

SUPREME COURT, APPELLATE DIVISION
FIRST DEPARTMENT

JULY 13, 2010

THE COURT ANNOUNCES THE FOLLOWING DECISIONS:

Mazzarelli, J.P., Andrias, Friedman, Nardelli, Moskowitz, JJ.

1350 Rachel L. Arfa, et al., Index 603602/05
Plaintiffs-Appellants-Respondents,

-against-

Gadi Zamir, et al.,
Defendants.

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546-552 West 146th Street LLC, et al.,
Intervenors-Defendants/Counterclaim
Plaintiffs/Cross-Claim Plaintiffs-
Respondents-Appellants,

2000 Davidson Ave. LLC,
Intervenor-Defendant/Counterclaim-
Plaintiff/Cross-Claim Plaintiff,

-against-

Rachel L. Arfa, et al.,
Counterclaim-Defendants-
Appellants-Respondents,

Gadi Zamir, et al.,
Cross-Claim Defendants,

[And Another Action]

Schlam Stone & Dolan LLP, New York (David J. Katz of counsel),
and Michael C. Marcus, Long Beach, for appellants-respondents.

Balber Pickard Maldonado & Van Der Tuin, P.C., New York (John Van
Der Tuin of counsel), for respondents-appellants.

Order, Supreme Court, New York County (Charles E. Ramos,
J.), entered September 16, 2008, which, to the extent appealed

from as limited by the briefs, denied plaintiffs' motion to dismiss intervenors-defendants' claims for an accounting and for waste and mismanagement as against plaintiff Rachel L. Arfa and granted plaintiffs' and cross-claim defendants' motions to dismiss the claim for statutory restitution, penalties and fees pursuant to Real Property Law § 440-a, unanimously affirmed, without costs.

Intervenors-defendants, which are New York limited liability companies, allege in support of their first and fifth claims (respectively, for an accounting and for waste and mismanagement) that they were managed by Harlem Holdings, LLC, a Delaware limited liability company; that the 60% owner of Harlem Holdings was Argelt LLC, an entity owned in part by plaintiff Arfa; that Arfa, in addition to being (through Argelt) a beneficial owner of Harlem Holdings, was one of Harlem Holdings' three managers; and that Arfa used her resulting control over intervenors-defendants' property to benefit herself at intervenors-defendants' expense. As it is alleged that Arfa was a beneficial owner and fiduciary of the entity that managed intervenor-defendants, intervenor-defendants have stated causes of action sounding in breach of fiduciary duty against her under both New York and Delaware law (see *Bullmore v Ernst & Young Cayman Is.*, 45 AD3d 461 [2007]; *In re Treco*, 229 BR 280, 289 [1999], *affd* 239 BR 36 [SD NY 1999], *vacated on other grounds* 240 F3d 148 [2d Cir 2001]); *Bay Center*

Apts. Owner, LLC v Emery Bay PKI, LLC, 2009 WL 1124451, *9-10, 2009 Del Ch LEXIS 54, *32-39 [Del Ch 2009]; *In re USACafes, L.P. Litig.*, 600 A2d 43, 48-50 [Del Ch 1991]).

Intervenors-defendants' second claim alleges that cross-claim defendant Amelite Management Services, Inc., the management company owned by plaintiffs Arfa and Alexander Shpigel and defendant/cross-claim defendant Gadi Zamir, while not licensed as a real estate broker, performed services for which a license is required under Real Property Law § 440-a. However, the documentary evidence demonstrates that Amelite, which admitted that it was not licensed, delegated the authority to perform those services to third-party unaffiliated licensed property management companies and therefore did not violate the statute by acting as a real estate broker.

We have considered the parties' remaining arguments for affirmative relief and find them unavailing.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010



CLERK

club in which M.S. was active. In order to facilitate after-hours communication concerning the poetry group, respondent provided her personal e-mail address to M.S. and another student. Thereafter, respondent and M.S. embarked on a series of frequent electronic communications, via e-mail and instant message, in which the two discussed literature, writing and movies. Respondent lent movies to M.S. that she thought he would find interesting, such as the documentary Fahrenheit 9/11. She also gave him a copy of The Catcher in the Rye.

In early 2005, respondent agreed to serve as faculty advisor to a theater group formed by M.S. and several other students. The group met frequently and, consequently, respondent's contact with M.S. increased substantially. They regularly communicated electronically after school hours, often after midnight. The on-line conversations included personal matters affecting M.S., including issues he was having with his mother. Respondent continued to lend M.S. movies she thought he might find interesting, including Harold and Maude, a 1972 film depicting a relationship between a teenage boy and an older woman.

In May 2005, respondent felt compelled to discuss with M.S. the nature of their relationship. She claims this was because of several incidents, which included M.S. posting on his personal blog: "you crazy woman you, look what you do to my heart?" She also became concerned that once, during theater rehearsal, M.S.

called her "Colleen my darling" and that another time during rehearsal he was standing particularly close to her. Respondent claims that she told M.S. during the discussion that their relationship had to be better defined. M.S. recalls respondent telling him that the lines in their relationship were becoming blurred and that she was "confused."

One month later, respondent and M.S. engaged in an instant message chat in which, according to M.S., respondent asked him whether he thought it was "crazy" or inappropriate for her to "think that there was something between us." Respondent, on the other hand, claims that after M.S. stated he was joking in the blog postings which alluded to feelings he had for her, she merely suggested that she must be "crazy" for thinking that M.S. was being sincere. This was the last electronic conversation between respondent and M.S., who ignored further entreaties by respondent to communicate.

On the last day of school in 2005, M.S. told another teacher about his communications with respondent. The teacher encouraged M.S. to file a report with the school's principal, which he did. The principal referred the matter to the Office of the Special Commissioner of Investigations, which opened an investigation. That night, respondent, unaware of the investigation, sent an e-mail to M.S., in which she stated that:

"I am not sure how we got to this place where we are not talking to each other. I think various feelings of hurt, fear, loss, anger etc. Powerful emotions that can make people act crazy even when they don't intend to...

"I want you to know I tried *so hard* to handle things in the right way, and feel I failed miserably. Constantly telling myself one thing, and at moments being overridden by emotion.

"Maybe you can understand, take pity and forgive. I know I haven't dealt very well with this situation, due to several reasons. One is, in one way I never in a million years would have thought I would have found myself in this situation, and I did not know how to deal with what I felt. In another way it is a situation I haven't dealt with in 10 years, so maybe I am rusty or something. But obviously the particulars make this unique and complex, certainly for me. I hope this is not too cryptic.

"I hope at some point we will be able to talk and understand each other better. You have meant too much to me for this to end 'in silence and tears,' as the Byron poem says. But if you don't want to talk to me, I will do my best to understand. Know that my intention was never to hurt you, and I am sure that you as well did not intend the reverse. I don't know how people can get so far away from what they intend, maybe partly lack of communication and the mix of emotions. But I hope you know I am truly sorry."

In response to this e-mail, M.S.'s mother and the assigned investigator composed and sent an e-mail to respondent, purporting to be from M.S., which stated that M.S. was "confused" and suggested that he had similar emotions as respondent concerning their relationship. Respondent replied later that day

by e-mail, stating that:

"I definitely relate to the chaotic mess in the head. I haven't meant to confuse the hell out of you. I just think the situation makes it incredibly confusing. I think we have both been afraid of being embarrassed. I think we have both been afraid of a lot of things. I feel like we have been doing this dance around each other since practically the beginning of the year.

"Because we have both been confused I have wanted us to talk. But that seems to create problems for both of us. When I have tried to talk to you, you seem to run a bit in the opposite direction. And my nervousness leads me to maybe not be entirely forthright. There is so much I would like to tell you, to discuss with you. But even now writing this, there is fear. You, I am sure, understand the risks involved for me. But you have no idea how happy it makes me to hear from you. And as far as where I am standing, there is only one place I would like to be standing. God, help me! So, I guess we should try to talk. I have often thought of the idea of talking over tea or coffee or the beach or something, I don't know how. I just didn't know how insane the idea was."

The next day, respondent sent two additional e-mails to M.S. imploring him to talk so they could sort out their feelings.

The investigator confronted respondent with her various e-mails and instant messages on June 30, 2005. During the interview, respondent admitted to the communications and acknowledged the inappropriateness of her actions, which she attributed to an "intellectual attraction" to M.S. that never resulted in physical contact. Shortly thereafter, respondent

began therapy.

