SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49M

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EMIGRANT BUSINESS CREDIT CORPORATION,

Plaintiff,

- v -

JOHN ARTHUR HANRATTY, EBURY STREET CAPITAL, LLC, EBURY FUND 1, LP, EBURY FUND 2, LP, EBURY 1EMI LLC, EBURY 2EMI LLC, EB 1EMIALA LLC, EB 2EMIALA LLC, EB 1EMIFL, LLC, EB 2EMIFL, LLC, EB 1EMIIN, LLC, EB 2EMIIN, LLC, EB 1EMIMD, LLC, EB 2EMIMD, LLC, EB 1EMINJ, LLC, EB 2EMINJ, LLC, EB 1EMINY, LLC, EB 2EMINY, LLC, EB 1EMISC, LLC, EB 2EMISC, LLC, RE 1EMI LLC, RE 2EMI LLC, EB 1EMIDC, LLC, ARQUE TAX RECEIVABLE FUND (MARYLAND), LLC, EBURY FUND 1FL, LLC, EBURY FUND 2FL, LLC, EBURY FUND 1NJ, LLC, EBURY FUND 2NJ, LLC, RED CLOVER 1, LLC, EBURY RE LLC, XYZ CORPS 1-10.

Defendants.

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INDEX NO. 158207/2022

MOTION DATE 11/16/2022

MOTION SEQ. NO. 002

DECISION + ORDER ON MOTION

HON. MARGARET CHAN:

The following e-filed documents, listed by NYSCEF document number (Motion 002) 41, 42, 43, 44, 45, 48, 49, 54

were read on this motion to/for DISMISS.

In this action involving credit facilities and related guaranties, plaintiff Emigrant Business Credit Corporation alleges three causes of action for breach of contract, fraudulent inducement, and fraudulent transfer. Defendants move pursuant to CPLR 3211 (a) (1) and (7) for an order dismissing the first cause of action regarding Ebury Street Capital, LLC (ESC) and Ebury RE LLC (Ebury RE) and dismissing the second and third causes of action regarding all defendants. Plaintiff opposes the motion.

Background

Plaintiff is a New York-based specialty finance company (NYSCEF # 1 – Complaint, ¶ 7). Hanratty is the manager of ESC, and ESC is the manager or general partner of all the other defendants (collectively with ESC, the Ebury Entities) (*id.*, ¶'s 8-9). On March 9, 2017, plaintiff extended credit facilities to defendants 1EMI LLC and Ebury 2EMI LLC (respectively, 1EMI and 2EMI and, together, the Borrowers) in amounts totaling $10,000,000 and $5,000,000, respectively, with 1EMI's facility later increasing to $13,500,000 on October 29,

2018 and to $15,000,000 on September 24, 2019 (*id.*, ¶ 33). Hanratty and various Ebury Entities issued guaranties connected to the facilities (*id.*, ¶'s 15, 37, 39).

The funds were to be used to finance the purchase of tax lien certificates that municipalities place on properties when an owner fails to pay municipal taxes (*id.*, ¶'s 32; 22). Investors purchase tax lien certificates from municipalities to profit from the interest rate chargeable on the certificate and to enable ownership of the underlying real estate through foreclosure (*id.*, ¶ 25).

Each Borrower owns special purpose entities (Ebury SPEs) that purchase, own, and sell tax lien certificates or real estate in various states (*id.*, ¶ 13). Plaintiff explains that the credit facilities were structured to allow the Borrowers to draw down revolving lines of credit against the value of a pool of eligible assets serving as collateral (*id.*, ¶'s 27; 34). The total amount the Borrowers could draw down was calculated by multiplying the amount of eligible collateral by the advance rate, which ranged from 70% to 85% (*id.*, ¶'s 28; 34). Any tax lien certificate that defendants purchased using the Credit Facilities, and its proceeds, served as the collateral and were to be delivered to a designated third-party custodian (*id.*, ¶'s 34, 50). Following the initial appointment of a custodian, on November 8, 2017, plaintiff consented to changing the custodian to be MTAG Services, LLC (MTAG) (*id.*, ¶ 52). Defendants were not allowed to retain custody of the tax liens or to service the tax liens themselves and all proceeds from the selling of a tax lien were to be deposited into plaintiff's lockbox account (*id.*, ¶'s 51, 91 [b]).

