SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: _____ **J.S.C.** **PART** 39

Index Number : 602529/2008

HARBINGER

vs

WACHOVIA CAPITAL MARKETS,

Sequence Number : 005

DISMISS ACTION

INDEX NO. 602529/08

MOTION DATE _____

MOTION SEQ. NO. 005

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH
ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE _____ FOR THE FOLLOWING REASON(S):

Dated: 12/23/10

J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IA PART 39

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HARBINGER CAPITAL PARTNERS MASTER FUND I, LTD.; AURELIUS CAPITAL MASTER, LTD.; AURELIUS CAPITAL PARTNERS, LP; LATIGO MASTER FUND, LTD.; UBS WILLOW FUND, LLC; MISSOURI STATE EMPLOYEES' RETIREMENT SYSTEM; BLACKROCK GLOBAL FLOATING RATE INCOME TRUST; BLACKROCK LIMITED DURATION INCOME TRUST; BLACKROCK SENIOR INCOME SERIES; BLACKROCK SENIOR INCOME SERIES II; BLACKROCK SENIOR INCOME SERIES III PLC; MAGNETITE V CLO, LIMITED; BLACKROCK SENIOR LOAN PORTFOLIO; HARCH CLO II, LTD.; RZB FINANCE LLC; SUNAMERICA INCOME FUNDS HIGH YIELD BOND FUND; SUNAMERICA SERIES TRUST HIGH YIELD BOND PORTFOLIO; and VARIABLE ANNUITY LIFE INSURANCE COMPANY II HIGH YIELD BOND FUND,

Plaintiffs,

-against-

WACHOVIA CAPITAL MARKETS, LLC d/b/a WACHOVIA SECURITIES; BDO SEIDMAN, LLP; GREGORY J. PODLUCKY; ROBERT LYNN; KRONES INC.; KRONES AG; VOLKER KRONSEDER; and HEINZ SOMMER,

Defendants.

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DECISION/ORDER
Index No.602529/08
Motion Seq. No. 005

BARBARA R. KAPNICK, J.:

This action arises out of a massive fraud allegedly orchestrated by Le Nature's, Inc., ("Le Nature's" or the "Company"), a beverage manufacturer, bottler, and distributor based in Latrobe, Pennsylvania that led to the Company's bankruptcy and

ultimate demise.[1] Plaintiffs filed an Amended Complaint dated September 3, 2009 to include as defendants Krones AG (the German corporation that manufactures bottling systems), Krones, Inc. (the U.S. subsidiary of Krones AG that markets, sells, and installs Krones AG's products and services in the U.S.), Heinz Sommer (the former President of Krones USA), and Dr. Volker Kronseder (the CEO of Krones AG).[2]

Background

The relevant facts, which are drawn from the Amended Complaint ("AC") except where otherwise noted, are as follows. Krones AG, together with its subsidiary Krones Inc. (collectively "Krones") manufactured, sold and installed bottling equipment for use in Le Nature's' new beverage production facility in Phoenix, Arizona, the upgrade of Le Nature's' Latrobe facility, and a proposed facility in the southeastern United States (AC ¶ 12).

From 2004 through 2006, Krones allegedly embezzled money from certain equipment lessors (the "Lessors") by falsely representing that the cost of the equipment (and associated services) that

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[1] This Court issued a 40-page decision on May 10, 2010 on motions by the other defendants to dismiss the claims against them. Familiarity with that decision is presumed.

[2] A Second Amended Complaint was filed in or about March 26, 2010, but that does not affect this motion.

Krones was installing at Le Nature's was over double the actual cost. When the Lessors paid Krones the inflated price, Krones allegedly transferred, or kicked back, the difference between the actual cost and the amount Krones received from those Lessors to Le Nature's. Plaintiffs allege that these cash kickbacks - which eventually totaled approximately $118 million - were a critical element in the scheme to manipulate Le Nature's financial statements and induce lenders, including plaintiffs herein, to loan money to Le Nature's (AC ¶ 12).