In early July 2005, M.S. discovered postings made by respondent to an on-line journal, under an alias. The entries for May and June 2005 consistently discussed respondent's strong feelings for an unidentified male. One entry described respondent and the person "standing... so close [to each other] I could feel the heat from his body radiate to me. I wanted to just let myself go, lean backwards and sink into him." Another talked about her desire to be "kissing him." Yet another stated that her thoughts regarding the person that day "were of a salacious nature." The vast majority of the postings, however, described the deep emotional pain respondent was experiencing from the person's decision to cease communicating with her.

In December 2005, after the investigation was concluded with a recommendation that respondent be terminated, petitioner filed charges against respondent, supported by five specifications. The first specification cited to each of the entries posted by respondent in the on-line diary. The second referred to respondent's statement to M.S. in May 2005 that the lines in their relationship were becoming blurred and the third specification was based on respondent's asking M.S. in June 2005 whether he thought it was "crazy" or inappropriate for her to "think that there was something between us." The fourth and fifth specifications concerned the e-mails sent by respondent to

M.S. on June 23 and June 24, 2005, respectively, in which she implored him to get together for a talk about their feelings towards each other. The Hearing Officer granted respondent's motion to strike the first charge, stating that the on-line journal was not intended for M.S.'s consumption; however, the ruling expressly provided that the entries could be used for the limited purpose of illuminating respondent's state of mind when making the communications that supported the remaining charges.

Respondent was found guilty of specifications three, four and five, the Hearing Officer having found that by making each communication respondent had placed M.S. in an uncomfortable position and had acted in a fashion unbecoming of a person in her position. The second specification was dismissed based on the fact that M.S. continued to communicate with respondent after she told him that their relationship had become "blurred." Describing respondent's behavior as "serious" and the type that "tends to destroy the teacher/student relationship," the Hearing Officer stated that it called for a "significant" penalty. In fashioning the penalty, he took note of respondent's remorse when confronted by the investigator and that she ceased all communications with M.S. at that time and shut down her on-line diary. The Hearing Officer credited respondent's testimony that she gained a valuable lesson regarding the importance of appropriate student-teacher relationships and that she had sought

therapy to deal with the emotional issues underlying her behavior. Based on his belief that respondent would not allow such a situation to occur again, he opted not to terminate her, but rather to suspend her without pay for 90 days, and to have her reassigned to a different school.

Petitioner commenced this proceeding, seeking an order vacating or modifying the arbitration award. Petitioner alleged that the dismissal of the second specification was "illogical and irrational" because the communication alleged therein was inappropriate, whether or not it made M.S. feel uncomfortable. It further contended that the penalty was inconsistent with the state's strong public policy interest in maintaining a safe environment in the schools. Petitioner asserted that the Hearing Officer's conclusion that respondent would not repeat her behavior was irrational.

Supreme Court granted the petition. The court acknowledged that the standard of review mandated by Education Law § 3020-a is that of CPLR article 75, which provides that an arbitration award may only be vacated on a showing of "misconduct, bias, excess of power or procedural defects" (*Austin v Board of Educ. of City School Dist. of City of N.Y.*, 280 AD2d 365, 365 [2001]; see CPLR 7511 [b][1]). However, following recent precedent from this Department, the court applied a "hybrid" standard which incorporated the arbitrary and capricious test embodied in CPLR

article 78. Utilizing this standard, the court concluded that "the penalty imposed by the arbitrator of a mere 90 day suspension violates a strong public policy to protect children and is accordingly without a rational basis." The court further stated that:

"The arbitrator's observation regarding the inappropriateness of placing a child in a position of a consenting adult is at the heart of why the penalty of a three month suspension is not rational and does not serve the public policy of protecting children. The arbitrator seems to have been impressed by the fact that the child had gone to college and had 'moved on with his life...' as well as that there had not been any physical contact between Ms. McGraham and her student and that the teacher had not actually asked MS out on a date. But as was noted by Justice Acosta in *New York City School District of the City of New York v. Hershkowitz* (7 Misc 3d 1012 (A) [2005]). . . it is irrational to use a student's resolve in the face of a teacher's improper and persistent advances, to minimize the teacher's improper conduct. Furthermore, in *Hershkowitz*, as is the case here, the arbitrator has 'failed to appreciate the harm that respondent's behavior may have on a child, both presently and in the future, by [respondent's] inappropriate conduct, even if [respondent] did not 'cross the line' and have physical contact with [the student]. (*id.*)"

Respondent does not question that Supreme Court applied the correct standard. Indeed, while CPLR 7511 is dictated by Education Law § 3020-a to be the proper standard of review, this Court has held that "where the parties have submitted to

compulsory arbitration, judicial scrutiny is stricter than that for a determination rendered where the parties have submitted to voluntary arbitration" (*Lackow v Department of Educ. (or "Board") of City of N.Y.*, 51 AD3d 563, 567 [2008]). Because the arbitration at issue was compulsory, "[t]he determination must be in accord with due process and supported by adequate evidence, and must also be rational and satisfy the arbitrary and capricious standards of CPLR article 78" (*id.*).

Applying this standard, we discern no basis upon which the court should have disturbed the Hearing Officer's determination. Under the circumstances of this case, we may not vacate on the ground that it is contrary to public policy. It is beyond question that, in the broadest sense of the term; there is a strong public policy in preventing student/teacher relationships that, whether of a sexual nature or not, threaten students' well-being. In upsetting an arbitral award on public policy grounds, however, more than a general societal concern must be at issue. Rather, the public policy exception applies only in "'cases in which public policy considerations, embodied in statute or decisional law, prohibit, in an absolute sense, particular matters being decided or certain relief being granted by an arbitrator'" (*Matter of New York City Tr. Auth. v Transport Workers Union of Am., Local 100, AFL-CIO*, 99 NY2d 1, 7 [2002], quoting *Matter of Sprinzen [Nomberg]*, 46 NY2d 623, 631 [1979]).

Moreover, "courts must be able to examine an arbitration . . . award on its face without engaging in extended factfinding or legal analysis, and conclude that public policy precludes its enforcement" (*Sprinzen*, 46 NY2d at 631).

Transport Workers involved two arbitral decisions arising out of separate accidents, one caused by the negligence of a train operator, another by the negligence of a bus operator which resulted in a pedestrian being injured. In both cases, the arbitrator declined to dismiss the transportation workers, instead demoting one worker for six months and docking him six weeks' pay, and docking the other over four months' pay and effectively placing him on probation. The public authority in each case challenged the awards, relying on Public Authorities Law § 1204(15), which grants to the authorities at issue the power "[t]o exercise all requisite and necessary authority to manage, control and direct the maintenance and operation of transit facilities . . . for the convenience and safety of the public." The Court of Appeals rejected this position, finding that "[t]he legislative authority to 'manage, control and direct' the operation of New York City's public transportation system for the 'convenience and safety of the public' does not translate into a statutory prohibition against some relinquishment to arbitrators of the final say in safety matters when they arise in the context of employee discipline." (99 NY2d at 9). Nor did the

Court find that such authority, "in any direct, let alone *absolute*, sense set forth requirements or standards for the disciplining of employees violating safety rules" (99 NY2d at 12).

Here, in claiming that the award violates public policy, petitioner points to article 10 of the Family Court Act and Social Services Law § 384-a. These are both statutory schemes which expressly recognize the paramount importance of the safety and welfare of children. However, they do not in any way govern school disciplinary proceedings, much less mandate the type of penalty which is appropriate in such proceedings. Indeed, the public policy at issue here is no different than the equally important public policy of protecting the physical safety of the riders of public transportation which was at issue in *Transport Workers*, and which was rejected by the Court of Appeals as forming the basis for the overturning of the arbitrator's awards in that case. We recognize that this conclusion appears to be directly at odds with the Third Department's decision in *Matter of Binghamton City School Dist. (Peacock)* (33 AD3d 1074 [2006], *appeal dismissed* 8 NY3d 840 [2007]) and the Second Department's decision in *Matter of Board of Educ. of E. Hampton Union Free School Dist. v Yusko* (269 AD2d 445 [2000]). However, for the reasons set forth by the dissent in *Matter of Binghamton*, we think that *Transport Workers* compels a different result from the

ones reached in those cases. Further, the award in this case recognizes the seriousness of the allegations and imposes a penalty which we do not think is disproportionate to the charges (see *Transport Workers*, 99 NY2d at 11 [finding that "although the awards directed reinstatement of the employees, they clearly did not disregard safety concerns and the seriousness of the breaches of safety rules. Instead, they imposed serious financial sanctions in both cases"])).

