

**Salt Aire Trading LLC v Sidley Austin Brown &
Wood LLP**

2009 NY Slip Op 32658(U)

November 10, 2009

Supreme Court, New York County

Docket Number: 603799/2007

Judge: Shirley Werner Kornreich

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

PRESENT: **JUSTICE SHIRLEY WERNER KORNREICH**

PART 54

Index Number : 603799/2007

SALT AIRE TRADING LLC

VS.

SIDLEY AUSTIN BROWN & WOOD

SEQUENCE NUMBER : 004

DISMISS

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

on this motion to/for _____

PAPERS NUMBERED

112

34
56

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

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION AND ORDER.**

FILED

NOV 13 2009

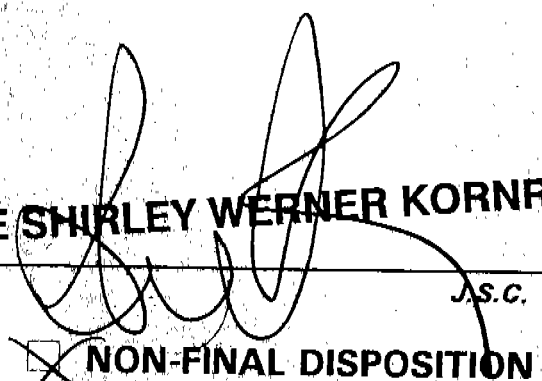
NEW YORK
COUNTY CLERK'S OFFICE

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

Dated: _____

11/10/09

JUSTICE SHIRLEY WERNER KORNREICH



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 54

-----X
SALT AIRE TRADING LLC, SALT AIRE
INVESTMENT TRUST, BLA INVESTMENTS, LLC,
SKJ INVESTMENTS, LLC, BRIAN KELLY &
JOELLE KELLY, HUSBAND & WIFE,

Index No.:603799/2007

DECISION and ORDER

Plaintiffs,

-against-

SIDLEY AUSTIN BROWN & WOOD LLP, *et al*,
Defendants.

FILED
NOV 13 2009
NEW YORK
COUNTY CLERK'S OFFICE

-----X
KORNREICH, SHIRLEY WERNER, J.:

In this action, plaintiffs Brian and Joelle Kelly and their affiliated entities, assert ten causes of action against defendants, alleging a conspiracy to structure and facilitate a series of transactions leading to plaintiffs' investment in the Coastal Common Trust Fund Series III Fund (CTF) for the purpose of generating tax deductions. Plaintiffs allege that defendants, in furtherance of their conspiracy, made fraudulent or negligent misrepresentations, concealed the nature of their relationships, breached their fiduciary duties, and committed professional malpractice to induce plaintiffs to enter into these transactions. Plaintiffs seek both equitable relief (constructive trust, rescission and restitution) and damages (actual and treble), including the deficiencies, interest, penalties and late fees paid when the Internal Revenue Service (IRS) disallowed the deductions.

Under motion sequence number 004, the law firm defendant Katten Muchin Rosenman LLP (Katten) moves to dismiss plaintiffs' complaint pursuant to CPLR 3013, 3016(b) and 3211(a) (1), (2), (5) and (7), relying in part on documentary evidence to demonstrate that Katten

never had an attorney-client relationship with plaintiffs and that it did not make any misleading representations to plaintiffs prior to their investment in CTF.¹ Katten also seeks to permanently stay a related arbitration pursuant to CPLR 7503(b). Plaintiffs oppose dismissal of the complaint, attaching a series of documents related to civil and criminal litigation involving defendant law firm Sidley Austin Brown & Wood LLP (Sidley Austin) and other institutional and individual defendants also sued by plaintiffs in this case. Plaintiffs ask that these documents, which include references to Katten, supplement the complaint. Plaintiffs do not oppose a stay of arbitration as to Katten, but state that they do not waive their right to compel arbitration as to any other defendant. Plaintiffs, in the last sentence of their Conclusion, alternatively request leave to amend the complaint. Plaintiffs previously withdrew a motion for leave to amend the complaint.

I. *Background*

A. *Summary of The Scheme*

The CTF tax shelter scheme at issue here was, without dispute, fraudulent. Key participants in the scheme, including Sidley Austin and the lender HVB, have admitted the fraud. In litigation by another investor against Sidley Austin and others, the Supreme Court explained that CTF “was structured to create a loss through the use of a loan from defendant HVB which, according to the promoters, would be used to purchase foreign currency options The negative basis in the transaction, created by the loan, was used to generate the loss.” *Williams v. Sidley Austin Brown & Wood, LLP*, 15 Misc3d 1125(A) (Sup Ct, NY County, 2007). Both the loan and

¹The complaint also refers to Katten’s predecessor firm Rosenman & Colin, LLP or “Rosenman.” The court will use “Katten” exclusively throughout the decision to avoid confusion.

the investment components of the scheme, however, were illusory and fraudulently represented.

