

At a Commercial Division Part 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 30th day of July, 2012

P R E S E N T:

HON. CAROLYN E. DEMAREST,
Justice.

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PARKLEX ASSOCIATES,
Plaintiff,

- against -

ROYAL CAPITAL MARKETS CORP., et al.
Defendants.

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**DECISION
AND
ORDER**

Index No. 25705/09

The following papers numbered 1 to 19 read on this motion: Papers Numbered

Notice of Motion/Order to Show Cause/Petition/ Cross Motion and Affidavits(Affirmations)Annexed	1,1-A, 1-B, 3
Opposing Affidavits (Affirmations)	4,7
Reply Affidavits(Affirmations)	8,12,13
Other Papers (Memoranda of Law)	2,5,6,9-11,14-19

The instant action parallels a special proceeding seeking the turnover of funds in the possession of defendants which were the proceeds of the sale of the sole asset of plaintiff Parklex Associates (Parklex) at the time and which had been improperly diverted from Parklex into accounts controlled by Fred Deutsch (Deutsch) who was also the sole principal of the general partner of Parklex, Parklex Associates, Inc. (PAI). That case, *The Scher Law Firm, as Nominee and Claimants' Representative v D B Partners I, LLC, RBC Capital Markets Corporation and Royal Bank of Canada*, Kings County Ind. No. 24633/2009, was decided by this Court, following an extensive hearing, on January 28, 2011 (27 Misc 3d 1230[A]) (hereinafter "DB Partners"). The Court's Decision and Order in that case was affirmed by the Appellate Division, Second Department, on July 5, 2012. Although the instant motion to dismiss pursuant to CPLR §3211 and plaintiff's cross-motion for summary judgment in this case were argued on August 2, 2011,

the Court deferred decision pending the decision of the Appellate Division because the issues raised herein were largely adjudicated in the earlier case. As the relevant facts are fully set forth in that decision, they need not be reiterated and that decision is incorporated herein by reference.

In this action, plaintiff Parklex seeks to recover damages against the defendants for their alleged negligence in failing to perform an “appropriate” inquiry into Deutsch and the accounts he had opened so as to prevent the diversion of funds from those accounts in violation of Parklex’s rights; for breach of fiduciary duty in failing to prevent the waste and diversion of funds in accounts held by entities controlled by Deutsch; and for aiding and abetting Deutsch’s breach of fiduciary duty to Parklex. It is essentially now undisputed that the funds transferred by Deutsch into the accounts he opened with Royal Capital Markets Corporation (RBCCM, formerly known as Dean Rauscher), a brokerage and financial services subsidiary of defendant Royal Bank of Canada (Bank), were the proceeds of the sale of plaintiff’s real property which Deutsch, as principal of Parklex’s general partner PAI, had the duty to preserve for the benefit of Parklex. The original case brought by plaintiff’s limited partner, Dietrich Holtkamp, challenging Deutsch’s diversion of the assets of Parklex, has been fully adjudicated, resulting in a judgment against Deutsch for \$44,163,637.53, inclusive of the funds derived from the sale of the real property which were improperly diverted into the RBCCM accounts created by Deutsch in various corporate and limited liability company names (*Parklex Associates v Parklex Associates, Inc.*, Kings County Index No. 14514/06). There is no question that Deutsch breached his fiduciary duty to plaintiff Parklex and its limited partners. The massive evidence adduced before this Court in multiple suits has also established that Deutsch created the various business entities that were used by him to open multiple accounts with RBCCM in order to defraud Parklex and its limited partners, and that Deutsch also violated temporary restraining orders issued by this Court, preventing the transfer of the funds held in the accounts of Parklex and PAI, by directly and indirectly transferring funds between accounts held at RBCCM in the name of PAI, Collateral Acquisition, LLC and D B Partners I, LLC. Deutsch also furthered his fraudulent scheme by obtaining a loan from the Bank with the assistance of the individual defendant employees of RBCCM who serviced his accounts. The Bank loan was secured by the assets in the D B Partners’ account so that funds could be obtained through the Bank without

disturbing the D B Partners' assets, which ultimately were recovered by the Bank when Deutsch defaulted on the loan. (See this Court's decision in DB Partners). The issue remaining in the instant action is whether defendants can be held answerable in damages for the losses sustained by Parklex as a result of Deutsch's fraud.

