

Koza v Mutual Fund Series Trust

2023 NY Slip Op 30498(U)

February 16, 2023

Supreme Court, New York County

Docket Number: Index No. 655297/2020

Judge: Margaret A. Chan

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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 49M

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SUSAN KOZA,

Plaintiff,

- v -

MUTUAL FUND SERIES TRUST, ALPHACENTRIC
ADVISORS LLC, NORTHERN LIGHTS DISTRIBUTORS,
LLC, JERRY SZILAGYI, BERT PARISER, TOBIAS
CALDWELL, TIBERIU WEISZ, ERIK NAVILOFF,
GARRISON POINT CAPITAL, LLC, FREDRICK SCHMIDT

Defendant.
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INDEX NO. 655297/2020

MOTION DATE 08/09/2022

MOTION SEQ. NO. 002

**DECISION + ORDER ON
MOTION**

HON. MARGARET A. CHAN:

The following e-filed documents, listed by NYSCEF document number (Motion 002) 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 77, 80, 81, 82

were read on this motion to/for

DISMISS

In this putative class action alleging strict liability and negligence claims against defendants for their alleged violation of Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (the Securities Act), defendant Garrison Point Capital, LLC (Garrison Point) moves pursuant to CPLR 3211(a)(1), (7) and (8) for an order dismissing the amended complaint against it. Plaintiff opposes the motion.

Background

This action concerns the AlphaCentric Income Opportunities Fund (the Fund) that lost about \$2 billion in a fire sale to meet a large amount of redemption requests during the coronavirus pandemic (NYSCEF # 8 - amended complaint, ¶¶ 3, 9-10). Plaintiff Susan Koza purchased shares of the Fund during the period of October 14, 2017 through March 22, 2020, inclusive (the Class Period) (*id.*, ¶¶ 1, 16). Defendant Mutual Fund Series Trust (the Trust) is the Fund's registrant and an open-end management investment company, and the Fund is one of the "series" of mutual funds within the Trust (*id.*, ¶ 17). Defendant AlphaCentric Advisors LLC (AlphaCentric) is the Fund's investment advisor and retained Garrison Point to act as the Fund's sub-advisor (*id.*, ¶¶ 19-20). Other defendants in this action are Northern Lights Distributors LLC (Northern Lights), the principal underwriter and distributor of the Fund, and individuals who are and/or were the Trust's trustees (Trustees) and officers (Individual Defendants) (*id.*, ¶¶ 22-28).

In the amended complaint, plaintiff alleges that the Fund's offering materials were false and materially misleading in violation of the Securities Act since the Fund, *inter alia*, portrayed itself as devoted to "capital preservation" while it was heavily invested in highly illiquid, risky and distressed assets such as legacy non-agency residential mortgage-backed securities (*id.*, ¶¶ 2-4, 50-53). In March 2020, the Fund experienced "a sudden, dramatic drop" in the value of its shares as it had to meet the large increase in redemption requests, losing over \$1.8 billion of Fund value in days (*id.*, ¶¶ 9-10, 85-91). Plaintiff alleges that the drop was not caused by general economic decline but rather "by Defendants' failure to adhere to the Fund's stated investment objectives and risky amassing of illiquid securities" (*id.*).

Plaintiff commenced the action on October 14, 2020 by filing a summons and complaint (NYSCEF # 1), and subsequently filed an amended complaint on February 26, 2021, adding Garrison Point as defendant (NYSCEF # 8). The amended complaint alleges three causes of action based on §§ 11, 12(a)(2), and 15 of the Securities Act respectively (*id.*, ¶¶ 136-156). The only claim against Garrison Point is the second cause of action for violation of § 12(a)(2) of the Securities Act.