Id.

The court in *Williams* originally dismissed the complaint, then reinstated it on submission of additional facts and circumstances, including HVB’s deferred prosecution agreement and the related federal criminal information and statement of admitted facts, entered in the United States District Court for the Southern District of New York on February 17, 2006. *United States v. Bayerische Hypo-Und Vereinsbank AGI*, No. 1:06-CR-00162 (SDNY 2006); *see Williams v. Sidley Austin Brown & Wood, LLP*, 13 Misc3d 1213(A) (Sup Ct, NY Cty 2006). The complaint by the Kelly plaintiffs makes allegations that are similar to those found sufficient in *Williams*.

B. *The Complaint*

The complaint alleges causes of action for fraud, joint venture conspiracy to commit fraud, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, constructive trust, statutory securities violations, professional negligence, negligent misrepresentation, breach of contract, rescission and unjust enrichment. The gravamen of the complaint is that all of the defendants, including Katten, were partners in a joint venture conspiracy to design, promote, market and implement a fraudulent tax shelter investment scheme known as CTF. The CTF investment scheme is described in the complaint as follows:

44. Enterprise, as trustee, established a fund known as the “Coastal Common Trust Fund Series III Fund” (“the Fund”) in which money would be invested. The private offering memorandum for the Coastal Common Trust Fund Series III which was delivered to Plaintiff is dated October 16, 2001. The promoters purported that the plan provides for a monthly valuation of the fund, and the taxable income and loss of the fund would be determined for each month and attributed to participants based on their proportional share in the fund. The Fund represented that it had arranged for a series of foreign currency options to be

transacted through the fund, creating a “straddle” and “strangle” position with the original contribution. The straddle transaction generated both losses and offsetting gains, and the losses were allocated to the investor, while the gains were allocated to other tax-indifferent entities.

45. As part of the CTF transaction, on December 3, 2001, [defendants] Braxton Management Inc. and HVB [Risk Management Products, Inc.] created a series of documents which falsely represented that HVB had made a loan of \$35 million through its HVB Structured Finance, Inc., which would be used to further the investment purpose as stated in the Coastal Trading Common Trust Fund Series III offering memorandum. The loan was a sham. Purported assignments of the loan were also shams.

46. The loan was represented in the Coastal Trading Common Trust Fund Series III offering memorandum to be the central purpose of the transaction. The fact that the loan was a sham makes the entire Coastal Trading Common Trust Fund Series III offering a sham.

It was never explained to plaintiffs that the loan from HVB was structured to remain with Braxton and defendant Enterprise Trust and would not be used to further the investment plan.

There is no dispute that the complaint properly alleges that CTF was an abusive tax shelter scheme designed to generate lucrative fees for the various participants, as the IRS ultimately determined. Specifically as to Katten, the complaint alleges:

108. Brown & Wood and Rosenman were not providing independent, individualized legal opinions for each of its clients as to the appropriateness of the tax treatment and legal effect applied to the Common Trust Fund Transaction.² Brown & Wood and Rosenman had a conflict of interest, which it did not reveal to Plaintiff and other investors in the Common Trust Fund. Brown & Wood and Rosenman prepared prototype opinion letters, and the promoters of CTF mass marketed these opinion letters, sending virtually identical opinion letters to multiple clients who entered into the Common Trust Fund transactions.

109. The Rosenman boilerplate opinion was referenced in the Coastal Trading Common Trust Fund Series III Agreement to create the appearance of legitimacy to the CTF loan and investment transactions, which were actually shams. The Rosenman boilerplate opinion was also referenced in the boilerplate

²“Brown & Wood” refers to Sidley Austin Brown & Wood LLP, and “Rosenman” refers to Katten Muchin Rosenman LLP and its predecessor firm.

Brown & Wood opinion letter to further the appearance of legitimacy to the CTF loan and investment transactions, which were actually shams.

110. Brown & Wood and Rosenman failed to disclose that the written plan of operation, as was described in the Coastal Trading Common Trust Fund Series III Agreement, contained false and misleading descriptions of the common trust fund transaction. ...

111. Brown & Wood and Rosenman authorized the use of their names in the marketing of the Common Trust Fund, and to specifically represent that opinion letters from Brown & Wood and Rosenman were available to verify and support the legitimacy of the transaction. Such representations, made with Brown & Wood and Rosenman's consent, furthered Defendants' fraudulent scheme by inducing reliance on the legitimacy of the Common Trust Fund. The Brown & Wood opinion letter specifically stated that it was written in reliance upon an opinion from Rosenman.

