

**SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION
TRIAL TERM, PART 44 SUFFOLK COUNTY**

PRESENT: Honorable Elizabeth H. Emerson

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**THE HAMLET AT WILLOW CREEK GOLF &
COUNTRY CLUB HOME OWNERS
ASSOCIATION, INC.,**

Plaintiff,

-against-

**THE HAMLET AT WILLOW CREEK, LLC,
ELLIOT MONTER, RICHARD SPIRIO and
RON BLOOMFIELD,**

Defendants.

_____^x

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DECISION AFTER TRIAL

The Hamlet at Willow Creek is a residential community consisting of two separate condominium developments located in Mount Sinai, New York. The two developments are comprised of 75 and 102 homes, respectively, for a total of 177 homes. The plaintiff homeowners association was created for the purpose of owning and maintaining the common areas of the Hamlet at Willow Creek, including the parking areas and roadways. The defendant LLC was the Hamlet at Willow Creek's sponsor and selling agent. The individual defendants were the sponsor-designated members of the first board of directors of the homeowners association. They were also principals of the defendant LLC and officers or employees of the Holiday Organization, Inc., the parent company of the defendant LLC.

The plaintiff homeowners association commenced this action against the sponsor and the individual defendants alleging that the roadways and curbs were not constructed in accordance with the offering plan and that the projected budget found in the offering plan

included inflated payroll expenses, which had the effect of reducing the sponsor's obligation for deficiency assessments. The complaint contains five causes of action. The first three for breach of contract against the sponsor, fraudulent concealment against the sponsor, and breach of fiduciary duty against the individual defendants arise from the alleged failure to construct the curbs and roadways in accordance with the offering plan. The fourth and fifth causes of action arise from the alleged inflation of payroll expenses in the projected budget. The fourth cause of action against the sponsor does not specify any particular theory of recovery.¹ The fifth cause of action against the individual defendants is for breach of fiduciary duty.

The trial of this action was conducted on April 4-8, April 11-12, June 28-29, and October 24-25, 2011. Ernest Francis, a former member of the board of directors of the plaintiff homeowners association; Thomas Colona, an employee of Soil Mechanics Drilling Corp.; Domenico Iannucci, the president of DLI Contracting; George Kulik, a professional engineer; the defendant Richard Spirio; and Jerome Rosenberg, a certified public accountant, were called as witnesses for the plaintiff. The defendants Elliot Monter and Richard Spirio; Michael Mesiano, an engineering inspector for the Town of Brookhaven; Joseph Chase, chief financial officer of the Holiday Organizaton, Inc.; Mark Meinberg, a certified public accountant; and Walter Goldsmith, an attorney, testified for the defendants. The defendants moved for a directed verdict at the conclusion of the plaintiff's case and again at the conclusion of their case. The court reserved decision on the motion. Transcripts of the trial testimony and post-trial memoranda of law were received in chambers on or about July 24, 2012.

The Fourth and Fifth Causes of Action

The offering plan and the declaration of covenants, restrictions, easements, charges and liens expressly provide that the board of directors of the plaintiff homeowners association shall fix and determine the operating expenses for the homeowners association, which shall be assessed equally among the 177 homeowners. The offering plan also provides as follows:

The Sponsor's obligation "Sponsor's Deficiency Budget Responsibility" for such assessments on unsold Homes...subject to this Declaration will be limited to the difference between the actual operating costs of the Association, including reserves on the Common Properties and on Homes to which title has been conveyed, and the assessments levied on owners who have closed title on their Homes based on a full occupancy budget. In no event, however, will the Sponsor be required to make a deficiency contribution in an amount greater than it would otherwise be liable for if it were paying assessment on unsold homes....In addition, any

¹Although not denominated, the fourth cause of action appears to sound in fraud.

surplus from prior years shall be applied to increase the Association reserve fund.

The offering plan contains a projected budget for the first year of operation of the homeowners association based on a fully occupied and fully staffed development of 177 homes. The amount allocated for payroll expenses in such budget is \$315,868.27. The plaintiff contends that the payroll expenses were inflated because, during the first two years and nine months of its operation, the homeowners association did not retain all of the employees listed in the budget. The plaintiff presented evidence at trial that, by using the actual payroll numbers for the years 2004, 2005, and the first nine months of 2006 instead of the projected numbers, the sponsor's deficiency budget responsibility would have been \$215,249.88 greater, which would have created a surplus and increased the homeowner association's reserve account. The defendants presented evidence at trial that their calculation of the sponsor's deficiency budget responsibility was correct and in accordance with the offering plan. In their post-trial memorandum of law, the defendants argue, inter alia, that the fourth and fifth causes of action are barred by the Martin Act.

