SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION: PART 39

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NORTHERN GROUP INCORPORATED and ALTITUDE PARTNERS, LLC,

Plaintiffs,

- against -

MERRILL, PIERCE, FENNER & SMITH INCORPORATED and MERRILL GOVERNMENT SECURITIES, INC.,

Defendants.

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DECISION and ORDER

Index No. 603271/2008
Motion Seq. No. 008

HON. SALIANN SCARPULLA, J.:

In this action for fraud, plaintiffs Northern Group Incorporated ("Northern") and Altitude Partners, LLC ("Altitude") (collectively, "plaintiffs") allege a loss of approximately $24 million of a $40 million investment in commercial mortgage backed securities ("CMBS") bonds purchased from defendants Merrill, Pierce, Fenner & Smith Incorporated ("Merrill") and Merrill Government Securities, Inc. ("Securities") (collectively "defendants") between May 2008 and July 2008. Defendants now move for summary judgment dismissing the complaint pursuant to CPLR 3212.

Merrill is a registered broker-dealer and Securities is a wholly-owned subsidiary of Merrill. Northern is a privately-held real estate investment firm, formed in 1990 by non-parties Jacqueline Fried ("Fried") and her son Alexander Dembitzer ("Dembitzer"), who are its sole shareholders. They are also the sole members of Altitude, which they formed in 2007 to retain the surplus cash from Northern's real estate ventures.

Defendants maintain that in 2008, Northern had assets of over $316 million, with a net worth of more than $200 million, and that during the relevant time period, Northern maintained a website where it described itself as an "opportunistic purchaser of real estate" with a "streamlined decision making process which allows Northern Group to quickly analyze investment opportunities, quantify the risk and commit the resources necessary to react to transactions expeditiously on a pre-emptive basis." The website also stated "'[b]uy what others do not want and create value' has been and will continue to be Northern Group's motto."

As alleged in the amended complaint, in May 2008, Northern entered into a consulting agreement with Irwin Boris ("Boris"). Boris' initial responsibility was to assist in obtaining financing and to assist in the management of the properties Northern managed. Boris later became the Chief Investment Officer of Northern and Altitude. Boris testified at his deposition that he had experience with commercial real estate assets. Immediately prior to joining Northern and Altitude, Boris was Managing Director at El Ad Capital/El Ad Group ("El Ad"), a real estate investment company.

In late 2007, while still at El Ad, Boris discussed with Merrill Managing Director John Mulligan ("Mulligan"), the potential purchase of certain "Mezz Cap" CMBS that Merrill was syndicating. On November 20, 2007, Boris informed Mulligan that "El Ad is interested in purchasing the AAA tranch[e] of the [Mezz Cap] security subject [to] ML providing financing." Defendants assert that over the course of the next few weeks, Boris

and Mulligan discussed the potential sale to El Ad of different classes of the Mezz Cap security, including pricing and the terms upon which Merrill might agree to finance a portion of the purchase price via repurchase, or "repo" financing. Ultimately, El Ad did not purchase the Mezz Cap securities

In April 2008, Boris contacted Mulligan to inform him he was employed by Northern, which was interested in buying CMBS. Defendants maintain that by that time, the market value of CMBS bonds had dropped substantially from the highs seen in early-to-mid 2007, and their decline had been reported by major media outlets. Boris indicated that Northern had substantial funds and wanted to close on any purchases quickly.

At Boris' request, Mulligan met with him, together with Dembitzer and Fried, on April 16, 2008, at Merrill's offices. Also attending the meeting was Tim Taylor, a Merrill director who assisted Mulligan in the syndication of whole loans and mezzanine bonds. Defendants assert that Mulligan then referred plaintiffs to Max Baker, a Merrill Director who worked as a trader under Mulligan on Merrill syndicate mortgage desk, also known as the primary desk. Sales coverage of plaintiffs'' account was assigned to Matthew LoVecchio ("LoVecchio"), who worked on Merrill's fixed income sales desk.

