SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

KATZRIN FINANCE GROUP, LLC, Plaintiff, -against- ARCAPEX LLC, BLACKTHORN ADVISORY GROUP LLC, LIGHT SWORD LLC, VINCENT NEY, JON GEIDEL, AND KATTEN MUCHIN ROSENMAN LLP, Defendants.	Index No. 651129/2014 DECISION AND ORDER Motion Sequence No. 002

ANIL C. SINGH, J.:

Defendants move to dismiss the complaint pursuant to CPLR 3016 (b), 3211 (a) 1, and 3211 (a) (7). For the reasons set forth below, the motion is granted.

Background

This action arises out of investments made by Katzrin Finance Group, LLC (plaintiff or Katzrin) in Blue King, Inc. (Blue King), a payday lending corporation wholly owned by the Chukchansi Indian tribe (the tribe), a sovereign nation recognized by the United States government. The defendants in this action are Vincent Ney (Ney) and Jon Geidel (Geidel), as well as companies owned by them Arcapex LLC (Arcapex), Blackthorn Advisory Group LLC (Blackthorn), and Light Sword LLC (Light Sword) (collectively, defendants). Plaintiff claims that defendants induced it to invest in Blue King, a doomed-to-fail enterprise, by misrepresenting key aspects of the venture's financial situation. Plaintiff claims (1) negligent misrepresentation against Ney, Arcapex, Blackthorn, and Light Sword; (2) fraud against Ney, Arcapex, Blackthorn, and Light Sword; (3) unjust enrichment against all defendants; and (4) aiding and abetting fraud

against Geidel. Plaintiff also brought professional malpractice and breach of fiduciary duty claims against the law firm Katten Muchin Rosenman LLP, its counsel during the alleged fraud, but ultimately dropped those claims against te firm.

Facts

David Azar (Azar) is the principle of Katzrin. He was introduced to Ney in or about 2005, where Ney discussed his success in the payday lending business (Azar had no prior experience or knowledge of the industry).[1] Over the next several years, Azar and Ney met periodically at business conferences and social gatherings. In 2010, Ney asked Azar for a $1 million loan for his payday lending business. Azar reviewed Ney's financial information and agreed to give Ney the loan, unsecured by any collateral. Ney subsequently repaid the loan in full. In 2012, Azar made another similar loan to Ney that was also repaid in full.

In or about February 2012, Ney solicited Azar's investment in the Blue King payday lending operation, claiming that the enterprise would be lucrative and low risk. The secret to the operation's success would lie in Blue King's corporate structure. The corporation was to be wholly owned by the Chukchansi Indian tribe, who—as a federally recognized sovereign nation—enjoyed limited sovereign immunity and was not subject to state or local payday lending regulations. This beneficial regulatory position, combined with the expert services provided by Arcapex, Blackthorn, and Light Sword, would make Blue King low risk and high reward.

[1] Payday lending is the business of providing small, short-term, unsecured loans—sometimes called cash advances—to individual borrowers. Because of their high risk and short term of maturity, payday loans tend to have very high interest rates ranging from $10 to $30 per $100 borrowed. Consumer Financial Protection Bureau, *What is a payday loan?*, ASK CFPB, http://www.consumerfinance.gov/askcfpb/1567/what-payday-loan.html (Updated Nov. 6, 2013).

From February 2012 to August 2012, Ney and his associate Geidel aggressively solicited plaintiff's investment in Blue King. Ney and Geidel met with Azar multiple times over this period, participated in numerous conference calls and emails, and provided Katzrin various business and financial documents to further solicit his investment. The three men discussed Blue King's structure, operations, and profitability. On April 9, 2012, Plaintiff sent copies of Blue King's business proposal and business structure to the law firm Katten Muchin Rosenman LLP seeking the firm's legal advice. Katten would provide counsel and conduct due diligence for Katzrin throughout the negotiation process. On May 21, 2012, Geidel sent an email to Azar stating that the servicing agreements, which allegedly contained information on how much the servicing entities owned by Ney and Geidel were to be paid by Blue King, but the documents were never provided to either Katzrin or Katten, despite request.

