

At an IAS Term, Part Comm-1 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at Civic Center, Brooklyn, New York, on the 3rd day of June, 2010.

P R E S E N T:

HON. CAROLYN E. DEMAREST,

Justice.

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THE SCHER LAW FIRM, AS NOMINEE AND CLAIMANTS' REPRESENTATIVE FOR THE PLAINTIFFS AND CLAIMANT LPS IN THE SETTLEMENT OF THAT CERTAIN ACTION PENDING IN THE SUPREME COURT, STATE OF NEW YORK, COUNTY OF KINGS, UNDER THE INDEX NUMBER 14515/2006, IN PURSUIT OF PLAINTIFFS' DERIVATIVE CLAIMS OF THE PARTNERSHIP AS THE LIMITED PARTNERS OF PARKLEX ASSOCIATES, A LIMITED PARTNERSHIP, SUING ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED,

Index No. 24633/09

Petitioner,

- against -

DB PARTNERS I LLC, RBC CAPITAL MARKETS CORPORATION,
AND ROYAL BANK OF CANADA,

Respondents.

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The following papers numbered 1 to 13 read on this motion:

	<u>Papers Numbered</u>
Notice of Motion/Order to Show Cause/ Petition/Cross Motion and Affidavits (Affirmations) Annexed _____	<u>1-3, 8-11, 14, 17</u>
Opposing Affidavits (Affirmations) _____	<u>4, 16</u>
Reply Affidavits (Affirmations) _____	_____
_____ Affidavit (Affirmation) _____	_____
Other Papers _____ Memoranda of Law _____	<u>5-7 12-13, 15</u>

In this turnover proceeding brought pursuant to CPLR 5225 (b) against respondents DB Partners I LLC (DB Partners), RBC Capital Markets Corporation (RBCCM), and Royal Bank of Canada (RBC) by the Scher Law Firm, as nominee and claimants' representative for the plaintiffs and claimant LPs (petitioners) in the settlement of a derivative action (*Holtkamp v Parklex Associates*, Sup Ct, Kings County, index No. 14514/06) (the Parklex action) by the limited partners of Parklex Associates, a limited partnership (Parklex), RBCCM and RBC move for an order dismissing the petition and modifying the restraining notices served upon them so that RBC may exercise its claimed right to liquidate the collateral that is the subject of the restraining notices to satisfy DB Partners' obligations to RBC, including the obligation to pay RBC's attorneys' fees and costs associated with enforcing its right to do so. Petitioners cross-move for an order granting them partial summary judgment directing the turnover of \$361,411.22 to them in partial satisfaction of a judgment against Fred Deutsch.

Facts

On May 8, 2006, Fred Deutsch, acting as the principal of Parklex's corporate general partner, Parklex Associates, Inc. (Parklex Associates), sold Parklex's real property located at 112-114 East 32nd Street in Manhattan (the Parklex office building) for approximately \$55 million. At the closing of the sale of the Parklex office building, Fred Deutsch directed that \$23,080,351.63 from the sale proceeds be wire transferred into an account in the name of FAL Associates LLC (FAL Associates) at JP Morgan Chase. FAL Associates was a Delaware limited liability company

formed on May 1, 2006, just seven days before the sale of the Parklex office building. Fred Deutsch is the sole member and principal of FAL Associates.

On May 11, 2006, Diedrich Holtkamp, one of the limited partners of Parklex, along with the other limited partners of Parklex (the Parklex plaintiffs), commenced the Parklex action, alleging that Fred Deutsch committed fraud by the transfer of the proceeds of the sale of the Parklex office building to FAL Associates, and seeking an accounting of Parklex's assets.

RBC, a Canadian corporation, is one of the largest financial institutions in North America, which provides, among other things, personal and commercial banking and wealth management services. RBCCM is a wholly owned subsidiary of RBC. RBCCM is one of the nation's largest full service securities firms, which serves individual investors and businesses. In the spring of 2006, Fred Deutsch was referred to Ronald A. Slevin, a senior vice president with RBC Dain Rauscher (RBC Dain), now RBCCM, by an existing client of RBC Dain. Ronald A. Slevin claims that after meeting with Fred Deutsch, he believed that Fred Deutsch was a successful real estate entrepreneur who was looking for a wealth management company to manage his money by investing in stocks and bonds.

On June 21, 2006, an account in the name of Collateral Acquisition LLC (Collateral Acquisition) was opened by Fred Deutsch at RBC Dain. On June 23, 2006, an account in the name of Parklex Associates was opened by Fred Deutsch at RBC Dain. On June 26, 2006, a wire transfer was made into the Parklex Associates account from an account outside of RBC or RBC Dain in the amount of \$6,104,173.86. On June 27, 2006, a wire transfer in the amount of \$4,604,173.86 was made from the Parklex Associates account into the Collateral Acquisition account at RBC Dain.

On July 6, 2006, an account in the name of DB Partners was opened by Fred Deutsch at RBC Dain. Fred Deutsch wholly owns and is the managing member and sole principal of DB Partners. The deposit account application signed by Fred Deutsch reflects that the source of funds from anticipated transaction activity would be from real estate proceeds. On July 10, 2006, a wire transfer from FAL Associates' account at JP Morgan Chase was made into the DB Partners account in the amount of \$10,000,000. On July 14, 2006, a second wire transfer from FAL Associates' account at JP Morgan Chase was made into the DB Partners account in the amount of \$10,035,823.80. Four other accounts in the name of DB Partners also were opened in September and October 2006 to allegedly facilitate the purchase and sale of securities for DB Partners.