Krones termed these kickbacks "excess payments," and allegedly explained them to the Lessors as refunds for deposits that Le Nature's had purportedly made on the equipment. The deposits, however, were entirely fictional. Krones knew that it never held $118 million of deposits from Le Nature's, yet it "refunded" tens of millions of dollars to Le Nature's under the false pretense that Le Nature's had deposited these amounts with Krones (AC ¶ 13).

In reality, the Amended Complaint asserts that Krones was thereby enabling Le Nature's to obtain from the Lessors additional financing that was not justified by the cost of the equipment. In doing so, Krones provided Le Nature's and its insiders with needed liquidity to keep the Company afloat. The Amended Complaint alleges

that the kickbacks to Le Nature's played a key role in Le Nature's' massive overstatement of sales revenue and net income (AC ¶ 13).

Plaintiffs also allege that each of the Krones defendants - including both Kronseder and Sommer personally - knew of the existence and extent of the fraud. Yet, the Amended Complaint asserts, for Krones' monetary gain, they took affirmative steps to assist the Le Nature's' insiders and others in their fraudulent scheme. These steps included (i) making false and misleading statements to the Lessors regarding the cost of the bottling equipment and the existence of the alleged equipment deposits held by Krones; (ii) providing fictitious documents reflecting an inflated purchase price for the Phoenix equipment; (iii) confirming fictitious invoices for bottling equipment; and (iv) making false statements to frustrate an investigation into a whistleblower's allegations (AC ¶ 14).

Based on this conduct, the plaintiffs assert that the Krones defendants allegedly aided and abetted the fraud conducted by Le Nature's and engaged in a conspiracy with Wachovia, BDO Seidman and the Le Nature's executives to fraudulently mislead plaintiffs or their predecessors, thereby generating hundreds of millions of dollars in fraudulent financing (AC ¶ 15).

The Amended Complaint sets forth causes of action against the Krones defendants for aiding and abetting fraud (eighth claim for relief) and civil conspiracy (ninth claim for relief).

The Krones defendants now move, pursuant to CPLR 3211(a)(7) and (a)(8), to dismiss plaintiffs' Amended Complaint as against them.

Defendants argue, in the first instance, that both of plaintiffs' claims must be dismissed for failure to plead any elements of the claims with sufficient particularity, pursuant to CPLR 3016(b).

The Court will deal with each claim individually.

Aiding and Abetting Fraud

The Krones defendants argue that Pennsylvania law controls here,[3] and that since Pennsylvania does not recognize a cause of action for aiding and abetting fraud, plaintiffs' claims against them must be dismissed.

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[3] Defendants maintain that Pennsylvania law should apply with particular force to the Krones defendants because there is no allegation in the Amended Complaint that any Krones party had any direct involvement with the credit facility or the alleged solicitation of plaintiffs in New York. Further, one of the Krones defendants, Mr. Sommer, is domiciled in Pennsylvania.

In opposition, plaintiffs argue, as they did on the previous motions, that like New York, Pennsylvania does recognize a cause of action for aiding and abetting fraud. Plaintiffs cite to two intermediate appellate court decisions in Pennsylvania, i.e., *Sovereign Bank v Valentino*, 914 A2d 415, 427 (Pa Super Ct 2007) and *Koken v Steinberg*, 825 A2d 723, 731 (Pa Commw Ct 2003) in support of this position. Plaintiffs also cite to *Kirschner v Wachovia Capital Markets, L.L.C.* (*In re Le Nature's Inc.*) 2009 WL 3571331 at *15 (WD Pa Sept. 16, 2009), in which Chief Judge Ambrose declined to dismiss the aiding and abetting claims asserted by the Liquidation Trustee of Le Nature's Liquidation Trust, predicting that the Supreme Court of Pennsylvania would adopt the Restatement (Second) of Torts §876 (b), providing for aiding and abetting liability. Therefore, plaintiffs argue there is no conflict of law between Pennsylvania and New York. Since there is no conflict, plaintiffs urge this Court to "dispense with the choice-of-law analysis and apply New York law." *See, Edison Fund v Cogent Inv. Strategies Fund, Ltd.*, 551 FSupp2d 210, 232 (SDNY 2008).

