

Sharp v Duff & Phelps, LLC

2023 NY Slip Op 30481(U)

February 15, 2023

Supreme Court, New York County

Docket Number: Index No. 652332/2021

Judge: Andrew Borrok

Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various New York State and local government sources, including the New York State Unified Court System's eCourts Service.

This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 53

-----X

BRADLEY D. SHARP, BRADLEY D. SHARP,

Plaintiff,

- v -

DUFF & PHELPS, LLC,

Defendant.

INDEX NO. 652332/2021

MOTION DATE N/A

MOTION SEQ. NO. 005

**DECISION + ORDER ON
MOTION**

-----X

HON. ANDREW BORROK:

The following e-filed documents, listed by NYSCEF document number (Motion 005) 54, 55, 56, 57, 58, 59, 60, 62, 63, 64, 65

were read on this motion to/for DISMISS.

Duff & Phelps, LLC’s (**Duff & Phelps**) motion to dismiss must be granted because the claims are time barred. The parties to the Contract (hereinafter defined) agreed that lawsuits involving claims arising out of the Contract must be brought within “one year from the date when the aggrieved party becomes aware of or ought reasonably to have become aware of the facts, which give rise to the other's alleged liability.” The claims in this lawsuit arise out of and relate to the provision of Duff & Phelps’ services pursuant to the Contract. Inasmuch as the Securities and Exchange Commission (the **SEC**) brought an enforcement action (the **SEC Action**) on March 22, 2019 based on the false valuation of DLI’s (hereinafter defined) assets, this is the latest time that the claims could have accrued. The parties entered into a Tolling Agreement (hereinafter defined) where the tolling expired on September 3, 2020 when the Plaintiffs first brought suit in California. At that time, there were 17 days remaining for the Plaintiffs to bring their lawsuit. They waited 70 days – *i.e.*, they filed on April 8, 2021. Thus, the claims are 53 days untimely and must be dismissed. The Plaintiffs’ argument that it gets extra tack-on days at the end of the

statute of limitations period because of the Governor's orders during COVID fails because the Executive Orders time period overlapped with the tolling agreements (*Chavez v Occidental Chem Corp.*, 35 NY3d 492, 505 n 8 [2020] ["A toll does not extend the statute of limitations indefinitely but merely suspends the running of the applicable statute for a finite and, in this instance, readily identifiable time period; keyed to judicial determinations recorded in the litigation record, the period of the toll is excluded from the calculation of the time in which the plaintiff can commence an action"]). Additionally, the Court notes that to the extent the claims are asserted on behalf of DLI or the Master Fund, the claims are also barred by the doctrine of *in pari delicto* because DLI and the Master Fund earned increased management fees based on their participation in the alleged fraud (*VA Management, LP v Odeon Capital Group, LLC*, 189 AD3d 525, 525 [1st Dept 2020], *lv denied* 36 NY3d 912 [2021]). Thus, the lawsuit must be dismissed.

The Relevant Facts and Circumstances

Reference is made to (i) an action (the **California Lawsuit**) captioned *Sharp v Duff & Phelps, LLC* brought on September 3, 2020 in United States District Court for the Central District of California (the **California Federal Court**), (ii) a certain Engagement Letter and Terms and Conditions (collectively, the **Contract**; NYSCEF Doc. No. 57), dated October 26, 2016, by and between DLI and Duff & Phelps, and (iii) a tolling agreement (the **Tolling Agreement**; NYSCEF Doc. No. 58), dated as of March 6, 2020 by and between the Receiver (hereinafter defined) and Duff & Phelps.

The Receiver brought the California Lawsuit alleging claims for breach of contract, professional negligence, gross negligence, aiding and abetting breach of fiduciary duty, and negligent

misrepresentation. Significantly, as it relates to this case, the California Federal Court (i) found that under binding 9th Circuit precedent, (x) the Receiver stepped into the shoes of Direct Lending and (y) both the contractual and tort claims arise under the Contract such that the parties' bargained-for forum selection clause required the lawsuit to be brought in New York and that such lawsuit could not be maintained in California and (ii) dismissed the California Lawsuit on the grounds of *forum non conveniens*:

While Sharp does not dispute that his contract claim is subject to the forum selection clause, he argues that his other claims do not “aris[e] out of th[e] Contract.” In the Ninth Circuit, “disputes ‘arising under’ the agreement [are] only those disputes ‘relating to the interpretation and performance of the contract itself.’” *Cape Flattery Ltd. v. Titan Mar., LLC*, 647 F.3d 914, 924 (9th Cir. 2011). In addition to the breach of contract claim, the complaint alleges claims for professional negligence, gross negligence, aiding and abetting breach of fiduciary duty, and negligent misrepresentation. ***All of these claims arose out of Defendant’s actions while performing its duties under the contract. Further, the negligence claims are very likely to require interpretation of the contract to determine exactly what Defendant’s responsibilities were and what disclaimers might have been specified in the contract***

