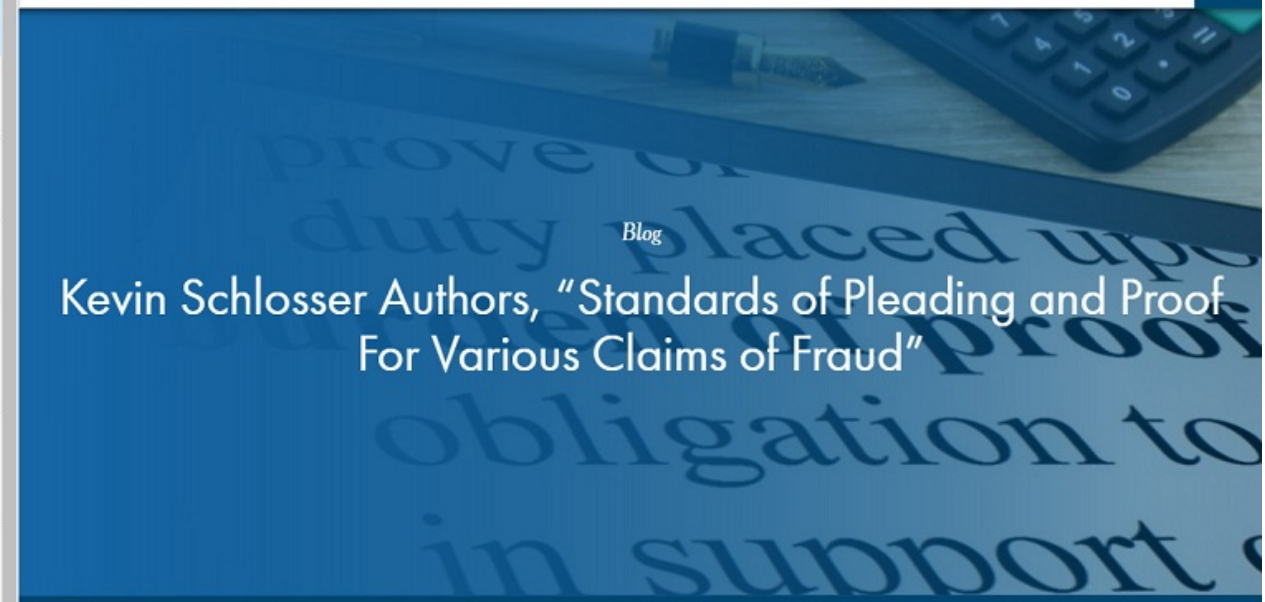
Exhibit “A”



Blog

Kevin Schlosser Authors, "Standards of Pleading and Proof For Various Claims of Fraud"

Dec 26, 2017 Litigation & Dispute Resolution

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My previous post addressed the different statutes of limitations that apply to claims of actual fraud, where intent to defraud is a necessary element, and constructive fraud, where proving intent to defraud is not required. The difference is that claims for actual fraud receive the benefit of the extended two-year period from the time the fraud was discovery or could reasonably have been discovered, while the statute of limitations for constructive fraud claims is a straight six years from when the wrong occurred.

This post addresses other differences in causes of action that do not require actual intent to defraud. Careful attention to these details is required to avoid unintended consequences.

Pleadings Particularity Requirement

The New York Debtor Creditor Law (DCL) has a number of provisions dealing with species of fraud in connection with conveyances of property that affects creditors. DCL Section 276requires an actual intent by the debtor to avoid claims of creditors. The so-called constructive fraud sections of the DCL do not require actual intent as an element – DCL 273 (conveyances by insolvent), DCL 273-a (conveyance by a defendant), DCL 274 (conveyances by person in business), DCL 275 (conveyance by person about to incur debts), DCL 277 (conveyance of partnership property).

"Pursuant to CPLR 3016(b), where a cause of action is based on fraud, the 'circumstances constituting the wrong' must be 'stated in detail,' including 'specific dates and items' (*Orchid Constr. Corp. v Gottbetter*, 89 AD3d 708, 710 [internal quotation marks omitted]; *see Doukas v Ballard*, 135 AD3d 896, 898)." *Swartz v Swartz*, 145 AD3d 818 (2d Dep't 2016). Recent cases discussing this pleadings standard can be found using the search function in this blog by simply searching for "3016."