It is well settled that "[t]he first step in any case presenting a potential choice of law issue is to determine whether there is an actual conflict between the laws of the jurisdictions involved." *Matter of Allstate Ins. Co. (Stolarz)*, 81 NY2d 219, 223

(1993). "In the absence of substantive difference...a New York court will dispense with choice of law analysis; and if New York law is among the relevant choices, New York courts are free to apply it." *International Bus. Mach. Corp. v Liberty Mut. Ins. Co.*, 363 F3d 137, 143 (2d Cir. 2004).

Here, this Court finds that there is no conflict between Pennsylvania law and New York law with regard to aiding and abetting fraud, based on the holding of the two intermediate courts in Pennsylvania, *supra*, and Judge Ambrose's decision declining to dismiss the aiding and abetting claim asserted by the plaintiff in that case which emanates from the same underlying fraud as does this case. Therefore, dispensing with a choice of law analysis, this Court will apply New York law.

The elements of a claim for aiding and abetting fraud under New York law are (1) the existence of a fraud; (2) the defendants' knowledge of the fraud; and (3) the defendants' provision of substantial assistance to advance the fraud's commission. *Cromer Fin. Ltd. v Berger*, 137 FSupp2d 452 (SDNY 2001); *Egnotovich v Katten Muchin Zavis & Roseman LLP*, 18 Misc3d 1120(A) at *10 (Sup Ct, NY Co 2008).

Defendants argue that even if New York law applies, the Amended Complaint fails to demonstrate how any of the Krones defendants could have had knowledge of Le Nature's' financial statement fraud on plaintiffs. The Krones defendants also argue that plaintiffs' allegations that "Krones was aware of, or consciously disregarded" the fraud perpetrated by Le Nature's on plaintiffs (AC ¶ 339) "are insufficient under the actual knowledge standard" which is applicable in New York. *See, Williams v Bank Leumi Trust Company*, 1997 WL 289865 at *5 [SDNY 1997].

While plaintiffs concede that "actual knowledge" must be alleged in a claim for aiding and abetting fraud, *see, e.g. Kaufman v Cohen*, 307 AD2d 113, 125 (1st Dep't 2003), they contend that they need not allege direct evidence of their knowledge of the fraud and can rely on circumstantial knowledge since "[t]he element of scienter...is...most likely to be within the sole knowledge of the defendant and least amenable to direct proof." *Houbigant, Inc. v Deloitte & Touche*, 303 AD2d 92, 98 (1st Dep't 2003). *See also, American Baptist Churches of Metro. N.Y. v Galloway*, 271 AD2d 92, 101 (1st Dep't 2000) ("what the parties actually knew is a matter for discovery, since much of the information is in defendants' control").

Plaintiffs assert that, nonetheless, the Amended Complaint goes well beyond what is required to adequately allege the Krones defendants' actual knowledge of the fraud. Specifically, plaintiffs allege that Krones falsely represented that the cost of the equipment it was installing at Le Nature's was over double the actual cost, that it helped Le Nature's to create false documents as to the cost of the equipment and that it participated in the kickback scheme by which Le Nature's was able to manipulate its books and financial statements, obtain cash to keep the Company afloat and thus enable Le Nature's to obtain even more financing from lenders, such as the plaintiffs.

Plaintiffs argue further that Krones' assertion that it did not know Le Nature's would misuse the money or create false and misleading financial statements based on that money, requires a "leap of faith" that is wholly inappropriate on a motion to dismiss. Indeed, Le Nature's was able to secure new financing by misrepresenting its revenues, income, profits, and assets. Central to Le Nature's ability to misrepresent this information was its creation and recognition of millions of dollars of false deposits (AC ¶¶ 225-227). Further, the Krones defendants allegedly knew that they were funneling more than a hundred million dollars of unearned, essentially stolen money into Le Nature's (AC ¶¶ 218, 225).