Of relevance here, Garrison Point is registered with the SEC as an investment advisor (*id.*, ¶¶ 19-20). While AlphaCentric was engaged by the Fund as the Fund's advisor, Garrison Point is not directly in contract with the Fund or the Trust (*id.*). Rather, Garrison Point was retained to serve as the investment sub-advisor to the Fund under an Investment Sub-Advisory Agreement with AlphaCentric (*id.*). Under the agreement, Garrison Point is responsible for selecting the securities for investment, and in return, receives a management fee that is calculated as "50% of the net management fees that the Advisor [AlphaCentric] receives from the [Fund]" (*id.*).

Garrison Point moves to dismiss the amended complaint against it (1) for failure to establish that it was a statutory seller within the meaning of § 12(a)(2) of the Securities Act and (2) for lack of personal jurisdiction. Specifically, Garrison Point argues that in its capacity as the sub-advisor, it solely made decisions regarding proxy voting for securities held by the Fund but did not offer or sell securities to plaintiff or anyone in the class. As to personal jurisdiction, Garrison Point argues that courts of this state do not have general jurisdiction over it because it neither is registered to do business nor maintains an office in New York. Garrison Point contends that it is also not subject to specific jurisdiction because plaintiff's §12(a)(2) claim does not arise from Garrison Point's advisory services and even the advisory services themselves were performed in California, where Garrison Point is located. Additionally, Garrison Point also joins in the motion to dismiss (motion sequence no. 3) made separate by other defendants.¹

¹ Other defendants' arguments in their joint motion to dismiss (MS003) can be summarized as follows: (i) plaintiff has not alleged any misrepresentations regarding diversification or liquidity, valuation, redemptions or systems, controls and compliance, (ii) plaintiff fails to

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Motion No. 002

Plaintiff opposes the motion, arguing that Garrison Point was a statutory seller since it solicited purchases of the securities from class members for its own financial gain by, for instance, posting on its website's "invest with us" page a link to "Learn about the AlphaCentric Income Opportunities mutual fund (IOFIX) which has a 4%-8% target return and a 5-star Overall Morningstar Rating," and promoting their work to build the Fund in an annual report letter to its investors (NYSCEF # 77 – pltf's opp at 9, 12-13). Plaintiff also counters that Garrison Point had substantial connections to New York since it worked directly with other New York-based defendants and chose New York law as the governing law under the agreement it entered with AlphaCentric.

In reply, Garrison Point first challenges plaintiff's new allegations regarding Garrison Point's website and its annual report letter, arguing that these additional facts should not be considered on a motion to dismiss when not alleged in the amended complaint. Garrison Point also maintains that it did not solicit any sales of the securities and cannot be subject to jurisdiction in New York.

Discussion

On a CPLR 3211(a)(7) motion to dismiss, the court must afford the pleadings a liberal construction, accept the allegations of the complaint as true and provide the plaintiff with "the benefit of every possible favorable inference" (*Leon v Martinez*, 84 NY2d 83 [1994]). A motion to dismiss pursuant to CPLR 3211(a)(1) may be appropriately granted "only if the documentary evidence submitted conclusively establish a defense to the asserted claims as a matter of law" (*Morgenthau & Latham v Bank of N.Y. Co., Inc.*, 305 AD2d 74, 78 [1st Dept 2003] [internal citations and quotations omitted]). Under these circumstances, "legal conclusions and factual allegations [in the complaint] are flatly contradicted by documentary evidence [such that] they are not presumed to be true or accorded every favorable inference" (*id.* [internal citation and quotation omitted]).

To state a § 12(a)(2) claim, "the plaintiff must allege: (1) the defendant is a 'statutory seller'; (2) the sale was effectuated by means of a prospectus or oral communication; and (3) the prospectus or oral communication include[d] an untrue statement of a material fact or omit[ted] 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" (*Youngers v Virtus Inv. Partners Inc.*, 195 F Supp 3d 499, 520 [SD NY 2016] [internal quotations and citation omitted]). As to the first element, "statutory seller" is someone who passed title or other interest in the security to the buyer for value, or successfully solicited the sale for financial gain (*id.* at 522, citing *Pinter v Dahl*, 486 US 622, 644 [1988]). Since plaintiff does not allege that Garrison Point directly sold the securities to her or other class members,

allege that defendants are statutory sellers under § 12(a)(2), and (iii) plaintiff's § 15 claim cannot stand as plaintiff fails to allege the §§ 11 and 12 claims (NYSCEF # 76).