The Martin Act authorizes the Attorney General to investigate and enjoin fraudulent practices in the marketing of stocks, bonds, and other securities within or from New York State, including participation interests in real estate (**Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership**, 12 NY3d 236, 243). The Martin Act makes it illegal for a person to make or take part in a public offering of securities consisting of participation interests in real estate unless an offering statement is filed with the Attorney General (**Id.**). The disclosure regulations adopted by the Attorney General pursuant to General Business Law § 352-e (6) to cover newly constructed condominiums detail the format and content of offering plans and filings (**Id.** at 244). The Martin Act authorizes the Attorney General to enforce its provisions and implementing regulations and to seek restitution and damages for injured parties (**Id.**). The Attorney General bears sole responsibility for implementing and enforcing the Martin Act, and there is no private right of action thereunder (**Id.**).

The fourth and fifth causes of action are based on the plaintiff's claim that the defendants inflated the budget projections in the offering plan in order to decrease the sponsor's deficiency budget responsibility. The Martin Act and the regulations promulgated thereunder require an offering plan to contain projections of income and expenses (**Hamlet on Olde Oyster Bay Home Owners Assoc., Inc. v Holiday Org., Inc.**, 2007 NY Slip Op 34253[U], *9, *affd* 65 AD3d 1284). Any inaccuracies in the offering plan are violations of the Martin Act, which can only be prosecuted by the Attorney General (**Id.**). A private litigant may not pursue a common-law cause of action when, as here, the claim is predicated solely on a violation of the Martin Act or its implementing regulations and would not exist but for the statute (**Assured Guar. [UK] Ltd. v J.P. Morgan Inv. Mgt. Inc.**, 18 NY3d 341, 353). To accept such a claim as valid would invite a backdoor private cause of action to enforce the Martin Act when no private right to enforce that statute exists (**Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership**, *supra*

at 245).

Since the budget projections were included in the offering plan as required by the Martin Act (*see*, General Business Law § 352-e) and the Attorney General's implementing regulations (*see*, 13 NYCRR 22.3 [g]), they cannot form the basis for the fourth and fifth causes of action against the sponsor, its members and principals (*see*, **Hamlet on Olde Oyster Bay Home Owners Assoc., Inc. v Holiday Org., Inc.**, 65 AD3d 1284, 1287, *citing Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership*, *supra* at 245). The cases upon which the plaintiff relies predate the Court of Appeals' decision in **Kerusa** (*see*, **Caboara v Babylon Cove Dev., LLC**, 54 AD3d 79; **Country Point at Dix Hills Home Owners Assn., Inc. v Beechwood Org.**, 21 Misc 3d 1110[A] [Emerson, J.] or are not binding on this court (*see*, **Baker v Andover Assoc. Mgt. Corp.**, 30 Misc 3d 1218[A] [relying on **Caboara**]; **Board of Mgrs. of Woodpoint Plaza Condominium v Woodpoint Plaza LLC**, 24 Misc 3d 1233[A]). Accordingly, the court finds that the plaintiff may not prevail on the fourth and fifth causes of action because they are barred by the Martin Act.

In any event, the plaintiff failed to establish its budget claims by a preponderance of the evidence. The court is unpersuaded by the testimony and evidence presented by the plaintiff's accountant, Jerome Rosenberg, and credits the testimony and evidence presented by the defendants' accountant, Mark Meinberg, and condominium expert, Walter Goldsmith, Esq. Moreover, the record does not reflect that the individual defendants breached a duty other than, and independent of, that contractually imposed upon the board (*see*, **Brasseur v Speranza**, 21 AD3d 297, 298). In the absence of any independently tortious conduct, the individual defendants cannot be held liable for breach of fiduciary duty (*see*, **Murtha v Yonkers Child Care Assn.**, 45 NY2d 913, 915).

In view of the foregoing, the court finds in favor of the defendants on the fourth and fifth causes of action.

The First, Second, and Third Causes of Action

The offering plan provided that the roads and parking areas in the Hamlet at Willow Creek were to consist of a two-inch thick top asphalted concrete wearing course over a four-inch thick compacted stone blend over a six-inch stabilized base. The curbs were to consist of Belgian block with a four-inch reveal,² one-inch at all driveway entrances and handicapped curb cuts (i.e., drop curbs). The first three causes of action for breach of contract, fraudulent concealment, and breach of fiduciary duty, respectively, are based on the defendants' purported failure to construct the roads and parking areas in accordance with these specifications and those

²The reveal is the space between the top of the asphalt and the top of the curb.

of the Town of Brookhaven.³ In their post-trial memorandum of law, the defendants argue, *inter alia*, that the first three causes of action are barred by the Martin Act.