On April 21, 2008, LoVecchio contacted Dembitzer and Boris regarding setting up plaintiffs' account. He noted they would be required to provide various documents, including an investment management agreement, an offering memorandum or prospectus, a certificate of formation or articles of incorporation and a tax identification number. In

response to plaintiffs' inquiry regarding margin financing for their purchases, LoVecchio requested plaintiffs' most recent financial statement and Boris provided him with a December 31, 2007 financial statement for Northern. The statement reflected Northern's assets exceeding $316 million and its net worth of over $210 million.

On May 5, 2008, Boris asked LoVecchio to substitute Altitude for Northern as the investment. LoVecchio requested a letter explaining the relationship between the two entities. Plaintiffs provided such a letter, and confirmed that there was no written investment management agreement between Northern and Altitude nor was there an offering memorandum. They also furnished the requested company formation documents and taxpayer identification information.

Defendants assert that on June 16, 2008, Boris sent Merrill two executed certificates attesting that Northern and Altitude were Rule 144A Qualified Institutional Buyers ("QIB"). Altitude's QIB certificate was previously provided to Goldman Sachs, and attested to ownership or investment on a discretionary basis of $118 million of eligible securities as of December 31, 2007. Northern's certificate attested to ownership or investment of the same amount of eligible securities as of March 31, 2008.

Between May 8, 2008 and July 21, 2008, plaintiffs purchased a total of 17 CMBS bonds in six trades from Merrill. Plaintiffs made fifteen of these purchases in the secondary market from Merrill's secondary mortgage trading desk. The other two trades were with Merrill's syndicate, or primary, mortgage desk. Plaintiffs requested that

Merrill provide repurchase financing, or "repo" financing, for each of the bonds they purchased. In connection with the financing, Altitude and Merrill executed a Master Repurchase Agreement ("MRA"), which contained terms regarding the repo financing and, among other things, set the terms by which Merrill would issue margin calls in the event the underlying collateral dropped below a certain margin maintenance.

Nine of the bonds purchased by plaintiffs were initially offered to the public and therefore, the Prospectus Supplements for the bonds were publicly filed with the Securities and Exchange Commission ("SEC") and were publicly available through the SEC's website as well as through other outlets. The remaining eight bonds were initially offered as private placement deals. Defendants state that some of those private deals had initial public offerings of more senior bonds for the same securitization, and thus also had publicly-filed prospectuses and prospectus supplements available with the SEC. Merrill sent plaintiff the Offering Circular and Structural and Collateral Term Sheet for one of the bonds purchased in the third trade.

Defendants assert that in connection with four of the trades, plaintiffs made their selections after receiving Merrill's daily CMBS offer spreadsheet listing the available bonds. Merrill also sent Trepp Deal Snapshots after sending the offers spreadsheet in connection with some of the trades. Two of the trades were initiated after Boris solicited information from Merrill regarding the offering prices and available financing for certain bonds and provided plaintiffs with a password to independently access the Trepp system.

Additionally, Boris engaged in e-mail negotiations and discussions with Merrill about the offerings.

During this period, defendants maintain that Boris also communicated with several other financial institutions, such as Lehman Brothers, Goldman Sachs and Morgan Stanley, and would sometimes provide snapshots of the offering levels of CMBS to obtain better.

Defendants further assert that after the first three trades, on June 13, 2008, Boris scheduled a meeting at Merrill to discuss methods to hedge plaintiffs' risk through the use of CMBX products and credit default swaps. LoVecchio met with Boris and Dembitzer at Merrill's offices on that date, together with Roger Lehman ("Lehman"), the head of CMBS research at Merrill, Julia Tcherkassova ("Tcherkassova"), Lehman's deputy in CMBS research, Max Baker, a trader on the primary mortgage desk, and Kiva Patten, a trader in real estate derivatives. Prior to the meeting, plaintiffs received Lehman's and Tcherkassova's June 12, 2008 CMBS Weekly research report, which stated:

> • CMBS market activity has dramatically slowed down as of late. This is no doubt, in part, related to the semi-annual CMSA convention held in New York this week but it is not the only reason. Concerns about the economy, inflation and the health of the financial services industry have resurfaced. This has led to a general increase in financial market volatility. . . . While it remains below the peak it reached in mid-March, it is clearly elevated from its recent lows.
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> • The rise in the uncertainty and volatility has also led to a lack of conviction by the buyer base. While investors were eager to add bonds a few weeks ago, at much tighter spreads, they are now sitting on the sides while some bonds are trading at much wider levels.

