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

PRESENT: BERNARD J. FRIED J.S.C. PART 60

Index Number : 602325/2004
PARU, MARDEN D.
vs
MUTUAL OF AMERICA LIFE INS.
Sequence Number : 001
DISMISS ACTION

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____
MOTION CAL. NO. _____

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

This motion is decided in accordance with the attached memorandum decision.

SO ORDERED

FILED
MAR 22 2007
COUNTY CLERK'S OFFICE
NEW YORK

Dated: 3/19/07

BERNARD J. FRIED J.S.C.
J.S.C.

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

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 60
----------X

MARDEN D. PARU, On Behalf of Himself and
All Others Similarly Situated,

Plaintiff,

Index No. 602325/04

-against-

MUTUAL OF AMERICA LIFE INSURANCE
COMPANY,

Defendant.

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For Plaintiff

Allegaert Berger & Vogel LLP
111 Broadway, 18th Floor
New York, New York 10006
(Louis A. Craco, Jr.
Cornelius P. McCarthy)

Beatie and Osborn LLP
521 Fifth Avenue, 34th Floor
New York, New York 10175
(Daniel A. Osborne)

For Defendant

Proskauer Rose LLP
1585 Broadway
New York, New York 10036
(Richard L. Spinoggatti
Karen D. Coombs
Matthew Rothman)

Fried, J.:

Defendant Mutual of America Life Insurance Company (Mutual) moves to dismiss the amended complaint, in this putative class action alleging wrongdoing in relation to

Mutual's oversight of a variable annuity plan. Plaintiff Marden D. Paru[1], bringing this action on behalf of himself and other similarly situated persons, cross-moves for leave to file a Second Amended Complaint.

Plaintiff purchased a variable annuity contract from Mutual, a life insurance company authorized to sell such contracts. Annuities are often chosen by investors, such as plaintiff, as long-term investment vehicles. Annuity purchasers allocate their premiums to the purchase of shares in various mutual fund alternatives, or sub-accounts. The annuity holder has the freedom to elect to add to, or transfer, funds from his or her sub-account at any time, although, as a long-term investment option, such trading is not, apparently, the norm. The holder of the annuity contract does not own shares in the sub-account, but rather, acquires Accumulation Unit Values (AUV). Plaintiff, and the class which he seeks to represent, chose to allocate some or all of their investment to the variable annuity fund known as the Scudder Variable Series: International Portfolio (the Scudder Fund).

As its name implies, the Scudder Fund trades on the international market. The calculation of the Scudder Fund's total assets less liabilities, the Net Asset Value (NAV), is calculated at the end of each business day in New York (4:00 P.M.) at the last trade price existing in the home market of each investment. Because these foreign exchanges may have closed hours before the NAV is calculated, the closing prices on the foreign exchanges are "stale," because they do not reflect events which occur after they have closed. Therefore, the NAV (from which the AUVs are calculated), is also "stale," and does not reflect market

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[1] Paru was substituted for the original plaintiff, Harriet P. Epstein.

influences which may affect the value of the fund's shares in the foreign exchanges.

As might be expected, certain investors have found a way to maximize their own investments based on this discrepancy. "Market timers," using up-to-date information which will likely affect the price of shares in the Scudder Fund sub-accounts, trade in and out of the Fund rapidly, so as to take advantage of that information. As a result, market timers increase their own holdings at the expense of the Fund's NAV, which is lowered by the practice, lowering, along with it, the value of each long-term investor's AUV. Market timing also increases transaction fees within the Fund, to the detriment of investors. The practice is not, however, illegal.

Plaintiff's amended complaint alleges breach of fiduciary duty on the part of Mutual for permitting market timing to occur in the variable annuity contracts. The action was removed to the United States District Court, Southern District of New York, on Mutual's motion, and designated *Paru v Mutual of America Life Insurance Company*, No. 04 Civ 6907 (*Paru*). Mutual argued that the action belonged in federal court because it was preempted by the federal Securities Litigation Uniform Standards Act of 1998, 15 USC § 77bb (f) (1) (SLUSA). Plaintiff moved to remand the action to state court, where it now resides.

