

**Board of Mgrs. of the Walton Condominium v 264  
H2O Borrower, LLC**

2018 NY Slip Op 34545(U)

January 29, 2018

Supreme Court, New York County

Docket Number: Index No. 650852/2017

Judge: Arlene P. Bluth

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SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK : PART 32

-----X  
THE BOARD OF MANAGERS OF THE WALTON  
CONDOMINIUM,

Plaintiff,

Index No. 650852/2017  
Motion Seq: 001

-against-

264 H2O BORROWER, LLC, ROBERT QUACO,  
DAVID LEVINE, and GLEN WOLLAND

**DECISION & ORDER**  
**ARLENE P. BLUTH, JSC**

Defendants.

-----X  
The motion to dismiss by defendants Quaco, Levine and Wolland (collectively, the  
“individual defendants”) is denied.

**Background**

This action arises out of a condominium building located at 264 Water Street in  
Manhattan. Defendant 264 H2O Borrower, LLC (“Sponsor”) was the sponsor for the building.  
The individual defendants were principals of the Sponsor.

The Sponsor purchased the building on July 28, 2011 and converted it to a condominium  
building. The offering plan included 26 residential units and a large commercial unit. Plaintiff  
claims that the Sponsor maintained control of the board of managers until about December 26,  
2014.

Plaintiff, the current Board of Managers, insists that soon after it took control of the  
board, the Sponsor informed plaintiff that the building needed significant improvements  
including, specifically, a completely new roof. Plaintiff argues that the Sponsor represented in

the offering plan that it had no knowledge of any material defects or major repairs needed for the building. Despite this representation, plaintiff claims that the building's exterior walls, roof, terraces and the lobby all need repairs and that this constitutes a breach of the offering plan.

Plaintiff brings two causes of action against the individual defendants: breach of fiduciary duty and fraud. The fraud claim is brought against only defendants Quaco and Levine.

The individual defendants move to dismiss these two claims. The individual defendants claim that the business judgment rule bars the fiduciary duty cause of action and that the fraud claim must be dismissed because it is pre-empted by the Martin Act.

In opposition, plaintiff insists that it has a cognizable cause of action for breach of fiduciary duty because the individual defendants acted to protect their personal finances rather than do what was in the best interest of the condo. Plaintiff also insists that it may pursue a fraud claim because its complaint contains affirmative misrepresentations, and only claims of omissions are barred by the Martin Act.

### **Discussion**

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. We accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*Leon v Martinez*, 84 NY2d 83, 87-88, 614 NYS2d 972 [1994] [citations omitted]).

### **Breach of Fiduciary Duty**

"To state a claim for breach of fiduciary duty, plaintiffs must allege that (1) defendant owed them a fiduciary duty, (2) defendant committed misconduct, and (3) they suffered damages

caused by that misconduct" (*Burry v Madison Park Owner, LLC*, 84 AD3d 699, 700 924 NYS2d 77 [1st Dept 2011]).

The moving defendants argue that plaintiff's complaint fails to state a claim for breach of fiduciary duty against them and that, even if it did, the business judgment rule bars this cause of action.

The Court finds that plaintiff has stated a claim for breach of fiduciary duty against the moving defendants. Plaintiff's complaint asserts that the individual defendants were appointed to make up the board of managers following the first closing (NYSCEF Doc. No. 1, ¶ 78). Plaintiff alleges that the individual defendants willfully failed to address the needs of the condo while in control of the board in order to maximize their own investments. Plaintiff claims that this failure forced plaintiff to undertake costly repairs to remedy problems about which the individual defendants knew but failed to address while they controlled the board (*see id.* ¶¶ 78-85).

Although the moving defendants correctly point out that the business judgment rule limits a court's ability to review decisions made by a board, this Court is unable to find that the business judgment rule applies under these circumstances at this stage of the litigation. On a motion to dismiss, the Court must take as true the allegations in the complaint. These allegations suggest that the individual defendants chose to ignore badly-needed repairs and leave a future board to deal with the huge expenses and numerous problems with the building. Plaintiff made a prima facie showing that these individual defendants lacked the independence required for board members (*see S.H. & Helen R. Scheuer Family Foundation, Inc., By and Through Scheuer v 61 Assocs.*, 179 AD2d 65, 69-70, 582 NYS2d 662 [1st Dept 1992] [observing that at the motion to

dismiss stage, application of the business judgment rule is not appropriate where plaintiff has met its prima facie burden to show a lack of disinterested independence or dual relation]).

The individual defendants' claim, in reply, that plaintiff submits "absolutely no evidence" supporting the contention that the moving defendants breached their fiduciary duties misses the point. Plaintiff need not substantiate or prove its claim on a motion to dismiss—it need only allege a cognizable claim. Plaintiff has done that here; plaintiff claims that the individual defendants did not take necessary action when they controlled the board despite knowing that the building needed work because doing the work would decrease their personal financial gain.

