Q China Holdings, Ltd. v TZG Capital Ltd.
2018 NY Slip Op 30779(U)
April 23, 2018
Supreme Court, New York County
Docket Number: 656359/2016
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH PART 54
Justice

Index Number : 656359/2016
Q CHINA HOLDINGS, LTD.
vs.
TZG CAPITAL LIMITED
SEQUENCE NUMBER : 002
MOTION TO DISMISS

INDEX NO. _____
MOTION DATE 4/13/18
MOTION SEQ. NO. _____

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). 67-79
Answering Affidavits — Exhibits _____ | No(s). 80-82
Replying Affidavits _____ | No(s). 84

Upon the foregoing papers, it is ordered that this ~~motion is~~

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

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

Dated: 4/23/18

SHIRLEY WERNER KORNREICH J.S.C.

1. CHECK ONE: ..... ☐ CASE DISPOSED ☒ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: .....MOTION IS: ☒ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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Q CHINA HOLDINGS, LTD., Index No.: 656359/2016

Plaintiff, **DECISION & ORDER**

-against-

TZG CAPITAL LIMITED and HSIANG I BEN TSEN,

Defendants.

----------X

SHIRLEY WERNER KORNREICH, J.:

Defendants TZG Capital Limited (TZG) and Hsiang I Ben Tsen (Tsen) move, pursuant to CPLR 3211, to dismiss all claims in the third amended complaint (the TAC) except for the breach of contract claim asserted against TZG. Plaintiff Q China Holdings, Ltd. (QCH) opposes. For the reasons that follow, defendants' motion is granted.

I. Factual Background & Procedural History

As this is a motion to dismiss, the facts recited are taken from the TAC (Dkt. 69)[1] and the documentary evidence submitted by the parties.

The parties are shareholders of Q-TZG Leasing Holding, Ltd. (the Company). The Company is incorporated in the Cayman Islands, operates a leasing company in China, and is governed by an Amended and Restated Shareholders Agreement dated December 19, 2013. *See* Dkt. 50 (the Agreement). The Agreement is governed by New York law and contains a broad New York forum selection clause. *See id.* at 12. The court limits its discussion of the

[1] References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF). The court notes that Dkt. 69 is the version of the TAC filed by defendants as an exhibit to their motion; for reasons unclear to the court, it originally was at Dkt. 45, restricted from public view. QCH shall promptly contact the e-filing clerk to lift such restrictions. To the extent the issue is the lack of an order permitting the amendment, the e-filing clerk is directed to the court's August 10, 2017 order. *See* Dkt. 44 ("[QCH] has leave to file a third amended complaint").

Agreement to those provisions pertinent to the instant motion. That said, it should be noted that the Agreement amended the prior iteration of the Company's shareholders agreement dated February 22, 2010 (Dkt. 75), and was executed in conjunction with TZG's acquisition of a controlling stake in the Company from QCH. *See* TAC ¶ 17 ("In December 2013, [QCH] sold control of [the Company] to [TZG], but retained a majority economic stake. This transaction was intended to allow [TZG] to make day-to-day business decisions, while requiring [QCH's] consent for major business decisions."). The Agreement appears to have principally been amended to reflect this change in control.

Section 5.1 of the Agreement provides that the Company is to be managed by a board of directors (the Board) and that QCH shall have one representative on the Board (defined as "the Q Director"). *See* Dkt. 50 at 7. The others on the Board are controlled by TZG. *See id.* Section 5.4 prohibits the Company from engaging in myriad enumerated transactions "without the affirmative vote of the Q Director." *See id.* at 8-10. Section 3.3 requires that Tsen, a managing principal of TZG who is a United States citizen that lives in China, to be significantly involved with the Company. *See id.* at 6. Tsen was on the Board at the time of the underlying events.

On December 31, 2015, without first notifying QCH or obtaining its consent, TZG caused the Company to sell (the Sale) a 70% stake in Q-TZG Financial Leasing (China) Co. Ltd. (the Subsidiary) to Shanghai Yu'an Investment Group Company, Limited (the Buyer). The Company had indirectly owned 99% of the Subsidiary though its ownership of Q-TZG Leasing Hong Kong Limited (LHKL). In this action, the parties dispute whether the Sale required QCH's consent under section 5.4 of the Agreement. However, the question of whether section 5.4 was breached is not at issue on the instant motion, and the court does not reach the issue.