Plaintiffs also urge the Court to reject the Krones defendants' attempt to "slice and dice" the fraud involved here into separate acts of wrongdoing, claiming that the alleged misrepresentations by the Krones defendants to the Lessors existed separate and apart from Le Nature's' fraudulent misrepresentations to the plaintiffs.

The defendants cite to the case of *Filler v Hanvit Bank*, 339 FSupp2d 553 (SDNY 2004), *aff'd* 156 Fed. Appx. 413 (2d Cir. 2005) to support their position. In *Filler*, however, there was no allegation that the defendants were aware of misconduct at the entity that defrauded plaintiffs; rather, the defendants were purportedly aware of fraud only at a subsidiary entity, and there was no allegation that the acts of the subsidiary should be attributable to the acts of the parent. The Amended Complaint here, in contrast, alleges that the Krones defendants knew of and were complicit in the fraudulent conduct at Le Nature's, and that plaintiffs were injured as a result of Le Nature's' fraud (*cf. Rosner v Bank of China*, 349 FedAppx 637 [2nd Cir. 2009]).

Therefore, it appears to this Court that plaintiffs have alleged with the requisite particularity that the Krones defendants played a central role in Le Nature's' fraudulent scheme by knowingly participating in the kickback of funds to Le Nature's,

enabling Le Nature's to fraudulently misrepresent their financial worth.

The movants next argue that the plaintiffs have failed to satisfy the "substantial assistance" element of an aiding and abetting fraud claim by failing to plead that the Krones defendants were active co-participants in the fraud claimed by plaintiffs. *See, In re Worldcom, Inc. Securities Litigation*, 382 FSupp2d 549, 560 (SDNY 2005); *Cromer Fin. Ltd. v Berger, supra.*

In opposition, plaintiffs argue that the critical test for "substantial assistance" is whether the alleged aiding and abetting conduct "made a substantial contribution to the perpetration of the fraud." *Pension Comm. of University of Montreal Pension Plan v Banc of America Securities, LLC*, 652 FSupp2d 495, 511 2009); *JPMorgan Chase Bank v Winnick*, 406 FSupp2d 247, 257 (SDNY 2005). Plaintiffs assert that the Amended Complaint more than adequately alleges such a substantial contribution. Specifically, it alleges that the Krones defendants affirmatively misrepresented the cost of the equipment and the existence of the deposits; created false documents with respect to equipment pricing; and affirmatively wired funds to Le Nature's that it knew the Company had no right to receive. This Court finds that these allegations in the Amended

Complaint are sufficient to show that defendants were active co-participants in the underlying fraud by Le Nature's.

Finally, the Krones defendants argue that plaintiffs have not alleged that any of their conduct was the proximate cause of plaintiffs' injuries, which is also necessary to satisfy the "substantial assistance" prong of the aiding and abetting fraud claim. *See, Stanfield Offshore Leveraged Assets, Ltd. v Metropolitan Life Ins. Co.*, 64 AD3d 4672, 476 (1st Dep't 2009); *Filler v Hanvit Bank*, 339 FSupp2d 553, aff'd 156 Fed Appx 413, *supra*.

However, plaintiffs argue that in New York, conduct proximately causes an injury if that injury is a "reasonably foreseeable result of the conduct." *Cromer Fin. Ltd. v Berger*, 137 FSupp2d 452, supra at 470.