It is well-settled as a matter of law in New York that generally neither a bank, nor a brokerage, owes a duty to third parties with respect to any fraud or wrongdoing that may be perpetrated by a client of the bank (*Lerner v Fleet Bank, N A*, 459 F3d 273, 286 [2d Cir 2006]; *In re Agape Litigation*, 681 F Supp 2d 352, 359 [EDNY 2010]; *Winkler v Battery Trading, Inc*, 89 AD3d 1016, 1018 [2d Dept 2011]) or the brokerage (*Kolbeck v LIT America, Inc*, 923 F Supp 557 [SDNY 1996] (“Securities brokers do not owe a general duty of care or disclosure to the public simply because they are market professionals. . . . A duty of care arises only when the broker does business with the plaintiff. Then, the duty of the broker is to attend to the plaintiff's business with due care”)).

Plaintiff's first and second causes of action allege that defendants are liable for negligence in failing to investigate Deutsch and his accounts following service of subpoenas seeking information regarding Deutsch's deposits of large sums into accounts held at RBCCM, together with motion papers reflecting plaintiff's contentions that these sums had been improperly diverted in breach of Deutsch's duty to plaintiff. The fact that defendants were made aware of plaintiff's claims did not establish the validity of such claims and did not create any duty running from defendants to plaintiff's limited partners to act on their behalf (see *Kolbeck* at 7: “Defendants cannot be charged with knowledge of [Deutsch's] misconduct simply because they had knowledge of accusations against him, without more”).¹ “To prevail on a claim of negligence in New York, plaintiff must show that: (1) defendant owed a duty of care to plaintiff, (2) defendant breached that duty, (3) defendant's breach proximately caused injury to plaintiff” (*Kolbeck*, at 11; *Solomon v City of New York*, 66 NY2d 1026,1027 [1985]). Since it is

¹In the DB Partners decision, it was confirmed that the service of the subpoenas on RBCCM in October and November 2006 gave “actual knowledge” to RBCCM of plaintiff's adverse claim to the assets in Deutsch-controlled accounts (see also, Decision in DB Partners of June 3, 2010, 27 Misc 3d 1230[A]), but knowledge that an adverse claim existed did not establish actual knowledge of the truth of such allegations.

undisputed that plaintiff was not a client of any of the defendants, the element of duty cannot be established and the first and second causes of action fail to state a cause of action and must be dismissed.

The third and fourth causes of action in plaintiff's complaint allege that all of the defendants had a fiduciary duty to plaintiff, apparently also based upon the service of the subpoenas seeking documentary evidence relating to the depository accounts maintained at RBCCM and the Bank, which "should have" alerted defendants to plaintiff's claims that the funds in the PAI account "were at issue in the Parklex Action" and were thus "a result of a fraudulent conveyance" rendering such funds held in trust for Parklex. Again, the fact that plaintiff's limited partners were contesting Deutsch's right to the funds he had transferred into accounts held at RBCCM did not establish the validity of such claims. Though Deutsch did, in fact, have a fiduciary duty to plaintiff as the controlling principal of the general partner, and the recipient of fraudulently conveyed property may be deemed to be a constructive trustee of such property for the benefit of the defrauded party (*Securities and Exchange Commission v Credit Bancorp, Ltd*, 290 F 3d 80, 88 [2d Cir 2002]; cf, *Julien J. Studley, Inc v Lefrak*, 48 NY2d 954, 956 [1979]), the funds at issue were not transferred to the defendants, rather, defendants were merely the custodians of such funds which remained the property of Deutsch and his various businesses.² While it is true that the Bank took control of DB's assets as security for a loan, the Bank gave good faith fair consideration for such assets in loaning funds to DB Partners and such conveyance was not, therefore, fraudulent (see *In re Sharp*, 403 F3d 43 [2d Cir 2005]). Thus, *108-4 West 108th Street Realty, Ltd v Redwood Development, Ltd*, (220 AD2d 279 [1st Dept 1995]) and *Julien J Studley, Inc v Lefrank*, (66 AD2d 208 [2d Dept 1979]), upon which plaintiff relies, are inapplicable to this case.