This special pleadings standard does not apply to certain "constructive fraud" claims. As observed by the Fourth Department in the recent and informative decision in *Matter of City of Syracuse Indus. Dev. Agency (Amadeus Dev., Inc.)*, 2017 NY Slip Op 08945 (4th Dep't Decided December 22, 2017), "claims for fraudulent conveyances under Debtor and Creditor Law §§ 273, 274, and 275 'are not subject to the particularity requirement of CPLR 3016, because they are based on constructive fraud' (*Ridinger v West Chelsea Dev. Partners LLC*, 150 AD3d 559, 560 [1st Dept 2017]; *see Gateway I Group, Inc. v Park Ave. Physicians, P.C.*, 62 AD3d 141, 149-150 [2d Dept 2009])."

There are also different standards of proof for constructive fraud claims.

Standard of Proof – Clear and Convincing and Preponderance

The two standards of proof in civil litigation are a preponderance of the evidence and clear and convincing proof. The New York Pattern Jury Instructions provide a straightforward and simple explanation of these respective standards of proof as follows:

[Clear and Convincing evidence] means evidence that satisfies you that there is a high degree of probability that there was (e.g., fraud, malice, mistake, a gift, a contract between the plaintiff and the deceased, incompetency, addiction), as I (have defined, will define) it for you.

To decide for the plaintiff it is not enough to find that the preponderance of the evidence is in the plaintiff's favor. A party who must prove (his, her) case by a preponderance of the evidence only need satisfy you that the evidence supporting (his, her) case more nearly represents what actually happened than the evidence which is opposed to it. But a party who must establish (his, her) case by clear and convincing evidence must satisfy you that the evidence makes it highly probable that what (he, she) claims is what actually happened.

N.Y. Pattern Jury Instr.–Civil 1:64.

The state and federal courts in New York have not provided clear guidance as to whether the clear and convincing standard that applies to claims of actual fraud also applies to claims of constructive fraud under the DCL. The case law in this regard was recently summarized concisely in *Piccarreto v. Mura*, 51 Misc.3d 1230(A) (NY Sup. Ct, Monroe Co. 2016), as follows:

The burden of proof under [DCL] Section 273 and 273–a seems somewhat in dispute. In 2003, a federal court in New York held that a preponderance standard governs claims under § 273, for reasons that apply with equal force to § 273–a. *See Lippe v. Bairnco Corporation*, 249 FSupp2d 357, 376 n. 6 (SDNY 2003). The Second Circuit affirmed that decision, *Lippe v. Bairnco Corp.*, 99 F. Appx. 274 (2d Cir.2004), and several subsequent federal decisions have taken the same approach. *See In re Dreier LLP*, 452 B.R. 391, 442 (Bankr.SDNY 2011); *In re Borriello*, 329 B.R. 367, 373 (Bankr.E.D.NY 2005).

However, New York appeal courts seem to require the higher standard in order to sustain claims in Section 273 and 273–a. *Matter of U.S. Bancorp Equip. Fin., Inc. v. Rubashkin*,98 AD3d 1057, 1060 (2nd Dept.2012) (reversing judgment in plaintiff's favor because the plaintiff "failed to establish, by clear and convincing evidence, ... a fraudulent conveyance under either section 273 or section 275 of the Debtor and Creditor Law"); *Farkas v. D'Oca*, 305 A.D.2d 237, 237 (1st Dept.2003) ("The trial court properly dismissed the complaint upon the ground that plaintiff had failed to establish by clear and convincing evidence that the payments at issue ... were fraudulent conveyances under either section 273 or section 273–a of the Debtor and Creditor Law."). The conflict between these lines of cases remains unresolved. *See Fannie Mae v. Olympia Mortgage Corp.*,No. 04–CV–4971, 2011 U.S. Dist. LEXIS 63669, 2011 WL 2414685, at 8 (EDNY. June 8, 2011) (noting, without resolving, the "dispute as to the appropriate standard of proof required to prove constructive fraud under § 273"). In the face of this unresolved judicial dispute, this court will apply the higher standard—clear and convincing evidence—to all of the plaintiff's claims under the Debtor/Creditor Law.

Distinction of Negligent Misrepresentation and Challenged Fiduciary Transactions

Although state courts apply the clear and convincing standard to "constructive fraud" claims under the DCL, the New York Pattern Jury Instructions recommend a preponderance of the evidence standard for "negligent representation" claims (that also do not require actual intent to defraud):

As you have heard, the plaintiff AB seeks to recover the damages that (he, she, it) claims were caused by (his, her, its) reliance on incorrect statement(s) that were negligently made by the defendant CD. Specifically, AB claims [*state plaintiff's claim(s)*]. CD denies [*set forth elements of plaintiff's claim(s) that defendant denies*] and contends [*state defendant's contentions*].

