Metropolitan Partners Fund IIIA, LP v GemCap Lending I, LLC
2023 NY Slip Op 33042(U)
September 1, 2023
Supreme Court, New York County
Docket Number: Index No. 656325/2020
Judge: Andrew Borrok

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

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METROPOLITAN PARTNERS FUND IIIA, LP, SERIES F&F OF METROPOLITAN PARTNERS FUND IV, LLC,SERIES INSTITUTIONAL OF METROPOLITAN PARTNERS FUND IV, LLC,METROPOLITAN EQUITY PARTNERS ADMINISTRATION, LLC,METROPOLITAN EQUITY PARTNERS MANAGEMENT, LLC,

Plaintiff,

- v -

GEMCAP LENDING I, LLC,MIDCAP FUNDING XVIII TRUST, MIDCAP FINANCIAL SERVICES, LLC,GEMCAP SOLUTIONS, LLC,RICHARD ELLIS, DAVID ELLIS

Defendant.

INDEX NO. 656325/2020

MOTION DATE N/A

MOTION SEQ. NO. 009

DECISION + ORDER ON MOTION

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HON. ANDREW BORROK:

The following e-filed documents, listed by NYSCEF document number (Motion 009) 200, 201, 202, 203, 204, 205, 219, 220

were read on this motion to/for DISMISS.

Upon the foregoing documents and as discussed below, the motion to dismiss is granted solely to the extent that the Plaintiffs may file a third amended complaint within 30 days of the date of this Decision and Order making clear the basis for their tortious interference claim.

The Relevant Facts and Circumstances

This is a case alleging that Richard and David Ellis (collectively, the **Ellis Brothers**) defrauded the Plaintiffs out of their bargained for rights in certain intercreditor agreements and other loan documents.

By way of background, the Ellis Brothers provided an acquisition credit facility to the Borrower (hereinafter defined) through their company GemCap Lending I, LLC (**GemCap 1**) to finance

the purchase and acquisition of certain auto loans. The Plaintiffs provided certain structurally subordinate financing to the Borrower which was used to pay down the Ellis Brothers' acquisition credit facility advanced by their company GemCap 1. To protect their rights, the Plaintiffs had bargained for certain rights set forth in intercreditor agreements and other loan documents, including a runoff agreement. Significantly, one such right included that no further advances would be made to the Borrower. The allegations in this case are, in sum and substance, that the Ellis Brothers' company GemCap 1, the successor-in-interest to the Original Acquisition Lender (hereinafter defined), violated the intercreditor agreement by advancing such additional money and otherwise causing the Borrower to conceal that such additional advances were being made. The Borrower eventually went bankrupt and the Plaintiffs were harmed. Subsequently, the Plaintiffs allege that when they sued GemCap 1, after GemCap 1's motion to dismiss was denied by this Court (NYSCEF Doc. No. 113), the Ellis Brothers had GemCap 1 default, and file bankruptcy. According to the SAC, the Ellis Brothers then went ahead and founded GemCap 2 (hereinafter defined), using the same telephone number, trademarks, marketing materials to continue the business of GemCap 1 (*i.e.*, and holding themselves out as having done exactly that) all in attempt to ringfence their liability in then-defunct GemCap 1 and avoid exposure to the Plaintiffs in this case.

More specifically, the Second Amended Complaint (the **SAC;** NYSCEF Doc. No. 181) alleges that Encore Park Fund 1, LLC (**EPF1**), Encore Holdings, LLC (**Encore Holdings**), and Encore Automotive Acceptance Corporation (**EAAC**, and, together with EPF1 and Encore Holdings, hereinafter, collectively, **the Borrower**) were in the business of acquiring and holding certain subprime auto loans (NYSCEF Doc. No 181, ¶ 18). EEAC funded its loan acquisitions through

a debt facility that was provided to them by GemCap 1 (*id.*, ¶ 19). Once a month, EPF1 would purchase certain lower-risk loans from EAAC and hold them in its own portfolio (*id.*, ¶ 20). EAAC would then use the proceeds from the sale of loans to EPF1 to pay down the acquisition debt facility (*id.*). EPF1 funded its loan acquisitions from EAAC through a debt facility that was provided to them by Park National Bank (the **Original Acquisition Lender**) and a debt facility that was provided to them by the Plaintiffs (*id.*, ¶ 21). These funds were advanced by the Plaintiffs pursuant to three promissory notes with an initial maturity date of February 10, 2019 and the funds from both the Original Acquisition Lender and the Plaintiffs were otherwise subject to certain requirements, including credit quality, EPF1's indebtedness relative to the value of its portfolio, and a reserve requirement (NYSCEF Doc. No. 181, ¶¶ 23-25). As discussed above, the Plaintiffs' loans were structurally subordinate to the Original Acquisition Lender's debt facility, and pursuant to Section 6.20 of the Loan and Security Agreement (NYSCEF Doc. No. 33), the Borrower and the Plaintiffs agreed that the Plaintiffs would receive EPF1's portfolio monthly reports indicating, among other things, the amount of the senior debt and providing notice of any advances of funds by the Original Acquisition Lender to EPF1 (NYSCEF Doc. No. 181, ¶¶ 29-30).