Initially, the cross motion to amend the amended complaint is granted in part. Mutual concedes plaintiff right to amend, insofar as he seeks to seeks to add a claim for contractual breach of the implied covenant of good faith and fair dealing, on the ground that the court is bound to permit amendment, as an exercise in the liberal approach to amendment generally applied by New York courts.

Mutual is correct that plaintiff should not be permitted to cannot amend his amended

complaint to include a cause of action for breach of fiduciary duty, especially since Plaintiff recognizes that "as a general matter under New York law, the relationship between an insurance company and its customers is contractual and not fiduciary" (Plt. M.O.L, p. 7, n.3). *See Uhlman v New York Life Insurance Company*, 109 NY 421 (1888); *Rabouin v Metropolitan Life Insurance Company*, 182 Misc 2d 632 (Sup Ct, NY County 1999), *affd on op below* 282 AD2d 381 (1st Dept 2001). Moreover, Plaintiff has failed to allege any special relationship between himself and Mutual at all, much less any facts which might make the matter a jury question. Indeed, in its concluding paragraph, Plaintiff that the facts alleged "possibly [state a claim] for breach of fiduciary relation". (Plt. M.O.L, p. 22). This is insufficient to withstand defendants' opposition. Therefore, plaintiff may amend, but cannot proceed on his claim for breach of fiduciary duty. Consequently, Mutual's motion to dismiss is properly addressed to the single cause of action remaining in the second amended complaint, the implied covenant of good faith and fair dealing.

In *Paru*, Judge Sprizzo reviewed whether SLUSA precluded the bringing of the action in the state court. Judge Sprizzo determined that SLUSA did not apply, and remanded the action to state court.

Paru is not binding on this court. While Mutual's appeal of *Paru* was pending, the United States Supreme Court issued an order stating that remands pursuant to SLUSA were not appealable in federal court, and had no collateral estoppel effect. *Kircher v Putnam Funds Trust*, -US-, 126 S Ct 2145 (2006). Therefore, the matter must be reviewed de novo.

Upon review of the applicable case law, and the facts as alleged in the present case, I conclude that the action is not precluded by SLUSA, and the Second Amended Complaint

may be filed, as limited above.

On a motion to dismiss, the court construes the complaint liberally. *511 West 232nd Owners Corporation v Jennifer Realty Company*, 98 NY2d 144 (2002); *Burrowes v Combs*, 25 AD3d 370 (1st Dept 2006). The court accepts the facts as alleged in the complaint as true, and accords the plaintiffs the benefit of every favorable inference, while determining only whether the facts as alleged fit into any cognizable legal theory. *511 West 232nd Owners Corporation v Jennifer Realty Company*, 98 NY2d 144, *supra*; *Bishop v Maurer*, 33 AD3d 497 (1st Dept 2006).

SLUSA provides, in pertinent part:

> (1) Class action limitations
>
> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State of Federal court by any private party alleging:
>
> (1) an untrue statement or an omission of a material fact in connection with the purchase or sale of a covered security;
>
> or (2) That the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

15 USC § 78bb (f) (1). The statute was passed to ensure that the federal courts be the "exclusive venue for class actions alleging fraud in the sale of certain covered securities." *Paru v Mutual of America Life Insurance Company*, 2006 WL 1292828, *2 (SD NY 2006).

As explained in *Paru*, an action must be removed under SLUSA when "(1) the underlying suit is a 'covered class action', (2) the action is based on state or local law, (3) the action concerns a 'covered security', and (4) the plaintiff has alleged that the defendant misrepresented or omitted a material fact or employed a manipulated or deceptive device or

contrivance in connection with the purchase or sale of a security." *Id.* at *2; *see also Dabit v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F3d 25 (2d Cir 2005), *vacated on other grounds* 126 S Ct 1503 (2006). In *Paru*, it was agreed that only the last requirement was at issue. In granting remand, the court determined that plaintiff's amended complaint was not based on allegations of misrepresentations or omissions of material fact which might trigger SLUSA.

In the federal court, Mutual contended that plaintiff's amended complaint, no matter how it was worded, was based on the allegation that Mutual failed to tell plaintiff that market timing was going on, an omission or misrepresentation, either explicit or implicit, of Mutual's alleged promise to plaintiff to see that the Fund was not tainted with the practice. Mutual contends that plaintiff is attempting to use artful pleading to avoid the preclusive effect of SLUSA. Plaintiff maintains that his action is based on Mutual's failure to act to protect plaintiff, which is neither a misrepresentation nor an omission.