* * *

114. Brown & Wood and Rosenman breached their fiduciary duties to Plaintiffs by failing to disclose to Plaintiff their inside knowledge of the CTF transaction and by failing to disclose in their opinion letters that the Common Trust Fund transaction was a sham.

115. Brown & Wood and Rosenman failed to disclose to Plaintiff that they were promoters of the Common Trust Fund transaction.

* * *

172. The Sedacca Defendants, the Sidley Austin Defendants and Rosenman assumed responsibility for coordinating the CTF transaction for Plaintiffs, had knowledge of the facts superior to Plaintiff's knowledge, and induced Plaintiff to believe that they were working on Plaintiff's behalf.³

The complaint also alleges that Katten, Sidley Austin and other defendants had an attorney-client relationship with, and fiduciary duty to plaintiffs, which they breached by, among other acts: misrepresenting that plaintiffs were represented by them and that they were independent, that the CTF transaction had economic substance, and by concealing that they were partners in the conspiracy and promoters of the CTF investment program. The complaint does

³The complaint refers interchangeably to "Brown & Wood" and "Sidley Austin."

* 7]

not allege that Katten made any specific representation to plaintiffs other than those made in the single opinion letter.

Katten does not dispute that it caused to be mailed to plaintiffs an opinion letter on November 27, 2001. Katten does, however, dispute that it had an attorney-client relationship with plaintiffs and that the opinion letter it admittedly prepared at Sidley Austin's request contained any misrepresentations. As further alleged in the complaint, this sham tax shelter scheme, along with numerous other schemes, were investigated by the United States Senate and the IRS, which found them to be invalid. The investigation led to several lawsuits and indictments against individuals and firms for their participation in the design, promoting, marketing, selling and implementation of abusive tax shelters. *See Williams v. Sidley Austin Brown & Wood, LLP*, 38 AD3d 219 (1st Dept 2007) (complaint reinstated on motion to renew in light of deferred prosecution agreement, statement of admitted facts and criminal information). Defendant J.R. Ruble, a Sidley Austin attorney, was indicted, along with eighteen others in September and October 2005.

In February 2006, defendant HVB Risk Management Products, Inc. (HVB) entered into a deferred prosecution agreement (DPA) with the United States Attorney for the Southern District of New York in which HVB admitted, in pertinent part, to participating in fraudulent tax shelter schemes, including CTF. In August, 2005, the co-head of HVB's financial group in New York, defendant Domenick DeGiorgio, pled guilty to two counts of conspiracy to defraud the IRS for his participation in the fraudulent tax shelter schemes. On May 23, 2007, the IRS announced that it had reached a settlement with Sidley Austin over the firm's role in the fraud, including the tax letters written by attorney Ruble, who is currently under indictment.

Katten does not dispute that it caused to be mailed to plaintiffs an opinion letter on November 27, 2001. Katten does, however, dispute that it had an attorney-client relationship with plaintiffs and that the opinion letter it admittedly prepared at Sidley Austin's request contained any misrepresentations.

C. Documents Supplementing the Complaint

Plaintiffs have submitted the following documents in opposition to the summary judgment motion and in further support of the complaint:

Declaration of Peter Molyneux. Molyneux, now deceased, was the Chief Financial Officer of defendant Northbridge Capital Management, Inc., and the owner of defendant Braxton Management, Inc. He signed a declaration that was filed in the *Williams v. Sidley Austin* matter in which he describes Katten's role in the design of the CTF loan structure:

In or about May, 2001 I learned from [defendant] Krieger about a proposal from [defendants] Michael Schwartz and Kevin Kops of the [defendant] firm Multinational Strategies, LLC, about a trading program that was tax advantaged and had been reviewed and vetted by the law firm of Rosenman & Colin LLP ("Rosenman"). I was advised that Rosenman would be preparing the documentation for the transactions and entities necessary for the participation of [defendants] Deerhurst and Northbridge and investors in the trading program.

* * *

The Rosenman firm assisted in establishing the transaction structure and prepared the structure's legal documentation, including the structure's offering document and the loan documents for [defendants] Bradonton and Braxton.

For this transaction [defendant] HVB US Finance, Inc. retained Shearman & Sterling, which worked with the Purrington and Rosenman firms, including preparing checklists for organizing the loan.

9]

Deferred Prosecution Agreement of HVB, Federal Criminal Information and Statement of Admitted Facts. HVB admits its role in various fraudulent tax shelters, including the fraudulent loan at the heart of the CTF transaction and “engaging in activity with others, including accounting firms, investment advisory firms, various individuals affiliated with those entities, lawyers and clients, all directed toward the implementation of the tax shelters.”

Felony Information of DeGiorgio, Guilty Plea, and related press release from the United States Attorney's Office. DeGiorgio was an officer of HVB and co-head of its Financial Engineering Group.