While **Kerusa** stands for the proposition that a private litigant may not pursue a common-law cause of action when the claim is predicated solely on a violation of the Martin Act or its implementing regulations and would not exist but for the statute, a plaintiff may bring a common law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act for its viability (**Assured Guar. [UK] Ltd. v J.P. Morgan Inv. Mgt. Inc.**, *supra* at 353). In **Caboara v Babylon Cove Dev., LLC** (54 AD3d 79), the Second Department held that causes of action to recover damages for common-law fraud and breach of contract based on affirmative misrepresentations in an offering plan were not preempted by the Martin Act. On a subsequent appeal in **Caboara**, the Second Department adhered to its prior determination, noting that **Kerusa** and **Hamlet on Olde Oyster Bay Home Owners Assoc., Inc. v Holiday Org., Inc.** (65 AD3d 1284) did not warrant a contrary result (**Caboara v Babylon Cove Dev., LLC**, 82 AD3d 1141, 1142-1143).

The violation at issue in **Kerusa** was an alleged omission from the filings required by the Martin Act and the Attorney General's implementing regulations (12 NY3d at 247). The **Kerusa** court expressly declined to decide whether an alleged affirmative misrepresentation of an item of information that the Martin Act or the Attorney General's implementing regulations required to be disclosed would support a cause of action for fraud as long as the elements of common-law fraud were pleaded (**Caboara v Babylon Cove Dev., LLC**, 82 AD3d at 1142, *citing Kerusa, supra* at 247 n 5). The violation at issue in **Caboara** was an affirmative misrepresentation in the offering plan. On the second **Caboara** appeal, the Second Department declined to overrule its prior holding in that case (**Id.**). The Second Department also declined to find that its holding in **Hamlet** extended **Kerusa** to preclude causes of action based on affirmative misrepresentations on the ground that they are preempted by the Martin Act. The Second Department distinguished **Hamlet** from **Caboara**, finding that **Hamlet** involved budget projections for new businesses, which are predictions or opinions, not statements of fact (**Id.** at 1143).

The plaintiff's first three causes of action are not based on any alleged omissions from filings required by the Martin Act or the Attorney General's implementing regulations, nor are they based on budget projections included in the offering plan as required by the Martin Act. Accordingly, the court finds that they are not barred by the Martin Act.

The first cause of action for breach of contract alleges that the defendants failed to construct the roads and parking areas in accordance with the offering plan and as required by the Town of Brookhaven. The elements of a cause of action for breach of contract are: (1) formation of a contract between the plaintiff and defendant, (2) performance by the plaintiff, (3)

³The Town's specifications are the same as those found in the offering plan.

the defendant's failure to perform, and (4) resulting damage (**Clearmont Prop., LLC v Eisner** 58 AD3d 1052, 1055). The parties agree that an offering plan is a contract (*see*, **511 W. 232nd Owners Corp. v Jennifer Realty Co.**, 285 AD2d 244, 247, *affd* 98 NY2d 144).

The record reveals that the roadways at the Hamlet at Willow Creek were paved with a two-inch thick top asphalt concrete wearing course in 2004 or 2005 (the "first lift"). In August or September 2006, the sponsor installed an additional one-inch thick asphalt concrete wearing course (the "second lift") on top of the first lift because the roadway had been damaged by heavy vehicles passing over it during construction of the development. The installation of the second lift repaired many of the defects in the roadway that had been brought to the sponsor's attention prior thereto, such as potholes and trenches. However, it reduced the curb reveals, particularly the one-inch drop curbs. At trial, the plaintiff sought to establish that the first lift was less than the two inches required by the offering plan; that the second lift reduced the curb reveals to less than four inches in some spots and to less than one inch, zero, or a negative number for a majority of the drop curbs; and that there was inadequate application of a tack coat between the first and second lifts, resulting in poor adhesion of the two lifts. The court finds that the plaintiff failed to establish its claims by a preponderance of the evidence.

The plaintiff introduced into evidence the results of core samples taken by Universal Testing & Inspection Services on June 26, 2006. The core samples measured the thickness of the pavement prior to the installation of the second lift. The report and testimony of the plaintiff's engineering expert, George Kulik, reveal that acceptable thickness has a tolerance of minus one-quarter inch to a maximum of three-quarters of an inch. Of the 43 core samples tested by Universal, only two had a thickness of less than 1.75 inches, and the average thickness of all samples was 2.21 inches. After the installation of the second lift, additional core testing was performed by Soil Mechanics Drilling Corp. The Soil Mechanics' report indicates the thickness of both the first and second lifts for 39 samples tested. The thickness of the second lift ranged from one-half inch to two inches. When the thickness of the second lift is added to the thickness of the first lift, the thickness of both lifts exceeds the two inches required by the offering plan for all 39 samples.