On September 25, 2006, a subpoena duces tecum was issued to RBC Dain on behalf of the Parklex plaintiffs. That subpoena duces tecum sought the production of all account information pertaining to the \$6,104,173.86 wire transfer into the Parklex account that occurred on June 26, 2006. RBC Dain responded to the subpoena duces tecum by producing documents.

On October 17, 2006, the Parklex plaintiffs issued a second subpoena duces tecum to RBC Dain, seeking account information pertaining to the Collateral Acquisition account, including, but not limited to the wire transfer on June 27, 2006 for \$4,604,173.86 made from the Parklex Associates account into the Collateral Acquisition account. The account information sought included the name of the account holder, account statements, and information regarding distribution of funds into and out of the account.

The October 17, 2006 subpoena duces tecum was withdrawn and reissued by a third subpoena duces tecum, dated October 26, 2006, to RBC Dain, seeking the same information sought by the October 17, 2006 subpoena duces tecum. That subpoena duces tecum, however, specifically

stated that its intent was to permit the Parklex plaintiffs to track the monies transferred from an account held by Parklex Associates on June 30, 2006, possibly in violation of a June 29, 2006 court order, which restrained and enjoined the defendants in the Parklex action from distributing any funds out of Parklex Associates' accounts without further order of the court. Attached to the third subpoena duces tecum was a copy of the court's June 29, 2006 order. The court's June 29, 2006 order stated that the temporary restraining order continued pending discovery, and that the defendants in the Parklex action were restrained and enjoined from distributing any funds in any and all accounts held or maintained in the name of Parklex Associates without further order of the court. It also required the defendants in the Parklex action to provide the Parklex plaintiffs with all documents relating to the Parklex office building and all books and records of the partnership. The October 26, 2006 subpoena duces tecum was accompanied by a cover letter from counsel for the Parklex plaintiffs. That letter stated that the Parklex plaintiffs were still awaiting information regarding a wire transfer that occurred from the Parklex Associates account to Commerce Bank in the amount of \$1,000,000 on June 30, 2006, which was to be supplied to them pursuant to a previous subpoena duces tecum.

Following communications between RBC Dain's in-house legal counsel and counsel for the Parklex plaintiffs, the Parklex plaintiffs issued a fourth subpoena duces tecum, dated November 2, 2006, to RBC Dain, seeking the same account information sought by the third subpoena duces tecum. Parklex Associates and other defendants moved to quash the October 26, 2006 and November 2, 2006 subpoenas duces tecum issued to RBC Dain. On December 4, 2006, counsel for the Parklex plaintiffs cross-moved for an order appointing a court-appointed accountant and enforcing the subpoenas duces tecum. This cross-motion was served upon the defendants as well as

upon Michael Pysno, Esq., an in-house lawyer for RBC Dain. The cross-motion claimed that “the [s]ubpoenas will show that . . . money was secreted by the [d]efendants to RBC to transfer such money out of traceable accounts of the Parklex Corporation to new and/or secret accounts” (Graff March 2010 Aff., Exhibit 1, p.2). The cross-motion further asserted plaintiffs’ belief that “the money was transferred from the Parklex Corporation into one of the [d]efendants’ personal accounts, or to an account dominated or controlled by them” (*Id.*, p. 7-8) and suggested that “[d]efendants may have tried to secret the money from the sale of the Partnership’s only asset” (*Id.*, p. 9). Fred Deutsch was named individually and accused of self-dealing.

On December 19, 2006, counsel for the Parklex plaintiffs wrote a letter to Pysno, informing him that the court had denied defendants’ motion. The Parklex plaintiffs’ counsel also forwarded a copy of the court’s order, dated December 18, 2006, to Pysno. The court’s December 18, 2006 order additionally referenced that plaintiffs’ cross motion to direct that the proceeds of the sale of the Parklex office building be deposited into an account supervised by the court was denied. On December 22, 2006, RBC Dain, by a letter written by Jessica Haukos, a paralegal at RBC Dain, responded to the subpoenas duces tecum by producing documents.

While the aforementioned four subpoenas duces tecum did not specifically mention DB Partners or the DB Partners accounts at RBC Dain, or refer to the more than \$20 million transferred into DB Partners’ account from JP Morgan Chase in July 2006, each of these subpoenas duces tecum listed the full caption of the Parklex action which named, among others, Parklex Associates, FAL Associates, and Fred Deutsch, as defendants.

In the spring of 2007, Fred Deutsch expressed a desire to obtain a line of credit from RBC, which, as noted above, was the parent company of RBC Dain. RBC allegedly understood that the

purpose of this line of credit was to fund the working capital needs of DB Partners' ongoing real estate business.

On May 3, 2007, RBC made a demand discretionary line of credit facility available to DB Partners in the amount of \$16 million, which was increased to \$17 million on December 19, 2007. In consideration for the extension of credit by RBC, DB Partners entered into a Pledge and Security Agreement dated May 3, 2007. Pursuant to section 2.1 of the Pledge and Security Agreement, in order "[t]o secure the [o]bligations . . . [t]hereafter owed, . . . [DB Partners] grant[ed], pledg[ed] and] assign[ed] . . . to and for the benefit of [RBC] and create[d] a first priority continuing security interest in favor of [RBC] in all right, title, and interest of [DB Partners] in and to any and all [c]ollateral." Pursuant to the definition of collateral in section 1 (d) of the Pledge and Security Agreement, the collateral consisted of the five securities accounts at RBC Dain in the name of DB Partners and all securities, financial assets, and other proceeds maintained in the DB Partners accounts.