Plaintiffs point to the fact that the Amended Complaint contains allegations that (1) Le Nature's' principal source of funding was from private parties, including lenders such as plaintiffs and their predecessors (AC ¶ 56); (2) the Krones defendants assisted Le Nature's in misleading Lessors to provide more than $100 million in excess of amounts required to pay for equipment from the Krones defendants (AC ¶ 218); (3) the Krones

defendants kicked back the excess amounts to Le Nature's thereby fueling the Company's continued fraudulent operations (AC ¶¶ 220-227); and (4) the Krones defendants assisted Le Nature's in lying about the amount of deposits made by the Company, which deposits were reflected as a substantial asset on the Company's financial statements (AC ¶¶ 207-208, 218-219). Given these allegations, this Court finds that plaintiffs have sufficiently alleged that it was "reasonably foreseeable" to the Krones defendants that Le Nature's would use the fruits of Krones' misconduct to mislead other investors, such as the plaintiffs or their predecessors, into providing unwarranted financing to Le Nature's.

This Court thus finds that that portion of the Krones defendants' motion seeking to dismiss the eighth cause of action for aiding and abetting fraud pursuant to CPLR 3211(a)(7) must be denied.

Civil Conspiracy

The Krones defendants next argue that the civil conspiracy claim fails under Pennsylvania law because plaintiffs have not pled that the sole purpose of the conspiracy was to injure plaintiff with malice.

Because New York law does not require a showing of malice or that injury to plaintiff is the "sole purpose" of the conspiracy, the Court must perform a choice of law analysis and determine which state's law applies. *K.T. v Dash*, 37 AD3d 107 (1st Dep't 2006). The New York interest analysis involves several steps and focuses on which jurisdiction "because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue raised in the litigation." *Babcock v Jackson*, 12 NY2d 473, 481 (1963).

Defendants argue that because the alleged conspiracy transpired in Pennsylvania, not New York, Pennsylvania is the forum with the greater interest with respect to plaintiffs' civil conspiracy claims and therefore this Court should apply Pennsylvania law. *See, Indosuez Intl. Fin. v National Reserve Bank*, 98 NY2d 238, 245 (2002). Since plaintiffs did not argue that New York has a greater interest, this Court will apply Pennsylvania law to the analysis of the civil conspiracy claim.

Pennsylvania courts have held that "[p]roof of malice, i.e., an intent to injure, is essential in proof of a conspiracy." *Thompson Coal Co. v. Pike Coal Co.*, 412 A2d 466, 472 (Pa Sup Ct 1979) and that this "requires a strong showing that the 'sole purpose of the conspiracy is to cause harm to the party who has

been injured' (citation omitted)." *Fleet Nat. Bank v Boyle*, 2005 WL 2455673 at *12 (ED Pa 2005); *Spitzer v Abdelhak*, 1999 WL 1204352 at *9 (ED Pa 1999).

Plaintiffs argue that the Krones defendants have failed to cite any Pennsylvania state court case adopting the "sole purpose to injure" requirement. Plaintiffs further contend that their allegations of intent are more than sufficient at the pleading stage. Finally, plaintiffs argue that their injuries were not merely an incidental side effect of Krones' otherwise legitimate business interest, but the "direct and proximate result" of Krones' unlawful conduct in furtherance of the conspiracy (AC ¶ 353). Plaintiffs state that this is all that is required under Pennsylvania law.

However, this court finds that there is a requirement to show malice under Pennsylvania law, and that in this case the plaintiffs have not alleged any facts showing malicious intent to injure. Rather, plaintiffs allege that the Krones defendants' goals in conspiring with Le Nature's were wholly self-serving, i.e., to "gain a stronger foothold" in the bottling equipment market and obtain further contracts from Le Nature's (Compl. ¶ 340). *See Guaranty Towers, LLC v Cellco Partnership*, 2007 WL 2617651 at *6 (M.D. Pa. 2007) (dismissing conspiracy claim on the ground that

plaintiff's allegations "that both defendants acted to obtain more revenue . . . are fatal to a civil conspiracy claim under Pennsylvania law"). Therefore, the cause of action for civil conspiracy is dismissed.