Ernest Francis testified for the plaintiff that, when the second lift was installed, the tack coat between the two lifts, which helps them to adhere to one another, was not sprayed over the entire road. Francis' testimony, however, is refuted by photographs that he took on the day the second lift was installed and by the testimony of Michael Mesiano, the engineering inspector for the Town of Brookhaven who was present with Francis when the second lift was installed. Mesiano testified that the application of the tack coat was acceptable. Mesiano also testified that a tack coat is not needed if the road is less than one-year old. Moreover, the Soil Mechanics' report introduced into evidence by the plaintiff shows a lack of bonding between the two lifts in only four out of 39 samples.

It is undisputed that, after the application of the second lift, the curb reveals were reduced to less than four inches in spots and 123 of the 177 driveways had drop-curb reveals of

less than one inch, zero, or a negative number. The parties' experts agreed that the main purpose of a curb reveal is to permit water to flow down to the catch basin and into the drainage system (i.e., "positive drainage"). Drainage is positive if the water flows along the curb line and there is no ponding of water more than 24 hours after a rainfall. The plaintiff's engineering expert, George Kulik, inspected the condition of the roadways at the Hamlet at Willow Creek on December 28, 2006, and again on January 8, 2007, after two inches of rain had fallen. Kulik's report and testimony reflect ponding in only two locations approximately six to eight hours after the rain had stopped. Kulik did not return to see if the ponding had dissipated within 24 hours.

Michael Mesiano testified that the reveal is not as important as the water flow at the curb line. Mesiano inspected the roads and curbs several times after the installation of the second lift in order to determine whether the sponsor's performance bonds should be released. He inspected the roads and curbs on September 12, 2007, less than 24 hours after a rainfall the day before, and did not see any ponding of water at that time. He inspected the roads and curbs again on August 6, 2008, within 24 hours after another rainfall, and took photographs of an area where there had been what he characterized as "extreme flooding."⁴ Mesiano did not see any flooding on August 6, 2008, and the photographs do not show any ponding at the location in question. Mesiano determined that the sponsor had constructed the roads in accordance with the specifications of the Town of Brookhaven and recommended that the Town release the sponsor's performance bonds. By a resolution dated November 25, 2008, the performance bonds were released.

The offering plan provided that the homes and common elements of the Hamlet at Willow Creek were to be constructed "substantially in the manner set forth in the engineering and Building Plans filed with and approved by the Town of Brookhaven." The plans for the roadways approved by the Town of Brookhaven contained the same specifications as the offering plan. The record reflects substantial compliance with those plans and the offering plan. Accordingly, the court finds in favor of the defendants on the first cause of action for breach of contract.

The second cause of action for fraud is based on the same factual allegations as the first cause of action for breach of contract. A cause of action to recover damages for fraud may not be maintained when, as here, the only fraud alleged relates to a breach of contract (*see, Rosen v Watermill Dev. Corp.*, 1 AD3d 424, 426). A cause of action will be found to sound in fraud rather than contract only when the legal relations binding the parties are created by the utterance of a falsehood, with fraudulent intent and reliance thereon, and the cause of action is entirely independent of the contractual relations between the parties (*see, Lee v Matarrese*, 17 AD3d 539, 540). The plaintiffs do not allege, nor does the record reflect, that the defendants made a material misrepresentation concerning an intention to perform a duty that was collateral

⁴Mesiano testified that the flooding at that location had been exacerbated by a water main leak.

or extraneous to the offering plan (**Id.**). Moreover, the record does not reflect that the defendants concealed any purported defects in the roadways of the Hamlet at Willow Creek. Rather, the record reflects that Ernest Francis, who served on the board of directors of the plaintiff homeowners association and on the grounds-and-maintenance committee, closely monitored the construction of the roads. Francis was a principal of Francis Bros. Sewage and Drainage and, as such, was fully familiar with the construction and installation of roads. He inspected the roadways prior to the installation of the second lift and made complaints to Michael Mesiano. He observed the preparation of the roads for the second lift, as well as the installation thereof. The record does not reflect that information about the roads and drainage was concealed from Francis or the plaintiff homeowner's association. Accordingly, the court finds in favor of the defendants on the second cause of action for fraud.

Finally, the court finds in favor of the defendants on the third cause of action for breach of fiduciary duty. The record does not reflect that the individual defendants breached a duty other than, and independent of, that contractually imposed upon the board (*see*, **Brasseur v Speranza**, 21 AD3d 297, 298). In the absence of any independently tortious conduct, the individual defendants cannot be held liable for breach of fiduciary duty (*see*, **Murtha v Yonkers Child Care Assn.**, 45 NY2d 913, 915).

Conclusion

The defendants are entitled to judgment in their favor on all five causes of action. The defendants' motion for a directed verdict is denied as academic.

Dated: November 16, 2012

J.S.C.