Section 3.1 (h) of the Pledge and Security Agreement provided that "an attachment, garnishment or forfeiture proceeding . . . commenced affecting any [c]ollateral" constitutes an "[e]vent of [d]efault." Pursuant to section 3.2 (b) (v) of the Pledge and Security Agreement, upon the occurrence of an event of default, RBC was given the right to liquidate the collateral and apply the proceeds to the repayment of any and all obligations. Section 17 of the Pledge and Security Agreement provided that DB Partners "agree[d], on demand, to pay to [RBC] the amounts of all costs and expenses, including reasonable attorneys' . . . fees . . . which [RBC] may incur in connection with the . . . enforcement of this Pledge [and Security] Agreement or the enforcement of the security interest granted [t]hereunder."

Section 2.4 of the Pledge and Security Agreement sets forth that RBC's security interest in the collateral "shall at all times be perfected by control." The "control" needed to perfect the security interest was granted to RBC in a separate agreement among RBC, RBC Dain, and DB Partners called the Pledged Account Agreement dated May 3, 2007 (the Control Agreement). Section 1.2 of the Control Agreement granted "control" over the collateral to RBC as defined in the Uniform Commercial Code (UCC).

A judgment (by way of a confession of judgment) in the total sum of \$15,574,597.19 in favor of the Parklex plaintiffs against Fred Deutsch, DB Partners' sole principal, was entered on July 20, 2009 in the Supreme Court, New York County, following the failure of a settlement agreement dated April 14, 2009, entered into by the parties in the Parklex action, due to Deutsch's default with respect to the first payment owed thereunder.

Petitioners served a restraining notice and information subpoena pursuant to judgment, dated July 30, 2009, on RBCCM, and served a restraining notice and information subpoena pursuant to judgment, dated August 12, 2009, on RBC, restraining the transfer from any accounts at RBC or RBCCM in which Fred Deutsch has an interest. RBC and RBCCM have frozen all accounts that Fred Deutsch controls in compliance with such restraining notices. The principal balance outstanding under DB Partners' line of credit is \$1,713,387.01 as of October 27, 2009. The past due interest is \$5,920.01. The market value of the collateral maintained in the DB Partners' accounts was \$2,080,718.24 (as of November 11, 2009) and consists primarily of treasuries. RBC claims that it has also incurred significant legal fees in responding to the petition in this turnover proceeding.

Discussion

On September 29, 2009, petitioners commenced this turnover proceeding against DB Partners, RBC, and RBCCM, by filing their notice of petition and petition, seeking a judgment pursuant to CPLR 5225 (b) directing them to turn over and deliver the entire balance (\$2,080,718.24 as of November 11, 2009) in the accounts held by RBCCM. In its petition, petitioners assert that by the July 12, 2006 wire transfer of \$10,000,000 and the July 14, 2006 wire transfer of \$10,035,823.80, the \$20,035,823.80 from FAL Associates' account at JP Morgan Chase was transferred into the accounts of DB Partners at RBC Dain in violation of Debtor and Creditor Law § 273-a. Petitioners allege that the funds in these accounts are the proceeds of a fraud perpetrated by the depositor, Fred Deutsch, upon them. RBC and RBCCM, by their motion, now seek to dismiss the petition, and petitioners have brought a cross motion for partial summary judgment in their favor.

Petitioners, in their cross motion, assert that since the principal balance outstanding under the line of credit, given by RBC to DB Partners, as of October 27, 2009, is \$1,713,387.01, and the market value of the collateral in the DB Partners' accounts as of November 11, 2009 is \$2,080,718.24, this leaves a difference of \$361,411.22, which petitioners contend should be immediately turned over to them in partial satisfaction of their judgment against Fred Deutsch.

RBCCM and RBC, in opposition, assert that RBC is entitled to recover legal fees and costs from the collateral under section 17 of the Pledge and Security Agreement. As noted, section 17 of the Pledge and Security Agreement provided that DB Partners "agrees, on demand, to pay [RBC] the amounts of all costs and expenses, including reasonable attorneys' . . . fees, which [RBC] may incur in connection with the . . . enforcement of this Pledge [and Security] Agreement or the

enforcement of the security interest granted hereunder.” Petitioners also rely upon section 8 of the Amended and Restated Demand Note, under which DB Partners “agree[d] to pay on demand all costs and expenses (including, but not limited to reasonable attorneys’ . . . fees) incurred by [RBC] (whether at trial, or appeal or without litigation) in connection with the collection of any sums due to [RBC] hereunder and the enforcement of its rights under this [n]ote and any other [c]redit [d]ocument.”

Petitioners argue that because RBC has not made a demand upon DB Partners for payment of its legal fees and costs, it effectively has waived its right to recover legal fees and costs from the collateral. Section 3.2 of the Pledge and Security Agreement, however, provided that upon the occurrence of an event of default, RBC, without demand for payment, may set off any and all collateral against any and all obligations. Moreover, RBC is still incurring attorneys’ fees. Thus, RBC has not waived its right to recover attorneys’ fees by not making a demand for such fees upon DB Partners.¹

RBCCM and RBC, in support of their motion, assert that the petition should be dismissed because they are entitled to the funds in the DB Partners’ accounts. They state that DB Partners has defaulted on the line of credit, under the terms of the Pledge and Security Agreement, due to petitioners’ commencement of this turnover proceeding against Fred Deutsch and the service of the restraining notices on them with regard to the accounts controlled by Fred Deutsch. RBCCM and RBC contend that since RBC has a perfected security interest pursuant to the loan documents and

¹ While the court finds that RBC has not waived its right to recover attorneys’ fees by not making a demand for such fees upon DB Partners, this issue may be merely academic if it is decided (as discussed below) that petitioners are entitled to recover the entire proceeds of the collateral to satisfy their judgment, leaving no collateral from which RBC may recover such attorneys’ fees.

the UCC, it is entitled to liquidate the collateral to satisfy DB Partners' obligations to RBC, including the obligation to pay all legal fees that RBC has incurred to enforce its rights.