> • We expect CMBS spreads will, in general, remain reactive to macro market conditions. That means the market's lack of conviction may be warranted as the macro environment swamps fundamental value in the near term. Given the increase in volatility spreads could continue to come under pressure. That said, we believe there remains longer term value at the top of the capital structure.

Following the meeting, Plaintiffs did not purchase any CMBX or CDS products through Merrill. Also on June 13, 2008, Boris engaged in discussions with a representative of National City Bank (National City") regarding National City acting as custody agent for plaintiffs' CMBS securities In the exchange, Boris advised the representative of the bank that plaintiffs had purchased $40 million in face value of CMBS and predicted total purchases by plaintiffs to be in excess of $200 million by year end.

Boris and LoVecchio continued to have discussions about potential bond purchases into the fall of 2008. However, plaintiffs did not make additional purchases of CMBS.

Pursuant to the MRA, Merrill issued a number of margin calls to plaintiffs during the margin financing period. The first margin call was issued on June 24, 2008 in the amount of approximately $460,000, with margin calls for that month totaling about $850,000. Thereafter, plaintiffs received margin calls totaling approximately $1.1 million in July 2008, $4 million in August 2008, $4.4 million in October 2008, and over $15 million in November 2008. After the first call, Boris remarked that plaintiffs should have taken out less leverage, but plaintiffs continued to seek repo financing.

Plaintiffs satisfied the margin calls through early November 2008. On November 10, 2008, they filed a verified complaint in this Court against Merrill, alleging theories of (1) fraud in the inducement, (2) breach of contract, (3) breach of fiduciary duty, (4) fraud and (5) reckless and negligent misrepresentation. Plaintiffs also filed a motion for a preliminary injunction, and sought a temporary restraining order, seeking to enjoin Merrill from liquidating plaintiffs' account. After a hearing on November 13, 2008, the Court (J. Kapnick) struck plaintiffs' proposed TRO and scheduled briefing on plaintiffs' preliminary injunction motion.

On November 14, 2008, Merrill issued a margin call to plaintiffs in the amount of approximately $810,000. On November 19, 2008, Merrill issued a default notice to plaintiffs based upon their failure to meet outstanding margin calls, advising plaintiffs that default had occurred under the MRA and that Merrill was terminating the agreement effective immediately. Pursuant to a stipulation dated November 24, 2008, plaintiffs withdrew their request for a preliminary injunction, paid off the repo financing, and the 17 CMBS securities were transferred to them.

Following the transfer, plaintiffs attempted to sell the CMBS to other institutions, but were not satisfied with the price offered to purchase them. Ultimately, in February 2009, plaintiffs sold the bonds for approximately $16.2 million, for a loss of over $24 million from the original $40.6 million they paid.

On February 5, 2009, Merrill served a verified answer to the verified complaint. On December 6, 2011, plaintiffs served an amended complaint, alleging three causes of action: (1) fraud, (2) breach of fiduciary duty and (3) reckless and negligent misrepresentation. Merrill served an answer to amended complaint on February 23, 2012.

The parties appeared before the Court (J. Kapnick) for oral argument on May 9, 2013, at which time the Court granted defendants' motion for summary judgment to the extent of dismissing the causes of action for breach of fiduciary and reckless and negligent misrepresentation. Accordingly, the only the cause of action for fraud remains, and is addressed in this decision.

In support of their motion, defendants argue that plaintiffs are sophisticated commercial real estate investors, and that their complaint fails to allege any actionable misstatements of a material, present fact, nor any material omissions that Merrill had a legal duty to disclose. Defendants also argue that plaintiffs can not establish reasonable reliance, or that any of the alleged misstatements or omissions proximately caused their alleged damages, nor can they show an intent to defraud.

