Arrowhead Capital Fin., Ltd. v Cheyne Specialty Fin. Fund, L.P.
2019 NY Slip Op 32867(U)
September 27, 2019
Supreme Court, New York County
Docket Number: 651962/2014
Judge: Jennifer G. Schecter
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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ARROWHEAD CAPITAL FINANCE, LTD., Index No.: 651962/2014

Plaintiff, **DECISION & ORDER**

-against-

CHEYNE SPECIALTY FINANCE FUND, L.P.,

Defendant.

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JENNIFER G. SCHECTER, J.:

Defendant Cheyne Specialty Finance Fund L.P. (Cheyne) moves to dismiss the amended complaint (Dkt. 406 [the AC]). Plaintiff Arrowhead Capital Finance, Ltd. (Arrowhead) opposes the motion. The motion is granted in part.

Familiarity with this action is assumed, the details of which are extensively set forth in the court's December 4, 2015 decision on Cheyne's motion to dismiss Arrowhead's original complaint (Dkt. 303 [the 2015 Decision]). In short:

> (Arrowhead), a judgment-creditor whose predecessor made a subordinated loan to non-party borrowers, brings this action against the former senior lender (Cheyne). Essentially, Arrowhead alleges that Cheyne settled with the borrowers and, in breach of its contractual and fiduciary duties, assigned and/or turned over the collateral securing Arrowhead's subordinated note to one of the borrowers, thus depriving Arrowhead of its security for repayment (2015 Decision at 1)

This court dismissed many of Arrowhead's claims, allowing it to proceed on its breach of contract and breach of fiduciary duty causes of action. Arrowhead's so-called "breach of trust" claims were dismissed as duplicative of the asserted breach of fiduciary duty claim (*see id.* at 2).

The following year, in the middle of discovery, Cheyne moved to dismiss based on Arrowhead's counsel's violation of Judiciary Law § 470 due to his failure to maintain a law office in New York. Following then-controlling Appellate Division authority, by order dated July 21, 2016, the court granted the motion and dismissed the action without prejudice and directed the entry of judgment (*see* Dkt. 392). Arrowhead appealed from the judgment, which brought up the 2015 Decision for review. The Appellate Division affirmed, holding that the dismissal was proper due to noncompliance with § 470 and that "the breach of trust claim [was] duplicative of the breach of fiduciary duty claim" (154 AD3d 523, 524 [1st Dept 2017]). On February 14, 2019, the Court of Appeals reversed the dismissal, abrogating the rule that noncompliance with § 470 is not correctible. It otherwise left in place the underlying rulings in the 2015 Decision (32 NY3d 645 [2019]).

On March 22, 2019, Arrowhead filed the SAC, asserting three causes of action: (1) "breach of trust" (despite its dismissal in the 2015 Decision in favor of a properly-pleaded breach of fiduciary duty claim), (2) fraud and (3) constructive fraud. Arrowhead apparently abandoned its breach of contract claim and instead pleaded fraud claims. Since amending its complaint, it has acknowledged that its breach of trust claim is the very breach of fiduciary duty claim previously upheld.

On April 25, 2019, Cheyne moved to dismiss the SAC, making some of the very arguments that were previously rejected on the prior motion to dismiss. They are again rejected. The breach of trust claim is the very breach of fiduciary duty claim that was

already upheld in the 2015 Decision and is so construed notwithstanding Arrowhead's insistence on calling it something else (*see* 2015 Decision at 25-31). Just as before, the question of whether the breach of fiduciary duty claim is time barred is not amenable to dismissal at the pleading stage (*see id.* at 34-35).

Cheyne does, however, argue for the first time that Arrowhead lacks standing to assert non-contractual claims. Arrowhead has standing to plead a claim for breach of fiduciary duty.[1] As previously discussed, after Arrowhead's predecessor (ACG) was defrauded by its manager, in late 2008, ACG and Arrowhead entered into a Consent Judgment and Permanent Injunction (Dkt. 428) which transferred to Arrowhead all of ACG's rights under the subject note and the Master Agreement (Dkt. 408). It is undisputed that tort claims were not expressly assigned to Arrowhead using the language ordinarily required by the Court of Appeals (*see Commonwealth of Pennsylvania Pub. Sch. Employees' Ret. Sys. v Morgan Stanley & Co.*, 25 NY3d 543, 550 [2015] ["where an assignment of fraud or other tort claims is intended in conjunction with the conveyance of a contract or note, there must be some language—although no specific words are required—that evinces that intent and effectuates the transfer of such rights"]).

