

PNC Bank, N.A. v Sprout Mtge., LLC

2023 NY Slip Op 32561(U)

July 25, 2023

Supreme Court, New York County

Docket Number: Index No. 653697/2022

Judge: Arlene P. Bluth

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**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY**

PRESENT: HON. ARLENE P. BLUTH PART 14

Justice

-----X

PNC BANK, NATIONAL ASSOCIATION,

Plaintiff,

INDEX NO. 653697/2022

MOTION DATE 07/13/2023

MOTION SEQ. NO. 004 005

- v -

SPROUT MORTGAGE, LLC, CHRISTOPHER WRIGHT,
MICHAEL STRAUSS, BANC OF CALIFORNIA, N.A., JOHN
DOES #1-5

**DECISION + ORDER ON
MOTION**

Defendants.

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The following e-filed documents, listed by NYSCEF document number (Motion 004) 68, 69, 70, 71, 72, 73, 79

were read on this motion to/for DISMISS.

The following e-filed documents, listed by NYSCEF document number (Motion 005) 74, 75, 76, 77, 80, 81, 82, 83, 84, 87, 88, 89

were read on this motion to/for DISMISS.

Motion Sequence Numbers 004 and 005 are consolidated for disposition.

Defendant Banc of California’s motion (MS004) to dismiss is granted. Defendant Michael Strauss’s motion (MS005) to dismiss is granted.

Background

At the time of the transactions complained of herein, defendant Sprout Mortgage, LLC (“Sprout”) was a mortgage loan servicer. Plaintiff commenced this action to obtain monies paid by third-party mortgage loan borrowers to Sprout, which plaintiff claims Sprout should have then paid over to plaintiff. It explains that it entered into a letter of intent in May 2022 in which plaintiff expressed an interest in purchasing certain mortgage loans worth about \$33 million in unpaid principal from Sprout. Plaintiff alleges that it then undertook a due diligence analysis of

Sprout's financial situation as part of an effort to complete the deal, but that Sprout became insolvent prior to the execution of the final agreement. However, plaintiff claims that Sprout hid its financial woes from plaintiff and provided inaccurate information about its financial status. The parties eventually entered into an agreement without plaintiff knowing of Sprout's true financial condition.

Plaintiff alleges that under the terms of this agreement, Sprout was to act as an interim servicer for the period of time between the closing date of the agreement and the servicing transfer date. Plaintiff maintains that Sprout acted as the interim servicer from June 2022 through August 22, 2022 and plaintiff took over servicing thereafter. During this time, Sprout was allegedly required to turn over to plaintiff all sums collected on the loans for two periods (June 28, 2022 to July 22, 2022 and from July 23, 2022 through August 22, 2022). Plaintiff insists that Sprout collected at least \$322,025.73 in principal and interest payments as well as \$98,471.43 in taxes and insurance during this period (plaintiff refers to these as the lockbox payments). It insists that Sprout never turned over these payments to plaintiff despite being required to do so under the parties' agreement.

Plaintiff also contends that defendants Strauss (Sprout's CEO) and Wright (Sprout's CFO) knew about Sprout's financial issues but intentionally did not tell plaintiff about it as part of an effort to induce plaintiff to sign the aforementioned agreement.

With respect to defendant Banc of California, plaintiff alleges that this defendant retained and transferred certain lockbox payments from the borrowers. Plaintiff alleges that Banc of California owned at least 5 of the 26 loans at issue. It contends that that Banc of California initially suspended or froze funds held by Sprout but, for some unexplained reason, released the lockbox payments contained in these accounts to defendants instead of to plaintiff.

Banc of California's Motion (MS004)

Banc of California moves to dismiss on the ground that it is a creditor of Sprout and so any payments it received from Sprout were for value. It argues that this invalidates plaintiffs' claim against Banc of California under a voidable transaction theory. Banc of California also argues that the unjust enrichment claims against it fails because plaintiff entered into several written agreements that form the basis of its claim (although none were with Banc of California).

