SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY: COMMERCIAL DIVISION

PRESENT: **HON. JENNIFER SCHECTER** **PART** 54

Justice

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DANIEL SHATZ,

INDEX NO. 655620/2018

Plaintiff,

- v -

DECISION AFTER TRIAL

DOUGLAS CHERTOK, VAST VENTURES LLC, VAST VENTURES V LP, VAST VENTURES GP LLC, VAST VENTURES VI LLC,

Defendants.

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This case concerns whether defendant Douglas Chertok, as manager of Vast Ventures VI LLC (Vast VI), breached his fiduciary duties to Vast VI and its non-managing member, plaintiff Daniel Shatz, by diverting the opportunity to invest in a company now known as Ripple Labs, Inc. (Ripple) to another LLC that Chertok managed--Vast Ventures V LLC (Vast V). More specifically, the issue is notwithstanding Chertok's "sole and absolute discretion" under Vast VI's operating agreement to select the companies in which Vast VI would invest (Dkt. 434 at 5 ["The LLC may invest in as many such private equity funds as the Managing Member elects in its sole and absolute discretion"], 10 ["The Managing Member, shall have sole and exclusive control of the management of the LLC and ... Members other than the Managing Member shall have no control of the management of the LLC, and shall have no rights or powers to carry on the affairs of the LLC"]), whether Chertok's decision to provide Vast V rather than Vast VI with the opportunity to invest in Ripple's convertible note in late 2013 was made in bad faith to enrich himself at the expense of Shatz and Vast VI (*Shatz v Chertok*, 180 AD3d 609, 610 [1st Dept 2020]).

The parties stipulated to a bifurcated bench trial on liability (Dkt. 654). After trial (*see* Dkts. 744, 745 [transcripts]; Dkts. 746, 751 [post-trial submissions], the court finds that plaintiff failed to prove his case.

Plaintiff's testimony was credible and the court largely agrees with his view of the facts as described in his post-trial brief. Chertok, by contrast, was not credible and it would be an arduous task to address each of his incredible factual contentions and all of his baffling conduct, such as his failure to disclose that he was a member of Ripple's board when soliciting plaintiff's investment and his misrepresentation about Ripple's intentions to raise money in response to plaintiff's October 23, 2013 inquiry (*see* Dkt. 210). Had he been forthright, it is likely that this litigation would have been entirely avoided.

DECISION AFTER TRIAL

Nonetheless, the evidence from the extensive discovery record that was presented at trial establishes that Chertok had no obligation to present plaintiff with the opportunity to invest in Ripple's convertible note and that he was permitted to do so through Vast V in December 2013. Thus, the court agrees with defendants that "the fact that Chertok agreed to invest in the failed Ripple Series A equity raise through Vast VI ... did not create a 'tangible expectancy' that all future investment opportunities in Ripple would be made through Vast VI" (Dkt. 746 at 19; *see Alexander & Alexander of N.Y., Inc. v Fritzen*, 147 AD2d 241, 247 [1st Dept 1989]).

As an initial matter, because deprivation of the opportunity to invest in Ripple did not "threaten the viability" of Vast VI, the court finds the "'necessary' for, or 'essential' to the line of business" corporate-opportunity test to be inapplicable (*see Alexander & Alexander of N.Y.*, 147 AD2d at 248). Vast VI is an investment vehicle that has no stand-alone "viability" as a going concern. It is merely a conduit for different investment opportunities. Therefore, the "tangible expectancy" test is more appropriate.

Applying that test, the court finds that if, between October and December 2013, Chertok was given the opportunity to acquire Ripple equity in a funding round on terms substantially similar to the Series A equity raise that was contemplated in July and August 2013, that would have been a corporate opportunity of Vast VI about which Chertok could not have lied to plaintiff or diverted to another fund. That would have been the very sort of bad faith described by this court and the Appellate Division and could have vitiated his absolute discretion defense under the operating agreement. But that is not what was proven.

The evidence showed that Ripple's convertible note was different than the proposed equity raise (*see* Dkts. 254, 298). The Series A round did not occur until a year later, in December 2014 (*see* Dkt. 677). There is no basis for holding Chertok liable for his failure to bring that opportunity to plaintiff. After all, had there been no contemplated equity raise in August 2013, there is no question that Chertok, in the first instance, would have had no affirmative obligation to bring any opportunity to plaintiff or Vast VI as his decision declining to do so would be squarely within his absolute discretion under the operating agreement. The question, instead, is whether the agreement by Shatz and Chertok that they would each invest $75,000 in Ripple's Series A, for which Shatz had provided the funds in August 2013, obligated Chertok to present Shatz with the opportunity to participate in Ripple's convertible note later that year after Ripple postponed its Series A round. The court finds that Chertok had no obligation to do so.