In *Paru*, plaintiff's original complaint contained allegations that Mutual had made misrepresentations or omissions concerning the existence of market timing in the Scudder Fund. These allegations were removed when plaintiff served its pared-down amended complaint. Regardless, Mutual argued that the amended complaint still contained, and was based upon, implicit allegations of a misstatement or omission, as follows: (1) the allegation that Mutual held itself out as an expert in long-term investments, thus representing that it would prevent such things as market timing to occur; (2) that the allegations in the amended complaint were necessarily based on the non-disclosure that market timing was taking place, regardless of the wording of plaintiff's claim; and (3) the allegation that the NAV was stale

was actually an allegation that the NAV was false, and therefore, "constituted a misstatement each time it was issued." *Paru*, at *4. However, the *Paru* court, in remanding the action to this court, found that the amended complaint did not "contain a single representation or omission of material fact made by defendant which could trigger SLUSA preemption." *Id.* at *5.

There have been a variety of cases which address the issue of when a securities action is precluded by SLUSA, based on the facial or implicit allegation of misstatement or omission. In *In re Mutual Funds Investment Litigation* (384 F Supp 2d 845 [D MD 2005])(*In re Mutual*), a case decided subsequent to *Paru*, Judge Motz of the United States District Court, District of Maryland, was faced with the same question of whether market timing cases are precluded by SLUSA as that which now stands before this court. The complaint in *In re Mutual* contained causes of action for breach of fiduciary duty/constructive fraud, aiding and abetting breach of fiduciary duty, and unjust enrichment. Although the plaintiffs in *In re Mutual* argued that none of their claims were preempted because "none of the claims require[d] proof of fraud or misrepresentation as a necessary component," Judge Motz found that the "elements of the state law claims" where preempted "on the face of the complaint," and would therefore be dismissed, with leave to replead without reference to allegations of misrepresentation or omission. *Id. at 871.* However, Judge Motz, in dicta, expressed his doubts that any claim could be stated which would not be based on misrepresentations or omissions.

The "necessary component" test is set forth in *Xpedior Creditor Trust v Credit Suisse First Boston (USA) Inc.* (341 F Supp 2d 258 [SD NY 2004]) (*Xpedior*). The court in *Xpedior*

states that

> [u]nder SLUSA, regardless of the words used by a plaintiff in framing her allegations and regardless of the labels she pastes on each cause of action, a court must determine whether fraud is a *necessary component* of the claim. Under this test, a complaint is preempted under SLUSA when it asserts (1) an explicit claim of fraud or misrepresentation (*e.g.*, common law fraud, negligent misrepresentations, or fraudulent inducement), or (2) other garden-variety state law claims that "sound in fraud" [emphasis in original]."

Id. at 261.

After a discussion of case law in various jurisdictions, the *Xpedior* court goes on to explain that, to make a determination as to whether a misrepresentation or omission is a necessary component of a claim, "the simple inquiry is whether plaintiff is pleading fraud in words or substance." *Id.* at 268. The court then explains that courts are to look to the gravamen of the complaint, and that "the real question was whether the claim was based on fraudulent conduct, regardless of the appearance of the words 'fraud' or 'misrepresentation.'" *Id.* The court expresses its belief that the "necessary component" test "makes a good deal of sense," and is a "practical rule that is easily followed by courts assessing claims of SLUSA preemption." *Id.*; *see also Gurfein v Ameritrade, Inc.*, -F Supp 2d-, 2006 WL 2959146, *1 (SD NY 2006)(breach of contract claim "does not rely on, or need, any assertion of misrepresentation or omission").

There are other approaches to determining whether SLUSA is implicated in a securities action. In *Rowinski v Salomon Smith Barney* (398 F3d 294 [3d Cir 2005]), the Court refused to find a difference between whether an allegation of misrepresentation or omission was a legal element of a cause of action, or whether it was a factual allegation underlying the claim. It held that "[p]laintiff's suggested distinction - between the legal and

factual allegations in a complaint - is immaterial under [SLUSA]." *Id.* at 300. Rather, the Court looked at whether the allegations of material misrepresentation "serve as the factual predicate of a state law claim." *Id.* Therefore, the complaint, which was "replete" with allegations of misrepresentation (*id.* at 298), satisfied the misrepresentation requirement in SLUSA. *In re Mutual* relies on *Rowinski*, but, in fact, suggests that *Xpedior* is not to the contrary, since *Xpedior* holds that a court must "probe the pleading" and look beyond the "technical elements of the claim' to the "factual allegations intrinsic to the claim as alleged." *In re Mutual* , 384 F Supp 2d at 872, quoting *Xpedior*, 341 F Supp 2d at 256-266.