Pursuant to CPLR 5240, a party served with a restraining notice is "forbidden to . . . transfer . . . any property in which [it] has an interest, except upon direction of the sheriff or pursuant to an order of the court, until the judgment or order is satisfied or vacated." CPLR 5240, however, vests the court with the discretion to modify a restraining notice (*see Technology Multi Sources, S.A. v Stack Global Holdings, Inc.*, 44 AD3d 931, 932 [2007]). RBCCM and RBC request that the court modify the restraining notices against them to permit them to liquidate the collateral to pay the monies owed by DB Partners to RBC under its line of credit.

RBC's Security Interest

RBCCM and RBC contend that they cannot be required to turn over the monies in the DB Partners' accounts to petitioners because RBC has a superior right to these monies under article 8 of the UCC. Article 8 of the UCC "sets forth rules governing the rights and obligations of parties in connection with the issuance and transfer of stocks, bonds, and other forms of debt commonly traded by investors" (*S.E.C. v Credit Bancorp, Ltd.*, 386 F3d 438, 447 [2d Cir 2004]). Article 8 applies where, as here, a broker dealer (RBCCM) holds financial assets, such as stocks and bonds in securities accounts that have been pledged to another entity (RBC) as collateral for a loan (*see id.*).

UCC 8-510 (a) provides:

"In a case not covered by the priority rules in Article 9. . . an action based on an adverse claim to a . . . security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control."

A “security entitlement” is defined as “the rights and property interest of an entitlement holder with respect to a financial asset” (UCC 8-102 [a] [17]). A “financial asset” includes “any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under [UCC article 8]” (UCC 8-102 [a] [9] [iii]). An “entitlement holder” is “a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary” (UCC 8-102 [a] [7]). A “securities intermediary” is a “clearing corporation” or “a person, including a bank or broker, that in the ordinary course of business maintains securities accounts for others and is acting in that capacity” (UCC 8-102 [a] [14]). A “securities account” is “an account as to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset” (UCC 8-501 [a]). The term “purchase” under the UCC includes “taking by . . . pledge [or] . . . security interest” (UCC 1-201 [32]). An “adverse claim” is “a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset” (UCC 8-102 [a] [1]).

Here, for purposes of UCC 8-510 (a), RBC is the person which, by advancing a line of credit and obtaining the Pledge and Security Agreement from DB Partners as the entitlement holder, purchased a security entitlement to the property interest of DB Partners with respect to the financial assets held in the securities accounts maintained at RBCCM, the securities intermediary. RBC thus contends that, pursuant to UCC 8-510 (a), no claim may be brought against it because it, as the

purchaser, gave value, did not have notice of the adverse claim, and obtained control (*see S.E.C.*, 386 F3d at 440). RBC argues, therefore, that even if the money transferred to RBC Dain in 2006 was the product of a fraudulent transfer, UCC 8-510 (a) precludes petitioners from asserting their claim against the collateral.

In addressing the question of whether RBC has met the requirements of UCC 8-510 (a), the court notes that it is undisputed that RBC gave value to DB Partners by loaning money to it (*see S.E.C. v Credit Bancorp, Ltd.*, 279 F Supp 2d 247, 263 [SD NY 2003], *affd* 386 F3d 438 [2d Cir 2004]). It is also undisputed that the Control Agreement perfected RBC's security interest in the collateral by giving RBC control over the collateral, and that RBC thereby obtained control over the collateral pursuant to the Control Agreement in accordance with the requirements of UCC 8-106 (d).

Notice of Adverse Claim: Willful Blindness

Petitioners contest that RBC lacked notice of an adverse claim as to the collateral maintained in DB Partners' accounts with RBCCM at the time it made the loan to DB Partners in May 2007. UCC 8-105 (a) (2) provides:

“(a) A person has notice of an adverse claim if:
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(2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim.”

“The Code describes this “willful blindness” test as the codification of a two prong test developed in cases decided more than a century ago” (*S.E.C.*, 386 F3d at 448; *see also* UCC 8-105, Comment 4; *Goodman v Simonds*, 61 US 343 [1857]). The first prong of the willful blindness test

of UCC 8-105 (a)(2) “turns on whether the person is aware of facts sufficient to indicate that there is a significant probability that an adverse claim exists” (UCC 8-105, Comment 4; *see also S.E.C.*, 386 F3d at 448). “Whether facts known to a person make the person aware of a ‘significant probability’ that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from these facts, taking account of the experience and position of the person in question” (UCC 8-105, Comment 4).

The second prong of the willful blindness test of UCC 8-105 (a) (2) “turns on whether the person ‘deliberately avoids information’ that would establish the existence of the adverse claim” (*id.*). “The test is the character of the person’s response to the information the person has” (*id.*). “The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed (*id.*).