Moreover, we find the penalty imposed here not to be so lenient as to have been arbitrary or capricious. Preliminarily, Supreme Court is incorrect that the hearing officer found the absence of physical contact and the fact that M.S. seemed to have "moved on with his life" to be mitigating factors. While the award discusses these facts, there is no evidence that the final disposition relied on them. To the contrary, the Hearing Officer condemned respondent's behavior in no uncertain terms, and the only mitigating factors he found revolved around respondent's remorse and the actions she took to prevent the problem from recurring. The Hearing Officer's conclusion that respondent was not likely to repeat her actions was necessarily a determination based on respondent's credibility, and he was in a far superior position than Supreme Court to make that determination (see *Whitten v Martinez*, 24 AD3d 285, 286 [2005]). Moreover, the determination was based on specific actions taken by respondent

such as her decision to seek treatment and her cessation of contact with M.S. Under those circumstances, the sanction was appropriate.

This case contrasts sharply with *Matter of Binghamton*, cited by Supreme Court and the dissent. There, the Court, in affirming the vacatur of a one-year suspension that Supreme Court had found "shockingly lenient" (33 AD2d at 1076) noted that the teacher "showed no remorse for the conduct proven by petitioners, disobeyed administrative direction to cease his relationship with the student and not transport her in his car, and continued to contact her even after disciplinary charges were brought against him" (33 AD3d at 1077). This case is also distinguishable from *Lackow v Department of Educ. (or "Board") of City of N.Y.* (51 AD3d 563 [2008], *supra*), upholding the sanction of dismissal, where the teacher had been warned three times about the inappropriateness of his behavior, yet allowed it to continue.

To be sure, we do not disagree with the dissent that respondent's behavior was highly inappropriate. We simply disagree that the evidence demonstrates that respondent is unrepentant and likely to pursue inappropriate relationships with students in the future. The dissent places too much emphasis on the on-line diary. The entries were not, as the dissent describes them, "communications," but rather respondent's musings which she posted under an alias on a public website without

informing the student that she had done so. Moreover, the Hearing Officer found that, at best, the entries confirmed that respondent had "romantic" feelings toward M.S. To the extent, however, that they express a desire to commence a physical relationship with M.S., we can only speculate that respondent planned to actually pursue such a course. Again, we do not condone respondent's communicated desire to even talk to the student about her feelings toward him, but the question before us is only whether there was a rational basis for the Hearing Officer to conclude that respondent is not a sexual predator who is unable to respect the boundaries that must exist between educators and their charges.

Finally, we do not view this case as being analogous to *City Sch. Dist. of City of N.Y. v Hershkowitz* (7 Misc3d 1012[A], 2005 NY Slip Op 50569 [u] [2005]), in which our dissenting colleague found a one year suspension to be inadequate where a teacher pursued a relationship with a student. First, the behavior in that case was far more egregious. The teacher sent sexually explicit e-mails to the student in which he directly invited her to have sex with him. Second, the teacher acted deceptively by instructing the student on how to keep his behavior hidden from her mother. Third, when the student's mother did find out, the teacher contacted the mother and discouraged her from making "a big deal" out of his conduct. Finally, it does not appear from

the *Hershkowitz* decision that, as here, the teacher showed remorse and took affirmative steps to reform himself such as seeking therapy. In fact, Justice Acosta rejected out of hand the teacher's claim that he was capable of rehabilitation. The sole basis for that contention was the teacher's attorney's statement that his client had not engaged in any misconduct for the six years that he had been on administrative duty while the charges were pending, an assertion which Justice Acosta called "speculative and unsustainable" and "unworthy of credence" (2005 NY Slip Op 50569[u], *7). Here, the Hearing Officer had a strong basis for concluding that respondent could be trusted once again to teach students. Accordingly, his decision to suspend respondent, but not terminate her, was supported by the evidence and not arbitrary and capricious.

All concur except Saxe and Acosta, JJ. who dissent in a memorandum by Acosta, J. as follows:

ACOSTA, J. (dissenting)

Because I believe that the 90 day penalty imposed is irrational and disconnected from the strong public policy of protecting children from improper conduct by those entrusted to educate and guard them, I respectfully dissent.

Respondent is a tenured high school teacher employed by petitioner. In December 2005, respondent was charged with inappropriate intimate conduct with one of her students.

Pursuant to New York Education Law § 3020-a, an arbitration hearing on the charges was held before an Arbitrator, who sustained three out of the five charges against respondent. The Department of Education (DOE) presented evidence to support the charges and specifications, which included e-mail and instant message communications between respondent and her student, M.S., and respondent's personal blog relating her feelings toward her student. Respondent argued that she believed M.S. had inappropriate feelings for her, and that her blog entries were an attempt to clarify their relationship.¹ Some of these communications include the following:

"May 02, 2005 --Why do the tears always come? My feelings for him are so strong, and I can't say or do anything - I love being close to him, talking to him, being around him,

¹ Respondent's contention that her Xanga blog entries were not intended to communicate to internet users, including her student, is belied by respondent unwittingly conceding that on certain occasions she posted her blogs in specific response to blog entries by her student.

but it is just so filled with pain at times also. Today at one point he was standing behind me so close I could feel the heat from his body radiate to me. I wanted to just let myself go, lean backwards and sink into him . . .

"May 05, 2005- Do I enjoy insanity? I know I enjoy feeling strong emotions. I know I just like being with him, talking with him. And what that is wrong?

"May 23, 2005 - In my heart I just feel I don't care about anything else but having the chance of being with him. Talking with him, *kissing him*. When he gets back I hope I can do what I want. I want to tell him that I think we should go out for coffee or tea and talk. Maybe go to the Muddy Cup . . . I want to talk to him about everything. Clear everything up. Ultimately I would love to tell him how I feel about him. And to know how he feels.

"May 28, 2005 -All I have thought about is it *moving beyond the realm of fantasy*. I want it to be more. But it is scary, for oh so many reasons. I've just been thinking about him so much. *Today my thoughts were of a salacious nature*. I can't wait to see him, but I also feel nervous" (emphasis added).

From May 2, 2005 to July 1, 2005, the record shows that respondent wrote 20 such blog entries. On or about June 23, 2005, Respondent wrote to M.S. among other things, the following:

"There is so much I would like to tell you, to discuss with you. But even now writing this, there is fear. *You, I am sure, understand the risks involved for me*. But you have no idea how happy it makes me to hear from you. And as far as where I am standing, there is only one place I would like to be standing. God, help me so! So, I guess we should try to talk. I have often thought of the idea of talking over tea or coffee or the beach or something, I don't know. I just didn't know how insane the idea was" (emphasis added).

Based on the blog entries and communications between respondent and M.S., the Arbitrator agreed with DOE that respondent had allowed an inappropriate relationship to develop,

had attempted to communicate her feelings, and ultimately attempted to blame the student for having feelings for her. The Arbitrator imposed a penalty of suspension without pay for 90 days, to be followed by reassignment to another school.

Thereafter, petitioner commenced this proceeding to vacate, or in the alternative, modify the penalty imposed by the Arbitrator. In a detailed 17 page decision, Supreme Court granted the petition, vacated the Arbitrator's decision and remanded the matter for the imposition of a new penalty. I believe Supreme Court properly vacated the Arbitrator's award as being irrational and violative of New York State's public policy to protect children from harmful conduct of adults *in loco parentis*.

Initially, and significantly, the issue in this case is not limited to whether the 90-day suspension is appropriate under the circumstances. Rather, the issue is whether the suspension is rational absent a specific finding that respondent, who was placed in a position of authority over children and who betrayed that trust and her responsibility, does not pose a danger to those students. Given the facts of this case, I do not believe the 90-day penalty is rational or that it deals appropriately with the public policy interest of protecting children against future misconduct by returning respondent to a different school

following her suspension. This belief is not based on the length of the penalty, but rather on its failure to adequately ensure against future similar misconduct. The record is devoid of any evidence that once respondent is placed back in an environment with adolescent students, she will not continue her improper conduct.