In opposing the motion for summary judgment, plaintiffs submitted affidavits from Dembitzer and Boris attesting to alleged misrepresentations made by Merrill's representatives. They assert that at the initial April 16, 2008 meeting, Mulligan was advised that plaintiffs were unfamiliar with CMBS but were interested in safe, short-term, liquid investments in which to park money until it was needed for other real estate

ventures. In response, Mulligan allegedly assured them that CMBS were liquid and traded in a competitive market; were as safe as U.S. Treasury and Israeli bonds; were based on loans that had been selected according to more stringent standards than those with which plaintiffs were familiar; and that their AAA and AA ratings meant that they were "money good."

Additionally plaintiffs submitted affidavits by experts who opine that plaintiffs were unqualified to purchase CMBS and mistakenly thought that they were in a fiduciary relationship with Merrill, and that plaintiffs did not meet the criteria for being Qualified Institutional Buyers or Accredited Institutional Investors. Finally, plaintiffs argue that Merrill failed to disclose various characteristics of CMBS relating to their value and liquidity.

Discussion

"To make a prima facie claim of fraud, the complaint must allege misrepresentation or concealment of a material fact, falsity, scienter on the part of the wrongdoer, justifiable reliance and resulting injury." *Dembeck v 220 Cent. Park S., LLC*, 33 AD3d 491, 492 (1st Dept 2006); *see Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 (1st Dept 2014). Furthermore, "in the absence of any affirmative misrepresentation or any fiduciary obligation, a party may be liable for nondisclosure where it has special knowledge or information not attainable by plaintiff, or when it has made a misleading partial disclosure." *Basis Yield*, 115 AD3d 128, 135.

Here, plaintiffs have not identified any actionable false statements regarding the CMBS, or established that they justifiably relied on any representations regarding their value or risk. Nor have they shown that defendants possessed any material information regarding their investments that was nonpublic or otherwise unobtainable.

The statements attributed to Mulligan regarding the safety and liquidity of the CMBS, were, at most, statements of opinion of value, future expectations or "puffery" not rising to the level of fraud. *See DH Cattle Holdings Co. v Smith*, 195 AD2d 202 (1st Dept 1994) (statements that option was a "safe investment" are "generally considered, not actionable statements of fact, but mere opinion and puffery"); *Elghanian v Harvey*, 249 AD2d 206, 206 (1st Dept 1998); *Sidamonidze v Kay*, 304 AD2d 415, 416 (1st Dept 2003); *Ashland Inc. v Morgan Stanley & Co., Inc.*, 700 F Supp. 2d 453, 465, 471 (SD NY 2010) (plaintiff's claim that Morgan Stanley repeatedly stated that it "would intervene and 'make the market,' thus ensuring liquidity," even if found to be true, was non-actionable puffery), *aff'd* 652 F3d 333 (2d Cir 2011). Notably, plaintiffs do not contend that Mulligan made any representations about the features and value of any particular CMBS bond at the time plaintiffs were considering purchasing it.

Rather, the only representations allegedly made pertained to Merrill's CMBS bond offerings in general, and were made several weeks before the first bond transaction. The actual selections were made by Boris after reviewing the list of offerings and the Trepp deal snapshots. Plaintiffs have not specified any misrepresentations of fact made to him

to induce a purchase. To the contrary, the record establishes that Boris was acting upon his own experience and understanding of the CMBS bond market.

Plaintiffs' assertion that Boris' knowledge was inadequate, and the attempt to portray Merrill as victimizing a naive elderly woman and her son, are unavailing. The record establishes that the corporate shareholders and officers were sophisticated real estate operators who controlled properties worth hundreds of millions of dollars. That being the case, they were not entitled to blindly accept Mulligan's generalities about CMBS safety. "[A] sophisticated plaintiff cannot establish that it entered into an arm's length transaction in justifiable reliance on alleged misrepresentations if that plaintiff failed to make use of the means of verification that were available to it." *HSH Nordbank AG v UBS AG*, 95 AD3d 185 (1st Dept 2012) (quotations and citations omitted). "New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations . . . by investigating the details of the transactions . . . ." *Global Mins. & Metals Corp. v Holme*, 35 AD3d 93, 100 (1st Dept 2006), *lv denied* 8 NY3d 804 (2007). If plaintiffs' understanding of commercial mortgage securitization was imperfect, they could have retained qualified financial experts to evaluate their anticipated investments. *See Barneli & Cie SA v Dutch Book Fund SPC, Ltd.*, 95 AD3d 736, 737 (1st Dept 2012) ("If neither plaintiff nor its representatives had expertise in algorithms or probability theory, then plaintiff should have retain[ed] qualified outside consultants" before investing $50 million).