(NYSCEF Doc. No. 64, at 1-2 [emphasis added]). The California Federal Court also rejected the Receiver’s argument that the case should be transferred to the District Court for the Southern District of New York rather than dismissed – *i.e.*, holding that the forum selection clause specified the courts of the State of New York (*id.*, at 3).

As relevant, the parties expressly agreed that New York law would govern any claim arising out of the Contract (NYSCEF Doc. No. 57, ¶ 27). Most significantly, as it relates to the instant dispute, the parties also expressly agreed to a broad one-year statute of limitations period with respect to any legal proceeding arising from or in connection with the Contract:

Both of us accept and acknowledge that any legal proceedings arising from or in connection with this Contract (or any variation or addition thereto) must be commenced within one year from the date when the aggrieved party becomes

aware of or ought reasonably to have become aware of the facts, which give rise to the other's alleged liability. Both of us also agree that no action or claims will be brought against any of our employees, officers, managers, or partners personally, in each case, who are acting solely in the scope of their employment

(*id.*, ¶ 23).

Under the Contract, Duff & Phelps was hired to generate a range of fair value estimates for DLI's investments and to assess the reasonableness of DLI's internal cash flow estimates for those investments (NYSCEF Doc. No. 57, at 1). The parties agreed that, in the course of performing its services for DLI, Duff & Phelps would use and rely upon financial and other information obtained from DLI and from various public, financial, and industry sources (*id.*, at 1-2). DLI represented that, to its knowledge, all information it provided would be correct in all material respects and Duff & Phelps was not responsible for the accuracy and completeness of information supplied by DLI (*id.*, at 2). These valuations would be used, among other things, to value DLI's assets, which were largely illiquid, and were held by the Master Fund (NYSCEF Doc. No. 49, ¶¶ 26-27). The valuations of the assets held by the Master Fund were used to assess management fees and performance fees charged by DLI to DLI Capital, which were then allocated to DLIF and DLIFF, and to calculate the value of DLIF and DLIFF's debt and equity investments in DLI Capital (*id.*, ¶¶ 28-29). In other words, and significantly, DLI earned management fees based on the net asset value (NAV) of the assets held under management. This, as described below, is the NAV that DLI purported fraudulently increased and which Duff & Phelps allegedly rubber-stamped.

The Plaintiffs allege in the Amended Complaint (the AC; NYSCEF Doc. No. 49) that Duff & Phelps grossly overvalued the investments of DLI by \$459.4 million and other DLI-related

entities and caused them hundreds of millions of dollars in losses (*id.*, ¶¶ 1-2). As discussed above, this was allegedly done based on unchecked information provided by Brendan Ross, the sole member of DLI and one of three members of DLI's board of directors (*id.*, ¶¶ 1, 12, 26). The Plaintiffs allege that this was done by Duff & Phelps to preserve an income stream in professional service fees from DLI (*id.*). These valuations were ultimately a substantial factor in forcing DLI and related entities into receivership.

On February 11, 2019, DLI first became aware that some of its investments were overstated and that such overstatement was likely the result of undetermined misconduct:

108. On February 11, 2019, DLI informed investors that DLIF and DLIFF had suspended withdrawals and redemptions effective February 8, 2019. DLI cited the delinquency of the VoIP obligor payments on a \$192 million loan as the reason for the suspension. For the first time, DLI informed investors that the Dutch government had been investigating VoIP since 2017, and that the cessation of payments was likely a result of undetermined misconduct, and that a substantial portion of the outstanding \$160 million loan balance may not be recoverable

(NYSCEF Doc. No. 49, ¶ 108).

By March 19, 2019, it was clear that DLI knew that its investments had been overstated for years. To wit, DLI informed its investors that its positions in QuarterSpot, one of its investments, was materially overstated for a period of years (*id.*, ¶ 109). This investment was one of the investments allegedly overstated by Duff & Phelps.