11/26/01 Coastal Trading Common Trust Fund Series III Agreement. ¶ 7 states:

Coastal hereby agrees to cause, on or prior to November 27, 2002, Rosenman & Colin to issue to the Investors, the Borrowers, the Grantor Trusts, Brian Kelly and Robert Kotick a legal opinion in a form similar to the draft opinion previously furnished by Coastal to counsel for the Investors stating that, among other things, the Fund (I) will be classified as a common trust fund under Section 584 of the Internal revenue Code of 1986, as amended, and the Income Tax regulations thereunder, (ii) will not be subject to Federal income Taxation and (iii) will not be treated as a corporation.

Katten Opinion Letter dated 11/27/01. The letter was addressed to plaintiffs Brian and Joelle Kelly and pertained to the issue of whether the CTF would qualify as a common trust fund under Code Section 584 and would not be subject to Federal income taxation. Katten stated on page 6 of its letter that its opinion was based on its review of the plan and on other pertinent instruments.

Three Court Decisions in Williams v. Sidley Austin Brown & Wood, LLP: 38 AD3d 219 (1st Dept 2007) (affirming the decision denying motion to dismiss second amended complaint); 13 Misc3d 1213A (Sup Ct, NY Cty 2006) (reinstating the complaint); 15 Misc3d

1125(A) (Sup Ct, NY County, 2007) (denying motion to dismiss second amended complaint).

D. *The Arbitration*

Plaintiffs filed a Demand to Arbitrate, dated February 1, 2008, with the American Arbitration Association (AAA). The parties named as defendants here are named in the Demand. Plaintiffs state in the Demand that they “are bringing this arbitration in lieu of the court action.” The CTF Subscription Agreement contains a mandatory arbitration provision in paragraph 19, providing in pertinent part:

Investor waives its right to remedies in court, including any right to a jury trial ... Investor agrees that any dispute arising out of, relating to or in connection with this Subscription agreement shall be resolved exclusively by arbitration to be conducted in accordance with the then current rules of the NFA or such other qualified forum as may be selected

The AAA has invited the respondents’ consent to the AAA’s continued administration of the arbitration. Neither plaintiffs nor the Katten defendants have apprised the court of the current status of the arbitration.

II. *Conclusions of Law*

A. *Motion to Dismiss*

On a motion to dismiss pursuant to CPLR 3211, the court must accept the facts as alleged in the complaint as true, accord plaintiff the benefit of every possible favorable inference and determine only whether the facts as alleged fit within any cognizable legal theory. *Morone v Morone*, 50 NY2d 481, 484 (1980); *Rovello v Orofino Realty Co.*, 40 NY2d 633, 634 (1976); *Skillgames, L.L.C. v Brody*, 1 AD3d 247, 250 (1st Dept 2003). CPLR 3026 mandates that “[p]leadings shall be liberally construed. Defects shall be ignored if a substantial right of a party is not prejudiced.” “However, factual allegations that do not state a viable cause of action, that

consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames, L.L.C. v Brody*, 1 AD3d at 250. Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law.

Moreover, in assessing a motion under CPLR 3211, a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint. *Rovello v Orofino Realty Co.*, *supra*, at 635. "[T]he criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one." *Id.* at 636. The test is whether the pleadings give adequate notice to the court and the adverse party of the transactions or occurrences intended to be proved. *Two Clinton Sq. Corp. v Friedler*, 91 AD2d 1193, 1194 (4th Dept 1983); *see Ackerman v 305 E. 40th Owners Corp.*, 189 AD2d 665, 666 (1st Dept 1993).

B. *Fraud*

The elements of a fraudulent misrepresentation claim consist of "a misrepresentation or a material omission of fact which was . . . known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party . . . and injury." *Lama Holding Co. v Smith Barney*, 88 NY2d 413, 421 (1996); *see Small v Lorillard Tobacco Co., Inc.*, 94 NY2d 43, 57 (1999). Among the circumstances under which a cause of action for fraudulent concealment may arise is where there has been a misleading partial disclosure. *L.K. Sta. Group, LLC v Quantek Media, LLC*, 62 AD3d 487 (1st Dept 2009), citing *Williams v Sidley Austin Brown & Wood, L.L.P.*, 38 AD3d 219, 220 (2007). CPLR 3016(b) provides that "Where a cause of action or defense is based upon misrepresentation, fraud, mistake, wilful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail."

At the outset, the court finds there is no impediment to considering the criminal information, the deferred prosecution agreement (DPA) and related documents, and the *Williams* decisions. Katten argues that the supplemental documents are irrelevant or inadmissible. Katten relies on the lack of reference to the “Rosenman” firm. But what the DPA and related documents do is detail the relationships of the parties, the mechanics of the various investment programs, including CTF, the lack of economic substance to the programs, and the falsity of the representations made to induce investment. Since Katten stated in its opinion that it had reviewed the pertinent documents before opining that the CTF would not be subject to Federal income taxation, the fact that these documents were false and the basis for a massive tax evasion investigation is directly relevant to this litigation.