The penalty imposed by the Arbitrator was based in part on the Arbitrator's conclusion that respondent's "remorsefulness and subsequent actions and prior record" demonstrated that respondent would not engage in this type of conduct in the future. This was an irrational conclusion. Respondent did express belated remorse for the situation she was in, but nevertheless *continued* to pursue a romantic relationship with her student. A pointed example is respondent's June 26, 2005 blog entry: "This is just so difficult. Because of course with in the realm of the way things are 'supposed' to be, obviously it is crazy. But life is all about things that don't happen like the norm. Many crazier things have happened and been okay"; respondent continues to write, "Damn the consequences." It could not be any clearer that whatever hesitation respondent may have had about her pursuit of her student, she determined the consequences were worth it, including shattering the sacred student-teacher relationship.

The Arbitrator's reliance on respondent's "subsequent actions" is likewise irrational. An investigation of respondent's conduct was commenced on or about June 15, 2005. During the interim, respondent continued her pursuit of M.S.,² and was subsequently called in for an interview on June 30, 2005 by the Office of the Special Commissioner of Investigations. It was only after this interview that respondent claims that she sought therapy. Prior to this, while respondent had acknowledged the impropriety of her feelings, she refused to correct them or to seek therapy until responsible adults intervened. Once the investigation commenced, respondent was forced to avoid contact with M.S. It was not by her own volition. I disagree with the majority that this forced cessation of contact with the student may be considered as an act of remorse.

Nor does the lack of any physical contact between respondent and the student justify the 90 day suspension. New York State has an "explicit and compelling public policy to protect children from harmful conduct of adults" (*Matter of Binghamton City School Dist. (Peacock)*, 33 AD3d 1074, 1076 [2006], appeal dismissed 8 NY3d 840 [2007]). This public policy overrides the absence of physical contact in this case. In *Binghamton*, the

² On June 30, 2005 respondent wrote "the connection between us is so incredible and special that we will be together in the future."

Third Department correctly noted, I believe, that a court's authority to overturn an arbitration award based on public policy grounds includes the State's compelling interest in protecting our children. The Second Department has likewise recognized that an arbitration award that does not sufficiently protect the children of the State can be vacated on public policy grounds (*Matter of Board of Educ. of E. Hampton Union Free School Dist. v Yusko*, 269 AD2d 445 [2000]). Indeed, placing emphasis on physical contact alone misses the point. Respondent's conduct was in fact harmful to her teenage student, and it is conduct that New York guards against.

To be sure, the lack of physical contact here is of no benefit to respondent inasmuch as it resulted from the child alerting adults and not from respondent's lack of effort. Indeed, the record clearly demonstrates that it was the student's maturity and resistance to respondent that prevented any carnal interaction, to the dismay of respondent. Again, some of respondent's blog entries are telling. On May 2, 2005, respondent wrote, "Today at one point he was standing behind me so close I could feel the heat from his body radiate to me. I wanted to just let myself go, lean backwards and sink into him." On May 23, 2005, respondent wrote that she just cared about being with her student and "kissing him." A few days later, respondent

began thinking about "moving beyond the realm of fantasy," and her thoughts "were of a salacious nature."

These examples, combined with respondent's relentless pursuit of her pupil, undoubtedly show that given the opportunity respondent would have moved "beyond the realm of fantasy." For example, respondent expressed her frustration of unrequited love on June 11, 2005, when she declared "I ha[t]e you: For not being honest with me. For making it seem so easy to let go, when all I want to do is hold on. For playing with my heart. For being what you are. For not holding me in your arms and telling me it will all be okay. For entering my life. Yet, still I want nothing more than to be with you."

An educator must be in control of her emotions and respect the boundaries required by her privileged position. The record is replete with examples of respondent allowing her emotions and improper thoughts to get the best of her. On May 5, 2005, respondent confidently asserted that "I know I enjoy feeling strong emotions." On June 14, 2005, respondent expressed hurt and anger toward a minor avoiding her romantic advances: "I had to leave, went down to the beach to let out the racking sobs. If I can't let this go, I don't know what is going to happen to me. It hurts so much. I am so angry at him. Yet, my heart refuses to let go." Respondent's June 27, 2005 blog makes it crystal

clear that she had no control of her emotions and thoughts, and the line of teacher and student was completely gone in her mind: "I cry, and cry, and cry, to what end . . . I don't know why him, I don't know how, I don't know anything anymore. I don't know what I am doing, or how I will go on. I have never faced anything this difficult in my life . . . Why did he bother to contact me if he didn't want us to talk? That's what kills me."

The Arbitrator's penalty does not address the State's interest in protecting children from a person who is unable to control such "strong emotions," and what steps respondent would take during the suspension period to keep her emotions under control. It is evident that the last thing on respondent's mind was to do her job, namely to educate her student. And that is precisely what the penalty must address; it must not only punish the teacher's misconduct, but fully protect students and guarantee that all efforts have been made to keep them from such a dangerous environment. Contrary to the majority's position, it is speculative to conclude that respondent *has* been rehabilitated. The majority points to no evidence to buttress its position that respondent, after serving a completely arbitrary temporal penalty, is fit to teach male teenage students. As noted, respondent self-servingly claims that she sought therapy after getting caught responding to the Special

Commissioner of Investigation's e-mail; yet respondent does not identify what therapy she underwent, the time period, and her progress, if any. I believe it is dangerous to the students of this State to allow teachers who have allowed themselves to be "attracted" to their students, whether "intellectually" or physically, to merely state, without more, that they are fit to teach after serving a specified suspension period.

Finally, respondent argues that Supreme Court improperly likened this case to that of *City School Dist. of City of N.Y. v Hershkowitz* (7 Misc 3d 1012(A) [2005], 2005 Slip Op. 50569(U)). I disagree. While the facts in *Hershkowitz* are different and respondent's overt actions therein were far more egregious, I believe there is a parallel. For example, in both instances, the teachers who were entrusted to educate and protect the children in their care attempted to engage them in a sexual manner. Unlike the respondent in *Hershkowitz*, respondent here was careful to cloak her intentions and thoughts in a more discrete and "romantic" way. Her communications were not outright vulgar or sexually explicit in nature as they were in *Hershkowitz*; the communications, nevertheless, very subtly demonstrated her sexual interest in a minor entrusted to her, just as the respondent in *Hershkowitz*. I, however, do not believe that respondent here should be protected because of her subtlety. In both *Hershkowitz* and here, the evidence indicated that the teachers were

insufficiently rehabilitated to be trusted with the education of their students, and the penalty imposed failed to address the State's public policy interests in protecting students.

For these reasons, I would affirm Supreme Court's order to vacate the arbitration award and remand the matter for imposition of a new penalty.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010


CLERK

Mazzarelli, J.P., Saxe, Moskowitz, Acosta, Renwick, JJ.

2348-

Index 600919/08

2349

Edgewater, Growth Capital

M-1858

Partners, L.P.,

Plaintiff-Appellant-Respondent,

-against-

Allied Capital Corp., et al.,

Defendants-Respondents-Appellants.

Vedder Price P.C., New York (Michael G. Davies of counsel), for appellant-respondent.

Robinson, Bradshaw & Hinson, P.A., Charlotte, NC (Garland S. Cassada, of the Bar of the State of North Carolina, admitted pro hac vice, of counsel), for respondents-appellants.

Order, Supreme Court, New York County (Richard B. Lowe, III, J.), entered November 7, 2008, which, in this breach of contract action, granted defendants' motion to dismiss plaintiff's first cause of action and denied the motion to dismiss the second cause of action, and order, same court and Justice, entered July 20, 2009, granting plaintiff's motion to reargue, and, upon reargument, adhering to its prior determination dismissing the first cause of action, unanimously affirmed, with costs.

Plaintiff and defendants are junior lenders under a credit agreement dated as of January 3, 2006. Pursuant to section 15.12 of the credit agreement, the agent for the junior lenders, defendant Allied Capital Corp. (Allied), could not release any liens that affected or impaired the borrower's obligations.