On March 22, 2019, the SEC filed the SEC Action against DLI alleging that DLI engaged in a multi-year fraud that resulted in \$11 million in overcharges of fees to fund investors and inflation of DLI's private funds' returns (*id.*, ¶¶ 110 and 111). In the SEC Action, the SEC alleged:

4. This matter concerns a multi-year fraud perpetrated by Defendant Direct Lending Investments, LLC (“DLI”), a registered investment adviser, through its then principal, Brendan Ross (“Ross”), which resulted in approximately \$11 million in over-charges of management and performance fees to fund investors, and the inflation of DLI’s private funds’ returns.

5. DLI advises a private fund structure that invests in various lending platforms, including QuarterSpot, Inc. (“QuarterSpot”), an online small business lender. Management at DLI recently discovered that for years, Ross, DLI’s 100% owner and then-chief executive officer, arranged with QuarterSpot to falsify borrower payment information for QuarterSpot’s loans and to falsely report to DLI that borrowers made hundreds of monthly payments when, in fact, they had not.

6. According to a senior executive representative of DLI, many of these loans should have been valued at zero, but instead were valued at par, because of the false payments Ross helped engineer. The effect of this was that, between 2014 and 2017, DLI cumulatively overstated the valuation of its QuarterSpot position by approximately \$53 million and misrepresented the Funds’ performance by approximately two to three percent annually. *As a result, DLI collected roughly \$11 million in excess management and performance fees from the Funds that it would not have otherwise collected, had the QuarterSpot position been accurately valued*

(NYSCEF Doc. No. 66, ¶¶ 4-6 [emphasis added]).

On April 1, 2019, the Court placed the Receivership Entities into receivership (*id.*, ¶ 112).

Bradley Sharp (the **Receiver**) was appointed as the Permanent Receiver for the Estate of Direct Lending Investments, LLC (**DLI**), Direct Lending Income Fund, L.P. (**DLIF**), Direct Lending Income Feeder Fund, Ltd. (**DLIFF**), DLI Capital, Inc., DLI Lending Agent, LLC, and DLIE Assets Bravo, LLC (DLI, DLIF, DLIFF, DLI Capital, Inc., DLI Lending Agent, LLC, and DLIE Assets Bravo, LLC, together with their successors, subsidiaries, and affiliated, collectively, hereinafter, the **Receivership Entities**). Bradley Sharp and Christopher Johnson (the **Liquidators**, and, together with the Receiver, hereinafter, collectively, the **Plaintiffs**) were appointed as Joint Official Liquidators of DLIFF.

On September 3, 2020, the Plaintiffs brought the California Lawsuit alleging breach of contract, professional negligence, gross negligence, aiding and abetting breach of fiduciary duty, and negligent misrepresentation. As discussed above, the California Federal Court dismissed the California Lawsuit on January 28, 2021. Following dismissal, the Plaintiffs brought suit here on April 8, 2021 to recover damages for the benefit of all of the Receivership Entities asserting causes of action for (i) professional negligence (first cause of action), (ii) gross negligence (second cause of action), (iii) aiding and abetting breach of fiduciary duty (third cause of action), (iv) negligent misrepresentation (fourth cause of action), and (v) breach of contract (fifth cause of action).

Discussion

On a motion to dismiss, the Court must afford the pleading a liberal construction, accept the facts as alleged in the complaint as true, accord the plaintiff 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 [1994]).

The Plaintiffs step into the shoes of DLI

The Plaintiffs stand in the shoes of the Receivership Entities and can only assert claims that the Receivership Entities could have asserted (*Eberhard v Marcu*, 530 F3d 122, 132 (2d Cir 2008)). As the California Federal Court also found in the California Lawsuit, the Plaintiffs stand in the shoes of the Receivership Entities and are bound to the terms of the Contract (NYSCEF Doc. No. 64, at 1).

New York law applies to the instant action

As discussed above, pursuant to the terms of the Contract, DLI and Duff & Phelps expressly agreed that New York law would apply to disputes arising under the Contract (*Royal Park Investments SA/NV v Stanley*, 165 AD3d 460, 461 [1st Dept 2018], citing *Ministers and Missionaries Ben. Bd. v Snow*, 26 NY3d 466, 470 [2015]). The Plaintiffs argument that the claims do not solely arise out of the contract and that therefore the Court must apply California law fails. It has already been determined that both contractual and tort liability arise in connection with the services provided pursuant to the Contract and that, as such, the forum selection clause applies. Inasmuch as the forum selection clause also mandates that New York law governs this dispute, New York law applies to the instant case (*Feinberg v Boros*, 99 AD3d 219, 226 [1st Dept 2012] [“It is well established that the doctrine of collateral estoppel bars a litigant from disputing an issue in another proceeding when that issue was decided against the litigant in a proceeding in which he had a full and fair opportunity to contest the matter”]; *Reid v Reid*, 198 AD2d 993, 994 [2d Dept 2021]). Even if the California Federal Court’s holding did not mandate this result, which it does, the result would be unchanged – *i.e.*, the parties agreed that New York law would apply to disputes involving the provision of Duff & Phelps services – the very thing at issue in this case.