Banc of California also moves to dismiss on jurisdictional grounds and argues that it is a California based company with no ties to New York. It emphasizes that it did not enter into any agreements with plaintiff and that the only basis for jurisdiction against any defendant in this case is the forum selection clause in the agreement between plaintiff and Sprout.

In opposition, plaintiff insists that there are more than enough alleged facts for the Court to assert jurisdiction of Banc of California. It argues that Sprout's actions, taken as the agent of Banc of California, suggests that Banc of California purposefully availed itself of New York law. Plaintiff emphasizes that the loans that were part of its agreement with Sprout were sold to Banc of California or other third parties for the benefit of Banc of California. It argues that principles of agency law compel the Court to find that jurisdiction is proper here.

In reply, Banc of California emphasizes that there are no allegations about how it transacted any business within New York. It admits that it entered into a master repurchase agreement with Sprout but that agreement is not the basis for the instant lawsuit (the agreement between Sprout and plaintiff is). Banc of California argues that plaintiff cannot show Banc of California's minimum contacts with New York by relying on a single contract with Sprout (a New York entity). It insists that there are no allegations that it exerted control over Sprout and the only agency relationship was that Sprout was the servicer of the loans.

“To be subject to general jurisdiction under CPLR 301, a defendant corporation must either be incorporated in New York or have its principal place of business in New York” (*Brocco v E. Metal Recycling Term. LLC*, 211 AD3d 628, 628, 181 NYS3d 535 [1st Dept 2022]).

Banc of California clearly established that it is neither incorporated in New York nor does it have its principal place of business in New York. Therefore, the Court must assess whether it can exert specific jurisdiction over this defendant.

“In order to determine whether specific jurisdiction exists under CPLR 302(a)(1), a court must decide (1) whether the defendant ‘transacts any business’ in New York and, if so, (2) whether the cause of action arises from such a business transaction” (*id.* [internal quotations and citations omitted]).

Here, the Court finds that it lacks jurisdiction over Banc of California as the amended complaint does not allege facts sufficient to show that this defendant transacted business in New York. Plaintiff asserts two causes of action against Banc of California: one for unjust enrichment and another under the Uniform Voidable Transactions Act. Both relate to lockbox payments (the payments that plaintiff says it was entitled to receive but that were sent to other parties, including Banc of California). But nowhere does plaintiff adequately explain how Banc of California engaged in any actions relating to these lockbox payments that implicate New York.

Banc of California has no branches in New York and its agreement with Sprout is governed by California law (NYSCEF Doc. No. 44, § 19). It insists that the accounts at issue were all located in California. Under these circumstances, Banc of California’s contacts with New York were simply too attenuated to justify assertion of jurisdiction over it here.

The Court also rejects plaintiff’s apparent argument that the Court can exert jurisdiction over Banc of California under an agency/principal theory. “To establish that a defendant acted

through an agent, a plaintiff must convince the court that the New York actors engaged in purposeful activities in this State in relation to the transaction for the benefit of and with the knowledge and consent of the defendant and that the defendant exercised some control over the New York actors. To make a prima facie showing of control, a plaintiff's allegations must sufficiently detail the defendant's conduct so as to persuade a court that the defendant was a primary actor in the specific matter in question; control cannot be shown based merely upon a defendant's title or position within the corporation, or upon conclusory allegations that the defendant controls the corporation” (*Coast to Coast Energy, Inc. v Gasarch*, 149 AD3d 485, 486-87, 53 NYS3d 16 [1st Dept 2017]).

Here, Sprout was merely the servicer for these loans. There are no allegations that Banc of California controlled Sprout or helped to conceal the fact that Sprout was facing financial difficulties. The Court observes that plaintiff alleges fraud claims against defendants Sprout, Strauss and Wright *but not* against Banc of California. There is no basis to find that an agency/principal relationship compels the Court to assert jurisdiction over Banc of California.