On January 22, 2016, while QCH was unaware of the Sale, TZG offered to purchase QCH's equity stake in the Company. TZG, in fact, had been unsuccessfully negotiating the sale of QCH's stake since May 2015. In April 2016, while the parties were still haggling over price, TZG falsely informed QCH that the Buyer was interested in purchasing a 70% stake in the Subsidiary when, in fact, it had already done so months earlier. On May 13, 2016, after QCH expressly directed TZG not to sell to the Buyer below a certain price, TZG told QCH that it had done so (for a price, it should be noted, that was almost 40% lower than the actual December 2015 sale price). QCH eventually discovered that the Sale had really occurred in December 2015 (through "documents filed with the Chinese government"), resulting, unsurprisingly, in the deterioration of the parties' relationship. *See* TAC ¶ 4. QCH never sold its stake in the Company to TZG.

On December 7, 2016, QCH commenced this action by filing a complaint in which it asserted claims against TZG, Tsen, and other individuals. *See* Dkt. 1. QCH, in violation of the Agreement's forum selection clause, also filed numerous parallel suits in Texas, California, and the Cayman Islands. After multiple court conferences, a failed mediation, and two amended complaints in this action, QCH changed counsel and cabined its litigation against TZG and Tsen to this court.[2] On August 31, 2017, QCH filed the TAC, in which it asserts causes of action for: (1) fraud; (2) breach of contract; (3) breach of fiduciary duty; and (4) fraudulent concealment. Each cause of action is asserted against both defendants, except for the breach of contract claim,

[2] "On August 9, 2017, the Court held a status conference, at which [defendants] indicated that they would renew their motion for injunctive relief regarding the non-New York actions and seek sanctions. Following the conference, [QCH] represented that it had voluntarily dismissed the non-New York actions that remained pending and filed the TAC, naming only TZG and Tsen as defendants." Dkt. 79 at 16-17; *see* Dkt. 21 (withdrawal of motion for anti-suit injunction); *see also GE Oil & Gas, Inc. v Turbine Generation Servs., L.L.C.*, 150 AD3d 586, 587 (1st Dept 2017).

which is only asserted against TZG. On October 2, 2017, defendants filed the instant motion to dismiss the first, third, and fourth causes of action. The court reserved on the motions after oral argument. *See* Dkt. 126 (4/3/18 Tr.).[3]

II. Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1st Dept 1992); *see also Cron v Hargro Fabrics, Inc.*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v*

[3] At the same oral argument, the court denied QCH's motion to disqualify defendants' counsel [*see* Dkt. 125], which had been filed on December 27, 2017, after the motion to dismiss had been fully briefed.

Mutual Life Ins. Co. of N.Y., 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

The undisputed motivation behind QCH's non-contractual claims is its desire to hold Tsen personally liable. Defendants take the position that this is improper, as such claims are, at best, duplicative of the contract claim. *See New York Univ. v Cont'l Ins. Co.*, 87 NY2d 308, 316 (1995) ("where a party is merely seeking to enforce its bargain, a tort claim will not lie."). They also contend that QCH has not, in any event, stated a claim for fraud, fraudulent concealment, or breach of fiduciary duty.

QCH has not stated a claim for fraud. It is well settled that claims for both fraud and fraudulent concealment require the pleading of detrimental reliance and out-of-pocket damages. *Ambac Assur. Corp. v Countrywide Home Loans, Inc.*, 151 AD3d 83, 85 (1st Dept 2017) ("The element of justifiable reliance is 'essential' to **any fraud claim**.") (emphasis added); *see Capin & Assn. v 599 W. 188th St.*, 139 AD3d 634, 635 (1st Dept 2016) (claim for fraudulent misrepresentation dismissed because "the complaint fails to allege **any specific detrimental reliance by plaintiff** on this misrepresentation.") (emphasis added); *see also Electron Trading, LLC v Morgan Stanley & Co.*, 157 AD3d 579, 582 (1st Dept 2018) (fraud claim dismissed because plaintiff "fail[ed] to allege 'actual pecuniary loss sustained as the direct result of the wrong.'"), quoting *Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413, 421 (1996). QCH does not plead either element. As discussed, the alleged fraud consisted of the misrepresentations about the status of the Sale, which had actually occurred in December 2015 but which was represented to not have closed until May 2016. QCH ***does not*** allege it engaged in any action to its detriment in reliance on these untruths. To be sure, had QCH actually sold its stake in the Company based on the understanding that the Sale had not yet occurred, perhaps it

might have a claim for being induced to sell based on a material misrepresentation about the value of the Company.[4] However, QCH never sold its stake.