While RBC and RBCCM concede that individuals at RBC Dain were aware that a lawsuit was ongoing concerning Parklex and that information relating to three June 2006 wire transfers involving the Parklex Associates and Collateral Acquisition accounts were connected to that litigation, RBC and RBCCM nevertheless contend that these facts were not sufficient to indicate that there was a significant probability that an adverse claim existed regarding the separate accounts in the name of DB Partners. RBC and RBCCM rely on the fact that the subpoenas duces tecum did not specifically concern DB Partners’ accounts or make any reference to the wire transfers from JP Morgan Chase into a DB Partners account in July 2006 of over \$20,000,000. They also rely on the fact that the two court orders annexed to the subpoenas duces tecum did not specifically name DB Partners, but dealt only with accounts of Parklex Associates. They argue that, even if RBC Dain is

found to have had actual knowledge of an adverse claim against DB Partners, it was a separate entity, distinct from RBC, and was under no duty to share its knowledge with RBC.

RBC Dain's Notice of Adverse Claim

Although it is RBC's knowledge of an adverse claim, and not that of RBC Dain, that will determine whether RBC has a protected security interest under the UCC, information known to RBC Dain is critical in light of the relationship between RBC and RBC Dain, its wholly-owned subsidiary. The uncontroverted facts demonstrate that RBC Dain had actual knowledge that Fred Deutsch, a named defendant in the Parklex action, as the sole principal of Parklex Associates, was the trustee of the funds described in the June 29, 2006 court order and that funds were transferred out of Parklex Associates' account at RBC Dain and into Collateral Acquisition's account at RBC Dain, also controlled by Fred Deutsch, just two days before the court order was issued. The receipt of the four subpoenas duces tecum, along with the June 29, 2006 court order, thus provided notice that there was a potential for diversion of assets and misappropriation. Moreover, as mentioned above, the subpoenas were the subject of dispute, resulting in a motion to quash the subpoenas, as well as a cross motion to appoint an accountant and enforce the subpoenas. RBC Dain's counsel was the recipient of a copy of the cross motion, which included allegations against Fred Deutsch involving self-dealing through secret bank accounts. RBC Dain also received communication from both counsel for the plaintiffs and counsel for the defendants relating to the subpoenas. Defendant Fred Deutsch's attorneys vigorously protested RBC Dain's disclosure to plaintiffs in response to one of the subpoenas, threatening to hold it responsible for any damages. The facts, as presented in the motion papers, clearly set out an adverse claim against Fred Deutsch, the principal of DB Partners,

and are sufficient to confer actual knowledge on RBC Dain of an adverse claim to all assets attributable to Fred Deutsch.

Petitioners have submitted evidence of various legal and regulatory directives imposed on banks and brokerages to support its claim that respondents failed to comply with their responsibilities to report and/or investigate the information they had.² RBC Dain was required to abide by the Bank Secrecy Act of 1970 (BSA), codified at 31 USC §§ 5311 *et seq.* and 31 CFR Part 103, as amended in particular by Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act), which governs procedures for opening new customer accounts, monitoring those accounts and maintaining records. As a broker-dealer, RBC Dain was also required to comply with regulations promulgated by the United States Securities and Exchange Commission (SEC), including NYSE Rule 445, and by the self-regulating National Association of Securities Dealers (NASD), including NASD Rule 3011. Although the rules and regulations governing financial institutions are voluminous, a number of them bear mentioning. 31 USC § 5318 (h) requires financial institutions to establish anti-money laundering programs, including, at a minimum, “(A) the development of internal policies, procedures, and controls; (B) the designation of a compliance officer; (C) an ongoing employee training program; and (D) an independent audit function to test programs.” 31 CFR 103.122 (b), requires financial institutions, including broker dealers, to establish a written customer identification program (CIP). The CIP must establish, at a minimum,

² The motions were originally argued on December 11, 2009, at which time, petitioners handed up a compendium of undefined rules and regulations. When it became apparent to this court that there was no rational distinction to be made between the entire relief sought in the petition and the limited request for partial summary judgment, and that further elucidation of the relevance of the statutory obligations imposed by federal law upon banks and brokerages was required, the court directed a supplemental briefing on these issues and calendared the case for additional argument on March 2, 2010.

procedures for obtaining customer identifying information prior to opening an account, verifying the identity of the customer to the extent reasonable and practicable, making and maintaining a record of information obtained relating to identity verification, determining whether a customer appears on any list of known or suspected terrorist organizations and providing each customer with adequate notice that information is being requested to verify the customer's identity (*see e.g.*, U.S. Securities & Exchange Commission, Anti-Money Laundering (AML) Source Tool for Broker-Dealers (Jan. 14, 2010), available at <http://www.sec.gov/about/offices/ocie/amlsourcetool.htm>). The broker-dealer must verify the customer's identity through documentary evidence and information including the name of the account holder, date of birth, address, and tax ID number. 31 USC 5318 (g) sets out requirements for reporting suspicious transactions to a government agency. RBC Dain, had, in fact, established an AML Program and a CIP, which purported to comply with AML regulations.