Strauss’ Motion (MS005)

In this motion, defendant Strauss moves to dismiss all the causes of action alleged against him. He insists that he was simply the CEO of Sprout and that he never communicated with plaintiff nor did he ever make any misrepresentations to plaintiff. Strauss argues that plaintiff failed to plead the fraud claims against him (for fraud in the inducement and aiding and abetting fraud) with the requisite particularity under the CPLR.

With respect to the fraudulent conveyance under the Debtor Creditor Law claim, Strauss argues that the allegations do not allege that he had any control over the subject funds and that,

in fact, the operative pleading asserts that another defendant had control. He argues that he cannot be held liable under the unjust enrichment claim because there is a binding contract between Sprout and plaintiff that governs this dispute.

In opposition, plaintiff argues that while plaintiff was negotiating the bulk loan purchase agreement, Strauss “knowingly caused material misrepresentations and omissions of fact” to be made to plaintiff. It argues that instead of accepting responsibility, Strauss wants to evade his obligations altogether. Plaintiff argues that Strauss has cherry-picked certain portions of the operative complaint. It insists that Straus knew that Sprout was struggling financially and that he approved the release of false financial statements.

Specifically, plaintiff argues that Sprout provided financial statements for 2020 and 2021, documents in which Strauss was intimately involved, that contained inaccurate information. It alleges that Strauss was actively seeking additional financing for Sprout during the time it was in negotiations with plaintiff so that Sprout could avoid insolvency. Plaintiff emphasizes that Sprout became insolvent prior to the execution of the final agreements between plaintiff and Sprout.

In reply, Strauss argues that the amended complaint conflates the actions of Sprout with those of Strauss and that is not sufficient to sustain the fraud causes of action against him. He insists that plaintiff cannot show that the damages it seeks against Sprout for breach of contract are distinct from those stemming from the fraud claims. Strauss also argues that plaintiff did not point to any specific transfers in connection with the voidable transfers claim under the Debtor Creditor Law.

Fraud Claims

“A plaintiff alleging an aiding-and-abetting fraud claim must allege the existence of the underlying fraud, actual knowledge, and substantial assistance. In turn, the elements of an underlying fraud are a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury” (*William Doyle Galleries, Inc. v Stettner*, 167 AD3d 501, 503, 91 NYS3d 13 [1st Dept 2018] [internal quotations and citations omitted]). “To plead a claim for fraud in the inducement or fraudulent concealment, plaintiff must allege facts to support the claim that it justifiably relied on the alleged misrepresentations” (*ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 25 NY3d 1043, 1044, 10 NYS3d 486 [2015]).

Plaintiff brings claims against Strauss both for fraud in the inducement and for aiding and abetting fraud. The amended complaint contends that “Strauss failed to disclose a material adverse change in Sprout’s financial condition, which Strauss knew or should have known prior to execution of the Agreement” (NYSCEF Doc. No. 77 at 22). It adds that “Strauss and Wright knew that Sprout had no ability to perform its obligations under the Agreement, service the Loans in accordance with generally accepted servicing standards, and remit the Lockbox Payments to PNC on the dates set forth in the Agreement” and that Strauss “knew or should have known that Sprout did not deliver financial statements that fairly presented the changes in Sprout’s financial position or ability to perform its obligations under the Agreement” (*id.* at 24).

Unfortunately, the Court is unable to find that these claims meet the heightened pleading standard required to sustain these causes of action as against Strauss (*see Manda Intern. Corp. v Yager*, 139 AD3d 594, 594, 32 NYS3d 145 [1st Dept 2016]). Plaintiff appears to argue that

Strauss should not have permitted allegedly false financial statements to be provided to plaintiff or let the agreement go forward when he knew that Sprout was insolvent. The problem is that the amended complaint is devoid of any allegations about Strauss' specific actions in relation to the purported misrepresentations (and omissions). For instance, there are no allegations that Strauss communicated (such as via email or telephone) about the agreement. And plaintiff only submitted a memorandum of law in opposition; it did not include an affidavit from someone with personal knowledge about Strauss' role in the transaction.