Where a person makes a statement that (he, she, it) knows or should know will be relied upon by another, that person is under a duty to the other person to take reasonable care that the statement is correct. Reasonable care means that degree of care that a reasonably prudent person would use under the same circumstances. When a person takes an action or makes a decision in reliance on an incorrect statement and the reliance was reasonable, that person is entitled to recover the damages (he, she, it) sustained as a result.

To recover, AB has the burden of proving, by a preponderance of the evidence, that (1) CD stated [*set forth statement(s) that plaintiff claims were made*]; (2) the statement was incorrect; (3) CD failed to use reasonable care to ensure that the statement was correct; (4) AB (heard, read) CD's statement; (5) CD knew or a reasonable person in CD's position would have known that AB would rely on the statement in [*state action that plaintiff took or decision plaintiff made in alleged reliance on the statement*]; (6) AB relied on CD's statement in [*state action that plaintiff took or decision plaintiff made in alleged reliance on the statement*]; (7) AB's reliance on CD's statement was reasonable; and (8) as a result of (his, her, its) reliance, AB suffered damage.

N.Y. Pattern Jury Instr.–Civil 321 (emphasis added).

Even this is not settled, however, as there is case law support for applying the clear and convincing standard to negligent misrepresentation claims:

Negligent misrepresentation is a species of fraud that replaces the required showing of scienter with a showing of negligence. Like actions for fraud, negligent misrepresentation actions typically are based on inference rather than direct evidence. Thus, ***New York's high standard of "clear and convincing" proof applies to actions for negligent misrepresentation as well as actions for intentional fraud.*** *See* *285 *Alice D. v. William M.*, 113 Misc.2d 940, 450 N.Y.S.2d 350, 354 (N.Y.City Civ.Ct.1982). *Cf. Ajax Hardware Mfg. Corp. v. Industrial Plants Corp.*, 569 F.2d 181, 186 (2d Cir.1977) (discussing "clear and convincing" standard required of actions for fraud and citing *Jo Ann Homes at Bellmore, Inc. v. Dworetz*, 25 N.Y.2d 112, 302 N.Y.S.2d 799, 250 N.E.2d 214 (1969); *Manchel v. Kasdan*, 286 A.D. 483, 144 N.Y.S.2d 694 (1st Dep't 1955) (*per curiam*), *aff'd*, 1 N.Y.2d 734, 151 N.Y.S.2d 940, 134 N.E.2d 687 (1956); *Cave v. Green*, 281 A.D. 560, 120 N.Y.S.2d 865 (1st Dep't 1953), *aff'd*, 308 N.Y. 754, 125 N.E.2d 109 (1955)).

Allen v. Westpoint-Pepperell, Inc., 11 F.Supp.2d 277 (S.D.N.Y.1997)(emphasis added).

Even further clarification is necessary for claims in which fraud is alleged against a fiduciary where the transaction is challenged by the

person or entity to whom the fiduciary duty is owed. In those circumstances, the fiduciary who enters into a transaction with the one to whom it owes a fiduciary duty has the burden of proving by clear and convincing evidence that the transaction was free of improper influence, fraud or other wrongdoing. The New York Court of Appeals in *Matter of Aoki v. Aoki*, 27 N.Y.3d 32 (2016) recently explained the rules applying to transactions involving fiduciaries (see my post for a full description). The Court of Appeals first pointed out: "It is a well-settled rule that '"fraud vitiates all contracts, but as a general thing it is not presumed but must be proved by the parties seeking to [be] relieve[d] ... from an obligation on that ground"'." The Court continued: "However, an exception to that general rule provides that where a fiduciary relationship exists between the parties, the law of constructive fraud will operate to shift the burden to the party seeking to uphold the transaction to demonstrate the absence of fraud." The Court noted that it had applied the constructive fraud doctrine in different contexts, but "the pertinent fact at present is that the fiduciary stood to benefit from the transaction itself." The Court cited prior case law in describing the doctrine of constructive fraud explaining that

"[when] the relations *between the contracting parties* appear to be of such a character as to render it certain that they do not deal on terms of equality but that either on the one side from superior knowledge of the matter derived from a fiduciary relation, or from overmastering influence, or on the other from weakness, dependence, or trust justifiably reposed, unfair advantage in a transaction is rendered probable, there the burden is shifted, the transaction is presumed void, and it is incumbent upon the stronger party to show affirmatively that no deception was practiced, no undue influence was used, and that all was fair, open, voluntary and well understood [emphasis supplied]."