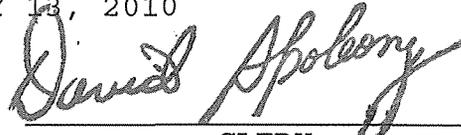
The court properly dismissed plaintiff's first cause of action alleging that defendants breached section 15.12 of the credit agreement by releasing all or substantially all of the liens on collateral securing loans the parties funded. Plaintiff asserts that: (1) by entering into a settlement agreement and agreeing to a foreclosure of the borrower's assets that the senior lender initiated, and (2) by releasing liens under that agreement, defendants Allied and Maps CLO Fund I, LLC (Maps) necessarily affected or impaired the borrower's obligations under the credit agreement. However, when plaintiff became a junior lender, it executed a "Fourth Amendment" to the credit agreement, whereby, under section 4(o), it gave up certain voting rights under the credit agreement, including those rights section 14.1(f) contained. Section 14.1(f) required the agent Allied to obtain the consent of affected junior lenders before releasing any lien, "other than as permitted by Section 15.12." Thus, with proper consent, Allied had authority to release liens that it could not otherwise release under 15.12. Because plaintiff waived its right to consent under this provision, only the consent of Maps, the other junior lender, was necessary. MAPS clearly consented because MAPS executed the settlement agreement that releases the liens at issue.

The court also properly declined to dismiss plaintiff's second cause of action. This cause of action alleges that defendants breached sections 14.1(c) and (i) of the credit agreement by reducing or releasing, or agreeing to reduce or release, obligations the borrowers had to the junior lenders. Sections 14.1(c) and (i) require the consent of all junior lenders to reduce the principal or interest on any loan, or to release the borrower from any obligation. Although section 4(a) of the Settlement Agreement states that it does not release these obligations, the section also includes a broad release clause for acts relating to the foreclosure sale, which could arguably encompass claims under the credit agreement. By releasing the liens and by agreeing to the foreclosure sale, defendants may have impaired the ability of the junior lenders to recover because foreclosure would strip the borrower of any assets with which to satisfy claims by the junior lenders. That Allied and MAPS could have assigned their loans, pursuant to Article 13 of the credit agreement, is of no moment. Any such assignment would still be subject to the Credit Agreement, and, to the extent enforceable, to the Settlement Agreement.

The Decision and Order of this Court entered herein on March 11, 2010 (71 AD3d 489 [2010]) is hereby recalled and vacated (see M-1858 decided simultaneously herewith).

THIS CONSTITUTES THE DECISION AND ORDER OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010



CLERK

Andrias, J.P., Catterson, Renwick, Richter, Román, JJ.

2788 Banco Popular North America,
Plaintiff-Respondent,

Case 28442/08
Index 63042/06
570218/07

-against-

Aharon Lieberman, et al.,
Defendants-Appellants.

Paul T. Gentile, New York, for appellants.

Rick, Steiner, Fell & Benowitz, LLP, New York (Garrett P.
Simulcik, Jr. of counsel), for respondent.

Order of the Appellate Term of the Supreme Court of the State of New York, First Department, entered on or about November 10, 2008, which, in this action by plaintiff bank to recover a property tax payment it mistakenly made after assigning a mortgage, affirmed an order of Civil Court, New York County (Jose A. Padilla, Jr., J.), entered on or about January 31, 2007, granting plaintiff's motion for summary judgment in the principal amount of \$18,630.99 against defendants, the mortgagor and its guarantors, and denying defendants' cross motion to dismiss the second and third causes of action and for leave to amend their answer to assert certain counterclaims, unanimously modified, on the law, to deny plaintiff's motion for summary judgment against defendant guarantors and to grant the cross motion to the extent of dismissing the second and third causes of action and granting leave to amend the answer to assert the first, second, third, fourth, and fifth proposed counterclaims, which are severed and

may continue as independent causes of action, and otherwise affirmed, without costs.

Plaintiff established its entitlement to recover from defendant High Tech, under the theory of unjust enrichment, the amount of property taxes it inadvertently paid on High Tech's mortgaged property (see *Roslyn Sav. Bank v Jude Thaddeus Glen Cove Mar.*, 266 AD2d 198 [1999]; *Bank of N.Y. v Asati, Inc.*, 184 AD2d 443 [1992]). Defendants' claim to a setoff based upon alleged improper banking practices by plaintiff is merely a "possible, unliquidated liability," and does not preclude plaintiff's immediate recovery of the property tax payment from High Tech (*Spodek v Park Prop. Dev. Assoc.*, 263 AD2d 478, 478 [1999], *lv denied* 94 NY2d 760 [2000]). Accordingly, plaintiff is entitled to summary judgment on its first cause of action against High Tech.

Although the guaranty executed by defendants Lieberman and Compositron was broad, it arose in the context of a loan facility and contemplated the guaranty of obligations incurred by High Tech as a "Borrower." Construing the guaranty strictly (see *White Rose Food v Saleh*, 99 NY2d 589, 591 [2003]), plaintiff's unjust enrichment claim to recover monies it mistakenly conveyed on High Tech's behalf, outside of any loan agreement, is simply not the kind of liability the guarantors agreed to secure (see *Nassau Trust Co. v LAC Indus.*, 83 AD2d 503 [1981], *lv denied* 55

NY2d 604 [1981]; see also *Giovanelli v First Fed. Sav. & Loan Assn. of Phoenix*, 120 Ariz 577, 583, 587 P2d 763, 769 [1978]). Accordingly, plaintiff is not entitled to summary judgment against the guarantors and plaintiff's second cause of action must be dismissed.

Once plaintiff assigned the mortgage, it lacked standing to sue to recover the overpayment under the mortgage documents (see *Commonwealth Land Tit. Ins. Co. v Lituchy*, 161 AD2d 517, 518 [1990]). Because plaintiff's claim against High Tech sounds solely in unjust enrichment and is not asserted under the mortgage, and because, as noted, plaintiff cannot assert any claim under the guaranty, the attorneys' fees provisions of the mortgage and guaranty do not apply. Accordingly, the third cause of action, seeking attorneys' fees, must also be dismissed.

As to defendants' motion for leave to amend their answer, CPLR 3013 requires that "[s]tatements in a pleading shall be sufficiently particular to give the court and parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and the material elements of each cause of action or defense." A defendant seeking to amend its answer to allege a counterclaim is not required to submit evidentiary proof to justify the amendment (see *Crespo v Triad, Inc.*, 294 AD2d 145, 148 [2002]).

Defendants' first, second, fourth, and fifth proposed

counterclaims, which are supported by an affidavit from defendants' certified public accountant based upon his review of defendants' bank records, contain facts sufficient to give the court and plaintiff notice of various allegedly improper withdrawals and excess debits, late charges, and interest assessed by plaintiff against defendants and the material elements of their claims for breach of contract. At a minimum, they state a claim for a setoff (see *Burns v Lopez*, 256 NY 123, 128 [1931]; *Banco do Estado de Sao Paulo v Mendes Jr. Intl. Co.*, 249 AD2d 137, 138 [1998]).

Defendants' third proposed counterclaim is also sufficiently pleaded. The tort of trade libel or injurious falsehood requires the knowing publication of false and derogatory facts about the plaintiff's business of a kind calculated to prevent others from dealing with the plaintiff, to its demonstrable detriment (see *Waste Distillation Tech. v Blasland & Bouck Engrs., P.C.*, 136 AD2d 633 [1988]). In addition, the facts so published must cause special damages, in the form of actual lost dealings (see *SRW Assoc. v Bellport Beach Prop. Owners*, 129 AD2d 328, 331 [1987]). The third proposed counterclaim satisfies these requirements by its allegations that plaintiff's failure to properly credit High Tech's loan payments adversely affected its credit; that plaintiff informed potential lenders that High Tech was in arrears, with knowledge that the statement was false; and that

plaintiff's adverse action caused Independence Bank to reject a long-term loan application at a favorable interest rate, which will result in High Tech paying over \$500,000 in additional interest over the life of a substitute loan it obtained from Washington Mutual Bank.

Thus, as plaintiff makes no claim of prejudice attributable to defendants' three-month delay in asserting the first, second, third, fourth and fifth proposed counterclaims, defendants are entitled to amend their answer to assert them (*see Daigle v Texas Intl. Co.*, 109 AD2d 648 [1985]). However, the sixth proposed counterclaim, seeking special or consequential damages as a remedy, fails as defendants have not alleged that the special damages they seek were "within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting" (*Chapman v Fargo*, 223 NY 32, 36 [1918]).