The documents also are replete with references to “other” attorneys and law firms and opinions created to support the programs. Katten does not deny its direct connection to CTF and Sidley Austin’s use of the Katten opinion letter to market the CTF program. Plaintiffs’ submissions, like the allegations in the complaint, must be given the benefit of every favorable inference. *Cron v Hargro Fabrics, Inc.*, 91 NY2d 362, 366 (1998). Viewed with the allegations in the complaint, which tie Katten directly to the underlying transactional documents, it is reasonable for the court to infer that Katten was one of the “other” attorneys referred to in the DPA and related documents.

Katten also attacks the Molyneaux Declaration on grounds that it contains inadmissible hearsay and runs afoul of the Dead Man’s Statute (CPLR 4519). The motion has not been converted on notice to a motion for summary judgment. At this stage the court may consider additional submissions for the limited purpose of remedying defects in the complaint or

preserving inartfully pled but potentially meritorious claims. *Cron v Hargro Fabrics*, 91 NY2d 362, 366 (1998), citing *Rovello*, 40 NY2d at 635-636 and *Arrington v New York Times Co.*, 55 NY2d 433, 442 (1982). The court is bound to consider these submissions in the light most favorable to the plaintiff. *Id.* Evidentiary deficiencies may affect the document's admissibility on summary judgment, but that decision is premature. In addition, even at the summary judgment stage, hearsay may be considered where the witness is identified, and the substance of his testimony and the basis for his knowledge is submitted. *Siegel v Wank*, 183 AD2d 158, 161 (3d Dept 1992).

Additionally, the court finds the *Williams* opinions relevant to this proceeding. In *Williams*, the First Department sustained an investor's allegations of fraud against HVB for its involvement in multiple tax shelter schemes, including CTF. The Court's reasoning applies equally to Katten. HVB, like Katten, painted itself as a nonessential participant in the tax shelter scheme, or a small, insignificant fish in a pool of barracuda. The First Department saw the allegations in a different light:

Although there are no allegations of any affirmative misrepresentations by HVB itself, and no fiduciary relationship arose between the individual plaintiff and HVB as the purported lender (*see Korea First Bank of N.Y. v Noah Enters., Ltd.*, 12 AD3d 321, 323, 787 NYS2d 2 [2004], *lv denied* 4 NY3d 710, 830 NE2d 1145, 797 NYS2d 816 [2005]), fraud is sufficiently stated by allegations giving rise to the permissible inferences (*see Cron v Hargro Fabrics*, 91 NY2d 362, 366, 694 NE2d 56, 670 NYS2d 973 [1998]) either that HVB had special knowledge or information regarding the IRS's posture that was not attainable by plaintiff, rendering it liable for nondisclosure regarding the tax shelter (*see Swersky v Dreyer & Traub*, 219 AD2d 321, 327-328, 643 NYS2d 33 [1996]), or that HVB's failure to disclose the roles of the other defendants was a misleading partial disclosure (*see Computer Possibilities Unlimited v Mobil Oil Corp.*, 301 AD2d 70, 82, 747 NYS2d 468, *lv denied* 100 NY2d 504, 793 NE2d 411, 762 NYS2d 874 [2003]; *cf. Elghanian v Harvey*, 249 AD2d 206, 671 NYS2d 266 [1998]).

38 AD3d at 220. HVB, as the loan originator, would have been in a position to know that the loan was a sham. CTF was a broad-reaching fraudulent tax shelter scam. The allegations submitted demonstrate that Katten's involvement extended beyond the innocent preparation and delivery of a narrow opinion. Katten, Molyneaux affirms, "reviewed and vetted" the CTF tax scheme, and prepared "the documentation for the transactions and entities necessary for the participation of [defendants] Deerhurst and Northbridge and investors in the trading program [CTF]." Katten insists that its involvement was limited to the drafting of the single, accurate opinion letter. The extent of Katten's involvement, at this point, is a question of fact.

The allegations of Katten's involvement also raise a reasonable inference of Katten's knowledge that the tax shelter program was fraudulent. The allegation of fraud raises the issue of the subjective intent informing the charged party's conduct. 3 Weinstein-Korn-Miller, NY Civ Prac para. 3016.04; see *National Westminster Bank USA v Weksel*, 124 AD2d 144, 149 (1st Dept 1987), *appeal denied* 70 NY2d 604 (1987). The court in *Weksel* explained that,

Frequently, it is only through the objective circumstances of an alleged fraud that the subjective element of the tort is susceptible of demonstration. Thus, to state a cause of action for fraud, it is often critical that the circumstances of the tort be stated with sufficient specificity to permit the inference of fraudulent intent.