As expiration of the senior acquisition facility approached in July 2018, the Original Acquisition Lender indicated that it wanted repayment and was not interested in extending the maturity date to allow the portfolio to "run off" (NYSCEF Doc. No. 181, ¶ 35). However, ultimately the Original Acquisition Lender and the Borrower agreed to extend the maturity of the senior facility and entered into a runoff agreement which required EPF1 to obtain a loan from the Plaintiffs to pay down the principal balance of the senior acquisition debt facility and modified the loan

agreements so that (i) the Original Acquisition Lender could make no further advances to EPF1 and (ii) EPF1 could not purchase additional loans from EAAC (*id.*, ¶¶ 36-38).

After the Borrower allegedly failed to find new financing options, the Plaintiffs agreed to pay off the Original Acquisition Lender and step into its shoes in order to protect its subordinated position (NYSCEF Doc. No. 181, ¶ 47).

According to the SAC, in January 2019 when the Plaintiffs sent the Borrower a set of deal documents for execution, the Borrower initially was unresponsive and then ultimately indicated GemCap 1 would take over the Original Acquisition Lender's position (*id.*, ¶¶ 48-52).

Following assignment from the Original Acquisition Lender, the SAC alleges that the Ellis Brothers caused GemCap 1 to breach the intercreditor and runoff agreements by, among other things, adding loans to the portfolio which were of inferior quality (*i.e.*, combining the EPF1 portfolio with the EAAC portfolio even through the EAAC portfolio did not have the same credit quality requirements) (*id.*, ¶¶ 53-59). The Plaintiffs also allege that GemCap 1 amended the documents governing the senior debt facility to increase its maximum commitment, in breach of the obligations set forth in the intercreditor agreements and the runoff agreement that limited EPF1's ability to borrow and GemCap 1's ability to lend (*id.*, ¶ 60). As alleged, EPF1 then purchased the entirety of EAAC's portfolio, nearly tripling the senior debt, and EAAC used the proceeds of that sale to repay EAAC's preexisting debt facility with GemCap 1, in alleged violation of the runoff agreement and without notice as required under the intercreditor agreements (*id.*, ¶¶ 61-64). Stated different, the allegations are that GemCap 1 took over the

senior debt to pay themselves off by advancing money in a way that violated the intercreditor agreements and the runoff agreement. This entire transaction allegedly damaged the Plaintiffs by (i) diminishing the credit quality of EPF1's portfolio, (ii) increasing the Plaintiffs' exposure to higher-risk loans in EAAC's portfolio, and (iii) increasing debt senior to the Plaintiffs in EPF1's portfolio (*id.*, ¶¶ 65-67).

GemCap 1 and the Ellis Brothers allegedly fraudulently hid this scheme from the Plaintiffs by (i) falsely representing that it had merely restated the Original Acquisition Lender's loan documents and then by failing provide them, (ii) falsely representing to the Borrower that all necessary consents and notices had been given and that the Plaintiffs were aware of the transactions, (iii) falsely representing to the Borrower that the Plaintiffs had access to complete and accurate reporting, and (iv) encouraging the Borrower to report and send to the Plaintiffs only what was in EPF1's portfolio before it was combined with EAAC's portfolio (*id.*, ¶¶ 69-78). Among other things, the Plaintiffs allege that this was intentionally done to induce the Plaintiffs to extend the maturity dates of their loans beyond the February 2019 maturity date, which the Plaintiffs claim they would not have done had they been aware of GemCap 1 and the Ellis Brothers' alleged fraud (*id.*, ¶¶ 79-84).