Insofar as plaintiff contends that High Tech's counterclaims are barred by the mortgage, an action to recover under a theory of unjust enrichment is "based on the equitable principles that a person shall not be allowed to enrich himself unjustly at the expense of another" (*Waldman v Englishtown Sportswear*, 92 AD2d 833, 836 [1983]). While the mortgage provides that High Tech waived the right to assert a counterclaim or offset "in any action or proceeding brought by [plaintiff] to enforce any of its rights under the note or under this mortgage," plaintiff's claim

against High Tech sounds solely in unjust enrichment and, if equity is to be achieved, plaintiff may not invoke the waiver provided for in the mortgage. However, in view of plaintiff's entitlement to summary judgment on its first cause of action and the yet uncertain nature of defendants' counterclaims, the latter, which raise separate issues, are severed and may continue as independent causes of action (see CPLR 603; *Perelmutter v New England Mut. Life Ins. Co.*, 79 AD2d 583 [1980], *affd* 55 NY2d 663 [1981]).

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010


CLERK

Mazzarelli, J.P., McGuire, DeGrasse, Freedman, Richter, JJ.

2931 Joseph L. Powell, et al., Index 18473/06
Plaintiffs-Appellants,

-against-

HIS Contractors, Inc., et al.,
Defendants,

GTL Construction, LLC,
Defendant-Respondent.

Davidson & Cohen, P.C., Rockville Center (Robin Mary Heaney of
counsel), for appellants.

Brown Gavalas & Fromm LLP, New York (Timothy G. Hourican of
counsel), for respondent.

Order, Supreme Court, Bronx County (Sallie Manzanet-Daniels,
J.), entered April 27, 2009, which, in an action for personal
injuries sustained in a fall on an unpaved section of sidewalk,
to the extent appealed from as limited by the briefs, granted
defendant-respondent GTL Construction, LLC's motion for summary
judgment dismissing the complaint as against it, unanimously
reversed, on the law, without costs, and the complaint reinstated
as against GTL.

Plaintiff Joseph L. Powell was injured when he fell into an
unfinished open area of a sidewalk that was missing a concrete
slab. The sidewalk abutted property owned by defendant 551 South
Columbus, LLC and was the site of a recent construction project.
Plaintiffs maintain that GTL was the contractor in charge of the
sidewalk installation and was responsible for the missing

concrete slab where Powell fell. GTL argues that it had no involvement with the sidewalk project and thus owed no duty of care to Powell.

A contractor's duty of care to noncontracting third parties may arise out of a contractual obligation or the performance thereof in three circumstances (*Church v Callanan Indus.*, 99 NY2d 104, 111 [2002]; *Espinal v Melville Snow Contrs.*, 98 NY2d 136, 139-141 [2002]; *Timmins v Tishman Constr.*, 9 AD3d 62, 66 [2004], *lv dismissed* 4 NY3d 739 [2004]). Those circumstances are: first, "where the [contractor], while engaged affirmatively in discharging a contractual obligation, creates an unreasonable risk of harm to others, or increases that risk" (*Church*, 99 NY2d at 111), second, "where the plaintiff has suffered injury as a result of reasonable reliance upon the [contractor's] continuing performance of a contractual obligation" (*id.*), and third, "'where the contracting party has entirely displaced the other party's duty to maintain the premises safely'" (*id.* at 112, quoting *Espinal*, 98 NY2d at 140).

Viewing the evidence in a light most favorable to plaintiffs, there is a triable issue of fact as to whether GTL created an unreasonable risk of harm to Powell or increased that risk. Jacqueline Monaco, comptroller of 551 South Columbus, the property owner, and John Bunton, a supervisor at GTL, testified that GTL was hired solely to perform interior work in the

building and that it did not supervise or coordinate the installation of the sidewalk. Plaintiffs rebutted this evidence through the testimony of John Occhipinti, vice president of defendant HIS Concrete Contractors, Inc., the entity that poured the concrete for the sidewalk. Occhipinti testified that he was hired by GTL to install the sidewalk, and the written proposal Occhipinti submitted for the project, a copy of which is in the record, was addressed to GTL.

Occhipinti stated that when he met with Bunton prior to commencing the work, Bunton told him that the existing sidewalk had been or would be removed by GTL. According to Occhipinti, Bunton then gave him directions as to precisely where the new sidewalk should be installed. Occhipinti further testified that when the installation was finished, he met with Bunton and they walked through the area to make sure the job was completed. The new sidewalk ended at a point just before the area where Powell fell, leaving an unfinished part with a missing slab. This evidence raises an issue of fact as to whether GTL in fact removed the existing sidewalk. It also raises a question as to whether GTL failed to direct that the new sidewalk completely replace the excavated area, which then created an unreasonable risk of harm to Powell or increased that risk.

GTL asserts that Occhipinti testified incorrectly and was mistaken about GTL's role in the sidewalk project. That

assertion, of course, underscores the existence of an issue of fact, and credibility issues should not be resolved on a summary judgment motion (see *Medina v 203 W. 109th St. Realty Corp.*, 16 AD3d 220 [2005]). GTL fares no better in relying on its copy of Occhipinti's proposal with "GTL Construction, LLC" crossed out and "551 So. Columbus LLC" handwritten in its place. At most, GTL's assertion that someone corrected this alleged error by HIS Concrete raises an issue of fact to be resolved at trial. Apart from arguing that Occhipinti testified incorrectly, GTL offers no evidence rebutting his testimony that GTL hired him and gave him specific instructions regarding where the sidewalk should be installed.

There is a question as to whether the statements which Occhipinti attributed to Bunton about the removal of the sidewalk are hearsay. Some evidence suggests that Bunton was an independent contractor for GTL and thus had no authority to speak for the company. Other evidence, however, raises an issue of fact as to whether the "speaking agent" exception to the hearsay rule would apply. In any event, there is nonhearsay evidence about GTL's role in the sidewalk project. Because the court's

function here is issue finding, not issue determination, summary judgment was not warranted (see *Martin v Citibank, N.A.*, 64 AD3d 477 [2009]).

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010


CLERK

from seeking to enforce its contract rights, defendant deposited with the court the amount in dispute, \$2 million. This Court reversed that order (71 AD3d 427 [2010]), making plaintiff, once again, defendant's judgment creditor.

Entirely unrelated to plaintiff's contract with defendant or any of the issues of law and fact involved in plaintiff's action to enforce that contract, iStar was the assignee of a mortgage, secured by, inter alia, insurance proceeds arising from any claims in connection with the mortgaged Pennsylvania premises owned by 1419 Tower LP, an entity allegedly controlled by defendant. Tower litigated an insurance claim against its carrier in a Philadelphia court and recovered more than \$5 million, which it deposited in its general revenue accounts, and, in the meantime, defaulted on the mortgage. iStar claimed entitlement to the insurance proceeds recovered by Tower, but Tower had apparently already expended the proceeds; the \$2 million that was deposited by defendant with the court in the present action seems to have been withdrawn from Tower's general revenue accounts before iStar made any demands for the insurance proceeds.

Since there are no issues of law or fact that iStar's claim to the insurance proceeds has in common with the present action, there is no basis to allow it to intervene in the present action

as a matter of judicial discretion under CPLR 1013. Moreover, such an intervention would significantly prejudice plaintiff by potentially depriving her of the funds to which she already enjoys an entitlement by reason of her judgment. Nor is iStar entitled to intervene as a matter of right pursuant to CPLR 1012, since its legal rights are not adversely affected by plaintiff's judgment, regardless that the practical pecuniary effect of that judgment's enforcement will be to hinder iStar's enforcement of its security interest. iStar's interest is not with the judgment itself, but in reaching the deposited funds, to which, as we have held, plaintiff is entitled.

Furthermore, since it appears that the insurance proceeds were not placed in a segregated account but, rather, were commingled with Tower's other revenues and expenses, it cannot be determined as a matter of law whether the deposited funds were ultimately derived, in whole or in part, from the insurance proceeds. Thus, the insurance proceeds that were received into and moved among Tower's accounts, and in diverse manners paid out of its accounts, are not "identifiable," and therefore not subject to iStar's claimed security interest (UCC 9-315[a][2], [b][2]). But even if iStar's accounting and tracing methodology were to be credited, and the insurance proceeds were found to be identifiable, they would still not be subject to

iStar's claimed security interest because Tower, the debtor, was no longer in possession of the proceeds when iStar first demanded them, and there is no record indication of any collusion by plaintiff with Tower to violate iStar's rights as a secured creditor (UCC 9-332[a], [b]).