Plaintiff alleges that "[d]efendants misappropriated advances to the credit facilities as well as [plaintiff's] collateral to pay tens of millions of dollars in distributions to company insiders—including Defendant John Hanratty—as well as other investors" (*id.* ¶ 1). Also, plaintiff charges the Borrowers with failing to repay the principal and interest for the credit facilities when they came due on November 10, 2021, which default has continued even after plaintiff sent a default notice on November 29, 2021 (*id.*, ¶ 38). Plaintiff alleges that the outstanding amounts exceed $21.8 million (*id.*, ¶ 38).

For its fraud claim, plaintiff alleges as follows: Hanratty consistently claimed that plaintiff was secured by collateral worth more than the outstanding amounts (*id.*, ¶ 43). For example, one of plaintiff's employees conveyed concerns to Hanratty about the 2019 financial audits, which valued the tax lien investments at around $17.2 million, being less than the approximately $18 million outstanding balance owed at the time (*id.*, ¶ 47). Hanratty responded that plaintiff was actually secured by $32 million in tax lien collateral, plus additional collateral amounts (*id.*, ¶ 47). Hanratty's claims of overcollateralization were intentionally false, and Hanratty even bragged about his ability to mislead plaintiff's employee (*id.*, ¶'s 47-49).

In March of 2021, plaintiff discovered that certain of the collateral was not held by the custodian (*id.*, ¶ 55). Plaintiff alleges that Hanratty subsequently misled plaintiff about the custodial status of the collateral. To wit, defendant shared a spreadsheet purporting to be from the custodian and indicated that as of August 31,

2021, the custodian had 6,782 tax lien certificates (*id.*, ¶'s 55-57). The custodian has since confirmed to plaintiff that as of that date, it only had custody of 518 tax lien certificates worth a fraction of the amount the spreadsheet had indicated (*id.*, ¶ 57). Hanratty admitted he was self-servicing almost 90% of the collateral (*id.*, ¶ 58).

Additional allegations of fraud include that Hanratty improperly inflated the value of certain liens, altered origination dates for hundreds of certificates, and misrepresented that certain advances would be used to finance purchases of tax lien certificates when they were instead used for investor distributions and settlements (*id.*, ¶'s 63; 68; 69-81). Further, defendants were required to deposit proceeds from sales of certificates into plaintiff's lockbox, but not only did defendants fail to do so, Hanratty also falsely represented that he owned the liens and that they were increasing in value (*id.*, ¶'s 94-96). And, because proceeds of tax lien certificates are treated as collateral, this means any owned real property that resulted from a foreclosure on a tax lien should also have been included as collateral. Defendants have been effecting transfers without receipt of fair consideration, however, preventing plaintiff from receiving sale proceeds (*id.*, ¶'s 97-100).

Hanratty and various Ebury Entities issued guaranties in connection with the credit facilities (*id.*, ¶'s 15, 37, 39). Plaintiff asserts that Hanratty is personally liable in accordance with validity guaranties he executed (*id.*, ¶ 42; NYSCEF # 11 – Validity Guaranties). Plaintiff also asserts liability by virtue of the Ebury Entities being alter egos of Hanratty and of one another (NYSCEF # 1, ¶'s 18, 109, 116, 124).

Shortly after plaintiff initiated this action, it moved by order to show cause (MS001) for injunctive relief to enjoin, *inter alia*, the transfer of defendants' assets, which this court granted by Decision and Order of November 29, 2022 (NYSCEF # 47). Since then, the parties have been proceeding with discovery while briefing the present motion, for which oral argument was held on June 1, 2023.

Discussion

On a motion to dismiss pursuant to CPLR 3211 (a) (7), the court must "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 into any cognizable legal theory" (*Siegmund Strauss, Inc. v E. 149th Realty Corp.*, 104 AD3d 401, 403 [1st Dept 2013]). Significantly, "whether a plaintiff . . . can ultimately establish its allegations is not taken into consideration in determining a motion to dismiss" (*Phillips S. Beach LLC v ZC Specialty Ins. Co.*, 55 AD3d 493, 497 [1st Dept 2008], *lv denied* 12 NY3d 713 [2009]). At the same time, "[i]n those circumstances where the legal conclusions and factual allegations are flatly contradicted by documentary evidence they are not presumed to be true or accorded every favorable inference' " (*Morgenthow & Latham v Bank of New York Company, Inc.*, 305 AD2d 74, 78 [1st Dept 2003] [internal citation and quotation omitted]).