As the New York Pattern Jury Instructions note, the clear and convincing standard applies to the burden placed on the fiduciary to prove the validity of the transaction:

Under the constructive fraud doctrine, where a fiduciary relationship exists between parties, "transactions between them are scrutinized with extreme vigilance, and clear evidence is required that the transaction was understood, and that there was no fraud, mistake, or undue influence. Where those relations exist, there must be clear proof of the integrity and fairness of the transaction, or any instrument thus obtained will be set aside or held as invalid between the parties," Ten Eyck v Whitbeck, 156 NY 341, 50 NE 963 (1898). Although in conventional fraud cases a party seeking rescission must prove the fraud, the burden of proof on that issue is shifted whenever the relations between the contracting parties appear to be of such a character as to render it certain that they do not deal on terms of equality and that—as a result of (a) one side having superior knowledge derived from a fiduciary relation, (b) one side having an overmastering influence, or (c) the other side operating from weakness, dependence, or trust justifiably reposed—unfair advantage in the transaction is rendered probable. In such circumstance, the transaction is presumed void, and it is incumbent upon the stronger party to show affirmatively that no deception was practiced, no undue influence was used, and that all was fair, open, voluntary and well understood, Gordon v Bialystoker Center and Bikur Cholim, Inc., 45 NY2d 692, 412 NYS2d 593, 385 NE2d 285 (1978); Cowee v Cornell, 75 NY 91 (1878). *In such situations, the burden of proof is on the stronger party to show, by clear and convincing evidence, that no undue influence was used, Matter of Estate of Nealon, 104 AD3d 1088, 962 NYS2d 481 (3d Dept 2013), aff'd, 22 NY3d 1045, 981 NYS2d 353, 4 NE3d 363 (2014). However, this shift in the burden of proof is applicable only in cases where the fiduciary or stronger party stood to gain as a result of the transaction*, Aoki v Aoki, 27 NY3d 32, 29 NYS3d 864, 49 NE3d 1156 (2016).

N.Y. Pattern Jury Instr.–Civil 320 (emphasis added).

Commentary

As can be seen from the above, much care should be taken in determining the different standards of pleading and proof for the various types of fraud claims that exist. The rules are not entirely consistent or clear so the relevant authorities must be analyzed and applied in a manner that best suits a party's position.

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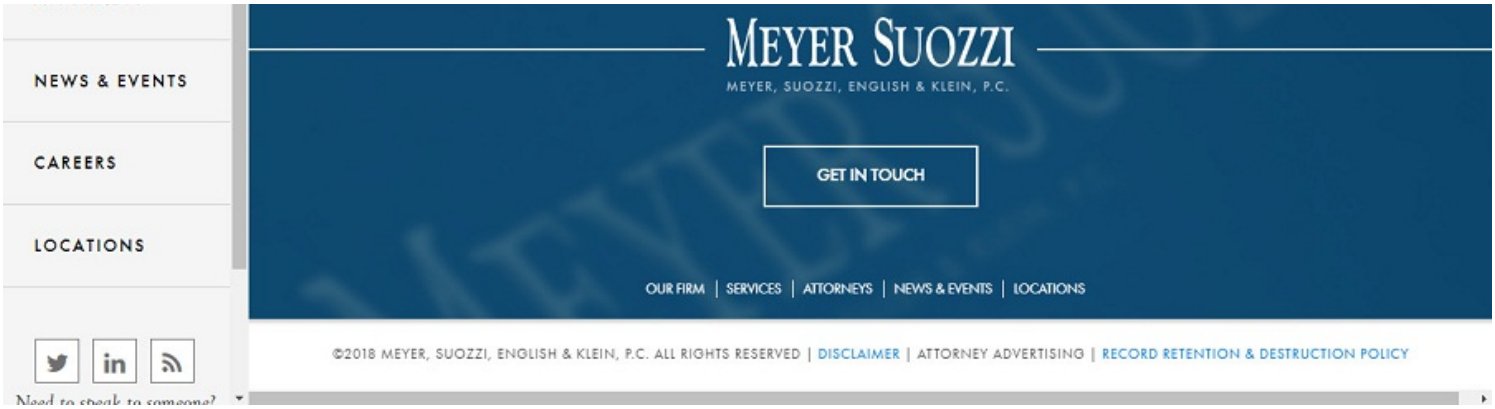
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