Garrison Point will be liable under § 12(a)(2) only if it “solicited” the sale (*Commercial Union Assur. Co., PLC v Milken*, 17 F3d 608, 616 [2d Cir 1994]).

A claim of solicitation requires allegations that defendant successfully solicited the plaintiff to purchase the securities at issue, and “motivated at least in part by a desire to serve his own financial interests or those of the securities owner” (*Pinter*, 486 US at 647). Notably, the Court in *Pinter* stated that Congress did not intend to hold persons liable whose participation was “collateral to the offer or sale” (*id.* at 650). Accordingly, the Court rejected a test for “statutory seller” that imposes liability on those whose actions were merely a “substantial factor” in causing the purchase (*id.* at 649-651). Applying the *Pinter* analysis, federal courts have consistently held that a defendant can be deemed a “statutory seller” if he “directly” and “actually” solicited the sale (*see e.g. Capri v Murphy*, 856 F2d 473, 478-479 [2d Cir 1988]; *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F Supp 2d 424, 438 [SD NY 2000]).

Under this standard, plaintiff has not sufficiently alleged that Garrison Point is a statutory seller under § 12(a)(2). Under the Investment Sub-Advisory Agreement, Garrison Point is responsible for selecting the securities and managing investment operations for the Fund (amended complaint, ¶¶ 19-20; NYSCEF # 24 - Ex.3-Investment Sub-Advisory Agreement). The agreement is silent on any responsibilities as to sale, marketing, or solicitation of investors. Also, the amended complaint contains no specific allegations to support that Garrison Point solicited any sale of the Fund’s shares (*id.*).

In opposing the motion to dismiss, plaintiff raises new facts about Garrison Point’s website and a letter to its investors dated March 31, 2019. Even taking the additional facts into consideration (*see generally Bd. of Mgrs. of Walton Condominium v 264 H2O Borrower, LLC*, 180 AD3d 622, 622 [1st Dept 2020] [plaintiff may remedy defects in its pleading in opposition to defendants’ motion to dismiss]), the court still finds the allegations insufficient to claim solicitation. Specifically, Garrison Point’s website page posts investment information about the Fund (NYSCEF # 77 – pltf’s opp at 9, n.7), and the 2019 letter was addressed to the Fund’s current investors – not Garrison Point’s prospective investors – for “another year of support for the Fund” (NYSCEF # 82, at 6/110 – Garrison Point’s letter [also stating in bold that “[t]his report is intended for the Fund’s shareholders”]). Given every favorable inference, these allegations are inadequate to establish that Garrison Point directly and actively solicited investors to purchase the Fund’s shares (*see Youngers*, 195 F Supp 3d at 522 [“[a]t most, the Complaint alleges that [the defendant] distributed the marketing materials ‘through their website and other channels’ ... [b]ut such allegations are insufficient”]; *cf. Hawaii Structural Ironworkers Pension Trust Fund v AMC Entertainment Holdings, Inc.*, 422 F Supp 3d 821, 856-857 [SD NY 2019] [finding active solicitation since the defendant prepared the registration statement and participated in marketing road shows

while motivated by financial gain]; *also cf. In re Vivendi Universal, S.A.*, 381 F Supp 2d 158, 187 [SD NY 2003] [finding active solicitation since the defendant “regularly appeared before investors and financial news agencies” to “encourage investors to purchase the securities”]).²

