New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

Web address: http://www.nylj.com

VOLUME 235—NO. 90 WEDNESDAY, MAY 10, 2006 ALM

OUTSIDE COUNSEL

BY LEO K. BARNES JR.

Spies, Lies and Business Torts

Espionage. Surreptitious moles. Clandestine meetings in Saint Tropez and New York. Is this the latest John Grisham novel? A new reality show? No!

The foregoing sets the scene for a recent decision in the Commercial Division, by Justice Charles Edward Ramos, resolving a prediscovery motion to dismiss allegations of corporate espionage, including the intentional placement of spies in the competition's workplace in an attempt to duplicate the competition's business operations.

'Louis Capital Mkts. v. REFCO'

In *Louis Capital Markets L.P. v. REFCO Group, et al.*,[1] plaintiff Louis Capital Markets (LCM) sued the REFCO Group, REFCO's president and five former LCM employees. LCM alleged that the defendants implemented a scheme to duplicate LCM's business operation by persuading LCM to hire Mr. Michael Benisty, then an employee of REFCO Paris, all the while intending to utilize Mr. Benisty's new position with LCM as a platform for REFCO to learn LCM's business, establish relationships with LCM's key employees and to duplicate LCM's business operation. LCM alleged that the defendants misappropriated LCM's trade secrets and business opportunities and that a group of LCM's most valuable employees resigned to join REFCO. As an aside, the allegations in the litigation pre-date the collapse of REFCO, which occurred this past fall, amid news reports that the commodities and futures broker was entrenched in an accounting scandal.

Ultimately, REFCO's former chief executive was indicted on federal securities fraud charges incident to his alleged attempt to hide up to $545 million in bad debt. Soon thereafter, the New York Stock Exchange suspended trading shares of REFCO Inc.

Contractual Relations

• ***Tortious Interference With Contractual Relations.*** In addressing the prediscovery motion to dismiss, Justice Ramos contemplated the first cause of action asserted

Leo K. Barnes Jr., *a member of Barnes & Barnes, P.C., can be reached at lkb@barnespc.com*

against Mr. Benisty for allegedly using wrongful means to persuade LCM employees Mellul and Pagani to breach their employment contracts with LCM. Relying upon the Court of Appeals decision in *Lama Holding Co. v. Smith Barney, Inc.*,[2] Justice Ramos detailed that in order to establish a claim for tortious interference with a contractual relationship, plaintiff must demonstrate: (1) a valid contract between plaintiff and a third party; (2) defendant's knowledge of that contract; (3) defendant's intentional procurement of the third party's breach; (4) actual breach; and (5) actual damages.

> *Recently, the Commercial Division resolved a prediscovery motion to dismiss allegations of corporate espionage, including placing spies in the competitor's workplace to try to duplicate business operations.*

The hallmark for the cause of action is whether the defendant's conduct constitutes improper interference.[3] Economic self interest which is financially motivated is a complete defense to a tortious interference claim so long as no allegations exist regarding illegal or otherwise wrongful conduct.[4] The Court of Appeals instructs parties to analyze several factors in determining whether conduct is improper:

> Included among the factors to be considered are the nature of the conduct of the person who interferes (a chief factor in determining whether conduct is improper), the interest of the party being interfered with (whether in an enforceable contract or in a contract voidable and thus unenforceable or terminable at will), and the relationship between the parties.[5]

Commentators have noted that it is often difficult to perform a complete analysis of whether specified conduct is improper, according to *Guard-Life*, until the completion of litigation:

> Because it requires examination of all the facts and circumstances surrounding the defendant's acts, followed by a value-laden weighing process, the Restatement's approach [adopted by the *Guard-Life* Court] makes it difficult to assess whether a particular act of interference is improper (and thus actionable) until after the issue has been litigated.[6]

The *LCM* Court ruled that pursuant to *Guard-Life Corp. v. Parker Hardware Mfg. Corp.*,[7] mere at-will employment contracts are insufficient to support a claim for tortious interference with contractual relationships. Since the Mellul and Pagani employment contracts were at-will agreements, the stated cause of action for tortious interference with contractual relations failed.