The Plaintiffs allegedly discovered the fraudulent scheme when GemCap 1 declared an event of default in March 2020 after the Plaintiffs mistakenly believed that the senior debt had been paid off in February 2020 (NYSCEF Doc. No. 181, ¶¶ 85-89). Around that time, GemCap 1 was about to default on its own obligations to its lender MidCap Financial Services, LLC (**MidCap**) (*id.*, ¶ 92). MidCap, GemCap 1, and the Ellis Brothers structured a strict foreclosure transaction

that was designed for MidCap to take only GemCap 1's performing loans while leaving GemCap 1's business intact and under the control of the Ellis Brothers (*id.*, ¶¶ 94-95). In this scheme, the SAC alleges that GemCap 1 was stripped of the assets crucial to its business operations as such assets were placed into a new entity under the control of the Ellis Brothers – GemCap Solutions, LLC (**GemCap 2**) (*id.*, ¶¶ 96-97). Pursuant to the foreclosure agreement entered into in August 2020, MidCap purchased all of GemCap 1's assets by transferring the assets that MidCap intended to retain to MidCap Funding XVII Trust (**MidCap 17**) and transferring the assts that would be returned to the Ellis Brothers to MidCap Funding XVIII Trust (**MidCap 18**) (*id.*, ¶¶ 114-119). The GemCap 1 loan to EPF1 was assigned directly to MidCap and MidCap sent notice to the Plaintiffs of its acquisition in September 2020. MidCap then notified the third-party servicer of the auto loans that MidCap 18 had replaced GemCap 1 as the senior lender to EPF1 (*id.*, ¶¶ 120-123).

The Plaintiffs also allege that in August 2020 the Ellis Brothers purchased back the assets that had been transferred to MidCap 18 under the foreclosure agreement, including non-performing loans and continuing business assets (NYSCEF Doc. No. 181, ¶¶ 124-127). Those assets include, among other things, GemCap 1's website domains, tradenames and trademarks, emails addresses and email content, telephone numbers, forms and documents used in the ordinary course of business, and all of the furniture, fixtures, equipment, and supplies at GemCap 1's office (*id.*, ¶ 128). In April 2021, the Ellis Brothers registered GemCap 2 and GemCap Holdings, LLC (**GemCap Holdings**) (*id.*, ¶ 133). GemCap 2's website was launched with the same URL as GemCap 1's website and represented, among other things, that it had been in business since 2008, which it indisputably had not been (*id.*, ¶¶ 134-136, *see* NYSCEF Doc. No.

190). GemCap 2 also used GemCap 1's mailing list, which included the Plaintiffs (NYSCEF Doc. No. 181, ¶¶ 137-138). MidCap also became the senior lender for GemCap 2 and, in a credit memorandum circulated for MidCap's parent company, **GemCap2 indicated that that the relationship between MidCap and GemCap existed since 2015 and that GemCap 2 was effectively a relaunch of its predecessor, GemCap 1** (*id.*, ¶¶ 140-146; *see* NYSCEF Doc. No. 193).

Pursuant to a Decision and Order of this Court dated January 25, 2022 (the **January 2022 Decision;** NYSCEF Doc. No. 113), the Court denied GemCap 1's motion to dismiss and held that the well pled complaint alleged sufficient facts to demonstrate that this Court had specific jurisdiction over GemCap 1 and that jurisdictional discovery was warranted as to whether GemCap 1 was subject to general jurisdiction.

After the Court issued the January 2022 Decision, GemCap 1 ghosted the Plaintiffs and this Court and defaulted in its obligations in defending this lawsuit. Ultimately, pursuant to a Decision and Order of this Court dated February 3, 2022 (the **February 2022 Decision;** NYSCEF Doc. No. 119), the Court granted a default judgment as against GemCap 1. On September 15, 2022, GemCap 1 filed bankruptcy (NYSCEF Doc. No. 181 ¶ 165). Subsequently, pursuant to a Decision and Order of this Court dated December 1, 2022 (the **December 2022 Decision;** NYSCEF Doc. No. 176), the Court granted the Plaintiffs' motion to file a second amended complaint (the **SAC;** NYSCEF Doc. No. 181) based on assertions of successor liability as against GemCap 2 and the Ellis Brothers, the principals of GemCap 1 and GemCap 2:

> Pursuant to CPLR 3205(b), leave to amend pleadings should be freely given unless there is prejudice or surprise resulting from the delay to the opposing party or if the proposed amendment is "palpably improper or insufficient as a matter of law" (McGhee v Odell, 96 AD3d 449, 450 [1st Dept 2012]). The plaintiff seeks to amend its complaint to add (i) Richard Ellis and (ii) David Ellis, the principals of an existing co-defendant GemCap Lending I, LLC (**GemCap 1**), as well as (iii) GemCap Solutions, LLC (**GemCap 2**), an entity which purportedly operates under the same name, trademarks, logos, URL, phone numbers, and email addresses as GemCap 1 (NYSCEF Doc. No. 174, ¶¶4-5). The proposed amendment is predicated on facts discovered during discovery which demonstrate potential liabilities of the added defendants.
>
> GemCap 1 allegedly transferred substantial assets to Messrs. Richard and David Ellis (collectively, **Ellis Brothers**) through a series of transactions, which allowed the Ellis Brothers to operate GemCap 2 as a successor to GemCap 1 (NYSCEF Doc. No. 174, ¶¶118-136). GemCap 1 then filed for bankruptcy on September 23, 2022 and failed to list the plaintiff as a creditor (*id.*, ¶¶165-169) despite the default judgment previously entered by the Court dated March 24, 2022 (Default Judgment; NYSCEF Doc. No. 150). Subsequently, the plaintiff now claims against GemCap 2 for GemCap 1's liabilities, including those found in the Default Judgment. In addition, the plaintiff claims against the Ellis Brothers for (i) tortious interference with respect to GemCap 1's contract breaches (NYSCEF Doc. No. 174, ¶¶65-68) and (ii) fraud for their alleged misrepresentations and omissions with respect to the EPF1 Portfolio (id., ¶¶69- 84), which formed part of the plaintiff's allegations against GemCap 1 in its First Amended Complaint (NYSCEF Doc. No. 44, ¶¶244-250). Thus, the plaintiff's proposed Second Amended Complaint presents no surprise or prejudice and can not be said to be utterly devoid of merit or palpably improper

(NYSCEF Doc. No. 176, at 1-2).

The Plaintiffs filed the well pled SAC asserting causes of action for (i) liability for the judgment entered against GemCap 1 (asserted as against GemCap2) (first cause of action), (ii) fraud (asserted as against the Ellis Brothers) (second cause of action), (iii) tortious interference (asserted as against GemCap 1 and the Ellis Brothers) (third cause of action), (iv) unjust enrichment (asserted as against GemCap2 and MidCap) (fourth cause of action), and (v) declaratory relief that (x) the Plaintiffs have a superior security interest in any contracts

remaining the portfolio and (y) GemCap 2 may be treated as a continuation of GemCap 1 (fifth cause of action).

The Ellis Brothers and GemCap 2 have again moved to dismiss arguing (x) this Court lacks jurisdiction over them and (y) the SAC fails to state a claim because (i) GemCap 2 is not a mere continuation of or the product of a *de facto* merger with GemCap 1, (ii) the fraud claims are not pled with sufficient particularity, (iii) there was no tortious interference because there is no underlying claim, and (iv) the unjust enrichment claim is precluded by the parties' contract in this case. The arguments fail.

Discussion

On a motion to dismiss, the court must afford the pleading a liberal construction and accept the facts as alleged as true, according 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]).

I. The Court has personal jurisdiction over GemCap 2 and the Ellis Brothers

A successor company may be found to have inherited its predecessor's jurisdictional status when there is a *de facto* merger between the two entities or where one entity is a mere continuation of its predecessor (*Semenetz v Sherling & Walden, Inc.*, 21 AD3d 1128, 1140-1141 [3d Dept 2005], citing *Societe Generale v Florida Health Sciences Ctr., Inc.*, 2003 WL 22852656 [SD NY 2003]; *see 47 East 34th Street (NY), L.P. v Bridgestreet Worldwide, Inc.*, 2019 WL 5788065, ** 6-8 [Sup Ct, NY County 2019]; *see also Lelchook v Societe Generale de Banque au Liban SAL*, 67

F4th 69, 77 [2d Cir 2023] ["a successor may inherit its predecessor's jurisdictional status in several situations: for example, if there was a *de facto* merger or consolidation of the two entities or if the successor is a 'mere continuation' of the predecessor"]). Jurisdictional contacts however are not imputed to a successor where the successor merely acquired the assets of the predecessor (*Gronich & Company, Inc. v Simon Property Group, Inc.*, 180 AD3d 541, 542 [1st Dept 2020]). The hallmarks of a *de facto* merger are (i) continuity of ownership, (ii) cessation of ordinary business and dissolution of the acquired corporation as soon as possible, (iii) assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation, and (iv) continuity of management, personnel, physical location, assets, and general business operation (*Fitzgerald v Fahnestock & Co., Inc.*, 286 AD2d 573, 574 [1st Dept 2001]). Not all of these elements are necessary to find a *de facto* merger (*id.*, at 574-575).