Breach of Contract; Alter Ego Allegations

"To plead a breach of contract, the proponent must allege the existence of a contract, the plaintiff's performance thereunder, the defendant's breach thereof, and resulting damages" (*Second Source Funding, LLC v Yellowstone Cap., LLC*, 144 AD3d 445, 445-46 [1st Dept 2016]).

Defendants initially argue in support of their motion to dismiss the breach of contract claim that ESC, Ebury RE, and Hanratty are not party to either of the Credit Agreements. In opposition, plaintiff raises that ESC is a guarantor, and Hanratty is a validity guarantor, to the Credit Agreements (NYSCEF # 48, at 6-8 citing NYSCEF #'s 8 and 11). In reply, defendants acknowledge ESC's guaranty and state that they "no longer move for dismissal of the breach-of-Credit Agreement claim against ESC" (NYSCEF # 54 at 1). Also recognizing Hanratty's Validity Guaranties, defendants nonetheless reiterate that plaintiff "still fails to identify any facts suggesting that he is a party to the Credit Agreements" (*id.*). This is unavailing to sustain a motion to dismiss a breach of contract claim that plaintiff premises on Hanratty's Validity Guaranties (NYSCEF # 1, ¶ 108).[1] It is undisputed that the guaranties do not reach Ebury RE, however, to which plaintiff's breach of contract claim depends on alter ego allegations that the court now addresses.

Defendants contend that plaintiff has failed to plead alter ego theory facts or the requisite showing that defendants abused the corporate form to defraud plaintiff (NYSCEF # 42 at 8-11). Providing a list of typical veil–piercing factors without supporting facts, defendants argue, is insufficient (*id.*, at 9-10). Plaintiff counters that it pled sufficient facts to establish defendants' alter ego liability, including inadequate capitalization of defendants, the intermingling of funds, and common ownership, officers, directors, and personnel, among others (NYSCEF # 48 at 9). In reply, defendants echo their rejection of the sufficiency of plaintiff's allegations (NYSCEF # 54 at 1-6).

An alter ego theory of liability to pierce the corporate veil generally "requires a showing that: (1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury. While complete domination of the corporation is the key to piercing the corporate veil, especially when the owners use the corporation as a mere device to further their personal rather than the corporate business, such domination, standing alone, is not enough; some showing of a wrongful or unjust act toward plaintiff is required" (*Shisgal v Brown*, 21 AD3d 845, 848 [1st Dept 2005] [quotation marks omitted] [rejecting motion to dismiss claim based on veil-piercing and listing various "indicia of a situation warranting veil-piercing" such as absence of corporate formalities, inadequate capitalization, use of funds for personal purposes, and more]).

[1] Defendants accept as much, stating that "the breach of contract claim against [Hanratty] should only be allowed to proceed with respect to the Validity Guaranties" (NYSCEF # 42 at 11).

Plaintiff sufficiently states a prima facie case for piercing the corporate veil. Defendants' argument that plaintiff has not connected the indicia of a situation warranting veil-piercing with facts showing defendants' abuse of the corporate form to harm plaintiff is unavailing given plaintiff's well-pled complaint and the standards applicable at this stage (*see Cortlandt St. Recovery Corp. v Bonderman*, 96 NE3d 191, 47 [2018] ["a fact-laden claim to pierce the corporate veil is unsuited for resolution on a pre-answer, pre-discovery motion to dismiss"]; *see also Baby Phat Holding Co., LLC v Kellwood Co.*, 123 AD3d 405, 407 [1st Dept 2014] [finding that wrongdoing in the veil piercing context "does not necessarily require allegations of actual fraud. While fraud certainly satisfies the wrongdoing requirement, other claims of inequity or malfeasance will also suffice"]).

Defendants' reliance on *Sound Commc'ns, Inc. v Rack & Roll, Inc.* is inapposite (88 AD3d 523 [1st Dept 2011]). There, where the complaint merely alleged that the entity defendant "functioned as the moving defendants' alter ego," the court found the plaintiff did "not sufficiently allege[] that [defendant's] status as a limited liability company was used to commit a fraud against plaintiff" (*id.* at 524). Here, plaintiff points out that its complaint alleges that defendants "used a web of sham corporate transactions—among companies controlled by Hanratty—to loot [plaintiff's] collateral and the loan proceeds" (NYSCEF # 48 at 10, n 6 citing NYSCEF # 1, ¶ 1). Overall, plaintiff's complaint includes the necessary allegations, as well as sufficient detail, to survive at this stage (*see e.g. 2406-12 Amsterdam Assoc. LLC v Alianza LLC*, 136 AD3d 512, 512 [1st Dept 2016] [sustaining pleading of veil piercing, negating the necessity of particularized allegations]).

