

CSAM Capital Inc. v Lauder

2008 NY Slip Op 30209(U)

January 17, 2008

Supreme Court, New York County

Docket Number: 0601376/2007

Judge: Herman Cahn

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

PRESENT: Cahn
Justice

PART 49

CSAM Capital Inc., et. al.

INDEX NO. 601376/07

- v -

Ronald S. Lauder, et. al.

MOTION DATE _____

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

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

Notice of Motion/ Order to Show Cause -- Affidavits -- Exhibits ...

Answering Affidavits -- Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE.....

FILED
JAN 25 2008
NEW YORK
COUNTY CLERK'S OFFICE

Dated: 1/17/08

[Signature]
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 49

-----X

CSAM CAPITAL INC., CREDIT SUISSE
ASSET MANAGEMENT, LLC, and
CREDIT SUISSE FIRST BOSTON, LLC,

Petitioners,

-and-

Index No. 601376/07

RONALD S. LAUDER; IAN F. LANDY
and KAREN E. LANDY, Individually and
as Trustees of the Ian F. Landy Revocable
Trust; LEV VOLFTSUN and
MARGARITA VOLFTSUN, Individually
and as Trustees of the Margarita Volftsun
Revocable Trust and the Lev. Volftsun
Revocable Trust; JOSEPH
AUGENBRAUN; JAMES N. HELLER and
DEBBIE L. HELLER; JAE HEA EDWARD
LEE; NOAM BARDIN and SHIMMY
ZIMELS; NIR TARLOVSKY, as General
Partner of the Tarlovsky Investment
Partnership; ITZHAK FISHER; and DAVID
A. DILL,

Respondents.

-----X

FILED
JAN 25 2008
NEW YORK
COUNTY CLERK'S OFFICE

Herman Cahn, J.

Petitioners move to dismiss an arbitration proceeding commenced by respondents, based on statute of limitations grounds, CPLR 7502(b) and 7503(b).

BACKGROUND

Respondents were investors in DLJ Emerging Growth Partners, LP (the "Fund"), an exchange fund that was launched in 1999 and offered by Donaldson Lufkin and Jenrette Securities Corporation ("DLJ"). Exchange funds permit investors to receive a limited

partnership interest in a pool of securities, which provides certain tax advantages. The Fund was comprised of newly-public, small-cap stocks, with little or no histories.

At some point thereafter, petitioner CSAM Capital began managing the Fund, as a result of a merger, and is the current general partner of the Fund.

Petitioner Credit Suisse Asset Management LLC ("CSAM LLC") is the parent company and sole shareholder of CSAM Capital, which respondents allege directed the actions of, and exercised control over, CSAM Capital. Petitioner Credit Suisse First Boston, LLC is the parent company of CSAM LLC and is also the successor to DLJ, which initially offered the Fund at issue here. The investors allege that the managers and employees responsible for the Fund were employees of DLJ and/or Credit Suisse First Boston, LLC.

Prior to investing in the Fund, all prospective investors received a Private Placement Memorandum ("PPM") and a Subscription Booklet, detailing the substantial risks of the investment. The Fund's initial closing took place in September 1999. Petitioners allege that each respondent invested in the Fund in either September 1999, March 2000 or June 2000.

In 1999 and 2000, the Fund performed extremely well. However, by September 2002, the Fund's value had declined substantially – having lost 90% of its value. It has never recovered.

On April 9, 2007, respondents filed the Statement of Claim and Demand for Arbitration with the American Arbitration Association ("AAA") alleging that petitioners made misrepresentations in order to induce them to invest in the Fund. The Statement of Claim includes allegations of fraud in the inducement, breach of contract, breach of fiduciary duty and gross negligence.

Shortly thereafter, the AAA advised petitioners that they would be required to select an

arbitrator by April 20, 2007. On April 19, 2007, petitioners expressly advised the AAA that they would not participate in the arbitration and would seek a stay, and requested an extension of time to select an arbitrator in the event the motion for the stay is denied. An extension of 10 days was granted; however, the AAA informed petitioners that absent a court order, petitioners were deemed to be refusing to participate and an award could still be granted.

