantly damaged MCPF’s reputation...caused the fund as a whole to fall far short of its investment goals”.

(Id. at ¶¶ 52, 53, 56).

In the breach of fiduciary duty cause of action plaintiff also alleges that Morrison Cohen breached its duty to plaintiff by improperly assuring plaintiff that the late filing would have no impact.

Plaintiff seeks \$12 million under each cause of action, plus an additional \$2.5 million in exemplary damages. In addition to the \$300,000 lost investment, plaintiff claims that damages are caused by the “lost ... significant economic opportunity...[which] would have allowed it to obtain a return on its investment in Dry Ice and the Loans it made to that company (Verified Complaint at ¶ 43, annexed to the Affidavit of Michael Furman, Defendant’s Motion to Dismiss).

Legal Analysis

On a motion pursuant to CPLR 3211, “the pleadings must be liberally construed and the

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facts alleged accepted as true; the court must determine 'only whether the facts as alleged fit within any cognizable legal theory [internal citations omitted]' (*Wiener v Lazard Freres & Co.*, 241 AD2d 114, 120 [1st Dept 1998]). "So liberal is the standard under these provisions that the test is simply 'whether the proponent of the pleading has a cause of action,' not even whether he has stated one [internal citation omitted] (*Id.*). In deciding a motion to dismiss a legal malpractice action, the facts alleged by plaintiff are assumed to be true, and plaintiff is afforded the benefit of every possible favorable inference (*See Gamiel v Curtis & Riess-Curtis PC.*, 16 AD3d 140 [1st Dept 2005]).

In order to recover for legal malpractice, a party must show (1) the existence of an attorney-client relationship; (2) negligence on the part of the attorney or some other conduct in breach of that relationship; (3) that the attorney's conduct was the proximate cause of the injury to plaintiff; and (4) that plaintiff suffered "actual and ascertainable" damages " (*Franklin v Winard*, 199 AD2d 220 [1st Dept 1993]; *Zarin v Reid & Priest*, 184 AD2d 385 [1st Dept 1992])). To satisfy the element of proximate causation, a plaintiff must preliminarily plead and ultimately prove that "but for" the attorney's malpractice, the client would have achieved a different result in the underlying transaction or would not have sustained any ascertainable damages (*Hand v Silberman*, 15 AD3d 167 [1st Dept 2005]).

For the purposes of this motion, defendants do not dispute their alleged misconduct in failing to perfect MCPF's security interest and that the complaint adequately alleges their negligence (Complaint at ¶¶ 17-19). For purposes of this motion, they do not dispute that the failure of an attorney to file a Uniform Commercial Code financing statement in the manner required by law to perfect a client's security interest constitutes negligence as a matter of law (*see*

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Uniform Commercial Code §§ 9-302, 9-401 (1) (c) [2005]; *S & D Petroleum Co., v Tamsett*, 144 AD2d 849 [3d Dept 1988]).

The gravamen of this legal malpractice claim is that defendants' alleged failure to perfect plaintiff's security interest and subsequent failure of the credit bid deal caused plaintiff damages. Plaintiffs allege that if the credit bid deal proceeded as intended, Dry Ice would have avoided liquidation and transformed sufficiently to generate enough profits to pay off its debts and generate income for plaintiff.

Defendants dispute plaintiff's claim that Morrison's untimely perfection of the loan documents was the "but for" cause of plaintiff's alleged damages and maintain that plaintiff will not be able to set forth a supporting factual basis for its allegations. According to defendants, the "bare legal conclusions set forth in the Complaint" that Dry Ice could have avoided liquidation and transformed sufficiently to generate income are "inherently incredible" and are "flatly contradicted by the outcome of the underlying bankruptcy proceedings" (see Defendant's Memorandum of Law at 11, annexed to Defendant's Motion to Dismiss). According to defendants, there are a myriad of reasons why Dry Ice failed, and any allegation of damages is mere speculation.

However, as noted above, at this preliminary stage in the litigation, MCPF need only allege, not prove the proximate cause element of its claim (see, *Gamiel v Curtis & Riess-Curtis, P.C.*, 16 AD3d 140, *supra*). Moreover, the facts, which must be accepted as true, and accorded the benefit of every possible favorable inference, sufficiently set forth MCPF's claim that but for defendant's alleged negligence in failing to perfect its security interests, the resulting alleged damages would not have been suffered.

Defendants are correct that the “but for” causation requirement in legal malpractice actions necessitates that the plaintiff prove “a case within a case,” because it demands a hypothetical re-examination of the events at issue absent the alleged legal malpractice (*Weil, Gotshal & Manges, LLP v Fashion Boutique of Short Hills, Inc.*, 10 AD3d 267 [1st Dept 2004]), and that absent such pleading and proof of a favorable outcome a case must be dismissed (*Id.*; *Tortura v Sullivan Papain Block McGrath & Cannavo, PC.*, 21 AD3d 1082 [2d Dept 2005]). Here, however, MCPF sufficiently alleged in the detailed complaint that defendants were retained to support plaintiff in the loans to Dry Ice and that they were negligent in failing to timely perfect their security interest, which had a direct impact on the credit bid deal, thereby undermining the ability of MCPF from having a more favorable outcome by realizing and recovering on its advances, as well as depriving it of the opportunity to realize additional returns from Dry Ice.

Moreover, although it is true that where proof is speculative and conclusory, a legal malpractice action must be dismissed (*Russo v Feder, Kasovitz, Issacson, Weber, Skala & Bass*, 301 AD2d 63 [1st Dept 2002]), since mere speculation about a loss resulting from the attorney’s omission is insufficient to make out a prima facie case of legal malpractice (*Plymouth Org. Inc. v Silverman, Cllura & Chernis*, 21 Ad3d 464 [2d Dept 2005]), however, at this pre-discovery stage, MCPF need only plead “allegations from which damages attributable to [defendant’s] conduct might be inferred” (*InKine Pharm Co v Coleman*, 305 AD2d 151,152 [1st Dept 2003] (quoting *Tenzer, Greenblatt, Fallon & Kaplan Ellenberg*, 199 AD2d 45 [1st Dept 1993])). Here, it may be reasonably inferred that plaintiff sustained a minimum of \$300,000 in damages as a result of the loan it made to Dry Ice, after defendant allegedly assured plaintiff that its secured

status would not be affected by the alleged untimely filing (Complaint at ¶ 22). In addition, it may be reasonably inferred that plaintiff may be able to support future damage calculations based upon projections from Dry Ice's sales data and track record that were allegedly created to prepare for the credit bid deal (Complaint ¶¶ 21-41). The parties should conduct discovery and move for summary judgment, if appropriate, upon completion. Thus, defendant's motion to dismiss the first cause of action is denied.

In the second case of action plaintiff asserts that defendant breached its fiduciary duty to plaintiff by failing to file the lien. A claim of breach of fiduciary duty which is duplicative of a legal malpractice claim must be dismissed (*Sonnenschine v Giacomo*, 295 AD2d 287 [1st Dept 2003]). Plaintiff's second cause of action does not add anything to the claim of legal malpractice and therefore must be dismissed.

Accordingly, it is

ORDERED that the motion to dismiss is granted to the extent that the second cause of action for breach of a fiduciary duty is dismissed.

Dated: 3/4, 2008


Hon. Doris Ling-Cohan, JSC

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