There is, however, evidence to suggest that RBC Dain did not fully comply with its established AML program. RBC Dain's AML Program described steps for designating accounts higher risk "due to legal structure, geography, nature of the business or other customer characteristics." The AML Program also listed examples of "red flags," the occurrence of which would signal possible money laundering or terrorist financing, which should have triggered RBC Dain's obligation to monitor, document and report suspicious activities to a government agency. Such "red flags" included an instance in which the customer has "a questionable background or is the subject of news reports indicating possible criminal, civil, or regulatory violations," an instance in which, "[f]or no apparent reason, the customer has multiple accounts under a single name or multiple names, with a large number of inter-account or third party transfers," and an instance in which the customer "maintains multiple accounts, or maintains accounts in the names of the family

members or corporate entities, for no apparent purpose” (see Marooney March 2010 Aff., Exhibit 3, p. 13-14). RBC Dain’s AML Program further stated that, should an employee at RBC Dain detect that a “red flag” event has occurred, the employee is instructed to contact the AML Compliance Office to conduct an investigation. The investigation, “may result in contacting the government, freezing the account, or filing a Form SAR-SF” (*id.* at 15).

According to RBCCM, with respect to the opening of the DB Partners’ accounts, RBC Dain complied with its customary due diligence requirements established by its CIP by obtaining the necessary certified corporate documents with respect to DB Partners and also obtaining personal information from Fred Deutsch, thus verifying his identity. RBCCM fails, however, to explain whether RBC Dain investigated why Fred Deutsch opened multiple accounts through different shell companies within the span of only a few months or why RBC Dain was served, only a few months thereafter, with four subpoenas duces tecum relating to one of those shell companies, indicating that Fred Deutsch may be guilty of civil violations. RBC Dain knew that DB Partners was formed as a limited liability company in the State of Delaware on July 5, 2006, just days before the over \$20,000,000 in wire transfers from FAL Associates were placed in its accounts. Based on its own manual, RBC Dain should have identified such suspicious behavior and conducted further inquiry. Although it is not necessary to determine whether RBC Dain should have taken any affirmative and protective measures with respect to the DB Partners accounts, such as filing a report or alerting a government agency, it is undeniable that sufficient facts existed to justify an inquiry into the accounts of all of Fred Deutsch’s shell companies.

Thus, when RBC Dain received actual notice through the subpoenas duces tecum that it was enjoined from distributing any funds from Parklex Associates’ account, it should have investigated

all other accounts established by shell companies of Fred Deutsch. Had RBC Dain's attorney reviewed the motion papers relating to those subpoenas which were supplied to him, he would have learned that the limited partners of Parklex Associates had claims against funds alleged to have been diverted to various unknown secret accounts. A review of those papers would have disclosed that the Parklex plaintiffs sought a money judgment against Deutsch and FAL Associates, in the amount of \$32,000,000, for conversion of the proceeds from the sale of the office building owned by the Parklex partnership in May 2006, in which most of the sale proceeds had been transferred to various entities controlled by Fred Deutsch. Such information would have created a suspicion that the monies received in the DB Partners accounts were received as a result of a fraudulent conveyance by FAL Associates to DB Partners, both of which were exclusively controlled by Fred Deutsch. RBC Dain was required by law to refrain from deliberately avoiding such easily accessible information that would have revealed a significant probability that there were adverse claims to the funds deposited into DB Partners' accounts (*see S.E.C.*, 386 F3d at 452).

“A bank's failure to conduct a reasonable inquiry when the obligation to do so arises will result in the bank being charged with such knowledge as inquiry would have disclosed” (*Home Sav. of Am. v Amoros*, 233 AD2d 35, 39 [1997]). Here, RBC Dain had reason to know that suspicious activity was afoot when it was served with the four subpoenas duces tecum naming Fred Deutsch, Collateral Acquisition, Management Services LLC (the sole member of DB Partners [*see Operating Agreement for DB Partners, Ex. 36 to Marooney March 2010 Affidavit*]), as well as FAL Associates, as defendants in the caption. RBC Dain had notice of the diversion of petitioners' funds by Fred Deutsch and could not simply “stick its head in the sand” and ignore the caption of the subpoenas duces tecum and the court's June 29, 2006 order. Thus, RBC Dain is charged with notice

that there was a significant probability that an adverse claim against the DB Partners accounts existed. Respondents' excuse, that, since RBC Dain received over 440 third-party subpoenas in 2006, it could not be expected to have notice based on the four instant subpoenas duces tecum served upon it, is to no avail. "Neither a large bank nor a small bank may urge that it is ignorant of facts clearly disclosed in the transactions of its customers . . . nor may a bank close its eyes to the clear implications of such facts" (*Grace v Corn Exch. Bank Trust Co.*, 287 NY 94, 107 [1941]).

Based upon actual notice of the claims of the Parklex partners that the funds in the accounts established at RBC Dain by Fred Deutsch were funds converted by Deutsch in violation of their rights, due diligence should also have been performed to determine what consideration was provided to FAL Associates by DB Partners for the over \$20,000,000 transferred. With a modicum of inquiry, RBC Dain would have learned that no consideration was provided by DB Partners and that the monies were fraudulently conveyed, as defined by Debtor and Creditor Law § 273-a, which provides:

"Every conveyance made without fair consideration when the person making it is a defendant in an action for money damages . . . is fraudulent as to the plaintiff in that action without regard to the actual intent of the defendant if, after final judgment for the plaintiff, the defendant fails to satisfy the judgment."

Since the funds transferred into the DB Partners' account were fraudulently conveyed, DB Partners became the trustee of these monies. In equity, the money in the hands of a fraudulent grantee "is a trust fund held by such grantee, as trustee ex maleficio, for the benefit of the creditors of the grantor" (*North River Mtge. Corp. v Jacob*, 144 Misc 842, 845 [1932]). Thus, RBC Dain, as custodian of those trust funds, had reason to expect to be held accountable to the plaintiffs in the Parklex action.