Moreover, as QCH's counsel clarified at oral argument, the only damages it allegedly suffered as a result of the fraud is that it held onto its stake in the Company when, perhaps, it might have sold its stake had it not been lied to about the Sale. *See* Dkt. 126 (4/3/18 Tr. at 19) ("we are therefore damaged and stuck with something because of the lies involved in the cover-up."). This is a quintessential "holder" claim that is not permitted under New York law. *See Bank Hapoalim B.M. v WestLB AG*, 121 AD3d 531, 535 (1st Dept 2014) ("This case is essentially a 'holder' fraud case—that is, the alleged fraud is that the [plaintiffs] held their assets instead of liquidating them. As a result, plaintiffs suffered no out-of-pocket loss."). Damages for being fraudulently induced not to sell securities are not permitted under New York law because, "[w]hen a claim sounds in fraud, the measure of damages is governed by the 'out-of-pocket' rule, which states that the measure of damages is 'indemnity for the actual pecuniary loss sustained as the direct result of the wrong.'" *Connaughton v Chipotle Mexican Grill, Inc.*, 135 AD3d 535, 538 (1st Dept 2016), *aff'd*, 29 NY3d 137 (2017) (*Connaughton II*), quoting *Lama Holding*, 88 NY2d at 421; *see Bank Hapoalim*, 121 AD3d at 535, citing *Starr Found. v Am. Int'l Group, Inc.*, 76 AD3d 25, 27-28 (1st Dept 2010); *see also AHW Inv. P'ship, MFS, Inc. v Citigroup Inc.*, 661 FedAppx 2, 4 (2d Cir 2016) ("the true measure of damages for fraud is indemnity for the actual pecuniary loss sustained as the direct result of the wrong."), quoting *Starr*, 76 AD3d at 27-28. Holder claims are considered impermissibly speculative because it is

[4] *See Starr, infra*, 76 AD3d at 28 n.3 ("A plaintiff who is fraudulently induced to enter into a transaction in which he accepts something of less value than what he gives up can state a cause of action for fraud, even if that plaintiff happened to make a profit on the deal because what he received was of greater value than his cost basis in what he gave up. **In the instant case, however, [plaintiff] seeks to recover the value it hypothetically might have received in a transaction that never took place.**") (emphasis added).

impossible to know what the plaintiff would have received for its stock had it not been induced to hold onto it. *Connaughton II*, 29 NY3d at 142-43 ("[T]here can be no recovery of profits which would have been realized in the absence of fraud. Moreover, this Court has consistent[ly] refus[ed] to allow damages for fraud based on the loss of a contractual bargain, the extent, and, indeed, ... the very existence of which is completely undeterminable and speculative.") (internal citations and quotation marks omitted); *Starr*, 76 AD3d at 28 ("A lost bargain more 'undeterminable and speculative' than this is difficult to imagine."). Thus, where, as here, the damages sought are based on what the plaintiff might have received had it sold its stock but for the fraud, the fraud claim must be dismissed because there can be no recovery for such injury under New York law. *See Varga v McGraw Hill Fin., Inc.*, 147 AD3d 480, 481 (1st Dept 2017).

The court also rejects QCH's contention that Tsen can be liable for damages otherwise recoverable under the Agreement because of his fraudulent misrepresentations and concealment. While QCH has stated a claim for breach of the Agreement against TZG based on the Sale, the Sale itself cannot give rise to a fraud claim because no actual misrepresentation was allegedly made prior to its occurrence. In other words, the only basis for the claim is non-compliance with the Agreement, not a pre-Sale collateral misrepresentation. Hence, the only reason the Sale was allegedly wrongful was because it required QCH's consent under the Agreement. Such an alleged breach of contract cannot be repackaged as a fraud claim merely by characterizing the wrongdoing as fraudulent.