Fraudulent Inducement

Next, defendants assert that plaintiff pleads no fraudulent inducement facts, contending that allegations supported by hearsay and information and belief are insufficient (NYSCEF # 42 at 11-15). And the fraudulent inducement count is allegedly duplicative of the breach of contract claim (*id.* at 16-18). In opposition, plaintiff argues that it has sufficiently pled the claim, with only limited and appropriate use of information and belief allegations (NYSCEF # 48 at 14-15). Plaintiff asserts that defendants' duplication argument is mistaken because, among other things, the fraud claim alleges "misrepresentations of present fact that are collateral to the contract" (*id.* at 15-16). In reply, defendants echo their initial arguments and clarify that they "do not argue that [plaintiff's] fraudulent inducement claim is duplicative of its claim for breach of the underlying Credit Agreements, only that it is duplicative of the claim for breach of the Validity Guaranties" (NYSCEF # 54 at 11).

"To state a cause of action for fraudulent inducement, it is sufficient that the claim alleges a material representation, known to be false, made with the intention of inducing reliance, upon which the victim actually relies, consequentially sustaining a detriment" (*Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Wise Metals Grp., LLC*, 19 AD3d 273, 275 [1st Dept 2005]). There are limits on when a fraud cause of action will be sustained if such allegations touch on a separate cause of

action for breach of contract to the extent of impermissible duplication (*see e.g. Varo, Inc. v Alvis PLC*, 261 AD2d 262 [1st Dept 1999]; *Project Cricket Acquisition, Inc. v Fla. Cap. Partners, Inc.* (180 AD3d 627 [1st Dept 2020]). Nevertheless, a "fraud claim will be upheld when a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, even though the same circumstances also give rise to the plaintiff's breach of contract claim. . . . Unlike a misrepresentation of future intent to perform, a misrepresentation of present facts is collateral to the contract . . . and therefore involves a separate breach of duty" (*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 293 [1st Dept 2011])

Defendants' motion to dismiss the fraudulent inducement claim is denied. Plaintiff's complaint sufficiently pleads the elements necessary to sustain the claim, even with the heightened pleading standard and even without regard to those certain allegations defendants argue are hearsay (NYSCEF # 1, ¶'s 55-96 [including allegations of: fabricating a spreadsheet to inflate the amount of collateral held by the contractually agreed third-party custodian; inflating values of collateral; periodically misrepresenting the status of certain amounts in signed certifications separate from the underlying credit agreements and validity guaranties; and duplicating liens in requests for advances]). That CPLR 3016 (b) requires particularized pleading, and that plaintiff relies on selective and limited use of information and belief allegations, does not mandate dismissal here given the well-pled and detailed complaint (*see e.g. MBIA Ins.*, 87 AD3d at 295 ["unassailable proof of fraud" not necessary; fraud claim sustained where complaint "sufficiently identifies . . . misrepresentations and describes when and how they were made . . . including through false and misleading loan tapes and prospectuses"]).

Nor are defendants correct that the fraudulent inducement count must be dismissed as duplicative of the breach of contract claim (relying on, *inter alia*, *Varo* and *Project Cricket*) because, as plaintiff asserts and as described above, the fraud claim is supported by assertions of misrepresentations of then-present fact that are collateral to the relevant contracts (*see e.g. Am. Media, Inc. v Bainbridge & Knight Labs., LLC*, 135 AD3d 477, 478 [1st Dept 2016] [complaint adequately stated fraud against owner of corporate counterparty "based on alleged misrepresentations of present fact concerning the capitalization of [the company] and the existence of [purported] account receivable from non-party"]). In that defendants limit their argument here to the Validity Guaranties (NYSCEF # 54 at 11), the allegations of fraud still extend beyond Hanratty's guaranty misrepresentations and, accordingly, are sustainable as being collateral to such agreements; in any event, to the extent certain allegations of fraud may also be contained in allegedly false representations, that is "of no consequence" (*MBIA Ins.*, 87 AD3d at 294).