Id. The defendant law firm in *Weksel* won its motion to dismiss, but the allegations in the complaint did not directly implicate the law firm in the underlying fraud; they alleged only that the law firm represented one of the charged principals. Unlike *Weksel*, plaintiffs here allege that Katten was directly involved in setting up and implementing the fraudulent tax shelter scheme. There is no evidence before the court suggesting that the fraudulent aspects of the scheme were

created or implemented after Katten's involvement had ended. If anything, the allegations establish that Katten was a principal, as opposed to a tangential player.

The court draws the following facts and inferences from the allegations of plaintiffs' complaint, the Deferred Prosecution Agreement, the Molyneaux declaration, the *Williams* decisions, and the additional supplemental documents, giving plaintiffs the benefit of every favorable inference, are that: the crux of the illegality in the CTF transaction was a sham or illusory loan and non-substantive investment; all of the transactions took place without money ever leaving the bank; Katten participated in the set up and the structure of these sham transactions from the beginning by creating fraudulent documentation; Katten prepared an admittedly "vanilla" opinion letter advising investors that the transactions would generate a tax loss; Katten knew that investors would rely on the conclusions; the opinion letter was then distributed to numerous investors; Katten received substantial fees for its participation; plaintiffs relied on the false representations and Katten's opinion in deciding to invest; and plaintiffs incurred substantial economic losses as a result of their reliance. The court, as it must, views plaintiffs' allegations of knowing and intentional fraud in this factual context. Viewed in this light, the complaint is sufficient.

C. *Conspiracy*

Although New York does not recognize civil conspiracy as an independent cause of action, allegations of conspiracy can connect the actions of separate defendants with an otherwise actionable tort. *Alexander & Alexander of NY v Fritzen*, 68 NY2d 968, 969 (1986). The elements of a conspiracy are: (1) a corrupt agreement between two or more parties; (2) an overt act in furtherance of the agreement, which constitutes an independent tort or wrongful act; (3) the

defendant's intentional participation in the furtherance of the plan or purpose; and (4) resulting damages or injury. *Id.*; see *Truong v AT&T*, 243 AD2d 278 (1st Dept 1997); *Albion Fund v State St. Bank*, 8 Misc 3d 264, 273 (Sup Ct, NY County), *aff'd* 2 AD3d 162 (1st Dept 2003).

Again, a similar issue was resolved in the *Williams* matter, and the findings and reasoning by the court in that case apply here.

The deferred prosecution agreement supplies the element of scienter and a shared "perfidious purpose" ... According to the deferred prosecution agreement, HVB, Ruble and/or Sidley Austin, and others [Katten] purposefully drafted the opinion letters and transactional documents to include misrepresentations regarding the substance, implementation and purpose of the CTF transactions, HVB's admissions show that Sidley Austin, Ruble and HVB purposefully participated with accountants and promoters to market and implement fraudulent tax shelters by making it appear that investors were taking loans to make leveraged investments when they were not, and indicates that, ... HVB, Ruble and Sidley Austin were more than just peripheral parties used to conduct otherwise lawful business transactions or provide subsequent support services. Thus, as indicated in the deferred prosecution agreement, the shared purpose of marketing and implementing fraudulent tax shelters was coupled with the independent torts of participating in the creation of false and misleading transactional documents, opinion letters, the making [of] bogus loans, and participating in sham investment transactions.

Williams v Sidley Austin, 13 Misc3d 1213A (Sup Ct, NY Cty 2006). The "transactional documents" that plaintiffs allege were false and misleading are not limited to Katten's opinion letter, but the transactional documents underlying the CTF investment program, which Katten had allegedly "vetted." Katten's opinion letter was then allegedly bundled with the Sidley Austin tax opinion and used to market the program and to induce investment by numerous wealthy individuals. The allegations, and the evidence admitted in connection with the CPLR 3211 motion, are sufficient to sustain plaintiffs' causes of action for conspiracy to commit fraud as

asserted against Katten.

D. *Breach of Fiduciary Duty*

The court agrees with Katten that the complaint fails to sufficiently plead the existence of a fiduciary duty between itself and plaintiffs. "A fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." *Mandelblatt v Devon Stores*, 132 AD2d 162, 168 (1st Dept 1987), quoting Restatement [Second] of Torts § 874, comment a. At no time did Katten serve as plaintiffs' counsel, and the facts do not establish that Katten had a principal role in managing the CTF program, unlike HVB.