On or about June 22, 2012, August 1, 2012, August 2, 2012, and August 22, 2012, Katzrin invested amounts totaling $5 million in Blue King. Upon completion of this initial investment, Katzrin received a closing binder that failed to disclose payments to the servicing entities and the Indian tribe. On or about November 26, 2012, Katzrin invested an additional $3 million in Blue King. In or about February 2014, Blue King failed to make a monthly payment due to Katzrin and Katzrin exercised its rights to recover half of its investment. Katzrin commenced this action by filing its Summons and Complaint on April 11, 2014.

Discussion

On a motion to dismiss for failure to state a cause of action, the court accepts all factual allegations pleaded in plaintiff's complaint as true, and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The

court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD2d 113 (1st Dept 2003).

Fraud

Under New York law, an action for fraud contains five elements. A plaintiff must show that (1) the defendant made a representation as to a material fact; (2) the representation was false; (3) the defendant made such representation with the intention of deceiving or misleading the plaintiff; (4) the plaintiff reasonably relied upon the defendant's misrepresentation; and (5) that reliance resulted in a legally cognizable injury to the plaintiff. *Ross v. Louise Wise Services, Inc.*, 8 N.Y.3d 478, 488 (2007); *Lama Holding Co. v. Smith Barney Inc.*, 88 N.Y.2d 413, 421 (1996); *P.T. Bank Central Asia v. ABN AMRO Bank N.V.*, 301 A.D.2d 373, 376 (1st Dep't. 2003). Omission or concealment may also rise to the level of fraud when the concealed information is material and the defendant has a special duty to disclose. *Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 179 (2011).

To survive a motion to dismiss, CPLR 3016 (b) also requires that parties alleging fraud must "state in detail the circumstances constituting the wrong" done to them. Courts have been clear, however, that 3016 (b) should not be interpreted to require some sort of significantly higher pleading standard, with the First Department stating that "these special provisions . . . constitute no more than a directive that the 'transactions and occurrences' constituting the

'wrong' shall be pleaded in sufficient 'detail' to give adequate notice thereof." *Foley v. D'Agostino*, 21 A.D.2d 60, 64 (1st Dep't. 1964).

The crux of plaintiff's claims is that the defendants deliberately failed to disclose the "exorbitant" payments that Blue King would be regularly making to Arcapex, Blackthorn, Lightsword, and the Indian tribe, which, if known, would have prevented plaintiff in investing in the enterprise and losing millions of dollars.[2] Plaintiff also alleges that Ney affirmatively misrepresented the Blue King venture's level of risk and potential for success, by promising Azar, *inter alia*, that Blue King's success was guaranteed by its unique and creative corporate structure and that Katzrin's investment was guaranteed to earn interest. New York courts have generally interpreted these kinds of forward-looking statements as mere puffery and overly optimistic opinion, however, which are a traditional part of most business transactions and do not constitute fraud. *Brown v. Lockwood*, 76 A.D.2d 721, 731 (2nd Dep't. 1980) ("It is the general rule that fraud cannot be predicated upon statements which are promissory in nature at the time they are made and which relate to future actions or conduct . . . Mere unfulfilled promissory statements as to what will be done in the future are not actionable as fraud."). *See also*, *Mandarin Trading Ltd.*, 16 N.Y.3d at 179 (holding that a defendant's appraisal letter estimating the value of a painting constituted a "nonactionable opinion."); *MMCT, LLC v. JTR College Point, LLC*, 122 A.D.3d 497, 498 (1st Dep't. 2014) (holding that a statement made by a developer to an investor that "the project was in a 'great area' and that [the developer] would prefer to invest his own money rather than rely on his family" was "non-actionable opinion or puffery."); *ESBE*

[2] Plaintiff's Amended Complaint attempts to recharacterize this failure to disclose as an affirmative misrepresentation or series of misrepresentation, presumably in an attempt to avoid having to plead a breach of a special duty to disclose. The Amended Complaint does not, however, allege any specific misrepresentations made by defendants with regard to payments made under the servicing agreements. It alleges only that defendants failed to provide the servicing agreements when plaintiff requested to review the documents, and concealed material information contained inside.