Prospective Business Relations

• ***Tortious Interference With Prospective Business Relations.*** However, an at-will employment relationship can support a cause of action premised upon tortious interference with economic relations. Justice Ramos noted that *Carvel Corp. v. Noonan*[8] "reiterated a distinction between the protection of rights granted in a contract and the protection of rights inferred from a prospective contract" such as an at-will employment agreement. Accordingly, recovery is permissible for tortious interference with prospective, noncontractual, business relations premised upon an at-will agreement.

To establish a claim for tortious interference with a prospective business relationship, New York Pattern Jury Instruction (PJI) 3:57 provides, in pertinent part:

> A (person, entity) who intentionally, know-

> ingly, and by wrongful means prevents another (person, entity) from entering into a contract that would have been entered into except for the interference, is liable to the other party for any damage sustained as a result of such conduct.…
>
> In order to recover, plaintiff, has the burden of establishing 1) that the defendant knew of the proposed contract between the plaintiff and [a third party], 2) that the defendant intentionally interfered with that proposed contract, 3) that were it not for the defendant's interference, the proposed contract would have been entered into, 4) that the defendant's interference was done by wrongful means, and 5) that the plaintiff suffered damages as a result.

Wrongful Means

To establish successfully element number four, wrongful means, plaintiff bears the burden of demonstrating "more culpable conduct on the part of the defendant."[9]

> The term "more culpable conduct" has been interpretedto mean criminal conduct, conduct that constitutes an independent tort or possibly any other wrongful means employed to harm another's prospective contractual relations. [Internal citations omitted]. It could also mean breach of fiduciary duty.[10]

In the *LCM* case, the Court noted that the general allegations regarding the corporate espionage and the planting of a mole to duplicate the competition's business operations satisfied the "more culpable conduct" standard. As noted, since the Mellul and Pagani employment contracts were at-will agreements, the stated cause of action for tortious interference with contractual relations failed. The Court recognized that its task on the motion to dismiss is to ascertain whether plaintiff has a cause of action, not whether it is perfectly stated. However, the Court refused to "transform" plaintiff's first cause of action for tortious interference with contractual relations into a viable cause of action for tortious interference with LCM's economic relations, and dismissed the first cause of action accordingly.

Aiding and Abetting

• ***Aiding and Abetting a Breach of Fiduciary Duty.*** Next, Justice Ramos turned to the second cause of action. Commercial practitioners are intimately familiar with PJI 3:59, the standard for asserting a breach of fiduciary duty. The crux of the duty is that a fiduciary owes an undivided and unqualified loyalty and may not act in any manner contrary to the interest of the partner, principal or employer. In the *LCM* litigation, in addition to standard breach of fiduciary duty claims, plaintiff also asserted claims against several individuals for aiding and abetting a breach of fiduciary duty as the second cause of action. The claim is significant since one who knowingly participates with a fiduciary in a breach of trust is liable for the full amount of the damage caused thereby.[11]

Justice Ramos quoted *Kaufman v. Cohen*[12] to establish the elements of aiding and abetting a breach of fiduciary duty: (1) a breach by a fiduciary of obligations to another; (2) that the defendant knowingly induced or participated in the breach; and (3) the plaintiff suffered damage as a result of the breach. Participation in the breach of the fiduciary duty must constitute a "substantial assistance" to the primary violator. In that regard, "substantial assistance" occurs when the defendant affirmatively assists, helps, conceals or fails to act when required to do so, thereby enabling the breach to occur; mere inaction constitutes substantial assistance only when the defendant owes a fiduciary duty directly to the plaintiff.[13]

The court denied the motion to dismiss the cause of action against, inter alia, Mr. Benisty. The allegations supporting the first element, breach of certain codefendants' fiduciary duty to LCM, were sufficient. To satisfy the second prong, LCM alleged that Mr. Benisty was "a mole who accepted employment with LCM for the sole purpose of gathering information and resources for REFCO. LCM has alleged that while Mr. Benisty was working for them, he was simultaneously involved in corporate espionage for REFCO by learning LCM's trading strategies and befriending their key employees."[14] Moreover, the "substantial assistance" prong was satisfied by the allegation that Mr. Benisty, while still employed at LCM, was engaged in recruiting LCM employees for the REFCO scheme.[15] The Court concluded that allegations asserting that Mr. Benisty knowingly participated in his codefendants' breach of their fiduciary duties to LCM were sufficient. Finally, LCM alleged damages resulting from the aiding and abetting the breach of fiduciary duty.