Certainly, if Tsen, who is not a party to the Agreement, had caused actual out-of-pocket damages to QCH, the contract action would not immunize him from liability. *See Allenby, LLC v Credit Suisse, AG*, 134 AD3d 577, 581 (1st Dept 2015). But here, as discussed, Tsen did not

cause any such damages because all of the alleged misrepresentations regarding the status of the

Sale occurred in 2016, by which time there was nothing QCH could have done to stop it. By then, QCH allegedly had already been damaged. While Tsen may have been part of a cover-up, QCH does not explain how the cover-up resulted in losses beyond those already suffered at the time of the Sale. Since Tsen did not cause any harm to QCH beyond the alleged harm caused by TZG after it allegedly breached the Agreement at the end of 2015, the alleged fraud in 2016 is not a basis to hold Tsen liable for what are essentially the very contract damages QCH seeks to recover from TZG.[5]

Finally, QCH has not stated a direct claim for breach of fiduciary duty against Tsen.[6] Directors of a Cayman Islands company owe fiduciary duties to the company, but not to its shareholders. *See Davis v Scottish Re Grp., Ltd.*, 138 AD3d 230, 236 (1st Dept 2016), *rev'd on*

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[5] The court is somewhat confused as to the proper measure of damages on the breach of contract claim. Even if QCH's consent rights were violated, if the Sale proceeds were indeed remitted to the Company, then the court does not understand how damages should be computed. The TAC claims that defendants' intended scheme was to understate the proceeds from the Sale by approximately $5 million and pocket the spread. *See* ATC ¶ 5. However, QCH discovered the true purchase price and does not appear to allege that it was stolen by defendants (instead of being remitted to the Company or LHKL). Indeed, if the Company did not get the proceeds from the Sale, such a complaint would be a derivative claim for breach of fiduciary duty (or perhaps, a double derivative claim on behalf of LHKL), as any recovery would belong to the Company or LHKL. *See Yudell v Gilbert*, 99 AD3d 108, 114 (1st Dept 2012). Here, QCH only asserts a direct claim for breach of contract. That said, since contract damages are not at issue on the instant motion, the court will not rule on the proper measure at this juncture.

[6] As noted above, QCH does not assert any derivative claims. *See Varga*, 147 AD3d at 481 ("The law of the Cayman Islands, which … governs this issue, generally prohibits derivative actions."). The court will not opine on whether QCH could establish a basis for pleading derivative claims. *See Wimbledon Financing Master Fund, Ltd. v Weston Capital Mgmt. LLC*, 2017 WL 3024259, at *19 (Sup Ct, NY County 2017) (addressing when derivative actions are permissible under Cayman Islands law).

other grounds, 30 NY3d 247 (2017) (*Davis II*). Consequently, QCH cannot sue Tsen for breach of fiduciary duty based on its status as a member of the Board.[7] Accordingly, it is

ORDERED that defendants' motion to dismiss the first (fraud), third (breach of fiduciary duty), and fourth (fraudulent concealment) causes of action is granted, the Clerk is directed to enter judgment dismissing the third amended complaint as against Hsiang I Ben Tsen, and the remaining claim, the second cause of action for breach of contract as against TZG Capital Ltd., is hereby severed and shall continue.

Dated: April 23, 2018

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C.

[7] Since the Company is incorporated in the Cayman Islands, Cayman Islands law governs its internal affairs. *Davis II*, 30 NY3d at 252. That said, the Shareholders Agreement is governed by New York law. The Agreement, however, does not state that it displaces the scope of the Company's directors' default fiduciary duties under Cayman Islands law with those applicable under the New York Business Corporation Law. The parties did not meaningfully address the question of how a Cayman Islands company's shareholders agreement may displace the default rules of Cayman Island corporate law (such as, for instance, how one may agree to displace default statutory LLC rules). The court will not opine on the subject because the outcome would not differ under New York law, as QCH is not alleged to have been the victim of disparate treatment as a minority shareholder. *See Alpert v 28 Williams St. Corp.*, 63 NY2d 557, 568-69 (1984). As discussed, the only alleged fiduciary breaches are the Sale and the subsequent cover-up. While the Sale may have required QCH's consent under the Agreement, it did not result in QCH suffering a financial harm distinct from any other shareholder (since the proceeds should have been remitted to the Company). To the extent QCH claims Tsen breached his fiduciary duties by lying about the status of the Sale in 2016, as discussed, such lies did not cause any actual damages to QCH. The failure to plead damages is fatal to a claim for breach of fiduciary duty. *See Estate of Spitz v Pokoik*, 83 AD3d 505, 506 (1st Dept 2011) ("an element of breach of fiduciary duty is damages."), citing *Laub v Faessel*, 297 AD2d 28, 30 (1st Dept 2002) ("For each of the direct causes of action included in the complaint—fraud, negligent misrepresentation **and breach of fiduciary duty**—plaintiff must establish that the alleged misrepresentations or other misconduct were the direct and proximate cause of the losses claimed.") (emphasis added)