All concur except Nardelli, J. who dissents in a memorandum as follows:

NARDELLI, J. (dissenting)

The proposed complaint by the intervenor alleges that \$5,500,000 of insurance proceeds were deposited into an account maintained by 1419 Tower, L.P. on May 12, 2008, and that defendant in this action, Christopher Martorella, is the "principal and controlling person" of 1419 Tower. The complaint further alleges that \$2,000,000 of that deposit was then transferred to a checking account belonging to 1419 Tower on May 23, 2008, and, in turn, a transfer of \$2,000,000 was made from that checking account to an escrow account belonging to an attorney representing Martorella in this matter. None of these facts are disputed. Further, defendant Martorella himself admits that on May 23, 2008, his counsel deposited \$2,000,000 with the Clerk of Supreme Court, New York County "for the purpose of providing security to [plaintiff] Jane Gladstein regarding the judgment she docketed on April 28, 2008." Martorella claims that the transfer of \$2,000,000 from 1419 Tower to his attorney's escrow account was to reimburse him for loans he had made to 1419 Tower totaling over \$8,000,000, but there is no documentation offered.

If, indeed, Martorella had loaned money to 1419 Tower, it presumably would be free to transfer money to him. That is an issue, however, this Court need not, or should not, decide at this juncture. The only issue presented on this appeal is

whether iStar FM Loan LLC should be permitted to intervene. While the bona fides of its dispute with 1419 Tower are the subject of an action in Pennsylvania, iStar certainly has presented in its proposed intervenor complaint a scenario in which significant factual issues exist as to whether the funds now on deposit with the Clerk of the Court were actually converted by Martorella.

CPLR 1012(a)(3) permits intervention as of right "when the action involves the disposition or distribution of . . . property and the person may be affected adversely by the judgment." The issue here is entitlement to the \$2,000,000. Certainly, iStar will be adversely affected if the money is released to Gladstein before there has been a determination as to whether it has an interest in the funds. Denial of the request to intervene is tantamount to a determination on the merits that it has no interest in the money, and that Martorella's claim that he was owed money by iStar is beyond question. On this record, I am unable to draw such a conclusion.

As the motion court observed, iStar simply seeks to have the \$2,000,000 remain where it is pending a final adjudication of the rights of all parties. The action in Pennsylvania will determine the dispute between iStar and 1419 Tower, including, presumably, whether there was a conversion of corporate funds. The courts of

this state will still have the ultimate say as to who has a superior claim to the money on deposit, but that issue can better be resolved after iStar is permitted to intervene.

Although I agree with the majority's conclusion that iStar's legal rights are not affected by the judgment obtained by Gladstein against Martorella, ultimately, the determinative issue will not be the consequences derived from obtaining a judgment. Rather, it will be whether iStar has an entitlement to funds that may have been converted to its detriment, regardless of any judgment obtained by Gladstein.

Additionally, the majority's conclusion, presumably as a matter of law, that the \$2,000,000 does not constitute identifiable proceeds under UCC 9-315 is perplexing, since the \$2,000,000 that was ultimately deposited in the court can readily be traced back to the proceeds of the insurance settlement. Finally, the conclusion that UCC 9-332 is relevant is also perplexing since Gladstein is not yet a transferee who has received the \$2,000,000. She is, at this stage, only a judgment creditor with regard to the \$2,000,000, and a judgment debtor has deposited money in court in an effort to secure a judgment. Whether Gladstein ultimately prevails in her claim will be

dispositive of whether she actually becomes a transferee of the money at the heart of this litigation. Until that time, however, Gladstein remains a claimant.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010



CLERK

JUL 13 2010

SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT,

Angela M. Mazzarelli,	J.P.
Richard T. Andrias	
David Friedman	
Eugene Nardelli	
Karla Moskowitz,	JJ.

1351
Index 603602/05

x

Rachel L. Arfa, et al.,
Plaintiffs-Respondents,

-against-

Gadi Zamir, et al.,
Defendants-Appellants,

Eli Mor, et al.,
Defendants.

[And Other Actions]

x

Defendants appeal from an order of the Supreme Court,
New York County (Charles E. Ramos, J.),
entered December 15, 2008, which, to the
extent appealed from as limited by the brief,
denied their motion to dismiss the fifth
cause of action of the verified second
amended complaint.

Wolf Haldenstein Adler Freeman & Herz LLP,
New York (Eric B. Levine and Alan A.B.
McDowell of counsel), for appellants.

Law Offices of Michael C. Marcus, Long Beach
(Michael C. Marcus of counsel), and Schlam
Stone & Dolan LLP, New York (David J. Katz of
counsel), for respondents.

FRIEDMAN, J.

The fifth cause of action pleaded in the verified second amended complaint seeks to recover for an alleged fraud relating to the purchase of the building at 552-562 Academy Street in Manhattan by an entity in which plaintiffs Rachel L. Arfa and Alexander Shpigel (collectively, Arfa/Shpigel) held a 60% interest and defendant Gadi Zamir held a 40% interest. Zamir arranged the purchase of the Academy Street building, which closed in April 2005, and Arfa/Shpigel allege that they, as holders of the majority interest, assented to the transaction based on several misrepresentations by Zamir, including (1) his understatement of the cost of the renovations the building needed, (2) his failure to disclose structural and foundational defects reflected in engineering reports, and (3) his failure to disclose building code violations for which he had given the mortgagee an undertaking. It is undisputed, however, that the cause of action based on these allegations falls squarely within the scope of the general release contained in the parties' subsequent "Agreement - Governance of Entities," dated June 9, 2005 (the Governance Agreement), which release covers "any and all" claims, whether "known or unknown," arising from prior

events.¹ Assuming (as we must on a motion to dismiss) the truth of Arfa/Shpigel's allegations, the Governance Agreement's general release bars the fifth cause of action as a matter of law. We therefore reverse and grant the motion to dismiss that claim pursuant to CPLR 3211(a)(5).

Arfa/Shpigel argue that, based on their allegations, the general release in the Governance Agreement was fraudulently induced and, therefore, ineffective. It is Arfa/Shpigel's theory that, during the negotiations leading to the execution of the Governance Agreement in June 2005, Zamir was obligated to correct his prior alleged misrepresentations concerning the condition of the Academy Street building. This theory is not pleaded in the

¹The Governance Agreement reallocated managerial authority over the parties' jointly held real estate interests. Specifically, although ownership was split between the parties 60% to Arfa/Shpigel and 40% to Zamir, the Governance Agreement provided, inter alia, that managerial authority would be divided between each side on a 50-50 basis. In addition, section 6 of the Governance Agreement, entitled "General Release," provides as follows:

"Each of the Principals [Arfa, Shpigel and Zamir], on behalf of themselves, the Controlled Entities and their Related Parties, hereby releases each of the other Principals and their Related Parties from any and all claims, demands, actions, rights, suits, liabilities, interests and causes of action, known and unknown, which they have ever had, have or may now have, which in any way pertain to or arise from any matters, facts, occurrences, actions or omissions which occurred prior to or as of the date hereof."

complaint, which does not allege that Arfa/Shpigel entered into the Governance Agreement based on any misrepresentations concerning the Academy Street building. Nonetheless, even assuming that Zamir was obligated to correct any prior misrepresentations during the negotiation of the Governance Agreement, that agreement (as Arfa/Shpigel themselves allege) was the result of rigorous, arm's-length negotiations between highly sophisticated parties.² According to the complaint, by the time the parties began negotiating the Governance Agreement, they had already developed an adversarial, even hostile, relationship.³ In this context, notwithstanding the fiduciary obligation owed by

²In their complaint, Arfa/Shpigel allege the facts establishing their sophistication. Arfa, an attorney, has practiced law with the Securities and Exchange Commission and as a partner in a large corporate law firm for more than 12 years. Shpigel, a 20-year veteran of the real estate business, is a principal in his own real estate brokerage firm and has served as a consultant on investing in the U.S. real estate market to Israel's largest pension fund and to prominent Israeli individuals.

³The complaint alleges that the negotiations leading to the Governance Agreement grew out of Zamir's dissatisfaction with his minority position in the enterprise, in which he was initially relegated to overseeing maintenance of the buildings. Out of his unhappiness, Zamir allegedly made various threats to disrupt the operation of the buildings and engaged in work stoppages and slowdowns. The complaint alleges that it was "[t]o appease Zamir and prevent him from destroying the value of the real estate portfolio" that Arfa/Shpigel negotiated and executed the Governance Agreement with Zamir, which, as previously noted, increased the latter's managerial authority within the enterprise from 33% to 50%.

each side to the other with respect to the management of the underlying real estate business, Arfa/Shpigel, as sophisticated businesspeople, had "an affirmative duty . . . to protect themselves from misrepresentations . . . by investigating the details of the transactions and the business" affected by the Governance Agreement (*Global Mins. & Metals Corp. v Holme*, 35 AD3d 93, 100 [2006], *lv denied* 8 NY3d 804 [2007]). In *Global*, for example, this Court granted summary judgment dismissing a fraud claim because the plaintiff unreasonably relied on alleged misrepresentations without fulfilling its duty to investigate (*id.* at 99), notwithstanding that the defendant owed a fiduciary duty to the plaintiff (*id.* at 98).