RBC's Notice of Adverse Claim

Although this court finds that RBC Dain had actual notice of the Parklex plaintiffs' adverse claim, petitioners must demonstrate that RBC, as the lender to DB Partners and the secured creditor under the UCC, also had actual notice of such adverse claim or was aware of facts sufficient to create a reasonable suspicion of the significant probability of petitioners' adverse claim, giving rise to a duty to investigate. Clearly, if the information known to RBC Dain is imputed to RBC, petitioners have met their burden. Thus, whether RBC can access its collateral in the DB Partners' accounts held by RBCCM, or whether such collateral must be turned over to petitioners, depends on whether RBC can demonstrate that it did not have notice of an adverse claim against the financial assets held in its subsidiary's accounts.

According to RBC, it conducted its customary due diligence on DB Partners and its sole beneficial owner, Fred Deutsch, in the spring of 2007, before extending a line of credit to DB Partners. This due diligence included: (1) obtaining copies of corporate organizational and formation documents, (2) conducting general news and public domain searches using search engines, such as Google, Westlaw, or Dun & Bradstreet, (3) conducting a Westlaw database search to confirm the existence of liens, litigation, or bankruptcy, and (4) conducting standard compliance checks for "know your customer," anti-money laundering and Patriot compliance, which included a database search on "World Check" software.³

³The majority of the documents supplied by the RBC and RBCCM, as evidence of the diligence conducted by RBC, were dated after May 3, 2007, the date the line of credit was extended and the security interest perfected. The searches conducted on Google and Westlaw provided to this court bear the timestamp of June 5, 2007, which seems to suggest that RBC had not completed its diligence upon the execution of Note, the Pledge and Security Agreement, and the Control Agreement (Marooney March 2010 Aff., Exhibit 52). Petitioners' Post-Hearing Brief corroborates this suggestion, alleging that although the line of credit was extended on May 3, 2007, Fred Deutsch did not actually submit his loan application to RBC until May 15, 2007, and RBC did not actually approve the loan until June 14, 2007 (*see* Petitioners' Post-Hearing Brief, p. 21).

RBC claims that its due diligence did not reveal any information that raised any “red flags” about DB Partners, Fred Deutsch, or the financial assets held in DB Partners’ securities accounts at RBC Dain, which were to be pledged as security for the line of credit. RBC further claims that even though it searched for prior criminal convictions, its search did not reveal the fact that Fred Deutsch was, in fact, a convicted tax felon.⁴ Respondents completed a “Risk Tiering Analysis” in which RBC described the nature of DB Partners’ business as “Real Estate Dev/Comm/Res” and categorized the risk posed by the company as “High” (Marooney March 2010 Aff., Exhibit 50). That same analysis stated that there had not been “negative information, or criminal allegations against client/alias, PEP, Special Approval or Beneficial Owner in the press” (*id.*).

Despite its claim that it performed a Westlaw database search to determine whether any pending litigation existed, and its own admission that it conducted a Google search that identified this court’s decision (*see* Def. March 2010 Memo of Law, p. 20), RBC has no explanation for its failure to read this court’s decision related to the Parklex action, dated April 23, 2007, less than two weeks before RBC extended a \$16 million line of credit to DB Partners (*see Parklex Associates v Parklex Associates*, 2007 NY Slip Op 50842(U), 2007). That decision would have revealed an adverse claim against Fred Deutsch and Parklex Associates. It explicitly included the allegations that Fred Deutsch wired \$23,080,351.63 to FAL Associates, the source of the funds for the DB Partners accounts, and that Fred Deutsch’s accountant had “participated in such malfeasance by the blurring of the corporate/partnership forms between Parklex and Fred’s other companies (*Id.* at *8).

⁴ RBC and RBCCM argue that the tax lien filed against Fred Deutsch by the IRS was filed in error (*see* Marooney March 2010 Aff., Exhibit 54). Such documentation evidencing that a lien was filed in error does not, however, controvert the affidavit of James Deutsch, Fred Deutsch’s son, who asserted that his father was a tax felon (*see* Graff Aff. in opposition to Motion to Dismiss, Exhibit C), nor does it controvert the affidavit of Adam Olszowy, who admitted that RBC failed to discover that Fred Deutsch was a convicted tax felon (*see* Graff Aff. in support of Cross-Motion, Exhibit A).

RBC claims that the opinion does not mention DB Partners and that RBC reasonably concluded that DB Partners was a separate entity unrelated to the Parklex Action. RBC, however, knew that Fred Deutsch was the principal of DB Partners, which was merely an asset holding company, and that he had described DB Partners' business purpose in the vaguest of terms, acknowledging that DB Partners did not even produce independent financial statements (*see* Marooney March 2010 Aff., Exhibit 45).

