



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SCHONFELD GROUP HOLDINGS, LLC,)
)
Petitioner/Plaintiff,)
)
v.) C.A. No. 6759-VCL
)
TRILLIUM HOLDINGS, LLC,)
)
Respondent/Defendant,)
)
and)
)
TRILLIUM TRADING, LLC,)
)
Nominal Respondent.)
_____)
)
TRILLIUM BROKERAGE SERVICES, LLC,)
)
Third-Party Plaintiff,)
)
v.)
)
SCHON-EX, LLC,)
)
Third-Party Defendant.)

MEMORANDUM OPINION

Date Submitted: February 21, 2012

Date Decided: March 6, 2012

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LASTER, Vice Chancellor.

Plaintiff Schonfeld Group Holdings, LLC (“Schonfeld”) and defendant Trillium Holdings, LLC (“Holdings”) each owned a 50% membership interest in Trillium Trading, LLC (“Old Trillium”). In January 2010, Old Trillium redeemed Schonfeld’s membership interest pursuant to a redemption agreement dated January 1, 2010 (the “Redemption Agreement” or “RA”). In this action, Schonfeld asserts wide-ranging claims against Holdings, including fraud in connection with the execution of the Redemption Agreement. Holdings has moved to dismiss in reliance on a broad release of claims in the Redemption Agreement. I hold that the release bars Schonfeld’s claims to the extent they arise out of events that occurred on or before January 1, 2010.

I. FACTUAL BACKGROUND

The facts for purposes of the motion to dismiss are drawn from the amended verified complaint and petition for judicial dissolution dated January 23, 2012 and the documents it incorporates by reference, which include the Redemption Agreement and other material agreements between the parties. Holdings has not moved to dismiss any claims arising from events that occurred after January 1, 2010, and I do not discuss them.

A. The Joint Venture

Old Trillium was a registered broker-dealer that operated a proprietary intraday equity and futures trading business. In layman’s terms, Old Trillium employed traders to buy and sell securities using Old Trillium’s funds, and the traders ended each day with their positions in cash.

Holdings formed Old Trillium in 2002 as a single-member New Jersey limited liability company. Non-party Lee Maschler owns Holdings.

In March 2003, Holdings admitted Schonfeld as an equal member in Old Trillium. Pursuant to an operating agreement dated March 25, 2003, Holdings and Schonfeld agreed that Holdings would serve as Old Trillium's sole manager. As such, Holdings managed the business and affairs of Old Trillium, subject to Schonfeld's veto rights over certain actions set forth in the operating agreement.

B. The Reorganization

In 2007, Andrew Fishman, Schonfeld's President, recommended to Maschler and Barry Schwarz, Old Trillium's CEO, that Old Trillium give up its broker-dealer registration and trade using strategies that did not require registration. Schwarz responded that "he wanted to create a new company to 'house, at the very least, the intraday proprietary trading business' while still retaining [Old Trillium] as a registered broker-dealer." Compl. ¶ 18 (quoting a December 20, 2007 email). Although Fishman and Mark Peckman, Schonfeld's General Counsel, preferred that Old Trillium deregister, Schwarz and Maschler "insisted in Managing Committee meetings and telephone calls that they wanted to retain [Old Trillium] as a broker-dealer and create a new company . . . to house the proprietary trading business." *Id.*

For reasons that remain unclear at this early stage of the case, the deregistration issue languished for approximately two years. Eventually, Schonfeld agreed to withdraw from Old Trillium and form a new venture with Holdings that would pursue trading strategies that did not require registration. In January 2010, pursuant to the Redemption Agreement, Old Trillium purchased Schonfeld's ownership units in Old Trillium. Schonfeld and Holdings formed a new Delaware entity, also called Trillium Trading,

LLC (“New Trillium”), that would have the “same members, same manager, same traders, and same proprietary trading business” as Old Trillium. *Id.* ¶ 3. The Redemption Agreement contained the following general release:

Schonfeld hereby releases and forever discharges [Old Trillium], each of its current and future affiliates (including Trillium Holdings LLC), each of their respective officers, managers, directors, members and shareholders, and each of their respective successors and assigns from and against all debts, obligations, promises, covenants, agreements, contracts, disputes, suits, actions, causes of action, judgments, damages, expenses, claims or demands, in law or in equity, which Schonfeld ever had, now has, or which may arise in the future, regarding any matter which arose or occurred on or before the Closing Date [January 1, 2010], whether known or unknown, fixed or contingent, absolute or conditional, to the extent directly or indirectly relating to, arising out or otherwise connected with: (i) the Units held by Schonfeld, (ii) the redemption transaction contemplated hereby and (iii) the sufficiency of the Redemption Price.