On the other hand, the claim for aiding and abetting breach of a fiduciary duty is different. To state a claim for aiding and abetting a breach of fiduciary duty, a plaintiff need only plead a breach of fiduciary duty, that defendant knowingly induced or participated in the breach, and damages resulting from the breach. *Kaufman v Cohen*, 307 AD2d 113, 125 (1st Dept 2003). "A person knowingly participates in a breach of fiduciary duty only when he or she provides 'substantial assistance' to the primary violator." *Id.* at 126. Actual knowledge, as opposed to merely constructive knowledge, is required and a plaintiff may not merely rely on conclusory and sparse allegations that the aider or abettor knew or should have known about the primary breach of fiduciary duty. *See Prudential-Bache Sec. v Citibank*, 73 NY2d 263 (1989); *Brasseur v Speranza*, 21 AD3d 297 (1st Dept 2005).

Plaintiffs have sufficiently pled that HVB and other CTF investment principals breached a fiduciary duty and that Katten provided substantial assistance, as discussed above in relation to the claims of fraud and conspiracy. To the extent that Katten's knowledge of the breadth of the

tax shelter scheme has not been alleged by particularized facts, its knowledge, ultimately, is a matter for discovery, as much of that information is necessarily in Katten's control. *See American Baptist Churches of Metro. N.Y. v Galloway*, 271 AD2d 92, 101 (1st Dept 2000) ("what the parties actually knew is a matter for discovery, since much of the information is in defendants' control"). Moreover, Katten has sufficiently been apprised of the conduct upon which plaintiffs' claim is predicated, and thus the notice standard of CPLR 3013 has been met.

E. *Unjust Enrichment and Constructive Trust*

A constructive trust may be imposed in favor of one who transfers property in reliance on a promise originating in a confidential relationship where the transfer results in the unjust enrichment of the holder. *Rogers v Rogers*, 63 NY2d 582, 585 (1984). The court in *Rogers* explained that, "In general, it is necessary to trace one's equitable interest to identifiable property in the hands of the purported constructive trustee (see 1 Palmer, Restitution, § 2.14; Restatement, Restitution 2d, Tent Draft No. 2, § 32)." *Id.* An unjust enrichment claim must allege that the plaintiff conferred a benefit on the defendant for which the defendant did not adequately compensate the plaintiff. *See Tarrytown House Condominiums, Inc. v Hainje*, 161 AD2d 310, 313 (1st Dept. 1990). Further, the plaintiff may only recover in circumstances where it would be unjust to allow the defendant to retain the benefit. *See Waldman v. Englishtown Sportwear, Ltd.*, 92 AD2d 833, 836 (1st Dept. 1983). Plaintiffs do not allege the existence of any identifiable property in the hands of Katten, only that Katten received "fees" for its participation in the CTF program. The claims for unjust enrichment and constructive trust, therefore, cannot stand.

F. *Securities Violations, etc.*

The claim for violation of the Securities Exchange Act of 1934 and Rule 10b-5 are dismissed for lack of subject matter jurisdiction. *See Fin. Indus. Regulatory Auth., Inc. v Fiero*, 10 NY3d 12, 17 (2008) (finding state courts “do not possess the power to hear and decide” claims brought under Exchange Act and/or implementing rules). The claim for violation of the Investment Advisors Act of 1940, 15 USC § 80b-6(1), (2) and (4), also is dismissed. There is no applicable private right of action under that statute. *See Kahn v Kohlberg, Kravis, Roberts & Co.*, 970 F2d 1030, 1033 (2d Cir. 1992). The court *sua sponte* dismisses these claims as to all the defendants.

However, the claim for violation of Sections 12(2) and 15 of the 1933 Exchange Act is actionable in this court. Section 12 provides that claims under that section can be brought in “any court of competent jurisdiction.” 15 USC 771. That provision states, in pertinent part,

§771. Civil liabilities arising in connection with prospectuses and communications
 (a) In general. Any person who--
 (1) offers or sells a security in violation of section 5 [15 USCS § 77e], or
 (2) offers or sells a security (whether or not exempted by the provisions of section 3 [15 USCS § 77c], other than paragraphs (2) and (14) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

The allegations sufficiently establish Katten's participation in the preparation of documents within the meaning of the statute. Further, one "uniquely positioned to ask relevant questions, acquire material information, or disclose his findings" can be deemed a seller within the meaning of Section 12(2). *See Seidel v Public Service Company of New Hampshire*, 616 F.Supp 1342, 1361-1362 (DNH 1985). The District Court in *Seidel* refused to dismiss the Section 12(2) claim against the law firm defendants, concluding that,

The arguments that the law firm defendants are not within the purview of section 12(2) of the 1933 Act must similarly fail, as that statute imposes liability for "untrue statements and omissions of material facts", and the pleadings are sufficient to allege participation of these defendants in the preparation of the documents of the type within the coverage of such statute. One "uniquely positioned to ask relevant questions, acquire material information, or disclose his findings" can be deemed a seller within the meaning of section 12(2). *Hagert v. Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1035 (D. Minn. 1981).