²Plaintiff's reliance, in its Memorandum in Support (at p. 42), upon the trust provisions of Lien Law, Article 3A, to convert an ordinary depository account into a trust account for its benefit, is completely misplaced. The statutory trusts created under the Lien Law as a matter of public policy are expressly intended for the exclusive benefit of those who have contributed to construction and have not been compensated from funds earmarked for that purpose. There is absolutely no analogy between plaintiff's claims and the statutory rights conferred under the Lien Law.

Moreover, the accounts at issue here were all merely depository, and not trust accounts, so that defendants are not chargeable with any extraordinary duty to plaintiff to be accountable for diversion of funds known to be held in trust (see *Renner v Chase Manhattan Bank*, 2000 WL 781081, *14, 2000 US Dist LEXIS 8552, *43 [SDNY]; *In re Agape*, 682 F Supp 2d at 360; *Matter of Knox*, 64 NY2d 434, 439 [1985] (Even in a situation in which the account is of a fiduciary nature, “the bank is not the fiduciary’s guarantor”). Nor does the Bank Secrecy Act or the USA Patriot Act (31 USC §§5311 *et seq*, specifically §5318), create a private right of action for the failure to investigate allegedly “suspicious” activity in the accounts of a client (*In re Agape at 360*; *Aiken v Interglobal Mergers and Acquisitions*, 05-Civ-5503, 2006 US Dist LEXIS 45730 [SDNY 2006]). Notably, plaintiff did not serve a restraining notice upon defendants with respect to accounts controlled by Deutsch until 2009, after their claims had been reduced to a judgment by confession; at the time the plaintiff claims to have been defrauded by the transfers of funds between accounts controlled by Deutsch in 2006 and 2007, plaintiff had merely sought information via subpoena. To suggest defendants should be held accountable for breach of a fiduciary duty they owed to plaintiff to safeguard the funds plaintiff’s limited partners claimed had been improperly diverted, operates on a fallacious premise that far exceeds the bounds of defendants’ legal obligations.

Finally, it is noted, that, as to the Bank, this Court has already determined, upon evidence adduced at an extended trial, that the Bank was not made aware of the information available to RBCCM regarding the pending Parklex litigation and made all reasonable efforts to evaluate the efficacy of the loan made to Deutsch based upon the assets of D B Partners held in the RBCCM account. In any event, neither the Bank, nor RBCCM, had any duty whatever, fiduciary or otherwise, to plaintiff to make an investigation or protect its interest (see *In re Sharp Int’l Corp & Sharp Sales Corp.*, 403 F3d 43, 52, n.2 [2d Cir 2004]). Plaintiff’s third and fourth causes of action fail to state a cause of action and are dismissed.

Following affirmance by the Appellate Division of this Court’s prior determination, and in response to inquiries from counsel regarding the status of the instant pending motions, the parties were advised that the Court intended to address both motions pursuant to CPLR 3212

based upon the evidence adduced at the prior hearing, at which all parties were represented.³ At this Court's direction, both sides have submitted supplemental letter briefs relating to the effect of the appellate decision. Plaintiff has agreed that the first, second, third and fourth causes of action must be dismissed, acknowledging that that decision is res judicata and collaterally estops further litigation of those claims. However, plaintiff contends that the Court's findings of fact in DB Partners require that plaintiff be granted summary judgment against RBCCM and defendant Slevin upon its fifth and sixth causes of action.