Holdings, Inc. v. Vanquish Acquisition Partners, LLC, 50 A.D.3d 397, 398 (1st Dep't. 2008) ("Claims based upon defendants' projections of returns on investment, such as the expected acquisition of the Orient Cruise Lines and the projected Southeast Cruise Holdings acquisitions, are not actionable because such projections are merely statements of prediction or expectation.").

a.) Materiality

The first element of a fraud claim is that the defendant must have misrepresented or concealed a material fact. New York courts have not closely defined what it means for a fact to be material, but have stated that a misrepresentation or omission that is "so trifling as to be legally inconsequential" cannot be considered material. *Gaidon v. Gardian Life Ins. Co. of America*, 94 N.Y.2d 330, 350 (1999). In *Roni LLC v. Arfa*, 74 A.D.3d 442 (1st Dep't. 2010), the court held that plaintiffs' allegation that "they never would have invested" in an enterprise had they known about undisclosed commissions that being paid out to the defendants was sufficient to satisfy the materiality element of their fraud claim. *Roni*, 74 A.D.3d at 445. It could not be said "as a matter of law that knowledge of these commissions would not have influenced [plaintiffs'] decision," so dismissal on materiality grounds was inappropriate. Katzrin has likewise alleged that it would not have invested in Blue King had it known how much was being paid to the servicing entities and the Indian tribe. The threshold is not particularly high, and since "this question is frequently one for the trier of fact," *Robitzek v. Reliance Intercontinental Corp.*, 7 A.D.2d 407, 409 (1st Dep't. 1959), plaintiff has sufficiently pleaded the first element of its fraud claim.

b.) Intent

A claim of fraud also requires that the plaintiff prove that the defendant purposefully misrepresented a material fact with the intention of deceiving the plaintiff. Proof of falsehood is not in itself sufficient. *See Friedman v. Anderson*, 23 A.D.3d 163, 167 (1st Dep't. 2005) ("A fraud claim is not actionable without evidence that the misrepresentations were made with the intent to deceive."). Much like materiality, intent is typically a question of fact best left for trial. *Cf. Shea v. Hambros PLC*, 244 A.D.2d 39, 47 (1st Dep't. 1998). At the motion to dismiss stage, New York "requires only that the complaint include facts from which it is possible to infer defendant's knowledge of the falsity of its statements." *Houbigant, Inc v Deloitte & Touche LLP*, 303 A.D.2d 92, 99 (1st Dep't. 2003). Here, plaintiff alleges that it repeatedly asked for access to the service agreements only to be denied or ignored, which is sufficient to allow an inference that defendants intended to deceive Katzrin by concealing information.

c.) Duty to Disclose

When a fraud claim is predicated on an omission or concealment, rather than an affirmative misrepresentation, the plaintiff is required to show that the defendant violated some duty to disclose the information. This stems from the longstanding common law rule that there is no generalized duty to disclose absent some special situation or relationship between the parties. A duty to disclose material facts exists when the parties are joined in a special relationship of trust and confidence (*e.g.*, between an attorney and her client or a trustee and the trust's beneficiary) or when the defendant is in possession of material information that the plaintiff is incapable of ascertaining "by the exercise of ordinary intelligence." *DDJ Management, LLC v. Rhone Group L.L.C.*, 15 N.Y.3d 147, 154 (2010) (quoting *Schumaker v. Mather*, 133 N.Y. 590, 596 (1892)).

Plaintiff argues that defendants' duty to disclose arises both out of a special relationship of confidence between Ney and Azar, built up over years of pleasantly doing business together, and the fact that the information contained in the service agreements was peculiarly within defendants' knowledge, unknowable to plaintiff by the exercise of ordinary intelligence.

Plaintiff argues that Azar and Ney's years as friendly acquaintances, and their history of two successful handshake deals in the past, have created special relationship of trust where defendants' were duty-bound to disclose any information material to plaintiff's decision to invest in Blue King. Plaintiff fails, however, to allege that the relationship between Ney and Azar was ever anything more than two casual acquaintances who occasionally did business together. While the courts have not developed a bright line threshold for when a relationship requiring affirmative disclosure is formed, it is clear that *something* more than arm's length business dealings or casual friendship is necessary. *See Dembeck v. 220 Cent. Park South, LLC*, 33 A.D.3d 491, 492 (1st Dep't. 2006) (holding that plaintiff's failure to demonstrate the existence of a fiduciary relationship where "one party is under a duty to act for, or give advice for the benefit of, another on matters within the scope of their relationship" was sufficient to deny their fraud claim.). *Cf. Striker v. Graham Pest Control Co. Inc.*, 179 A.D.2d 984, 985 (3rd Dep't. 1992) (holding that a real estate broker, when he took it upon himself to arrange a pest inspection on the plaintiff/purchaser's behalf and representing to the plaintiff that the house had passed inspection, created a duty to disclose any material facts related to that representation. The duty did not exist before defendant took affirmative steps to place himself in a position of trust where he was acting *on behalf of* the plaintiff.). While the plaintiff's allegations must be presumed to be true when reviewing a motion to dismiss, conclusory statements that a "special relationship of