Discovery may reveal that the individual defendants exhibited the requisite independence, that the issues with the building did not require immediate attention and that the business judgment rule protects their actions. But simply claiming that the business judgment rule shields the board's decisions does not merit dismissal of this cause of action. The purpose of a board of managers is to look out for the interests of the condo—if a controlling faction of that board (here, the individual defendants) choose to ignore necessary repairs for personal gain and passes that clear and obvious expense on to a new board, then that constitutes a breach of their fiduciary duties to the condo while they served on the board.

### **Fraud**

"The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages" (*Eurycleia Partners, L.P. v Seward & Kissel, LLP*, 12 NY3d 553, 559, 883 NYS2d 147 [2009]).

The moving defendants argue that plaintiff's fraud claim is barred by the Martin Act.

"The Martin Act authorizes the Attorney General to investigate fraudulent practices in the marketing of stocks, bonds and other securities within or from New York State. . . . In 1960, . . . the Legislature was asked to choose a legislative approach for the protection of purchasers in offerings of cooperative and condominium units. The choice was incorporated into the state's blue sky law (the Martin Act) and was a disclosure approach— full disclosure of risks and unit purchasers' self-protection by the analysis of risks" (*Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership*, 12 NY3d 236, 243, 879 NYS2d 17 [2009]).

"[A] private litigant may not pursue a common-law cause of action where the claim is predicated solely on the violation of the Martin Act or its implementing regulations and would not exist but for the statute. But, an injured investor may bring a common-law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act for its viability. Mere overlap between the common law and the Martin Act is not enough to extinguish common-law remedies" (*Assured Guar. (UK) Ltd. v J.P. Morgan Inv. Mgt. Inc.*, 18 NY3d 341, 353, 939 NYS2d 274 [2011]).

Plaintiff relies upon a recent First Department decision, *Bd. of Managers of South Star v WSA Equities, LLC* (140 AD3d 405, 30 NYS3d 876(Mem) [1st Dept 2016]), in opposition to this branch of the individual defendants' motion. In that case, the First Department found that "To the extent the fraud claim is based on omissions in the offering plan . . . it is barred by the Martin Act. However, to the extent it is based on defendants' affirmative misrepresentations . . . it is not barred" (*id.* at 405).

This Court finds that under *WSA*, the complaint states a cognizable cause of action for fraud because it identifies affirmative misrepresentations by the individual defendants in the offering plan. Plaintiff pled this claim with the requisite particularity (*see* CPLR 3016(b)) by identifying that these misrepresentations were made (in the offering plan) and to whom they were made (to the residential unit owners). The complaint alleges, for instance, that the individual defendants “knew, at the time the Plan was filed, the Condominium roof had failed, and was leaking” even though the Plan stated that “there are currently no leaks in the roof and the condition appears to be adequate” (NYSCEF Doc. No. 1, ¶¶ 93, 95). Plaintiff claims that the residential unit owners relied upon these misrepresentations when purchasing the condo units and are now left with a structurally unsound building requiring extensive repairs (*id.* ¶¶ 98-101). This constitutes a purported affirmative misrepresentation rather than an omission.

The individual defendants failed to sufficiently distinguish *WSA*. Instead, they cite to *Kerusa* (a Court of Appeals case mentioned above) for the proposition that a fraud claim based on the offering plan is not allowed under the Martin Act. But *WSA* suggests that fraud claims can be viable under certain circumstances and another Court of Appeals case (*Assured Guar. (UK) Ltd.*) explicitly allows fraud claims not entirely dependent on the Martin Act’s disclosure rules.

Further, a review of the underlying decision in *WSA* reveals that it involved nearly an identical situation to the instant matter. In *WSA*, the plaintiff (also the Board of Managers) asserted a fraud claim based, in part, on misrepresentations about the condition of the building in the offering plan (*see Bd. of Managers of South Star v WSA Equities, LLC*, 2014 5390551, \*5 [Sup Ct, NY County 2014]). The Supreme Court found that plaintiff had properly pled a fraud claim and the First Department modified that finding only to the extent that it dismissed the fraud

allegations based on omissions. Therefore, plaintiff in the instant action properly alleged a fraud claim based on misrepresentations in the offering plan.

Accordingly, it is hereby

ORDERED that the motion to dismiss is denied. Movants to serve and file an answer in accordance with the CPLR.

This is the Decision and Order of the Court. The parties are directed to appear for the already-scheduled preliminary conference on May 8, 2018 at 2:15 p.m.

**Dated: January 29, 2018**  
**New York, New York**



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**ARLENE P. BLUTH, JSC**

**HON. ARLENE P. BLUTH**