ADCO Elec. Corp. v Fahey
2006 NY Slip Op 30784(U)
March 8, 2006
Supreme Court, New York County
Docket Number: 109834/2005
Judge: Richard B. Lowe III
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 56

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ADCO ELECTRICAL CORPORATION, a New Jersey Corporation, d/b/a SCHOLES ELECTRIC & COMMUNICATIONS,

Plaintiff,

- against -

BRUCE FAHEY, BRIAN McMAHON, PLATZER, SWERGOLD, KARLIN, LEVINE, GOLDBERG & JASLOW, LLP,

Defendants.

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Index No. 109834/2005

DECISION AND ORDER

RICHARD B. LOWE, III, J.:

Motion sequence numbers 001 and 002 are consolidated for disposition.

In motion sequence 001, defendant Platzer, Swergold, Karlin, Levine, Goldberg & Jaslow, LLP (Platzer Swergold) moves to dismiss the Complaint pursuant to CPLR 3211(a) (7) and (c) for failure to state a cause of action, for, inter alia, conversion and money had and received. In motion sequence 002, defendants Bruce Fahey (Fahey) and Brian McMahon (McMahon) move to dismiss the Complaint against him pursuant to CPLR 3211 (a) (7) for failure to state a cause of action for, inter alia, conversion and fraudulent concealment.

BACKGROUND

This action arises out of the alleged unlawful conversion of some $2 million allegedly belonging to the plaintiff.

On or about June 26, 2000 non-party Morgan Stanley & Co. Inc. (Morgan Stanley) entered into a Construction Management Agreement with non-party (and now defunct) McCann, Inc. (McCann) for the purpose of having McCann serve as Morgan Stanley's construction manager on

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various projects in New York and New Jersey. One of these projects involved Morgan Stanley's offices at 111 Pavonia Avenue in New Jersey.

In September 2003, McCann hired plaintiff ADCO Electrical Corporation (ADCO) to perform electrical work at the New Jersey project. Plaintiff periodically submitted invoices for the work performed to McCann, who in turn submitted the invoice, along with other invoices, to Morgan Stanley for payment.

In December 2003, plaintiff submitted an invoice to McCann in the amount of $381,330. In January 2004, plaintiff submitted an invoice to McCann for $2,859,975, which did not include the $381,330 amount, and to which McCann submitted only a reduced invoice for $2,097,315 to Morgan Stanley. Plaintiff alleges that the McCann received reimbursements from Morgan Stanley to cover plaintiff's invoices as well as invoice of the other subcontractors, and did not reimburse the plaintiff. Specifically, the plaintiff alleges that McCann received $1,419,810.13 from Morgan Stanley in January 2004, but failed to pay ADCO. ADCO also alleges that McCann received $2,511,147.64 from Morgan Stanley in February 2004, which ADCO avers McCann reimbursed the plaintiff only the $381,330 amount, but not the $2,859,975 amount.

The plaintiff alleges that under the Construction Management Agreement, McCann was to hold all moneys received in trust. However, ADCO alleges that Fahey and McMahon, as officers, directors, and shareholders of McCann, willfully and intentionally concealed material information from the plaintiff regarding payments received from Morgan Stanley and, instead, directed payments to other parties and not to the plaintiff. McCann soon filed bankruptcy on or about April 15, 2004, retaining Platzer Swergold as its counsel in the bankruptcy proceedings. ADCO alleges that Platzer Swergold received monies as payment for its services from McCann that are due and owing to the

plaintiff.

The plaintiff, on July 15, 2005, brought action against the defendants by Summons and Complaint. The plaintiff alleges four causes of action: against Fahey and McCahon individually for conversion (first cause of action) and fraudulent concealment (second cause of action), and against Platzer Swergold for conversion (third cause of action) and money had and received (fourth cause of action).

DISCUSSION

In a motion to dismiss pursuant to CPLR 3211 (a), the court takes the facts as alleged in the Complaint as true and accords the benefit of every possible favorable inference to the non-movant (*see Rovello v Orofino Realty Co., Inc.*, 40 NY2d 633, 634 [1976]). The court addresses each of the causes of action the defendants seek dismissal of.

I. Motion Sequence 001: Platzer Swergold's Motion to Dismiss

Platzer Swergold moves to dismiss the two causes of action against it, arguing that because it is a holder in due course, Platzer Swergold took the payment free of all claims and defenses. Alternatively, Platzer Swergold argues that the plaintiff does not, and cannot, establish the existence of a trust. The court need not deal with the alternative argument Platzer Swergold advances, as it finds that ADCO has failed to show that the defendant was not a holder of the money in due course.