Given the sweeping scope of the Governance Agreement's general release, Arfa/Shpigel were obligated, before signing, to investigate all prior transactions for which they had not previously conducted due diligence that might give rise to a claim against Zamir. Had such due diligence been performed, the matters concerning the Academy Street building Zamir allegedly had misrepresented -- all of which concerned the physical condition of the building as reflected in engineering reports and noticed violations -- presumably would have been revealed.

Arfa/Shpigel, however, do not allege that they conducted any such due diligence, nor do they allege that Zamir prevented them from doing so. Indeed, Arfa/Shpigel do not even allege that they asked Zamir to provide them with the engineering reports on the Academy Street building at any time before entering into the Governance Agreement.

Arfa/Shpigel cannot avoid the release set forth in the Governance Agreement unless they establish that their reliance on Zamir's alleged misrepresentations was reasonable, and such reasonable reliance "is a condition which cannot be met where, as here, 'a party has the means to discover the true nature of the transaction by the exercise of ordinary intelligence, and fails to make use of those means'" (*New York City School Constr. Auth. v Koren-Diresta Constr. Co.*, 249 AD2d 205, 205-206 [1998], quoting *Stuart Silver Assoc. v Baco Dev. Corp.*, 245 AD2d 96, 98-99 [1997]). Arfa/Shpigel do not allege that they made any use of the means available to them to ascertain the truth of the alleged misrepresentations at issue before they entered into the Governance Agreement. Accordingly, as a matter of law, assuming the truth of the facts alleged in the complaint, Arfa/Shpigel cannot avoid the effect of the general release they granted Zamir by executing the Governance Agreement.

To reiterate, Arfa/Shpigel's allegations demonstrate that the release in the Governance Agreement was the result of rigorous, arm's-length negotiations between highly sophisticated parties who were already in a highly adversarial position. Specifically, as alleged in the complaint, Zamir essentially extorted Arfa/Shpigel to enter into the Governance Agreement by threatening to cease performing maintenance work on the properties unless Arfa/Shpigel agreed to increase Zamir's vote to 50%, notwithstanding his lesser ownership interest. To this end, Zamir allegedly went so far as to engage in work stoppages and slowdowns. Faced with Zamir's threat to pull the maintenance staff out of the properties, Arfa/Shpigel relented and agreed to sign the Governance Agreement, even though they could have fired him, in order to avoid a "bitter internecine battle." Thus, the release in the Governance Agreement related directly to the parties' conflicts over the management and maintenance of the properties.

Given the parties' adversarial relationship, and Arfa/Shpigel's contention that Zamir extracted the Governance Agreement from them by duress, Arfa/Shpigel -- each a highly sophisticated business person -- had, by their own account, clear notice of Zamir's alleged dishonesty. Given Arfa/Shpigel's

receipt of "hints" that Zamir was not trustworthy, a "heightened degree of diligence [was] required of [them]," and they "[could not] reasonably rely on [Zamir's] representations without making additional inquiry to determine their accuracy" (*Global Mins.*, 35 AD3d at 100). "When a party fails to make further inquiry or insert appropriate language in the agreement for its protection, it has willingly assumed the business risk that the facts may not be as represented" (*id.*, citing *Rodas v Manitaras*, 159 AD2d 341, 343 [1990]; see also *Graham Packaging Co., L.P. v Owens-Illinois, Inc.*, 67 AD3d 465 [2009]; *Permasteelisa, S.p.A. v Lincolnshire Mgt., Inc.*, 16 AD3d 352 [2005]). The "adversarial" nature of the parties' relationship "negate[s] as a matter of law any inference that business [people] as sophisticated as [Arfa/Shpigel] were relying on [Zamir] for an objective assessment of the value of their investment" (*Centro Empresarial Cempresa S.A. v American Móvil, S.A.B. de C.V.*, ___ AD3d ___, ___, 2010 NY Slip Op 04719, *9, citing *Shea v Hambros PLC*, 244 AD2d 39, 47 [1998]). Moreover, the implication of Arfa/Shpigel's position is that "a fiduciary can never obtain a valid release without first making a full confession of its sins to the releasor," a proposition that has

never been the law (*Centro Empresarial*, ___ AD3d at ___, 2010 NY Slip Op 04719, *9).

Arfa/Shpigel's reliance on *Littman v Magee* (54 AD3d 14 [2008]) is misplaced. In *Littman*, a general release in the agreement for the sale of the plaintiff's interest in a closely-held business was held not to bar a fraud action against a former fiduciary at the pleading stage because the complaint was deemed to allege that the defendant fiduciary had told the plaintiff that no further documentation bearing on the valuation of the enterprise existed. While *Littman* reaffirmed that even a fraud claim against a fiduciary must establish justifiable reliance on the alleged misstatement, the case held that the alleged misrepresentation concerning the availability of information relevant to the transaction raised an issue as to whether plaintiff justifiably relied on the defendant's statements without making further investigative efforts (54 AD3d at 19). Here, by contrast, Arfa/Shpigel do not allege that Zamir did or said anything to impede their ability to investigate the truth and completeness of his representations concerning the Academy Street building. On the contrary, assuming the truth of the complaint, Arfa/Shpigel never asked Zamir for even a page of documentation of the condition of the building.

Also inapposite is *Blue Chip Emerald v Allied Partners Inc.*

(299 AD2d 278 [2002]), in which the managing member of a joint venture was sued for purchasing the interest of the other member based on the manager's misrepresentation or concealment of the true price range in which it was negotiating to sell the venture's underlying asset. In holding that the defense was not entitled to the dismissal of the *Blue Chip* complaint notwithstanding certain representations and disclaimers in the agreement governing the purchase and sale of the interest of the plaintiff (BCE), we emphasized, based on the allegations of the complaint, that

"it cannot be said as a matter of law that BCE had at its disposal ready and efficient means for obtaining or verifying the relevant information on its own. For example, there is no reason to believe that BCE could have learned the substance of the [manager's] discussions with potential purchasers from public sources or from some easily located private source, such as the Venture's financial records. Indeed, such offers might well not have been documented at all . . . , or might have been reflected only in letters, e-mail, or notes that could be discovered only through a full-blown, litigation-style review of the [manager's] files. Moreover, in view of the competitive nature of business and the natural presumption that BCE should look to its own partner for information about the Venture, it cannot be assumed . . . that BCE had only to make phone calls to the potential purchasers identified in the buy-out agreement to learn what they were offering for the [underlying asset]" (*id.* at 280-281 [citations omitted]).

The facts of *Blue Chip* are readily distinguished from those alleged here. In *Blue Chip*, when the parties closed their deal -- which entailed only contractual disclaimers of reliance, not (as here) a formal general release -- their relationship had not deteriorated to the level of distrust that existed between Arfa/Shpigel and Zamir when the Governance Agreement was executed. Thus, the plaintiff in *Blue Chip* sold its interest without having received the "hints of falsity" (*Global Mins.*, 35 AD3d at 100) that should have placed Arfa/Shpigel on guard here. In addition, Arfa/Shpigel claim to have been deceived as to the physical condition of the Academy Street building -- a matter readily subject to verification through due diligence, as is evident from the complaint itself -- and there is no allegation that, notwithstanding their high level of sophistication and extensive experience in the real estate business and law, they made any effort to verify Zamir's alleged misrepresentations concerning the building's condition. Again, Arfa/Shpigel do not even allege that they requested an opportunity to review the reports on the building in Zamir's possession. Further, building code violations are matters of public record that can be readily ascertained by an interested party.

Accordingly, the order of the Supreme Court, New York County (Charles E. Ramos, J.), entered December 15, 2008, which, to the

extent appealed from as limited by the brief, denied the motion by defendants Gadi Zamir and Zamir Properties, Inc. to dismiss the fifth cause of action of the verified second amended complaint, should be reversed, on the law, with costs, and the motion granted.

All concur.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 13, 2010


CLERK