The term "more culpable conduct" has been said to mean criminal conduct, an independent tort harming another's contractual relations.

Two Key Points

Two points regarding plaintiff's claim for damages warrant elaboration. First, although plaintiff, of course, bears the burden of proving damages, cases involving breaches of fiduciary duty are treated as a "special breed" of cases where the normally stringent rules for damage calculation are relaxed.[16] In fact, the Court entertains significant leeway in ascertaining a fair approximation of the loss as long as the Court's methodology and findings are supported by inferences within the range of permissibility.[17] At a minimum, plaintiff must establish that the defendants' conduct was a substantial factor in causing an identifiable loss.[18] Second, with respect to claims for punitive damages, the limitation of punitive damages to conduct directed to the public generally does not apply in cases involving a breach of fiduciary duty,[19] and the award of punitive damages is permissible upon establishing intentional or deliberate wrongdoing, aggravating or outrageous circumstances, a fraudulent or evil motive, or simply a conscious act that willfully or wantonly disregards the rights of another.[20]

The *LCM v. REFCO, et al.* action before Justice Ramos is currently stayed pursuant to REFCO's bankruptcy filing.

1. *Louis Capital Markets, L.P. Successor to Louis Capital Markets, L.L.P against REFCO Group Ltd., L.L.C., Alain Fellous, Michael Benisty, Henri Condron, Benjamin Chouchane, Lionel Mellul and Marcos Pagani*, index number 601028/04 in New York County's Commercial Division before Justice Ramos. An edited version of the decision is published as follows: 9 Misc.3d 283, 801 N.Y.S.2d 490.
2. 88 N.Y.2d 413, 646 N.Y.S.2d 76 (1996).
3. *Guard-Life Corp. v. Parker Hardware Mfg. Corp.*, 50 N.Y.2d 183, at 189-90, 428 N.Y.S.2d 628, at 631 (1980).
4. *Foster v. Churchill*, 87 N.Y.2d 744, 642 N.Y.S.2d 583 (1996).
5. Supra, note 3, at 190, 632.
6. Brodie, Frederick A., "Theft or Loss of Business Opportunities," COMMERCIAL LITIGATION IN NEW YORK STATE COURTS, 2nd Ed., § 80.49, at 1359.
7. 50 N.Y.2d 183, 428 N.Y.S.2d 628 (1980).
8. 3 N.Y.3d 182, 785 N.Y.S.2d 359 (2004).
9. *Guard-Life*, at 190.
10. *LCM* decision, at 21.
11. *Wechsler v. Bowman*, 285 N.Y. 284 (1941).
12. 307 A.D.2d 113, 760 N.Y.S.2d 157 (1st Dept. 2003).
13. See annotations to N.Y. Pattern Jury Instr. —Civil 3:59.
14. *LCM* decision, at 34.
15. The annotations to PJI 3:59 relate that plaintiff is not required to allege that the aider and abettor had an intent to harm, only actual knowledge of the breach of duty. Accordingly, constructive knowledge of the breach is legally insufficient to sustain the cause of action.
16. *Gibbs v. Breed, Abbott & Morgan*, 271 A.D.2d 180, 710 N.Y.S.2d 578 (1st Dept. 2000).
17. *Venizelos v. Oceania Maritime Agency, Inc.*, 268 A.D.2d 291, 702 N.Y.S.2d 17 (1st Dept. 2000).
18. *Coty v. Steigerwald*, 291 A.D.2d. 796, 737 N.Y.S.2d 744 (4th Dept. 2002).
19. *Sherry Associates v. Sherry-Netherland, Inc.*, 273 A.D.2d 14, 708 N.Y.S.2d 105 (1st Dept. 2000).
20. *Buchwald & Associates v. Rich*, 281 A.D.2d 329, 723 N.Y.S.2d 8 (1st Dept. 2001).

This article is reprinted with permission from the May 10, 2006 edition of the NEW YORK LAW JOURNAL. © 2006 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact ALM Reprint Department at 800-888-8300 x6111 or visit **www.almreprints.com**. #070-09-07-0044