And as to the allegations that defendants are "controlling persons" under section 15 of the 1933 Act and section 20(a) of the 1934 Act, it is clear that such term means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. 17 C.F.R. § 230.405. Attorneys fall within the ambit of "controlling persons" when they are in some sense culpable participants in the acts perpetrated by the controlled person.

Id. The same reasoning applies here.

G. *Negligent Misrepresentation, Professional Negligence*

A party may recover for loss sustained as a result of another's negligent misrepresentation where there is privity of contract between the parties or a relationship so close as to approach privity. *Parrott v Coopers & Lybrand*, 95 NY2d 479, 483 (2000). Lawyers may be liable for professional negligence to third parties for "harm caused by professional negligence in the

presence of fraud, collusion, malicious acts or other special circumstances. “ *Prudential Ins. Co. v Dewey Ballantine, Bushby, Palmer & Wood*, 80 NY2d 377, 384-386 (1992).

The *Prudential* case is analogous to the case before the court. There, the defendant law firm, pursuant to its client's instructions, furnished an opinion letter to the plaintiff third party in connection with a proposed restructuring of a debt owed plaintiff by the client. The court found that the law firm owed a duty of care to the plaintiff so as to support the plaintiff's negligence cause of action based on false assurances contained in the opinion letter. The court found material, allegations that the defendant was aware that the opinion letter was to be used by the plaintiff in deciding whether to permit the debt restructuring, that the plaintiff relied on the opinion letter in agreeing to the debt restructuring, and, that by addressing and sending the opinion letter directly to the plaintiff, the defendant engaged in conduct which evinced its awareness and understanding that the plaintiff would rely on the letter. Despite the absence of direct privity between the parties, the court found a duty of care.

This court, under the same reasoning, finds allegations sufficient to establish a duty of care by Katten to plaintiffs. As in *Prudential*, Katten sent an opinion letter directed to plaintiffs at the request of their client and alleged co-conspirator Multi National Services, Inc., the opinion letter played an important part in the marketing of the CTF program, and plaintiffs relied on the letter in deciding whether to invest. The claims for negligent misrepresentation and professional negligence remain.

H. *Breach of Contract and Rescission*

Because the existence of a valid and binding contract is not alleged, the complaint fails to state a cause of action for either breach of contract or rescission. Plaintiffs' claim that they were

third-party beneficiaries of the contract between Katten and its client and that Katten breached its duty of good faith and fair dealing under that contract, is unavailing. The allegations do not establish that the contract was made specifically for plaintiffs' benefit. *See Mandarin Trading Ltd. v Wildenstein*, 65 AD3d 448, 460 (1st Dept 2009). These claims are dismissed.

I. *Leave to Amend the Complaint*

Plaintiffs belatedly seek leave to amend the complaint. Although they had filed a motion seeking this relief, they withdrew it. Plaintiffs' current informal request is procedurally deficient. *See, e.g., Marinelli v Shifrin*, 260 AD2d 227 (1st Dept 1999) (finding affidavit of merit and evidentiary showing necessary to support motion for leave to amend). Accordingly, it is

ORDERED that the defendant Katten's motion to dismiss the claims against it in the complaint is granted, in part, and denied in part, in that the following is dismissed: the third cause of action to the extent it alleges breach of fiduciary duty by Katten; the fourth cause of action for constructive trust; the fifth cause of action to the extent it alleges Katten's violation of sections 15 and 20(a) of the Exchange Act and Rule 10(b)-5; the sixth cause of action for violation of the Investment Advisors Act of 1940 and aiding and abetting that violation; the eighth cause of action for breach of contract; and the ninth cause of action for unjust enrichment; and it is further

ORDERED that defendant Katten's motion to dismiss, in all other respects, is denied; and it is further

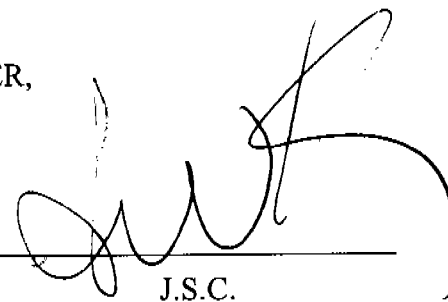
ORDERED, on consent of the plaintiffs, that defendant Katten's motion for a stay of the arbitration proceeding is granted on consent; and it is further

ORDERED that plaintiffs' request for leave to amend the complaint is denied; and it is further

ORDERED that the parties shall appear in Part 54 of the New York Supreme Court, Commercial Division, for a Preliminary Conference on Thursday, November 19, 2009, at 9:30 A.M.; and it is further

ORDERED that the Clerk shall mail a copy of this Decision and Order to all parties. .

ENTER,



J.S.C.

Date: November 10, 2009
New York, N. Y.

FILED
NOV 13 2009
NEW YORK
COUNTY CLERK'S OFFICE