Plaintiff did not contend that Strauss signed the subject agreement. In fact, the letter of intent was signed by another employee of Sprout (NYSCEF Doc. No. 77 at 40) as was the Mortgage Loan Purchase and Interim Servicing Agreement (*id.* at 102) and the Form of Purchase Price and Terms Agreement (*id.* at 129). In other words, plaintiff's theory of Strauss' liability seems to be that he should have done something because, as CEO of Sprout, he was surely well aware of Sprout's impending financial troubles. But without any details about specific misrepresentations made by this defendant the Court must dismiss these two causes of action. "A corporate officer may be held personally liable for a fraudulent act committed in his or her capacity as a corporate officer provided that the officer personally participated in the misrepresentation or had actual knowledge of it" (*Hutter v PNC Bank, N.A.*, 155 AD3d 844, 847 [2d Dept 2017]). The record here is devoid of any allegations about Strauss' personal participation in the alleged misrepresentation.

The Court recognizes that plaintiff points to the allegedly inaccurate financial statements, but the Court is unable to find that Strauss is personally bound by any assertions in those statements simply because he was the CEO of Sprout. Under that view, a CEO is therefore personally liable for the accuracy of these statements simply due to his or her role. Such a

conclusion defies basic principles of corporation law. Without more allegations about Strauss' role in preparing those statements, the Court dismisses these claims.

The Court emphasizes that discovery may reveal that Strauss had a larger role in the purported fraudulent scheme and, in that case, plaintiff is of course free to amend its pleading to add Strauss back to the case. But, on this record, the Court cannot ascribe every act of Sprout to that of its CEO without sufficient details about his individual participation.

Remaining Claims

A similar analysis applies to the remaining claims. The Court dismisses the Uniform Voidable Transactions claim against Strauss as this claim failed to sufficiently allege Strauss' role with respect to this claim, other than to assert that he knew Sprout should not accept the lockbox payment transfers. That Sprout may have wrongfully accepted those transfers does not state a claim against Strauss—the amended complaint does not allege that Strauss initiated or accepted any transfers in his individual capacity.

And the Court severs and dismisses the unjust enrichment claim against Strauss as well. Plaintiff makes overbroad allegations that “Strauss, Wright, Banc, and John Does #1-5 knew that they had no right to retain the Lockbox Payments” (NYSCEF Doc. No. 77 at 28). But the operative pleading insists that Sprout benefitted from the alleged wrongful transfer of the lockbox payments (*id.* at 11) and there are no details about how Strauss was individually enriched as part of this purported scheme.


Accordingly, it is hereby

ORDERED that defendant Banc of California's motion (MS004) to dismiss is granted; and it is further

ORDERED that defendant Strauss' motion to dismiss (MS005) is granted; and it is further

ORDERED that the Clerk is directed to enter judgment in favor of these two defendants and against plaintiff along with costs and disbursements upon presentation of proper papers therefor.

See NYSCEF Doc. No. 86 for details about the next conference.

<u>7/25/2023</u> DATE		 ARLENE P. BLUTH, J.S.C.
CHECK ONE:	<input type="checkbox"/> CASE DISPOSED	<input checked="" type="checkbox"/> NON-FINAL DISPOSITION
	<input checked="" type="checkbox"/> GRANTED <input type="checkbox"/> DENIED	<input type="checkbox"/> GRANTED IN PART <input type="checkbox"/> OTHER
APPLICATION:	<input type="checkbox"/> SETTLE ORDER	<input type="checkbox"/> SUBMIT ORDER
CHECK IF APPROPRIATE:	<input type="checkbox"/> INCLUDES TRANSFER/REASSIGN	<input type="checkbox"/> FIDUCIARY APPOINTMENT <input type="checkbox"/> REFERENCE