Fraudulent Transfer

Defendants assert that plaintiff pleads no fraudulent transfer facts, but instead merely, on "information and belief," recants legal conclusions (NSYCEF # 42 at 19-20). Plaintiff responds by asserting that its allegations are sufficient at this

stage, including where it has pled substantial allegations that do not rely on information and belief to sustain this claim (NYSCEF # 48 at 20).[2]

Plaintiff adds that "the circumstances of the alleged transfers—which were made between insiders and moved assets away from the Defendants that are in contractual privity with [plaintiff]—are more than enough to create an inference of fraudulent intent" (NYSCEF # 48 at 20). And plaintiff points to Ebury RE's website listing of properties of certain of the other defendants (*id.*). In reply, defendant repeats the alleged insufficiency of the allegations, as to both actual and constructive fraudulent transfer, and rejects the import plaintiff would draw from Ebury RE's listing (NYSCEF # 54 at 14-15).

"To state a cause of action for constructive fraudulent conveyance under Debtor and Creditor Law §§ 273, 274, and 275, the complaint must allege that the transferor transferred assets without receiving fair consideration in exchange" (*McCormack Family Charitable Found. v Fid. Brokerage Services, LLC*, 195 AD3d 420, 421-22 [1st Dept 2021], *lv to appeal denied*, 37 NY3d 912 [2021]). Such claims "are not subject to the particularity requirement of CPLR 3016, because they are based on constructive fraud" (*Ridinger v W. Chelsea Dev. Partners LLC*, 150 AD3d 559, 560 [1st Dept 2017]).

"Under DCL § 276, '[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors' . . . . Claims under DCL § 276 require proof of 'actual fraud' rather than simply 'constructive fraud' " (*214 Knickerbocker LLC v Pan*, 2022 NY Slip Op 33579[U] at 7 [Sup Ct, NY County 2022], *affd*, 2023 NY Slip Op 02959 [1st Dept 2023] [quotation marks and citations omitted]). CPLR 3016 (b) requires a fraud claim to state in detail the circumstances constituting the wrong:

> The purpose of section 3016(b)'s pleading requirement is to inform a defendant with respect to the incidents complained of. We have cautioned that section 3016(b) should not be so strictly interpreted as to prevent an otherwise valid cause of action in situations where it may be impossible to state in detail the circumstances constituting a fraud. . . . Thus, where concrete facts are peculiarly within the knowledge of the party charged with the fraud, it would work a potentially unnecessary injustice to dismiss a case at an early stage where any

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[2] Plaintiff points to paragraph 4 of the complaint (NYSCEF # 1), which states:
Since the default, [plaintiff] has discovered that Defendants impermissibly paid out over $22 million in distributions to their investors in 2018 and 2019—without [plaintiff's] knowledge and in violation of the Credit Agreements—while at the same time withdrawing over $27 million in funding from the Credit Facilities. . . . Finally, [plaintiff] has discovered that Defendants fraudulently transferred millions of dollars' worth of [plaintiff]'s collateral to Ebury RE LLC . . . to prevent [plaintiff] from receiving sale proceeds from sales of the collateral and from foreclosing on the collateral. . . .

> pleading deficiency might be cured later in the proceedings.

(*Pludeman v N. Leasing Sys., Inc.*, 10 NY3d 486, 491–92 [2008] [citations and quotation marks omitted]).

Defendants' motion to dismiss is denied. That defendants identify cases where courts have found, on different facts, complaints insufficiently alleging fraudulent transfer is unavailing to support dismissal of this well-pled complaint (NYSCEF # 42 at 19, citing, *inter alia*, *Carlyle, LLC v Quik Park 1633 Garage LLC* (160 AD3d 476, 477 [1st Dept 2018]). Read with favorable inferences, given the allegations of distributions which rendered defendants uncollateralized and unable to pay plaintiff the amounts owed, plaintiff's actual and constructive fraudulent transfer claims survive (*see e.g. Epiphany Community Nursery School v Levey*, 171 AD3d 1, 9 [1st Dept 2019] [sustaining fraud claims on motion to dismiss, including where the "allegations in the complaint are not bare legal conclusions. Nor are they inherently incredible"]; *see also Pludeman* at 491–92).

Conclusion

In light of the foregoing, it is hereby

ORDERED that defendants' motion to dismiss (MS 002) is denied in the entirety; and it is further

ORDERED that counsel for plaintiff shall serve a copy of this decision, along with notice of entry, on all parties within ten days of entry.

06/29/2023
DATE

MARGARET CHAN, J.S.C.

CHECK ONE:		CASE DISPOSED		x	NON-FINAL DISPOSITION		
		GRANTED	x DENIED		GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER			SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN			FIDUCIARY APPOINTMENT		REFERENCE