trust and confidence" existed are insufficient to plead the existence of an affirmative duty to disclose. Here plaintiff has not adequately pled a fiduciary relationship between the parties.

On the other hand, a duty to disclose also exists "where one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair." *P.T. Bank Central Asia v. ABN AMRO Bank N.V.*, 301 A.D.2d 373, 378 (1st Dep't. 2003) (quoting *Chiarella v. United States*, 445 U.S. 222, 248 (1980)). This is known as the "special facts" doctrine. *Id.* The question of whether the information defendants' allegedly withheld was uniquely within their control to the extent that justice and fairness demands disclosure is properly a question of fact that cannot be answered solely on the pleadings. *Id.*; *Kimmell v. Schaefer*, 89 N.Y.2d 257, 264 (1996).

d.) Reliance

In order to succeed on a fraud claim, a plaintiff must show both that they relied upon the defendant's misrepresentations and that such reliance was justifiable. *Stuart Silver Assocs. v. Baco Dev. Corp.*, 245 A.D.2d 96, 98-99 (1st Dep't 1997). As the Court of Appeals has repeatedly stated:

> [I]f the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations.

Centro Empresarial Cempresa S.A. v. América Móvil, S.A.B. de C.V., 17 N.Y.3d 269, 278–79 (2011) (citation omitted). Assuming defendants had a duty to disclose the information contained in the service agreements, plaintiff still needs to show that its alleged reliance was justified given the nature of their relationship.

A plaintiff will generally have no difficulty showing it was justified in relying on representations made by its fiduciary, while a plaintiff alleging fraud within the context of an ordinary arm's length transaction will have a much tougher time. Similarly, it is much more difficult for sophisticated parties acting under the advice of counsel to plead justifiable reliance than those with little-to-no business experience.

Centro is particularly instructive. As in the current case, the plaintiff's fraud claim partially hinged on the allegation that the defendants failed to disclose financial information necessary to determine the value of plaintiff's investment. *Centro Empresarial Cempresa*, 17 N.Y.3d at 279. As here, the plaintiffs were a sophisticated business entities with the benefit of legal counsel. *Id.* The plaintiffs were aware that defendants had not supplied all the information that they were entitled to but failed to take actions necessary to protect their interests. *Id.* In the court's words, this was "an instance where plaintiffs have been so lax in protecting themselves that they cannot fairly ask for the law's protection." *Id.* (citation omitted). In the current case, plaintiff hired counsel to conduct due diligence, was aware that defendants possessed information that was potentially important to its business decisions, was denied access to that information, and decided to invest anyway. *C.F ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 25 NY3d 1043, 1045 [2015] (finding reasonable reliance was sufficiently stated when plaintiff sought information on how defendant would participate in the transaction, defendant made an affirmative misrepresentation).

"New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions and the business they are acquiring." *Global Mins. & Metals Corp. v. Holme*, 35 A.D.3d 93, 100 (1st Dep't. 2006). *See also Abrahami v. UPC Constr. Co.*, 224

A.D.2d 231, 234 (1st Dep't. 1996) (holding that sophisticated businessmen had a duty to exercise ordinary diligence and conduct an independent appraisal of the risk they were assuming.). But at the same time the law does "not impose a duty on plaintiffs to insist on a "prophylactic provision" in agreements" in order to protect themselves. *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 25 NY3d at 1045.