Plaintiff's fifth and sixth causes of action, alleged against all of the defendants, seek damages for aiding and abetting a breach of fiduciary duty. These claims are again premised upon the service of subpoenas which, plaintiff claims, apprised defendants that Deutsch had a fiduciary duty to it relating to the funds in the various accounts maintained at RBCCM, and secured to the Bank, that required defendants to "to take steps necessary and reasonable to prevent diversion of the monies in the PAI and [Collateral Acquisition] account" which defendants failed to take, thereby assisting Deutsch "in concealing the monies from Parklex and thereby enabling [Deutsch] to breach his fiduciary duty to Parklex". Plaintiff alleges that each of the defendants "knew or should have known" that Deutsch had a fiduciary duty to it which had been breached. However, it is well-settled that such allegations are insufficient to make out a cause of action for aiding and abetting a breach of fiduciary duty.

"The elements of a claim for aiding and abetting a breach of fiduciary duty under New York law are: (1) a breach by a fiduciary of obligations to another, (2) knowing participation by defendant in the breach, and (3) damages to plaintiff" (*Kolbeck v LIT America, Inc*, 939 F Supp at 244, citing *S & K Sales co v Nike, Inc*, 816 F2d 843, 847-48 [2d Cir 1987]). There is no longer a question that Deutsch breached his fiduciary duty to plaintiff; however, under New York law, knowledge of that breach by defendants must be actual, and not, as plaintiff alleges, merely constructive (*Kaufman v Cohen*, 307 AD2d 113, 125-26 [1st Dept 2003]; *Kolbeck* at 245; *Agape* at 365). Moreover, substantial assistance, knowing participation and proximate causation must

³The individual defendants were not named parties in DB Partners, although some of them testified at the hearing, but they are represented, as employees of the defendants, by the same counsel to all defendants in this action.

be demonstrated (*Id.*). In *Kolbeck*, a case analogous to that herein, in which defrauded investors sought to recover losses from a brokerage that had been used in the fraud on a theory that it had aided and abetted the perpetration of the fraud, the court declined to permit the action to proceed based upon plaintiffs' own assertions that they had been swindled out of the money held in the brokerage accounts, finding such allegations insufficient to establish defendants' actual knowledge of the underlying breach of fiduciary duty (939 F Supp at 246). The court further found the *Kolbeck* complaint insufficient in demonstrating the required substantial assistance, noting that substantial assistance consists in affirmative action, intentional concealment or failure to act under a duty to do so. Quoting *Dillon v Militano* (731 F Supp 634, 639 [SDNY 1990]), the *Kolbeck* court held "inaction constitutes substantial assistance only when 'an independent duty to act was a duty owed to the defrauded investor'. . . That is, inaction, or a failure to investigate [like that alleged herein], constitutes actionable participation only when a defendant owes a fiduciary duty directly to the plaintiff; that the primary violator owes a fiduciary duty to the plaintiff is not enough" (939 F Supp at 247; see also, *Sanford/Kissena Owners Corp v Daral Properties, LLC*, 84 AD3d 1210, 1212-13 [2d Dept 2011]; *In re Sharp*, 403 F2d at 50-52; *Winkler*, 89 AD3d at 1018, quoting *Rosner v Bank of China*, 528 F Supp 2d 419, 427 [SDNY 2007]: "'fact that participants use accounts at a bank to perpetrate it . . . does not . . . rise to the level of substantial assistance'"; *Stanfield Offshore Leveraged Assets, Ltd v Metropolitan Life Ins Co.*, 64 AD2d 472, 476 [1st Dept 2009]).