Under the Uniform Commercial Code (UCC), in order for a holder of an instrument to take in due course and free of all claims and defenses, the holder must take "(a) for value; and (b) in good faith; and (c) without notice that is overdue or has been dishonored or of any defense or claim to it on the part of any person" (§3-302 [1]). Pursuant to UCC § 3-304 (7), "to constitute notice of a

claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith." Holders in due course "are to be determined by the simple test of what they *actually knew*, not by speculation as to what they had reason to know, or what would have aroused the suspicion of a reasonable person in their circumstances" (*Hartford Acci. & Indem. Co. v American Express Co.*, 74 NY2d 153, 163 [1989] [emphasis added], citing *First Nat'l Bank v Fazzari*, 10 NY2d 394, 399 [1961]).

Here, there is no dispute that Platzer Swergold took the money for valuable services the firm rendered to McCann. However, the plaintiff fails to demonstrate that the defendant had notice that the plaintiff was actually owed these funds. Notice "demands nothing less than actual knowledge of the claim against the instrument or of facts indicating bad faith in taking the instrument" (*Hartford Acci. & Indem. Co.*, 74 NY2d at 162, citing *Chemical Bank of Rochester v Haskell*, 51 NY2d 85, 92-93 [1980]; *First Intl, Bank, Ltd. v L. Blankstein & Son, Inc.*, 59 NY2d 436, 445 [1983]). Other than the conclusory allegation that the defendant *should have known* that money belonged to the plaintiff, there is nothing in the Complaint, even construed liberally, that shows that the defendant had any actual knowledge that the money was due and owing to ADCO.

The plaintiff also fails to show that Platzer Swergold took the money in bad faith. In determining whether a holder has taken the instrument in good faith, there is a combined "subjective inquiry into what the holder actually knew with an objective inquiry into whether a person with that knowledge would have accepted the instrument, i.e., whether the holder consciously ignored facts that would have put him or her on notice of a claim or defense" (*Adamar, Inc. v Chase Lincoln First Bank, N.A.*, 201 AD2d 174, 176 [1st Dept 1994], citing *Hartford Acc. & Indem. Co.*, 74 NY2d 153). The plaintiff contends that the defendant should have made an investigation into McCann's finances

prior to taking on its representation of McCann in the bankruptcy proceedings because McCann contacted the firm "to work out its financial issues in the hope of avoiding a court supervised restructuring" (Platzer Aff ¶ 4). However, "merely failing to investigate upon acquiring information that would give rise to reasonable suspicion, while perhaps an act of negligence, does not constitute subjective bad faith or dishonesty" (*First Union Nat'l Bank v A.G. Edwards & Sons, Inc.*, 262 AD2d 106, 107 [1st Dept 1999]). Here, the facts alleged do not "constitute subjective bad faith or dishonesty" on the part of the Platzer Swergold Moreover, the court doubts the alleged facts even gave rise to a need for an investigation.

The plaintiff has failed to sufficiently plead that defendant Platzer Swergold is not a holder in due course (*Transglobal Mktg. Corp. v Derfner & Mahler, LLP*, 246 AD2d 482 [1st Dept 1998] [the party alleging a holder of an instrument not in due course has the burden to show non-compliance with UCC § 3-302 (1)]). Accordingly, the defendant takes the instrument free of all claims and defenses, and the Complaint must be dismissed against it. The motion to dismiss is granted.

II. Motion Sequence 002: Fahey and McMahon's Motion to Dismiss

Defendants Fahey and McMahon both move to dismiss the Complaint against them. Fahey argues that plaintiff ADCO has failed to adequately plead causes of action for conversion and fraudulent concealment as well as the existence of a trust, important to both causes of action at issue. McMahon, in addition to the arguments Fahey makes, also avers that ADCO lacks standing to bring this action against him because a previous action in the Federal Bankruptcy Court declared McMahon not liable.

A. *Conversion*

The main argument that both Fahey and McMahon advance in their motions to dismiss the cause of action for conversion is that there was no trust and, as such, no conversion because there was no money kept in trust for the benefit of ADCO. McMahon also argues that he is not liable pursuant to the declaration of the Bankruptcy Court. Both parties concede that the New York Lien Law is irrelevant in this action; however, ADCO argues that common law trust applies.