Moreover, the amended complaint does not allege that Garrison Point stood to financially benefit from the increased sale. Courts have found that the financial benefit test is satisfied if the defendant received compensation as a direct result of soliciting the sale of the shares (*Perry v Duoyuan Print., Inc.*, 2013 WL 4505199, at *12 [SD NY Aug. 22, 2013]; *see e.g. Wilson v Saintine Exploration and Drilling Corp.*, 872 F2d 1124, 1126-27 [2d Cir 1989] [“earn[ing] a commission from an actual seller for persuading their clients to make a particular investment”]; *Vivendi*, 381 F Supp 2d at 181 [“receiving a \$3 million bonus ... for boosting [the seller’s] EBITDA by 30%”]). On the other hand, the mere fact that a defendant was provided “financial incentives” is not enough to allege solicitation (*Youngers*, 195 F Supp 3d at 523). Here, as the Fund’s sub-advisor, Garrison Point only received a management fee for its services of selecting securities. Plaintiff does not plead that Garrison Point received, or was promised to receive, any compensation for soliciting sales of the Fund’s shares. Thus, Garrison Point is not a § 12(a)(2) statutory seller.

Plaintiff’s argument that Garrison Point is a statutory seller because it “controlled a person who offered and sold Fund shares” also fails (NYSCEF # 77 – pltf’s opp at 12-13). In its capacity as the sub-advisor, Garrison Point selected securities for the Fund’s investment under its agreement with the Fund’s advisor. That level of involvement, without more, is not enough to establish Garrison Point’s control of the Fund or the Trust. Further, as a matter of law, liability of a control person arises under § 15 of the Securities Act, which is not alleged here against Garrison Point (*Erie County Empls.’ Retirement Sys. v NN, Inc.*, 205 AD3d 644, 646 [1st Dept 2022] [§ 15 of the Securities Act creates liability for those who exert control over any person liable under § 11 or 12 of the Act]; *see also Wilson*, 872 F2d at 1127 [“persons who do not meet the *Pinter* test for statutory sellers may not be held liable under Section 12 as aiders and abettors” either]).

Accordingly, since the allegations in the amended complaint, together with the additional facts raised in plaintiff’s opposition to this motion, do not give rise to an inference that Garrison Point is a statutory seller, this claim under § 12(a)(2) of

² Also, plaintiff’s reliance on *Mahar v Gen. Elec. Co.*, 65 Misc 3d 1121, 1124 [Sup Ct, NY County 2019], *aff’d* 188 AD3d 534 [1st Dept 2020] is misplaced. In *Mahar*, unlike here, the defendant was the issuer of the at-issue securities, attempting to evade § 12 liability by arguing that its agent was the one who solicited and sold the securities (*id.*). The court rejected the defendant’s argument and found it a statutory seller, reasoning that to hold otherwise would defy logic and referring to the defendant’s solicitation on website which enabled investors to purchase its stock directly from it (*id.* at 1123-1130).

the Securities Act is dismissed against Garrison Point. In light of this dismissal, the court need not reach parties' other arguments regarding personal jurisdiction.³


Conclusion

In view of the above, it is

ORDERED that the motion by defendant Garrison Point Capital, LLC to dismiss the claim against it for violation of Section 12(a)(2) of Securities Act is granted; and it is further

ORDERED that the Clerk is directed to enter judgment in favor of defendant Garrison Point Capital, LLC and dismissing the amended complaint against it.

This constitutes the Decision and Order of the court.

2/16/2023																							
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³ Although courts normally address personal jurisdiction prior to reaching the merits, in cases such as this one with multiple defendants over some of whom the court indisputably has personal jurisdiction, courts may first address the legal sufficiency of the cause of action that is collectively challenged by all defendants (see MS 003) and, if the claim is dismissed in its entirety, courts may not need to reach the personal jurisdiction issue raised by some defendants (see e.g. *ONY, Inc. v Cornerstone Therapeutics, Inc.*, 720 F3d 490, 498 n 6 [2d Cir 2013]; *Lee v Mondelez Intl., Inc.*, 2022 WL 16555586, *12 n 13 [SD NY, Oct. 28, 2022]).