As in *Kolbeck*, defendants herein, although made aware of plaintiff's pending lawsuit against their client Deutsch, owed no duty to plaintiff to intervene on plaintiff's behalf to investigate their client or protect, for plaintiff, assets that had been placed in their possession by their client. In retrospect, it is clear that Deutsch was using the services of RBCCM to conceal from plaintiff the location of the proceeds of the sale of its building and thereby frustrate plaintiff's recovery; however, there is no indication that defendants were active and knowing participants in Deutsch's breach of his fiduciary duty so as to render them liable for aiding and abetting such breach. The provision of routine financial services to a client does not constitute substantial assistance to the breach of the client's fiduciary duty to another, nor can the collection of fees for services rendered create a reasonable inference of fraudulent intent (see *Rosner*, 528 F

Supp 2d at 426-27; *Agape*, 681 F Supp 2d at 364-65; *Renner*, 2000 WL 781081 at *13, 2000 US Dist LEXIS 8552 at *38-42).

In his most recent submission to this Court, Austin Graff, Esq., counsel for plaintiff, argues that because I stated at oral argument of the motion on August 2, 2011, that I was “troubled” by “the aiding and abetting breach of duty”, such remark, together with my findings of fact contained in the DB Partners decision, constrain the Court to grant his client summary judgment against RBCCM and defendant Slevin on those causes of action on a theory of collateral estoppel. The Court finds no logic in that contention.

The issue before the Court in DB Partners was the right of the Bank, as a secured creditor, to obtain the security held by RBCCM in DB’s brokerage account which had been pledged to the Bank in return for a \$17 million loan. Uniform Commercial Code §8-510(a) was controlling of the case and plaintiff’s claim to turnover of the funds rested on whether the Bank had had knowledge of plaintiff’s adverse claim to the funds at the time it made the loan. The Court unequivocally found that the Bank did not have such knowledge, had given value for the security lien and was entitled to enforce its right to the collateral. In the instant case, plaintiff seeks to hold defendants answerable in damages for the losses it sustained as a result of Deutsch’s fraudulent breach of his fiduciary duty.⁴

Plaintiff’s claim depends upon the establishment of a duty owed to it by defendants. Although, based upon the evidence adduced at the prior hearing, this Court found that RBCCM employees Slevin and Kalata (who is not a defendant herein), as well as its attorney Michael Pysno, by virtue of the receipt of the subpoenas and motion papers, had actual notice of the adverse claim of plaintiff, their awareness of such allegations does not meet the requirement for the tort claim of aiding and abetting a breach of fiduciary duty, that they actually “knew” that such a breach had in fact occurred. Plaintiff’s insistence that the awareness of its limited

⁴In its Memorandum in Support, plaintiff recites, as its ad damnum, the sum of the balances in various Deutsch-controlled accounts on several dates relating to the service of the subpoenas, inclusive of the PAI account, the balance of which actually increased following service of the subpoenas. It is assumed that the balance in these accounts, in excess of the Bank’s right to the DB Partners’ funds, has been turned over to plaintiff pursuant to the restraining order and prior orders of this Court.

partners' claims created a duty, running to its benefit, to investigate Deutsch and the source of the funds deposited with RBCCM, or to impede Deutsch's diversion of such funds, is completely without merit in the circumstances. Any duty breached by RBCCM employees by their willful blindness to information that should have given rise to reasonable suspicions ran to the Bank, which stood to lose its collateral had such knowledge been imputed to it. Neither RBCCM, nor its employees, owed any duty to plaintiff to make inquiry or to restrain the use of the funds in its possession. Moreover, although RCBBM employees inadvertently facilitated Deutsch's fraud by creating the various accounts and by arranging for the Bank loan that enabled Deutsch to indirectly access funds invested through the DB account, such activity does not, as a matter of law, constitute substantial assistance. Plaintiff has not, therefore, established that it has a cause of action for aiding and abetting the breach of a fiduciary duty against any of the defendants. Accordingly, the fifth and sixth causes of action must be dismissed.

Conclusion

Defendants' motion to dismiss the complaint is granted pursuant to CPLR 3212 and plaintiff's motion for summary judgment is denied.

This constitutes the decision and order of the Court.

CAROLYN E. DEMAREST
JUSTICE OF THE SUPREME COURT