Dismissal is required because the claims are time-barred

Parties to a contract “may agree to limit the period of time within which an action must be commenced to a period shorter than that provided by the applicable statute of limitations” (*J Construction Co., LLC v Westchester Fire Ins. Co.*, 165 AD3d 1076, 1078 [2d Dept 2018]). Contractual limitations periods should be enforced where the limitation is not unreasonably short

(*Dart Mechanical Corp. v City of New York*, 121 AD3d 452, 452 [1st Dept 2014] [enforcing a six-month contractual limitations period]). In this Contract, the parties agreed to one year from the time that the claims accrued. Inasmuch as the parties agreed that the claims accrued when either party ought to reasonably become aware of claim, the latest the claims could have accrued is on March 22, 2019, the date the SEC brought the SEC Action¹. (Arguably, the claims accrued much earlier than that as Mr. Ross' knowledge would be imputed to DLI – and he is the primary source of the alleged fraud). The parties entered into the Tolling Agreement effective March 6, 2020, just 17 days short of the expiration of the one-year contractual limitations period. The Tolling Agreement was set to expire on June 5, 2020, unless extended. The Tolling Agreement was ultimately extended until the Plaintiffs filed their lawsuit in California on September 3, 2020. That case was dismissed by order of the California Federal Court dated January 28, 2021. The contractual limitations period then began to run again, but the Plaintiffs did not bring their suit within 17 days as required. Instead, they waited 70 days to file this lawsuit – *i.e.*, on April 8, 2021. Thus, the claim is untimely and must be dismissed. The Plaintiffs argument that the earliest date on which the claims could have accrued is after the receivership was appointed and permitted to conduct its investigation fails. The Receiver was appointed precisely because of the valuation problem and the Receiver does not get extra time based on its appointment. It steps into the shoes of DLI and is bound by that time period. Nor do the Executive Orders of the Governor operate to tack on extra time at the end of the tolled period. The tolling agreement was in place during the Executive Orders in question and the Executive Orders do not provide for a tack-on once ended that would save these claims (*Chavez*, 35 NY3d at 505 n 8).

¹ The Defendants argue, for purposes of this motion, that the latest date by which the claims could have accrued is April 1, 2021, when the Receiver was appointed. Even under this theory, the claims would have been 45 days late and therefore still time barred.

In pari delicto bars the claims asserted on behalf of DLI and the Master Fund

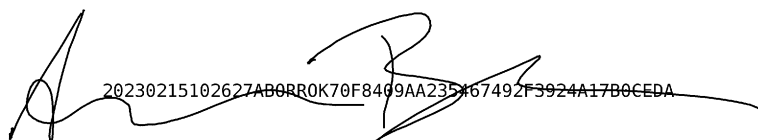
“The doctrine of in pari delicto mandates that the courts will not intercede to resolve a dispute between two wrongdoers” (*Kirschner v KPMG LLP*, 15 NY3d 446, 464 [2010]). It bars a party that has been injured “as a result of its own intentional wrongdoing from recovering for those injuries from another party whose equal or lesser fault contributed to the loss” (*Rosenbach v Diversified Group, Inc.*, 85 AD3d 569, 570 [1st Dept 2011]).

The Plaintiffs’ claims brought on behalf of DLI and the Master Fund are barred by *in pari delicto* (*VA Management, LP*, 189 AD3d at 525 [finding that the adverse interest exception is unavailable where the plaintiff “benefitted directly from its employees’ fraud by way of inflated NAV for the funds it managed”]). As discussed above, DLI inflated NAV so that it could charge more fees. Duff & Phelps allegedly rubber-stamped. DLI can not now claim against Duff & Phelps by virtue of their alleged contribution to this fraud. However, for completeness, *in pari delicto* would not bar the claims brought by DLI Capital, DLIF, or DLIFF. These are the feeder funds who paid the asset management fees based on the over-inflated NAV.

The Court has considered the Plaintiffs’ remaining contentions and finds them unavailing.

It is hereby ORDERED that Duff & Phelps’ motion to dismiss is granted.

2/15/2023
DATE



20230215102627AB0RR0K70F8409AA235467492F3924A17B0CEDA

ANDREW BORROK, J.S.C.