Critically, plaintiff failed to propose a workable limiting principle governing what opportunities Chertok would have to bring to plaintiff (*see* Dkt. 746 at 18-19). Chertok normally had no obligation to bring any opportunities to plaintiff and had sole and absolute discretion over what to invest in. Had Chertok never told plaintiff about the Series A or the convertible note and instead caused Vast V to participate in Ripple's debt issuance, then plaintiff would not have had any claim. Chertok's obfuscation, while regrettable, is inapposite. He always had the absolute right to deny Vast VI of the opportunity to invest in the convertible note. What he could not do was present an investment, take plaintiff's

money after both he and plaintiff agreed to invest, and then return plaintiff's money based on a lie that the investment opportunity abated. That would have been what occurred had Vast V immediately funded a 2013 Series A investment instead of Vast VI. But since the Series A round did not materialize in 2013--indeed, it came later in December 2014, after Vast V had made other different investments in Ripple--plaintiff has no valid grievance.

In the absence of any duty by Chertok to acquire any particular opportunity, neither Shatz nor Vast VI can claim to have had any tangible expectancy in any prospective opportunity until Chertok actually brought the opportunity to them (*see Alexander & Alexander of N.Y.*, 147 AD2d at 248). So while agreeing to invest in an equity raise but then failing to do so based on the lie that the opportunity to participate in the raise was no longer available and then diverting the opportunity to participate in that raise to another Vast fund would support a claim for diversion of a corporate opportunity, failing to present a new opportunity about which there was never an agreement to invest does not. Here, since the debt issuance was never an opportunity presented to plaintiff in the first place, that Chertok may have breached his duty of candor to plaintiff by failing to fully inform him of the full context of Ripple's changed funding plans--for instance, Chertok's disingenuous October 23, 2013 email--did not actually harm plaintiff or Vast VI. There is no basis in logic or caselaw to deem an investment a corporate opportunity merely due to a fiduciary's misrepresentation on which the plaintiff did not detrimentally rely. After all, the outcome would be the same even if Chertok had been honest with Shatz by telling him that the Series A was being postponed and that he was giving the opportunity to invest in the convertible note to Vast V in light of Vast V's participation in Ripple's earlier convertible notes. Ripple's decision to postpone its Series A, and not anything Chertok said or did, is the reason why Shatz lost the opportunity to invest in Ripple's Series A.

If there was evidence that Ripple conspired with Chertok to change the terms of its funding to create a pretextual basis to deny plaintiff the 2013 Series A opportunity to invest, then perhaps plaintiff may have had a meritorious claim. But there is no evidence that Ripple's decision to issue debt rather than equity was motivated by Chertok's relationship to plaintiff, and given the size of the proposed investment that is implausible. Instead, the evidence merely indicates that once Ripple decided to issue a convertible note, Chertok was allocated $100,000 to participate (*see* Dkt. 259). Chertok provided that opportunity to Vast V, which had already participated in a convertible note transaction with Ripple and to which he also had fiduciary duties, instead of offering it to another LLC that he managed, Vast VI (*see* Dkts. 239, 240). There was nothing wrongful about Chertok's decision to do so.

The court also rejects Shatz's argument that the Series A round and convertible note were sufficiently similar such that he should have been given the opportunity to invest. He avers that "the terms of the convertible notes also were intended to mimic the equity interests and 'upside' potential those investors would have received if they had been able to invest in the Series A round in August 2013, along with a 15% discount to further entice them to proceed" (Dkt. 751 at 23). While there are, of course, some similarities between a convertible note and Series A round, it is beyond cavil that there are material differences

between the two, and that Ripple itself saw fit to issue a convertible note and delay its Series A round by a year is proof enough that this not a mere matter of semantics.

To be sure, debt and equity investments may be economically equivalent or substantially similar such that a tangible expectancy in one makes the other a corporate opportunity. But, in this case, Shatz failed to prove that to be true. Setting aside the $50,000 difference between what Vast VI could have invested in the Series A and the convertible note, plaintiff's comparison of the terms of the Series A and the convertible note is not sufficient to establish a breach of fiduciary duty. Both investments are complex transactions that present significant risk to sophisticated investors. Parsing the differing legal and financial risks of each investment is not trivial. Seemingly economically equivalent transactions can be effected in ways that present materially differing risks and benefits. Whether motivated by tax, regulatory or even bankruptcy concerns, the structure matters. Shatz did not call an expert witness nor did he meaningfully compare the two potential investments. The court is in no position to do so.