Jurisdiction Over Dr. Kronseder and Mr. Sommer

The Krones defendants next argue that plaintiffs have included no specific basis for alleging that this Court has personal jurisdiction over Dr. Kronseder or Mr. Sommer. They further contend that because such an exercise of jurisdiction does not comport with principles of due process, and is unreasonable, this Court should decline to exercise personal jurisdiction over these two defendants. Moreover, defendants assert that where a defendant is not shown to have a connection to New York, is not alleged to have acted in New York or to have been a party to a conspiracy that involves acts in New York and no plaintiff is alleged to have any connection to New York, common sense alone requires the Court to decline to exercise jurisdiction.

Under CPLR 302(a), "a court may exercise personal jurisdiction over any non-domiciliary . . . who in person or through an agent: (1) transacts any business within the state . . ."

The Court of Appeals has held that

> [t]o determine what constitutes a transaction of business we have been guided - as was the Legislature in enacting

> CPLR 302(a)(1) - by U.S. Supreme Court opinions delineating proper bases for personal jurisdiction under the Federal Due Process Clause (*see e.g. Longines-Wittnauer Watch Co. v Barnes & Reinecke*, 15 NY2d 443, 452, 458 [1965], citing, among other precedents, *International Shoe Co. v Washington*, 326 US 310, 316 [1945]). Thus, we have held that "[t]he overriding criterion" necessary to establish a transaction of business is "some act by which the defendant purposefully avails itself of the privilege of conducting activities within [New York]" (citations omitted). When a defendant engages in purposeful activity here, personal jurisdiction is proper because it has "invok[ed] the benefits and protections of [our] laws" (citations omitted).

Ehrenfeld v Bin Mahfouz, 9 NY3d 501, 508 (2007).

Here, neither Dr. Kronseder nor Mr. Sommer has any of the traditional contacts with New York necessary for personal jurisdiction under CPLR 302(a)(1), and nothing in the Amended Complaint establishes jurisdiction under this section. Dr. Kronseder lives in Germany and Mr. Sommer lives in Pennsylvania (Kronseder Decl. ¶ 5; Sommer Decl. ¶ 4); neither has ever lived, owned real estate, paid taxes, or voted in New York (Kronseder Decl. ¶ 7; Sommer Decl. ¶ 6); and neither has ever been to the state except on personal travel or for occasional business purposes not related to the subject of this litigation (Kronseder Decl. ¶ 8; Sommer Decl. ¶ 7).

Plaintiffs have similarly failed to come forward with any basis for jurisdiction under CPLR 302(a)(3), and have not made a "sufficient start" to warrant jurisdictional discovery.

Pursuant to CPLR 302(a)(3),

> a court may exercise personal jurisdiction over any non-domiciliary, ... who in person or through an agent:
>
> * * *
>
> 3. commits a tortious act without the state causing injury to person or property within the state, ... if he
>
> > (i) regularly does or solicits business or engages in any other persistent course of conduct, or derives substantial revenue from goods used or consumed or services rendered, in the state, or
> >
> > (ii) expects or should reasonably expect to have consequences in the state and derives substantial revenue from interstate or international commerce;

Here, this Court does not find any allegation in the Amended Complaint to even suggest that Dr. Kronseder or Mr. Sommer regularly conducts business in New York, derives substantial revenue from goods used or consumed or services rendered in New York, or that they should reasonably have expected that any of their actions would have consequences in New York.

Accordingly, that portion of the motion seeking to dismiss the Amended Complaint as to the individual defendants Volker Kronseder and Heinz Sommer is granted, and the Clerk shall enter judgment dismissing the Complaint as against said individual defendants with prejudice and without costs or disbursements.

Defendants Krones Inc. and Krones AG are directed to serve and file an Answer to the eighth cause of action within 30 days of entry of this Decision/Order.

A status conference is now scheduled for all parties remaining in this case on February 23, 2011 at 10:30 a.m.

This constitutes the decision and order of this Court.

Dated: December 23, 2010

BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK
J.S.C.