DISCUSSION

As to arbitration, there is no disagreement among the parties that there is a valid arbitration agreement that requires any dispute related to the Fund to be arbitrated. The Fund's Subscription Booklet specifically states that "any claim, controversy, dispute or deadlock arising under this agreement . . . shall be settled by arbitration administered under the rules of the American Arbitration Association." (Fund Subscription Booklet at 10.) However, disagreement arises over whether the defense of statute of limitations raised by the petitioners should be decided by the arbitrator or by the court prior to arbitration.

State vs. Federal Law

Petitioners move for the court to issue an order dismissing the arbitration because pursuant to CPLR 7502(b) and 7503(b), if the claim would have been barred by the statute of limitations had it been brought in state court, then a party is entitled to seek to stay the arbitration.

However, a threshold issue must first be addressed – namely, whether state law relating to arbitration, CPLR Article 75, or The Federal Arbitration Act (the "FAA"), Title 9 U.S.C., applies. Section 2 of Title 9, U.S.C. states that the rules described therein apply to arbitration provisions in any "contract evidencing a transaction involving commerce." Section 1 defines

“commerce” as including “commerce among the several States.” Claims stemming from transactions relating to securities that trade on national exchanges have been held to involve interstate commerce. *Smith Barney, Harris Upham & Co., Inc. v Luckie*, 85 NY2d 193 (1995). This action – related to fund management of a hedge fund – falls within that definition and is thus subject to the FAA.

As a general rule under the FAA, a broad grant of power is given to the arbitrator to decide prerequisites to arbitrability, such as issues of waiver, delay and time limits. *Diamond Waterproofing Systems, Inc. v 55 Liberty Owners Corp.*, 4 NY3d 247, 252 (2005). However, an exception exists where the parties include a choice of law provision in the agreement stating that New York law would govern the agreement and its enforcement. *Id.* at 253. If such a provision is included, and New York law applies, the issue of whether there is a valid statute of limitations defense becomes one for the court, and not the arbitrator, to decide. *Id.* 7502(b) of the CPLR allows a party to make an application to the court to bar the arbitration if “the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in a court of the state.”

The Fund’s Subscription Booklet provides that the agreement “shall be governed, construed, and enforced in accordance with the laws of the State of New York, without reference to any principles of conflicts of law” This language indicates that the investors consented to having the agreement enforced under the laws of New York, and thus the issue of whether the statute of limitations bars the arbitration proceeding commenced by the respondents, is one for the court.

Statute of Limitations

The Statement of Claim included claims for fraud in the inducement, breach of contract, breach of fiduciary duty and gross negligence. Petitioners argue that the claims brought by respondents have a maximum limitations period of six years, pursuant to CPLR 213(1), (2) and (8). Petitioners argue that since most of respondents invested in the Fund between 6 ½ and 7 ½ years ago, the statute of limitations bars these claims.

A. Fraud

The statute of limitations period for a cause of action alleging fraud is the longer of six years from the wrongful conduct or two years from when the party knew, or should have discovered, the fraud. *Rostuca Holdings, Ltd. v Polo*, 231 AD2d 402, 403 (1st Dep't 1996).

There is no dispute that more than six years has passed since the investors invested in the Fund. Therefore, the issue is when the investors discovered the alleged fraud. Respondents argue that their cause of action for fraud rests on the claimed misrepresentations that petitioners made in order to induce them to invest in the Fund. They maintain that they only learned of the fraud on November 7, 2006 and, therefore, the arbitration proceeding was commenced well within the limitations period. They further contend that they learned of the fraud when a manager of the Fund, Mr. Neuburger, admitted – during cross examination in another arbitration proceeding – that the managers did not have hedging experience, even though respondents allege they were told and promised that the managers had the necessary experience to manage the Fund. Respondents commenced the arbitration proceeding on April 9, 2007, well within the two-year discovery period.

Petitioners claim that respondents were on notice of the potential fraud claim by

September 2002, because they knew the Fund had lost over 90% of its value by that time. They argue that such a major loss in value is sufficient to put investors on notice of the potential fraud. As support, they cite *Ghandour v Shearson Lehman Brothers, Inc.*, 213 AD2d 304 (1st Dep't 1995), wherein the court held at page 306 that "the substantial losses sustained by the accounts under the circumstances . . . was sufficient to place plaintiffs on notice of the potential fraud." The plaintiff in that action alleged that an employee of defendant Shearson Lehman Brothers, Inc. made false representations in order to fraudulently induce him to open two commodities trading accounts in 1983, in which he invested \$2,000,000. There, plaintiff lost a significant amount of money by the time trading was discontinued in October 1984.

