SCANNED ON 4/13/2007

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

PRESENT: Hon. KARLA MOSKOWITZ, Justice — PART 03

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INTER-ATLANTIC FUND, L.P.

Plaintiff,

- against -

WILLIAM G. ALVARO, GLOBAL GROUP HOLDINGS, INC.,

Defendants.

----------x

INDEX NO. 601611/2006

MOTION DATE _____

MOTION SEQ. NO. 001

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	

FILED
APR 13 2007
NEW YORK
COUNTY CLERK'S OFFICE

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying Decision and Order.

Dated: April 5, 2007

KARLA MOSKOWITZ 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: PART 3

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INTER-ATLANTIC FUND, L.P.

Plaintiff,

Index No. 601611/2006

- against -

WILLIAM G. ALVARO, GLOBAL GROUP HOLDINGS, INC.,

Defendants.

DECISION and ORDER

FILED
APR 13 2007
COUNTY CLERK'S OFFICE
NEW YORK

KARLA MOSKOWITZ, J.:

In this action by a private equity firm to recover a $4,000,000 investment in a mortgage banking concern, plaintiff alleges that it relied upon misrepresentations made by the company and its principal regarding corporate finances and regulatory compliance and that these misrepresentations induced plaintiff to advance the funds. Defendants move to dismiss the First Amended Complaint for failure to state a claim, failure to plead fraud with particularity and upon documentary evidence. (CPLR 3211[a][1], [7] and CPLR 3016[b]). The court denies the motion except to the extent set forth below.

The First Amended Complaint/Background

The following facts are from the First Amended Complaint, plaintiff's opposing affidavit and the relevant transactional documents annexed to the parties' submissions. Plaintiff Inter-Atlantic Fund, L.P. ("Inter-Atlantic") is a private equity fund that invests in early-stage companies. Defendant Global Group Holdings, Inc. ("Global Group") is a corporation that provides residential mortgage products. Global Group has two wholly-owned subsidiaries, non-parties Global Home Loans & Finance, Inc. ("Global Home Loans") and American Title Agency, Inc. (d/b/a Easy-Close Settlement Services) ("American Title") (collectively, "the Companies"). Global Home Loans offers mortgage banking

services, and American Title provides title and closing settlement services. Defendant William G. Alvaro ("Alvaro") is chairman, chief executive officer and sole stockholder of Global Group and chief executive officer of Global Home Loans.

In late 2003, Alvaro placed a newspaper advertisement seeking funding for mergers, acquisitions and expansion of the Companies' business. Inter-Atlantic responded, and, in early 2004, Alvaro sent Inter-Atlantic a "Confidential Memorandum" ("Memorandum") that non-party Global Home Loans had prepared. The Memorandum provided information regarding the Companies and outlined their plans to become a leader in the mortgage banking industry. Defendants also sent Inter-Atlantic balance sheets and statements of income as of December 31, 2002.

After reviewing the materials, Inter-Atlantic conducted due diligence into the Companies' operations. It retained an independent accounting firm to investigate the Companies' finances, internal accounting controls, the reasonableness of related-party transactions and material correspondence with municipal, state and federal regulatory agencies. Defendants provided three years of financial statements, access to the Companies' accounting firm and that firm's working papers for the year ending December 31, 2003 and materials relating to governmental permits, litigation, federal taxes and corporate minutes. Although Inter-Atlantic's independent accountant raised concerns regarding Global Home Loan's accounting practices, it found no material errors in its financial statements or deficiencies in regulatory compliance.

On July 16, 2004, Inter-Atlantic, Global Group and Alvaro entered into a Note and Warrant Purchase Agreement ("Agreement"). In exchange for providing $4,000,000 to Global Group, Inter-Atlantic obtained a 10% senior secured note from Global Group payable in 2009. Additionally, Inter-Atlantic obtained a warrant for 2,500,000 shares of Global Group's stock and entered separate agreements with the Companies under which Inter-Atlantic obtained security interests in their assets.

Alvaro also agreed to a limited personal indemnification provision. As is relevant here, section 8.4 of the Agreement provides:

> Alvaro shall indemnify and hold harmless [Inter-Atlantic] and its Affiliates and their respective directors, officers, and agents from and against any and all Losses solely arising out of or resulting from . . . a material breach of any representation or warranty of the Company set forth in ARTICLE III **as a result of fraud of the Company and/or Alvaro.**
> (Emphasis supplied).