As the court stated in *Paru* (2006 WL 1292828, *3)

> [w]hile this Court is mindful that plaintiff may not escape SLUSA preemption through artful pleading meant to disguise allegations of misstatements or omissions, it is similarly mindful that defendant may not recast plaintiff's Complaint as a securities fraud class action so as to have it preempted by SLUSA.

In the present action, plaintiff's original complaint contained allegations of misrepresentations or omissions to support several causes of action, including breach of fiduciary duty. While it appears that the amendment of that complaint was to avoid SLUSA preemption, it does not mean that the resulting amended complaint fails to do so, or that there are allegations of misrepresentation or omission still lurking behind plaintiff's present claim.

First, Mutual maintains that, when plaintiff alleges that the NAV becomes "stale" with the passage of time, he is alleging that the NAV was untrue, that it was, effectively, an explicit misrepresentation. However, as the *Paru* court noted, the NAV is not untrue merely because it becomes outdated. The damage to plaintiff comes from "an inherent inefficiency" in the pricing of the value of the Fund, not a misrepresentation. *Paru*, at *4.Next, Mutual

points to plaintiff's allegation that Mutual held itself out as an expert in investments. Mutual contends that the "essence" of this allegation is that Mutual represented that it would protect plaintiff from market timing. However, as the *Paru* court noted, it is the damage market timing does to the long-term performance of the Fund, and Mutual's failure to act to protect its investors that formed the basis for plaintiff's claim. Thus, the *Paru* court found that "non-disclosure of market timing timing is not a necessary allegation implicit in the Complaint." *Id.* In making this finding, *Paru* followed *Xpedior* in requiring that a court look "beyond the face of the Complaint to the substance of plaintiff's allegations," resulting in the finding that allegations of misrepresentation, implicit or explicit, did not underlie plaintiff's cause of action. *Id.* at *3.

Mutual responds that plaintiff's present claim is also based on an implicit promise to inform plaintiff that market timing was occurring in the Fund. However, while plaintiff could have alleged that, it is not required that he do so in order to allege that Mutual failed to follow its obligation with regard to plaintiff.

I agree with that the gravamen of plaintiff's complaint is not based on misrepresentations at all, despite the fact that it could be, and that the plaintiff's action does not require misrepresentations to be valid. "Simply because the operative facts of a complaint *can* give rise to a claim of fraud does not mean that the complaint *must* be read as alleging fraud [emphasis in original]" (*Xpedior*, 341 F Supp 2d at 268), and "[t]he choice of legal theories is a strategic choice to be made by plaintiff, and neither the court nor the defendant is permitted to override that choice." *Id.* Mutual does not have the right to recast

plaintiff's allegations so as to cause the action to be precluded under SLUSA.[2]

As a result, it is

ORDERED that defendant Mutual of America Life Insurance Company's motion to dismiss the amended complaint is denied; and it is further

ORDERED that plaintiff Marden D. Paru's cross motion to file a Second Amended Complaint is granted, to the extent stated in this decision; and it is further

ORDERED that defendant is directed to serve an answer to the complaint within 20 days of service of this order with notice of entry; and it is further

ORDERED that a Preliminary Conference will be held on April 18, 2007 at 10:30 a.m.

Dated: 3/19/07

ENTER:

J.S.C. BERNARD J. FRIED J.S.C.

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Mutual refers to a statement in *Xpedior*, describing the facts in *Dudek v Prudential Securities, Inc.* (295 F3d 875 [8th Cir 2002]), in which the Dudek court relied heavily on misrepresentations which were strategically deleted in order to avoid SLUSA, but which still permeated the remaining causes of action. This is not the case in the present action, where, as the *Paru* court noted, plaintiff's cause of action simply did not contain allegations of misrepresentation.