All the court may infer from the record is that each investment would generally correlate with the success of the company and that Ripple did not think it was a good idea to proceed with the Series A in 2013 and saw fit to issue another convertible note instead (*see* Dkt. 751 at 26 [the "reason Ripple's capital raise was postponed at that time was that its (then) sole lead investor, Fortress, had not yet approved the terms of the deal"]). Thus, the court cannot conclude that the terms of the proposed Series A and the convertible note were essentially the same and that they had no material differences. Perhaps they didn't. But plaintiff, who bears the burden of proof, failed to prove it.

Moreover, even if the court agreed with plaintiff and reached contrary conclusions on all of the foregoing issues and found that Chertok diverted the corporate opportunity to invest in the convertible note, plaintiff would still not prevail since he has not shown that Chertok did this in bad faith to enrich himself at the expense of plaintiff and Vast VI. Assessing bad faith and wrongful enrichment is difficult where, as here, a manager faces dueling loyalties to members of two LLCs and where his decision about which LLC should be given the opportunity is a zero-sum decision relative to the LLCs but presents the manager with differing levels of risk and upside. In considering whether Chertok was really enriching himself, it is necessary to compare how he would benefit from the investment through Vast VI versus Vast V--the former having greater upside while putting more principal at risk; the latter having lower upside but less downside by earning part of the profit in fees without putting additional principal at risk (*see* Dkt. 746 at 22-23). The parties do not cite any cases addressing how to assess whether a fiduciary has sought to enrich himself in bad faith when his decision, even if personally motivated, involved more than just making the choice that clearly leads to more marginal profit when there are tradeoffs that necessarily impel a subjective decision based on the fiduciary's subjective risk appetite. Chertok's choice to invest through Vast V and thereby limit both his upside and risk lacks the hallmark of a fiduciary succumbing to sheer greed by chasing profit, and suggests other driving motivations. Perhaps he had a limited appetite for risking more of his own money investing in Ripple. Perhaps with only $100,000 made available he thought it was fairest to give the opportunity to the fund that had already participated in Ripple's

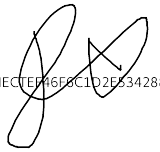
prior debt raises. Or given the paltry size of the investment relative to Chertok's net worth, perhaps he was less motivated by the differing risk and reward of investing through Vast V or Vast VI but rather was motivated by the hope of currying favor with the members of Vast V, even if it meant less profit for him on this deal, hoping that presenting the opportunity would be more profitable for him in the long run by making those investors more likely to work with him in the future.

Ultimately, Chertok had to choose between Vast V and Vast VI. He reasonably picked the former and was deceptive to the latter. That is regrettable but not actionable since Chertok did nothing wrong by favoring Vast V in this instance. He could only pick one and the other would necessarily miss out. That does not mean Chertok would have been in the wrong regardless of which he picked. So notwithstanding Chertok's lack of credibility, based on the proof at trial, the court is not convinced that he acted in bad faith or that his fiduciary duty to Vast VI required him to present the convertible-note opportunity to it after the Series A was postponed.

In the end, these sophisticated parties entered into an operating agreement that is highly protective of Chertok and its terms must be strictly enforced. Having found that Chertok's conduct did not actually rise to the requisite level of culpability because despite his dishonesty towards plaintiff he had the right to present the investment opportunity to Vast V instead of plaintiff and Vast VI, there is no basis to hold defendants liable for any damages suffered by plaintiff and Vast VI due to them not having had the opportunity to invest in Ripple. So while Chertok's dishonesty may have been a breach of fiduciary duty, such breach was not the proximate cause of any damages to plaintiff because even if Chertok had told the truth, there is nothing plaintiff could have done differently since Chertok had sole and absolute discretion to decide if plaintiff would have the opportunity to invest and plaintiff failed to present credible evidence that Chertok acted in bad faith to enrich himself at plaintiff's expense (*see Laub v Faessel*, 297 AD2d 28, 30 [1st Dept 2002]; *see also Suttongate Holdings Ltd. v Laconm Mgt. N.V.*, 173 AD3d 618, 619 [1st Dept 2019], citing *One Times Square Assocs. v Calmenson*, 292 AD2d 174 [1st Dept 2002]).

Having found that Chertok cannot be held liable on plaintiff's breach of fiduciary duty claim based on the terms of the operating agreement, plaintiff's other claims for aiding and abetting breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing necessarily fail.

Accordingly, it is ORDERED that the Clerk is directed to enter judgment dismissing the complaint with prejudice.



DATE: 9/20/2022 **JENNIFER SCHECTER, JSC**

Check One: [X] **Case Disposed** [ ] **Non-Final Disposition**