Here, Katzrin had the power to refuse to invest any of its money into Blue King until it had an opportunity to examine the service agreements. It was a sophisticated investor represented by a major law firm considering entering into an industry its own attorneys had warned was risky due to regulatory concerns. But here, Katzrin knew exactly what information it required, knew defendants likely possessed the information, and even knew what specific documents to ask for, but failed to take reasonable steps to protect its investment. Moreover, plaintiff continued investing for months following the last alleged discussion concerning the service agreements, even investing an additional $3 million months after completing the initial investment and months after plaintiff's own documentary evidence indicates it was made aware of the amounts being paid to the service providers and the Indian tribe. Thus, it is not the court's role to insulate sophisticated businesses entities from the consequences of their own risky investments.

The Court of Appeals reiterated in *ACA Fin. Guar. Corp.* that, "the question of what constitutes reasonable reliance is not generally a question to be resolved as a matter of law on a motion to dismiss" *Id.* However, in contrast to Katzrin's alleged actions here, plaintiff in *ACA Fin. Guar. Corp.* made an inquiry regarding its guaranty of a synthetic collateralized debt obligation and alleged that affirmative misrepresentations were made regarding the transaction. The allegations made by plaintiff here fall squarely within the holding of *Centro. See supra.* Plaintiffs knew that defendants had not supplied them with the financial information to which

they were entitled, triggering "a heightened degree of diligence" *Pappas v Tzolis*, 20 NY3d 228, 232-33 [2012] (quoting *Centro,* 17 N.Y.3d at 279). Where no reasonable protective step is alleged, the fraud claim fails, as a matter of law and may be dismissed. *Schumaker v. Mather*, 133 N.Y. at 596. Plaintiff's reliance on defendants' alleged misrepresentations is not justifiable as a matter of law.

e.) Injury

Plaintiffs alleging fraud must also show that their reliance on defendants' misrepresentations proximately caused them a legally cognizable injury. It is unnecessary to discuss injury here, as plaintiff has failed to plead justifiable reliance.

Negligent Misrepresentation

The elements of a claim for negligent misrepresentation are very similar to the elements for fraud. "A claim for negligent misrepresentation requires the plaintiff to demonstrate (1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information." *Mandarin Trading*, 16 N.Y.3d at 180 (citation omitted). Since it has already been shown that there was no special or privity-like relationship between the parties, and that Katzrin could not have justifiably relied on defendants' alleged misrepresentations, it is unnecessary to delve any farther into plaintiff's negligent misrepresentation claim.

Unjust Enrichment

The central question at the heart of any unjust enrichment claim is "whether it is against equity and good conscience to permit the defendant to retain what is sought to be recovered."

Paramount Film Distrib. Corp. v. State of New York, 30 N.Y.2d 415, 421 (1972). In order to prevail, "[a] plaintiff must show that (1) the other party was enriched, (2) at that party's expense, and (3) that it is against equity and good conscience to permit [the other party] to retain what is sought to be recovered." *Mandarin*, 16 N.Y.3d at 182 (citations omitted). The purpose of allowing claims of unjust enrichment is to prevent injustice in unusual situations where, notwithstanding the fact that no tort or breach of contract may have occurred, circumstances have created an equitable obligation running from an enriched party to an injured party. *Corsello v. Verizon New York*, 18 N.Y.3d 777, 790 (2012). It is not, however, merely a catchall cause of action for when a plaintiff's primary claims fail. *Id.* Here, Katzrin fails in its unjust enrichment claim for one of the same reasons Mandarin failed: "there are no indicia of an enrichment that was unjust where the pleadings failed to indicate a relationship between parties that could have cause reliance or inducement." *Mandarin*, 16 N.Y.3d at 182. Katzrin has failed to show that it was ever in a situation where it could have justifiably relied on defendants' representations, and so cannot prevail on its unjust enrichment claim.

Aiding and Abetting Fraud

Since plaintiff has failed to plead a primary cause of action for fraud, it is unnecessary to discuss its secondary claim against Geidel of aiding and abetting that fraud.

Conclusion

Accordingly, it is hereby

ORDERED that the motion by defendants Arcapex LLC, Blackthorn Advisory Group LLC, Light Sword LLC, Vincent Ney, and Jon Geidel to dismiss all of plaintiff's claims against them is GRANTED.

Date: October 22, 2015

New York, New York

Anil C. Singh