Among the warranties and representations in Article III were those set forth in sections 3.7(a)-(b), in which Global Group asserted that various financial statements between December 2002 and April 2004 "fairly present the financial condition and changes in stockholders' equity . . . as at the dates and for the periods to which they apply . . . No false or artificial entry has been made in the books and records of the Company or any Company Subsidiary." Additionally, in section 3.12, Global Group represented and warranted that "[t]he Company and each of the Company Subsidiaries has heretofore operated in compliance in all material respects with all applicable laws, rules, regulations, codes, ordinances, orders, policies, and guidelines of all Government Authorities . . . ." Finally, in section 3.26, Global Group warranted that "[n]o representation . . . made by the Company or any Company Subsidiary in this Agreement . . . or any other Document delivered by or on behalf of the Company or any Company Subsidiary . . . contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained herein or therein not misleading."

In Article IV of the Agreement, Inter-Atlantic made several representations regarding its expertise and due diligence. In section 4.3, plaintiff acknowledged it had the opportunity to ask and receive information from representatives of the Companies regarding their finances and operations. In section 4.5, plaintiff warranted that it had substantial experience in making investment decisions and

that it understood that the investment the Agreement contemplated carried a high degree of risk. Further, section 4.7 of the Agreement provided:

> No oral or written representations have been made, and [Inter-Atlantic] has not relied upon any representations of any officer, director, employee or other personas related to this transaction except as otherwise set forth in this Agreement, the other Transactional documents or in any certificate, instrument or other document being delivered in connection herewith.

Additionally, the Agreement subjected plaintiff's obligation to close to the condition it "shall have completed all of its business, legal and accounting due diligence with respect to the Company and its business and operating plan and shall, in its sole judgment, be satisfied with the results thereof."

Simultaneously with the execution of the Agreement, Global Group executed a Senior Secured Note. Section 6 set forth various events of default. Under 6(c), the Note permitted acceleration if "[a]ny representation or warranty made by [Global Group] in the [Agreement] . . . shall have been untrue or misleading in any material respect as of the Closing Date."

Plaintiff alleges that, in the first quarter of 2005, it retained an auditing firm that identified numerous accounting irregularities in the Companies' 2004 financial statements. In particular, the firm noted that Global Home Loans and American Title had not reconciled cash and escrow accounts to detailed schedules; that American Title lacked detailed written documentation of its accounting procedures; that disparities existed between American Title's subsidiary ledgers and the general ledger; and that American Title lacked the internal controls to segregate escrowed fiduciary assets from general assets. The audit also revealed that American Title erroneously categorized loan payments held in escrow as "assets" and that American Title had commingled fiduciary funds with ordinary revenue in a manner that overstated revenue by approximately 400%. The opposing affidavit of plaintiff's managing director further alleges that American Title commingled its funds with money in

fiduciary accounts as of December 31, 2003; that Alvaro received money from branch managers that Global Home Loans' 2003 financial statements did not report; and that the 2003 financial statement of Global Home Loans and American Title inappropriately accounted for related party transactions among those companies as well as among Alvaro's other businesses.

In late 2004 Alvaro advised Inter-Atlantic that the New York State Banking Department was investigating Global Home Loans' operation of net branches. Additionally, at about the same time, the United States Department of Labor began investigating Global Home Loans for minimum wage violations in connection with its payment of certain loan originators. As a result of the federal investigation, Global Home Loans had to change its commission practices. As a result of the Banking Department investigation, Global Home Loans entered into a settlement that severely undermined its loan origination franchise. Global Home Loans had to (1) cease all net branching activities; (2) refrain from establishing any new branches for two years; (3) post an additional surety bond; (4) remain on probation for two years; and (5) pay $50,000 in fines.

The complaint alleges that Global Group's business significantly deteriorated in 2005. In May 2005, Fannie Mae advised Global Home Loans that it was in violation of the agency's net-worth requirements as a result of losses and the security interest granted to Inter-Atlantic. On December 2, 2005, the parties entered into an amendment of the agreement ("Amendment"), in which plaintiff agreed to release its security interests in Global Home Loans and waive its right to review the Companies' audited financial statements for 2004. In exchange, Global Group agreed to provide plaintiff with audited financial statements for 2005 by March 2006 and agreed that the failure to pay the Note by June 30, 2006 would constitute a default unless Global Group met certain net income goals that year. Global Group also agreed to reimburse plaintiff for expenses it incurred in connection with the Amendment.