The well pled SAC alleges that both GemCap 1 and GemCap 2 are/were owned by the Ellis Brothers, GemCap 1 filed for bankruptcy shortly after transferring its assets to the Ellis Brothers so that they could run GemCap 2 without business interruption, and GemCap 2 continues to operate GemCap 1's business, including by using the same name, trademarks, logos, URL, phone numbers, and email addresses and that GemCap2 held itself out as a continuation of GemCap1's business. These allegations are sufficient at this stage of the proceedings to demonstrate that GemCap 2 has inherited GemCap 1's jurisdictional status.

The Ellis Brothers are also subject to personal jurisdiction. The SAC alleges that the Ellis Brothers were the primary actors who exercised control over the GemCap entities, purposefully

availed themselves of the benefits of New York, caused the breaches of the intercreditor agreement in New York, manipulated the corporate forms to avoid addressing the Plaintiffs' claims, and otherwise benefited from the transactions at issue (NYSCEF Doc. No. 181, ¶¶ 69-84, 94-97, 114-146) (*Kreutter v McFadden Oil Corp.*, 71 NY2d 460 [1988]; *Coast to Coast Energy, Inc. v Gasarch*, 149 AD3d 485, 487 [1st Dept 2017]). As such, the Court has jurisdiction.

II. The Well-Pled SAC States a Claim For Fraud

The elements of a cause of action sounding in fraud are a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance, and damages (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). Corporate officers and directors may be held individually liable if they participated in or had knowledge of the fraud, even if they did not stand to gain personally. Although fraud claims must be pled with sufficient particularity (CPLR 3016[b]), this requirement should not be interpreted to prevent an otherwise valid cause of action where the concrete facts are peculiarly within the knowledge of the party charged with the fraud (*Pludeman v Northern Leasing Systems, Inc.*, 10 NY3d 486, 491-492 [2008]). Concrete facts as to the Ellis Brothers and GemCap 1's alleged fraud are particularly within their possession and knowledge, and they have refused to engage in adequate discovery as to those claims. However, as discussed above, the Ellis Brothers allegedly engaged in fraud by, among other things, causing the Borrower to conceal that the Borrower had agreed to combine EAAC's portfolio with EPF1's portfolio and by otherwise falsely representing that they had not made additional senior advances in violation of the intercreditor agreement to induce the Plaintiffs to rely on such representations so that the Plaintiffs would agree to extend the maturity date of their own loans. As a result, the Plaintiffs allege they were damaged by the

underperformance of the portfolio and the addition of senior debt. This is sufficient at this stage of the litigation.

III. Tortious Interference with Contract

A cause of action for tortious interference with contract requires a plaintiff to demonstrate (i) the existence of a valid contract between the plaintiff and a third party, (ii) the defendant's knowledge of that contract, (iii) the defendant's intentional procurement of the third-party's breach of the contract without justification, (iv) actual breach of the contract, and (v) damages resulting therefrom (*330 Acquisition Co., LLC v Regency Savings Bank, F.S.B.*, 293 AD2d 314, 315 [1st Dept 2002]). As discussed at oral argument (8.29.23), it is incumbent on the Plaintiffs in filing an amended pleading which must be done no later than 30 days from the date of this Decision and Order to demonstrate which contract at issue they allege was tortiously interfered with.

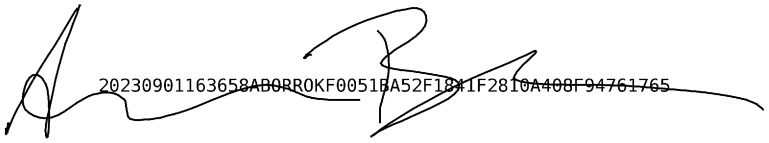
IV. Unjust Enrichment

To state a claim for unjust enrichment, a plaintiff must allege that (i) the defendant was enriched, (ii) at the plaintiff's expense, and (iii) that it is against equity and good conscience to permit the defendant to retain what is sought to be recovered (*Schroeder v Pinterest Inc.*, 133 AD3d 12, 26 [1st Dept 2015]). The Plaintiffs allege that any funds received by MidCap, GemCap 1, or GemCap 2 attributable to the EPF1 portfolio prior to the alleged misconduct by GemCap 1 and the Ellis Brothers should be returned to the Plaintiffs because, absent such misconduct, the senior debt would have been paid off and the Plaintiffs would have been paid on their loans. At this

stage of the litigation, this claim may be pled in the alternative and need not be dismissed as duplicative.

It is hereby ORDERED that the motion to dismiss is granted solely to the extent that the Plaintiffs are given leave to file a third amended complaint to sufficiently plead a cause of action for tortious interference; and it is further

ORDERED that such third amended complaint shall be filed within 30 days of the date of this Decision and Order.



9/1/2023
DATE

ANDREW BORROK, J.S.C.

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