RA § 7.1 (the “General Release”).

In connection with the transaction, Old Trillium changed its name to Trillium Brokerage Services. In December 2010, Old Trillium gave up its broker-dealer license. Schonfeld points out that this decision conflicted with the representations made by Schwarz and Maschler that they wanted to maintain Old Trillium as a stand-alone broker-dealer.

C. The Alleged Wrongdoing

Schonfeld alleges that since 2003, Holdings “implemented illegal and fraudulent trading practices” at Old Trillium. Compl. ¶ 15. “As a result, [Old Trillium] was repeatedly investigated and sanctioned by regulators for, among other things, entering

non-bona fide securities orders and manipulating the securities markets resulting in [Old Trillium] having to pay enormous attorneys' fees and fines." *Id.*

Old Trillium does appear to have had its share of regulatory difficulties:

- In August 2006, Old Trillium "agreed to a censure, a \$225,000 fine, and an undertaking to revise its written supervisory procedures" as a result of an investigation by the National Association of Securities Dealers ("NASD") related to non-*bona fide* orders by Old Trillium's traders. *Id.* ¶ 16 (internal quotation marks omitted). Eight of Old Trillium's traders were fined a total of \$90,000 and suspended for periods of one to four months.
- In July 2007, after a Financial Industry Regulatory Authority ("FINRA") investigation, Old Trillium consented to be "censured, fined \$15,000 and required to revise its written supervisory procedures." *Id.* ¶ 17.
- In September 2010, based on an investigation from November 1, 2006 through January 31, 2007, FINRA fined Old Trillium \$1 million for using "layered, non-bona fide market moving orders to generate selling or buying interest in specific stocks." *Id.* ¶ 24 & Ex. H. Old Trillium's former Director of Trading, its Chief Compliance Officer, and nine of its traders were also fined a total of \$802,500, required to pay \$292,000 in disgorgement, and suspended from the securities industry for periods from six months to two years.

New Trillium appears to be continuing the regulatory tradition. In December 2010 and May 2011, the SEC served subpoenas on New Trillium. *Id.* ¶ 25. In March 2011, FBI agents visited and attempted to interview traders who had previously been sanctioned by FINRA. *Id.* ¶ 26. The New Jersey U.S. Attorney's Office is investigating New Trillium for securities laws violations. *Id.*

In addition to allegedly improper trading practices, Schonfeld alleges that Holdings repeatedly breached Old Trillium's operating agreement and managed Old Trillium "in an illegal, oppressive, and fraudulent manner." *Id.* ¶ 4. According to the complaint,

- Holdings failed to obtain Schonfeld’s approval of hiring and compensation decisions as required by the operating agreement and overcompensated employees (*Id.* ¶¶ 27-32, 34);
- Holdings failed to provide Schonfeld with sufficient or reliable financial, supervisory, and compliance reports and adequate updates regarding regulatory and criminal investigations (*Id.* ¶¶ 32, 37-38);
- Old Trillium employees performed work for other of Holdings’ business interests (*Id.* ¶ 33);
- Holdings refused to hire appropriate supervisory personnel or institute appropriate compliance procedures (*Id.* ¶ 35-36);
- Holdings used Old Trillium’s proprietary trading strategies at other firms without authorization and without paying compensation (*Id.* ¶ 39);
- Holdings allowed two traders to use unapproved long-term trading strategies, resulting in millions of dollars of losses (*Id.* ¶ 40); and
- Holdings rejected Schonfeld’s requests to hire Battea Class Action Services, eventually hiring a more expensive class action services firm without Schonfeld’s approval (*Id.* ¶ 41).

D. The Litigation

On August 5, 2011, Schonfeld filed this action. The complaint alleges that Schonfeld was fraudulently induced into executing the Redemption Agreement because, contrary to its representations, Holdings did not intend to maintain Old Trillium as a registered broker-dealer. According to Schonfeld, Holdings misrepresented its intentions because Holdings “was aware that [Schonfeld] may have claims against it and wanted to induce [Schonfeld] into signing the release in the Redemption Agreement before [Schonfeld] discovered such claims.” *Id.* ¶ 21.