RBC does not explain what action was taken when DB Partners was identified as a high risk business, or whether it verified the actual source of DB Partners' funds, or ever became aware of the litigation pending against Fred Deutsch and his shell companies. In fact, Fred Deutsch filled out a "Global Private Banking Deposit Account Application" for RBC which identified the source of funds for DB Partners as "Business/Employment/Real Estate Proceeds" (*see* Marooney March 2010 Aff., Exhibit 46). There is no evidence that RBC attempted to investigate the meaning of such description, especially in light of the readily accessible pending litigation against Fred Deutsch related to self-dealing from real estate proceeds. RBC should certainly have detected a few discrepancies in the paperwork provided. It is noted that in DB Partners' Limited Liability Company General Resolution, executed by Fred Deutsch on RBC's letterhead for "Global Private Banking," New York is certified as the state of DB Partners' formation, for which a certificate is certified to have been filed on June 16, 1999. Apparently no one at RBC took cognizance of this discrepancy when this form, dated May 15, 2007, was compared with the verification on May 3, 2007, from the Secretary of State of Delaware, confirming that DB Partners was formed in that state on July 5, 2006. (*Compare* Exhibit 34 and 35 to Marooney March 2010 Affidavit). Further, while the Control Agreement accurately described DB Partners as a Delaware limited liability company, a corporate

resolution signed by Fred Deutsch, dated July 12, 2006, given to RBC, inconsistently and inaccurately again certified that DB Partners was a corporation organized under the laws of New York. At the very least, RBC was duty-bound to question the inconsistency in these representations so as to establish the correct identity of its debtor.

Whether the knowledge of RBCCM can be imputed to RBC remains a question of fact. Fred Deutsch executed an RBC Dain form on May 15, 2007, consenting to the sharing of information amongst the members of the RBC Financial Group. Although this form was executed approximately two weeks after the line of credit was issued, it appears that RBC obtained Deutsch's signature in connection with its diligence efforts related to its decision to extend credit to DB Partners (*see* Verified Petition, Exhibit EE). Additional connections between RBC and RBC Dain/RBCCM also existed. RBC specifically noted that Fred Deutsch was not required to provide a reference letter as typically required because he had been an RBC Dain customer for more than a year (*see* Marooney March 2010 Aff., Exhibit 44).

Citing UCC 8-105, Comment 4, RBC correctly points out, however, that knowledge may not be imputed throughout an organization under the UCC, and that only the knowledge of the specific individuals that conducted the transaction is relevant to establishing whether the organization had notice of an adverse claim. RBC argues that even if RBC Dain had notice, it cannot be shown that RBC had the requisite knowledge to put it on notice of the Parklex plaintiffs' adverse claim. Pursuant to UCC 8-105, "[a]pplication of the 'deliberate avoidance' test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization" (UCC 8-105, Comment 4). "Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts

indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication” (*id.*). However, “[a]n organization may also ‘deliberately avoid information’ if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions” (*id.*; *see also S.E.C.*, 386 F3d at 448).

Here, Adam K. Olszowy, the senior credit officer at RBC, is silent as to whether he was aware of the earlier subpoenas duces tecum or of an adverse claim against Fred Deutsch’s financial assets, but only states that the August 12, 2009 subpoena was the first third-party subpoena related to Fred Deutsch received by RBC. Moreover, RBC submitted credit documentation prepared by Lorraine McKeon, but did not clarify what her role was in the transaction, nor did RBC submit an affidavit from her. None of the affidavits submitted identify all of the individuals involved in the approval of the RBC transaction. None of the affidavits submitted clarify the extent of communication between RBC and RBC Dain, although it was evident that RBC must have communicated with RBC Dain, a signatory of the Control Agreement, to verify that the DB Partners’ accounts were valid collateral for RBC’s loan to DB Partners. None of the affidavits submitted speak to the potential interrelationship of RBC and RBC Dain’s in-house legal counsel which was in direct communication with petitioner, The Scher Law Firm, as counsel to the Parklex partners. If, as appears likely, RBC was privy to the information made known to RBCCM/RBC Dain prior to making the loan to DB Partners (such as the subpoenas, the multiple accounts in the names of various business entities all controlled by Fred Deutsch, inconsistencies in the information provided regarding DB Partners, and the shifting of funds among the various accounts held by RBC Dain), RBC had a duty to make further inquiry regarding the suspicious circumstances that

suggested the existence of adverse claims. Its failure to do so could only be attributed to deliberate avoidance or willful blindness, requiring this court to impute to RBC notice of the Parklex plaintiffs' adverse claim.

Conclusion

CPLR 5225 (b) provides:

“Upon a special proceeding commenced by the judgment creditor, against a person in possession or custody of money or other personal property in which the judgment debtor has an interest, or against a person who is a transferee of money or other personal property from the judgment debtor, where it is shown that . . . the judgment creditor's rights to the property are superior to those of the transferee, the court shall require such person to pay the money, or so much of it as is sufficient to satisfy the judgment to the judgment creditor.”

The evidence adduced upon the motion and cross motion clearly establishes merit to the petitioners' claims and requires the denial of the motion to dismiss. CPLR 409 (b) directs: “[t]he court shall make a summary determination upon the pleadings, papers, and admissions to the extent that no triable issues of fact are raised,” and “may make any orders permitted on a motion for summary judgment.” While petitioners have only moved for partial summary judgment, as no legal distinction can be made between petitioners' claims against the entirety of the assets held by RBCCM and its limited demand for the difference between all assets and RBC's claim of a security interest up to the balance owed by DB Partners on the loan, partial summary judgment is denied to petitioners. Because a triable issue has been raised regarding RBC's knowledge, through the employees directly involved in the subject transaction, of circumstances which would have placed it on notice of the Parklex plaintiffs' adverse claim to the assets contained in the RBCCM accounts of DB Partners, the court orders an immediate trial, pursuant to CPLR 3212 (c), to determine the

interrelationship between RBC and RBC Dain, now RBCCM, and the information known to RBC at the time the loan was made. The parties are directed to appear with their witnesses in Commercial Division Part I at 10 A.M. on July 6, 2010.

This constitutes the decision, order, and judgment of the court.

E N T E R,

J. S. C.