Global Group did not provide the financial statements, meet the net income requirements or reimburse plaintiffs as the Amendment required. On May 8, 2006, plaintiff notified defendants that Global Group was in default of its obligations under the Agreement and the Amendment and declared the outstanding amounts of approximately $4.7 million due and payable. Global Group has not paid its indebtedness, and Global Home Loans allegedly surrendered its New York mortgage banking license effective May 17, 2006. This action followed.

The First Amended Complaint sets forth four causes of action. The first cause of action asserts that Alvaro and Global Group fraudulently induced plaintiff to enter into the Agreement, the Amendment and related transactions. The second cause of action pursues the same claim under a theory of negligent misrepresentation. The third cause of action demands a declaratory judgment that Alvaro indemnify plaintiff pursuant to section 8.4 of the Agreement, and the fourth cause of action seeks the same relief against Global Group. Plaintiff also seeks punitive damages against defendants.

Discussion

The court grants the motion to dismiss as to the fraud, negligent misrepresentation and punitive damages claims but otherwise denies it. On a motion to dismiss, the court must "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory." (Amay Indus., Inc. Retirement Trust v Brown, Raysman, Millstein, Felder & Steiner, 96 NY2d 300, 303 [2001]). The standard "is not whether the plaintiff has artfully drafted the complaint but whether, deeming the complaint to allege whatever can be reasonably implied from its statements, a cause of action can be sustained." (Stendig, Inc. v Thom Rock Realty Co., 163 AD2d 46, 48 [1st Dept 1990]). Further, the court may freely consider affidavits of the plaintiff to cure any defects in the pleading. (Rovello v Orofino Realty Co., 40 NY2d 633, 635 [1976]). Where, as here, a party submits documentary

evidence in support of its motion, a court grants dismissal only if the materials conclusively establish a defense as a matter of law. (Leon v Martinez, 84 NY2d 83, 88 [1994]). Ultimately, "the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one." (Guggenheimer v Ginzburg, 43 NY2d 268, 275 [1977]).

Liberally construing the complaint, as plaintiff's opposing affidavit supplements, the court finds that the third and fourth causes of action set forth a cognizable claim for breach of the Agreement against both defendants. Specifically, plaintiff may seek indemnification for its losses pursuant to section 8.4 of the Agreement to the extent it can prove that the representations and warranties in Article III regarding the Companies' 2003 financial statements and regulatory compliance were false. Plaintiff's allegations concerning the commingling of funds, improper accounting of funds received and related party transactions afford defendants with sufficient notice of the claims against them, as do the claims relating to the violations of banking and minimum wage laws. Although the relevant causes of action seek declaratory relief, the court deems them to plead ordinary contract claims. "A cause of action for a declaratory judgment is unnecessary and inappropriate when the plaintiff has an adequate, alternative remedy in another form of action, such as breach of contract." (Apple Records, Inc. v Capitol Records, Inc., 137 AD2d 50, 54 [1st Dept 1988]; see also Artech Information Systems, L.L.C. v Tee, 280 AD2d 117 [1st Dept 2001]).

Defendants center their objections on the complaint's reliance upon the Confidential Memorandum and various pre-contractual oral statements. Although the court concurs with defendants regarding the preclusive effect of the Memorandum's express disclaimers and the merger clause in the Agreement, plaintiff's opposition abandons reliance on extra-contractual representations in favor of the specific warranties in Article III of the Agreement. Similarly, defendants' objection to the complaint's improper reliance on post-closing accounting irregularities and non-compliance with

GAAP is moot given plaintiff's identification, in its opposing affidavit, of material, non-GAAP related violations in 2003 and earlier. Plaintiff has also alleged sufficient facts from which the court can infer that defendants knew their operations violated banking and labor laws prior to the closing, even if, as defendants correctly point out, plaintiff cannot charge defendants with failing to disclose the existence of the agency investigations that only commenced after the execution of the Agreement.