The complaint asserts six counts. Counts I and II seek dissolution of New Trillium. Counts III and IV assert claims for Holdings’ misconduct as a manager of Old

and New Trillium. Count V seeks damages for breaches of the operating agreements governing Old and New Trillium. Count VI seeks a declaration that the General Release is void under a theory of fraudulent inducement. Holdings has moved to dismiss all claims arising out of events pre-dating the General Release. Because I grant the motion on that basis, I do not reach Holdings' other grounds for dismissal.

II. LEGAL ANALYSIS

A complaint should be dismissed if it fails to state a claim on which relief could be granted. *See* Ct. Ch. R. 12(b)(6). The General Release can be considered on a Rule 12(b)(6) motion because the complaint incorporates the Redemption Agreement by reference. *See, e.g., Meer v. Aharoni*, 2010 WL 2573767, at *3 (Del. Ch. June 28, 2010) (“In evaluating defendant’s motion to dismiss, the Court may also consider the unambiguous terms of the Original and Amended Stipulations, the Proposed Settlement, and the Release, which are integral to the complaint and the resolution of this motion.”); *Canadian Commercial Workers Indus. Pension Plan v. Alden*, 2006 WL 456786, at *2 n.9 (Del. Ch. Feb. 22, 2006) (“The Court may consider the Release in deciding a motion to dismiss because the Complaint makes reference to it.”).

The Redemption Agreement and General Release are governed by New York law. RA § 8.5. In June 2011, New York’s highest court addressed when a release can be set aside because of fraudulent inducement. *See Centro Empresarial Cempresa S.A. v. Am. Movil, S.A.B. de C.V.*, 952 N.E.2d 995 (N.Y. 2011).

New York law recognizes the validity of general releases, which “constitute[] a complete bar to an action on a claim which is the subject of the release.” *Id.* at 1000

(quoting *Global Mins. & Metals Corp. v. Holme*, 824 N.Y.S.2d 210, 214 (N.Y. App. Div. 2006)). “If ‘the language of a release is clear and unambiguous, the signing of a release is a jurat act binding on the parties.’” *Id.* (quoting *Booth v. 3669 Del.*, 703 N.E.2d 757, 758 (N.Y. 1998)). “[A] signed release ‘shifts the burden of going forward . . . to the [plaintiff] to show that there has been fraud, duress or some other fact which will be sufficient to void the release.’” *Id.* (second alteration and omission in original) (quoting *Fleming v. Ponziani*, 247 N.E.2d 114, 118-19 (N.Y. 1969)).

“[A] release may encompass unknown claims, including unknown fraud claims, if the parties so intend and the agreement is ‘fairly and knowingly made.’” *Id.* (quoting *Mangini v. McClurg*, 249 N.E.2d 386, 392 (N.Y. 1969)). “[A] party that releases a fraud claim may later challenge that release as fraudulently induced only if it can identify a separate fraud from the subject of the release. Were this not the case, no party could ever settle a fraud claim with any finality.” *Id.* (citation omitted).

The General Release explicitly extinguished all claims, known or unknown, “directly or indirectly relating to, arising out or otherwise connected with: (i) the Units held by Schonfeld, (ii) the redemption transaction contemplated [by the Redemption Agreement] and (iii) the sufficiency of the Redemption Price.” RA § 7.1. On its face, this broad and unambiguous language releases all claims asserted in the complaint that arise out of events that occurred on or before January 1, 2010.

Counts III and IV assert claims for Holdings’ grossly negligent and willful misconduct as a manager of Old Trillium. These claims assert that Holdings took improper action that harmed the value of Schonfeld’s units, either directly or indirectly

by decreasing the value of Old Trillium. The parties join issue over whether many of these claims are direct or derivative. In either case, they fall within the General Release because they relate to “the Units held by Schonfeld.” RA § 7.1. They also fall within the General Release because they relate to “the sufficiency of the Redemption Price,” *id.*, which was calculated based on the value of Schonfeld’s membership interest in Old Trillium.

Count V asserts claims for breaches of the operating agreement. Here again, the claims assert that Holdings took improper action that harmed the value of Schonfeld’s units or caused the value of Old Trillium to decline. The claims in Count V therefore fall within the General Release because they relate to “the Units held by Schonfeld” and to “the sufficiency of the Redemption Price.” RA § 7.1.