The court in *Ghandour* stated that any determination as to when a plaintiff could have reasonably discovered the fraud "turns upon whether a person of ordinary intelligence possessed knowledge of facts from which the fraud could be reasonably inferred." *Id.* at 305–06. Here, the loss of such a drastic amount – over 90% of the Fund's value – put the investors on notice of the potential fraud as of late 2002. Even if the investors did not have actual knowledge of the alleged fraud at that time, they were aware of the fact of the significant loss, from which fraud could be reasonably inferred. Thus, since more than two years have passed since the investors could have discovered the alleged fraud, the statute of limitations has run and the fraud claim should be dismissed.

However, with regard to two investors, James N. Heller and Debbie L. Heller (the "Hellers"), the arbitration is dismissed because evidence indicates their actual knowledge of the alleged fraud as of July 2001 and they did not commence the arbitration within the statute of limitations period. As discussed above, the statute of limitations period is either six years from

the wrongful conduct or two years from discovery of such conduct, whichever is longer. *Rostuca Holdings, Ltd.*, 231 AD2d at 403. Since the investors allege that the petitioners fraudulently induced them to invest in the Fund, the six-year time period began to run at the time they invested in the Fund, which occurred in September 1999. More than six years has passed from the time of the alleged fraudulent conduct to the time the arbitration proceeding was commenced in April 2007. Thus, their claims can only proceed if they meet the two-year discovery rule.

By letter dated July 19, 2001, the Hellers acknowledged that they did not believe the loss in value of the Fund was a result of natural market changes, but instead due to mismanagement on the part of the Fund's managers. The letter, addressed to John Paoella, Director of Exchange Fund Products at Credit Suisse Asset Management, LLC, reads as follows:

My investment in the fund has been decimated. While I understand and accept the risks of such an investment, *I don't believe that the results achieved are simply due to market fluctuations.* I believe that many of the losses are *due to gross mismanagement* of the Fund and a breach of the Fund management's fiduciary responsibility. . . . I am not an investment professional, but the series of irresponsible, wrong headed, misguided and disastrous decisions by the Fund managers defies any definition of prudent financial management. . . . I have notified my attorney to proceed to take whatever actions are necessary to protect my interests and will notify the SEC of this situation.

(Emphasis added.) (John Paoella Aff, Exh B at 1, 3.) The letter not only specifically states that the Hellers believed the Fund was being grossly mismanaged, but also clearly indicates that they had contacted their attorney and advised him to take any necessary steps. Therefore, they are deemed to have had knowledge of the alleged fraud at least as of the date of the letter, and since they did not bring an action within two years of July 19, 2001, the statute of limitations has run on their fraud claims.

B. Remaining Causes of Action

In addition to the fraud claim, the investors also alleged breach of contract, negligence and breach of fiduciary duty in the Statement of Claim.

The statute of limitations for a breach of contract claim is six years from when the cause of action accrued, CPLR 213(2). A claim premised on a contract accrues when the contract is executed, which, in this instance, was June 2000 for respondents Bardin and Zimels, March 2000 for respondent Lee and September 1999 for the remaining respondents. As such, it is clear that by the time the Notice of Arbitration was filed in 2007, more than six years had passed and, thus, the statute of limitations had expired on the breach of contract claims. The breach of contract claims contained in the Statement of Claim are, therefore, dismissed.

Pursuant to CPLR § 214, a negligence claim is subject to a three-year statute of limitations period. However, since more than three years has passed from the alleged negligent acts with regard to management of the Fund, those claims are also dismissed.

The breach of fiduciary duty claims are governed by either a three-year or six-year statute of limitations period, depending on the nature of the relief sought. *Carlingford Ctr. Point Assocs. v MR Realty Assocs., L.P.*, 4 AD3d 179, 179–80 (1st Dep't 2004). When monetary relief is sought, the shorter time period applies, but when relief is equitable in nature, the six-year period is used. *Id.* Regardless of the relief sought by the investors, the statute of limitations has nonetheless run, as more than six years has passed since the respondents invested in the Fund.

Accordingly, it is

ORDERED that the arbitration is dismissed in its entirety; and it is further

ORDERED that the clerk enter judgment accordingly.

Dated: January 17, 2008

ENTER:



J.S.C.

FILED
JAN 25 2008
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