Defendants also suggest that plaintiff's contractually acknowledged status as a sophisticated investor and its extensive due diligence pursuant to the Agreement preclude it from claiming reasonable reliance on any misrepresentations. This argument is without merit insofar as the Agreement specifically grants plaintiff remedies to address misstatements in the warranties. These provisions would be meaningless if plaintiff's sophistication and diligence automatically barred any claim of fraud against defendants. To the extent defendants suggest that plaintiff had or should have had actual knowledge of the Companies' true financial condition or legal compliance, defendants are merely raising a factual question regarding reasonable reliance that is not amenable to resolution at this procedural juncture.

The causes of action for fraud and misrepresentation, however, are either superfluous or insufficient. A court dismisses as duplicative claims for fraud or fraudulent inducement that do not arise out of facts separate from or allege damages distinct from a contract or related cause of action. (See Town House Stock LLC v Coby Housing Corp., 36 AD3d 509 [1st Dept 2007]; Richbell Information Services, Inc. v Jupiter, 309 AD2d 288 [1st Dept 2003]; McMahan & Co. v Bass, 250 AD2d 460 [1st Dept 1998]); J.E. Morgan Knitting Mills, Inc. v Reeves Bros., Inc., 243 AD2d 422 [1st Dept 1997] [disallowing as duplicative fraud action based on false contractual warranty against undisclosed liabilities burdening property]; compare First Bank of the Americas v Motor Car Funding, Inc., 257 AD2d 287 [1st Dept 1999] [fraud claim based on contractual warranties permitted where

misrepresentations also concerned matters relating to loans not specifically addressed by warranties]). Where the parties have specifically contracted for remedies in the event of misrepresentation, the action should proceed in contract rather than tort. (See In Re Enron, 2005 WL 356985 at *11 [SDNY 2005]). Here, the parties negotiated a discrete indemnity provision to address "any and all losses" as a result of the defendant's fraud or misrepresentation.

Also, aside from demanding punitive damages (that I dismiss infra), plaintiff does not explain how the amount of damages it could obtain from breach of warranty or breach of the agreement is any different from what it could obtain through a fraud claim. Indeed, the damages plaintiff describes from the alleged fraud, namely its initial investment and accrued interest (see Pl. Opp. Mem. at 20), appear to be exactly the same damages that plaintiff could obtain through breach of contract. (Id. see also J.E. Morgan Knitting Mills, Inc. v Reeves Brothers, Inc., 243 AD2d at 423 [1997]).

Plaintiff's claims relating to the fraudulent inducement of the Amendment fail as a matter of law under CPLR 3016(b). "General allegations that a party entered into a contract with the intention not to perform it are insufficient to support a claim for fraud." (Town House Stock LLC v Coby Housing Corp., 36 AD3d 509, 509 [1st Dept 2007]). Moreover, statements of "prediction or expectation" are not actionable. (Naturopathic Labs Intern., Inc. v SSL Americas, Inc., 18 AD3d 404 [2005]). Nor are mere opinions regarding corporate performance. (See Longo v Butler Equities II, L.P., 278 AD2d 97 [1st Dept 2000]). Accordingly, plaintiff cannot premise a fraud claim upon allegations of Alvaro's alleged representations that business was "strong" or "promising" or that he would "do whatever [he] need[ed] to do to ensure the firm moves in the right direction and your investment is covered," particularly when he made these representations at a time when plaintiff concedes knowledge of the serious nature of the Companies' problems.

Finally, the court dismisses the plea for punitive damages. This garden-variety commercial dispute over a failed investment between sophisticated private parties does not implicate egregious tortious conduct directed at the general public. (New York Univ. v Continental Ins. Co., 87 NY2d 308 [1995]; Rocanova v Equitable Life Assur. Soc., 83 NY2d 603 [1994]); Rivas v Amerimed USA, Inc., 34 AD3d 250 [1st Dept 2006]).

Accordingly, it is

ORDERED, that the motion to dismiss is granted to the extent of dismissing the first and second causes of action and the plea for punitive damages, and those claims are severed and dismissed; and it is further

ORDERED, that the part of the motion to dismiss the third and fourth causes of action is denied to the extent that plaintiff may pursue those claims in contract; and it is further

ORDERED, that the Clerk shall enter judgment accordingly; and it is further

ORDERED, that the remainder of the action shall continue.

Dated: April 5, 2007

FILED
APR 13 2007
NEW YORK
COUNTY CLERK'S OFFICE

ENTER:

J.S.C.