Count VI asserts a claim for fraudulent inducement that also is encompassed by the General Release. Similar to the release in *Centro Empresarial*, the General Release expressly covers all “future,” “unknown,” and “contingent” claims and is broad enough to encompass unknown fraud claims relating to the subject matter of the General Release. *See Centro Empresarial*, 952 N.E.2d at 1000 (“The phrase ‘all manner of actions,’ in conjunction with the reference to ‘future’ and ‘contingent’ actions, indicates an intent to release defendants from fraud claims . . . unknown at the time of contract.”). Schonfeld’s claim for fraudulent inducement falls squarely within the scope of the release: Holdings’ representation that it intended to maintain Old Trillium’s broker-dealer registration related both to Schonfeld’s units in Old Trillium and the redemption transaction. Indeed, the complaint alleges that Holdings’ stated desire to maintain the registration was the

impetus for the redemption transaction itself and for Schonfeld's decision to sell its units back to Old Trillium, areas expressly covered by the General Release. *See* Compl. ¶ 20. Schonfeld has failed to "identify a separate fraud from the subject of the release" upon which this Court could invalidate the General Release. *Centro Empresarial*, 952 N.E.2d at 1000.

As in *Centro Empresarial*, "[t]hat the parties had a fiduciary relationship does not alter [this] conclusion." *Id.* at 1001. "A sophisticated principal is able to release its fiduciary from claims—at least where . . . the fiduciary relationship is no longer one of unquestioning trust—so long as the principal understands that the fiduciary is acting in its own interest and the release is knowingly entered into." *Id.*

Contrary to Schonfeld's assertion that Holdings sought to conceal the regulatory issues at Old Trillium, Schonfeld knew about much of the alleged misconduct. Schedule 3.6 to the Redemption Agreement disclosed five pending regulatory and litigation matters, including three FINRA matters, an SEC matter, and a New York State Department of Taxation and Finance case. RA § 3.6. Schonfeld also knew that Holdings had not been complying with what Schonfeld believed to be its rights under the operating agreement. According to the complaint, despite Schonfeld's requests, Holdings repeatedly failed to provide Schonfeld with adequate information about Old Trillium. Schonfeld allegedly did not receive adequate responses to its requests for information regarding "supervisory, compliance, and regulatory issues" that underlie many of the allegations in the complaint. Compl. ¶ 38. Holdings also allegedly failed to comply with Schonfeld's "repeated requests" for "sufficient or reliable financial reports, including

trader and officer compensation formulas, explanations of the status of [Schonfeld's] capital account . . . and other information concerning [Old Trillium]." *Id.* ¶ 37. In addition, "[d]espite [Schonfeld's] repeated requests," Holdings "failed to obtain [Schonfeld's] approval . . . for hiring and compensation decisions" as required by the operating agreement." *Id.* ¶ 32; Pl.'s Answering Br. 11. Schonfeld also knew by 2008 that Holdings had allowed two of Old Trillium's traders "to use unapproved long term trading strategies at [Old Trillium] resulting in millions of dollars of losses." Compl. ¶ 40 & Ex. I.

Schonfeld and Holdings were negotiating to end their relationship in Old Trillium and start another relationship in New Trillium. Each was a sophisticated party acting in its own self-interest. "As [a] sophisticated entit[y], [Schonfeld] negotiated and executed an extraordinarily broad release with [its] eyes wide open. [Schonfeld] cannot now invalidate that release by claiming ignorance of the depth of [its] fiduciary's misconduct." *Centro Empresarial*, 952 N.E.2d at 1002; *see Arfa v. Zamir*, 952 N.E.2d 1003, 1004 (N.Y. 2011) (upholding dismissal of fraud claims for misrepresentations pre-dating a release where the plaintiffs "had ample indication prior to [the release] that defendant was not trustworthy" and "failed to allege that the release was induced by a separate fraud"); *Usach v. Tikhman*, 2011 WL 6106542, at *8 (S.D.N.Y. Dec. 7, 2011) ("[The counterclaim plaintiff] is a sophisticated businessman. He had ample grounds to mistrust his business partner, and decided to settle Having done so, [he] cannot now bring suit on the basis of claims that fall squarely within the scope of the . . . Release.").

III. CONCLUSION

The General Release extinguished Schonfeld's claims arising out of events that occurred on or before January 1, 2010. Holdings' motion to dismiss is therefore granted. The case will proceed as to events post-dating January 1, 2010. **IT IS SO ORDERED.**