Also, plaintiffs may not claim reliance on the alleged representations because the risks they complain of were disclosed in the prospectuses and other publicly available documents. *In re Dean Witter Managed Futures Ltd. Partnership Litigation*, 282 A.D.2d 271, 271 (1st Dept 2001). Plaintiffs' assertion that defendants did not send them the prospectuses has no force, as they could have asked for them or otherwise obtained them. *See Terra Securities Asa Konkursbo v Citigroup, Inc.*, 740 F Supp2d 441, 449 (SD NY 2010) ("The availability of information in this context is not whether the requisite material was made available to Plaintiffs by Defendants. Rather, available in this context denotes accessible -- would the information necessary to unmask the alleged fraud have been accessible to the sophisticated party through minimal diligence"). Both Boris and Dembitzer testified that they did not visit the SEC website to locate and review the publicly available prospectuses.

Nor can plaintiffs rely on the exception under the "special facts" doctrine. Absent a fiduciary relationship between parties, that doctrine only imposes a duty to disclose "when one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair." *Pramer S.C.A. v Abaplus Int'l. Corp.*, 76 AD3d 89, 99 (1st Dept 2010). The party invoking it must show "that the material fact was information peculiarly within the knowledge of the defendant . . . and . . . that the information was not such that could have been discovered by the plaintiff through the exercise of ordinary intelligence." *Jana L. v W. 29th St. Realty Corp.*, 22 AD3d 274, 278 (1st Dept 2005)

(internal quotations and citations omitted). Although plaintiffs complain that Merrill failed to make complete disclosure regarding the reliability of the bond ratings, the liquidity of the market and loan delinquency rates, they do not contend that this information was in Merrill's exclusive possession.[1]

Plaintiffs' argument that they were ineligible to purchase the securities because they did not meet the criteria for Qualified Institutional Buyers or Accredited Institutional Investors, also fails. Putting aside the question of whether plaintiffs should be estopped from denying their qualifications after submitting sworn certifications that they were QIBs, QIB status, at most, indicates sophistication. *See, e.g., Dodona I, LLC v Goldman, Sachs & Co.*, 847 F Supp 2d 624 (SD NY 2012). The papers submitted show that the plaintiffs were highly sophisticated regardless of whether they were technically QIBs. And even if plaintiffs were not sophisticated with respect to complex CMBS, their reliance on the alleged oral assurances of safety was unreasonable as a matter of law due to their lack of inquiry. *See Iconix Brand Group Inc. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 505 Fed Appx 14, 17 (2d Cir 2012) (unpublished decision) ("To protect itself, Iconix simply had to request this important document before acquiescing in a $13 million purchase of unregistered securities that it knew were salable only to Qualified Institutional Buyers"); *Brown v E.F. Hutton Grp., Inc.*, 991 F.2d 1020, 1032–33 (2d Cir 1993) (plaintiffs' "asserted reliance on the brokers' alleged oral statements, without

[1] Further, the Court (J. Kapnick) found at oral argument that there was no "indication that there is anything that was in defendants' exclusive control."

further inquiry, [was] reckless and unjustifiable," notwithstanding assumptions that plaintiffs were "unsophisticated investors and that the brokers initiated the transactions").

Accordingly, defendants' motion for summary judgment is granted and the action is dismissed.

In accordance with the foregoing it is

ORDERED that the motion by defendants Merrill, Pierce, Fenner & Smith Incorporated and Merrill Government Securities, Inc. for summary judgment is granted, and plaintiffs Northern Group Incorporated and Altitude Partners, LLC amended complaint is dismissed; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

This constitutes the decision and order of this Court

Dated: New York, New York
July 25, 2014

ENTER:

Saliann Scarpulla, J.S.C.