[1] The fiduciary duty claims derive from the Master Agreement, which provides that Cheyne would hold the Notes "in trust" (*see* 2015 Decision at 26). This situation is no different than one presented when a minority member transfers his membership interest in an LLC. The managing member continues to owe fiduciary duties to the new member, who can also sue derivatively for past breaches. The same is true here, since any fiduciary duty breach exclusively affects the value of the notes – a loss that can only be suffered by the current noteholder. By contrast, had Arrowhead sued for fraudulent inducement – a claim not predicated on duties of the trustee arising from the contract – that claim would have been dismissed for lack of standing (*see Dexia SA/NV v Morgan Stanley*, 135 AD3d 497 [1st Dept 2016]).

But the rule set forth in *Commonwealth* does not apply. Instead, General Obligations Law (GOL) § 13-107(1) applies and provides that

> Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee ***all claims or demands of the transferrer***, whether or not such claims or demands are known to exist, (a) for damages or rescission against the obligor on such bond, (b) ***for damages against the trustee*** or depositary under any indenture under which such bond was issued or outstanding, and (c) for damages against any guarantor of the obligation of such obligor, trustee or depositary [emphasis added].

Simply put, "the wording of (GOL) § 13-107 makes it eminently clear that the buyer of a bond receives ***exactly the same*** 'claims or demands' as ***the seller held*** before the transfer (*Bluebird Partners, L.P. v First Fid. Bank, N.A.*, 97 NY2d 456, 461 [2002] [emphasis added]). In other words, all of the seller's claims against the trustee are passed to the purchaser. Thus, Arrowhead has standing to sue Cheyne on all claims on which ACG would have had standing to sue before the transfer (*see id.*), including pre-transfer breach fiduciary duty claims. Cases "applying (GOL) § 13-107(1) as interpreted by the *Bluebird* court make no distinction between bond-related contract claims and bond-related tort claims" (*One William St. Capital Mgmt. L.P v U.S. Ed. Loan Trust IV, LLC*, 2017 WL 2152585 at *3 [Sup Ct, NY County May 17, 2017]).

Commonwealth, which did not involve application of GOL § 13-107, did not purport to abrogate *Bluebird*. After all, a statute expressly governing a particular subject matter trumps a default common-law rule to the contrary. Thus, it is unsurprising that courts continue to apply *Bluebird* and GOL § 13-107 (*see, e.g., Royal Park Invs. SA/NV v*

Deutsche Bank Natl. Trust Co., 2017 WL 1331288, at *6-7 [SDNY Apr. 4, 2017] [involving "breach of trust" claim]).

The court also rejects Cheyne's argument, made without citation to supporting authority, that a note governed by a master agreement is so different from a bond governed by an indenture such that GOL § 13-107 is inapplicable. They are functionally the same. GOL § 13-107(2) defines "bond" to "mean and include any and all shares and interests in an issue of bonds, notes, debentures or other evidences of indebtedness of individuals, partnerships, associations or corporations, whether or not secured" (*see Ellington Credit Fund, Ltd. v Select Portfolio Servicing, Inc.*, 837 F Supp 2d 162, 182 [SDNY 2011] [collecting cases]). The Note here fits that description. The point of a debt structure involving an indenture and a trustee is to assign the responsibility of administering the secured assets to someone other than the investor. That was Cheyne's job here. Thus, Arrowhead has standing under GOL § 13-107.

Nonetheless, the fraud claims are dismissed as duplicative. They allege conduct that is identical to the alleged breaches of fiduciary duty but emphasize that they were fraudulent in nature. That the alleged fiduciary violations amount to fraud was addressed in the 2015 Decision (*see id.* at 34-35). Because the damages are identical (and arguably less as fraud damages are limited to out-of-pocket losses),[2] the claims are dismissed as duplicative (*Interventure 77 Hudson LLC v Falcon Real Estate Inv. Co., LP*, 172 AD3d

[2] *See Connaughton v Chipotle Mexican Grill, Inc.*, 29 NY3d 137, 142 [2017]).

481, 481-82 [1st Dept 2019], citing *Pai v Blue Man Grp. Pub., LLC*, 151 AD3d 456, 457 [1st Dept 2017]).

Accordingly, it is ORDERED that Cheyne's motion to dismiss the SAC is granted only to the extent that the second and third causes of action are dismissed as duplicative and the first cause of action is deemed to be one for breach of fiduciary duty.

Dated: September 27, 2019

ENTER:

Jennifer G. Schecter, J.S.C.