In order to bring a viable action for conversion, the plaintiff must allege that he had ownership, possession or control of the money which is the subject of the action. (*Peters Griffin Woodward v WCSC, Inc.*, 88 AD2d 883, 884 [1st Dept 1982]). The plaintiff must show that they had an immediate superior right of possession to the identifiable fund and the exercise by defendants of unauthorized dominion over the money in question to the exclusion of plaintiff's rights (*Employers' Fire Ins. Co. v Cotten*, 245 NY 102, 105 [1927]; *Bankers Trust Co. v Cerrato, Sweeney, Cohn, Stahl & Vaccaro*, 187 AD2d 384, 385 [1st Dept 1992]).

Here, the plaintiff argues that McCann held the moneys in trust for the benefit of the plaintiff, and claims ADCO had ownership of the subject money in this action. ADCO utilizes the Construction Management Agreement as evidence that there was a trust created under common law giving ADCO the benefit of moneys received by Morgan Stanley by McCann. The Construction Management Agreement indeed provides that:

> Promptly upon receipt of each payment from Owner [Morgan Stanley], [McCann] shall make payments to each laborer, subcontractor and supplier for whose services, labor or materials an application was submitted and payment advanced by Owner. [McCann] shall hold all monies received on account of the Contract Price, as adjusted, in trust for such purpose in accordance with the provision of the laws of the state of New York.

(*See* Complaint, Ex 1 at 13).

Reading the Complaint liberally in favor of the non-movant, the court finds that the plaintiff has made a viable cause of action for conversion. Here, the agreement explicitly provides that McCann "shall hold all monies . . . in trust in accordance with the provision of the laws of the state of New York." While the Lien Law does not apply in this matter since this is work performed outside New York (*see Allied Thermal Corp. v James Talcott, Inc.*, 3 NY2d 302 [1957]), the common law theory of trusts still applies in this matter (*accord Hinkle Iron Co. v Kohn*, 229 NY 179 [1920]). McCann was obligated under its contractual agreement with Morgan Stanley to create a trust to hold the moneys paid by Morgan Stanley for the benefit of the laborers and subcontractors. Further, the plaintiff has plead that there were monies received from Morgan Stanley which was due on the invoices submitted by ADCO for payment. In addition, the plaintiff is able to trace the monies and funds it is owed. Finally, the plaintiff has shown that McCann utilized that monies instead of reimbursing the plaintiff for work done.

Accordingly, there is a viable action for conversion. Since officers and directors may be held personally liable for conversion (*Hinkle Iron Co.*, 229 NY 179), the plaintiff may bring action against Fahey and McMahon as directors and officers of the now defunct McCann.

As to McMahon personally, there is an argument that the Federal Bankruptcy Court adjudged him not liable and, further, only the Chapter 11 Bankruptcy Trustee may bring claims concerning conversion and misappropriation of funds. Here, while it is true that the Bankruptcy Trustee found that McMahon "had no ability or authority to direct or alter corporate financial decisions (*see* McMahon Aff, Ex. C), this release was for claims the Trustee himself made against McMahon. As articulated in *In re McMann, Inc.*, the Bankruptcy Trustee had no authority to avoid and recover

'property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings'" (318 BR 276, 382 [SD NY 2004], quoting *Begier v IRS*, 496 US 53, 58 [1990]). The Trustee could not "recover the trust funds as fraudulent transfers" (*id.*). McMahon's argument must fail because, in this situation, only the subcontractor, whose money is held in trust for its benefit, may bring suit.

As such, the motion to dismiss the first cause of action for conversion as to Fahey and McMahon is denied.

B. *Fraudulent Inducement*

Fahey and McMahon also argue that the motion to dismiss the second cause of action for fraudulent inducement should be dismissed because the plaintiff has failed to state a cause of action or with particularity the alleged fraud. The court agrees.

In order to bring an action for fraudulent concealment, the Complaint must allege that the defendants made a material misrepresentation of fact, that the misrepresentation was made intentionally in order to defraud or mislead the plaintiff, that the plaintiff reasonably relied on the misrepresentation, that the plaintiff suffered damage as a result of its reliance on the defendants' misrepresentation, and that the defendants had a duty to disclose material information and that they failed to do so (*P.T. Bank Cent. Asia v ABN AMRO Bank N.V.*, 301 AD2d 373, 376 [1st Dept 2003]; *Swersky v Dreyer and Traub*, 219 AD2d 321, 326 [1st Dept 1996]). Such actions in fraud must be stated in detail (CPLR 3016 [b]).

The plaintiff argues that the defendants had superior knowledge regarding when payment was made by Morgan Stanley to McCann for disbursement to the subcontractors, and, accordingly, should have provided that information to the plaintiff. While there is no dispute that Morgan Stanley

did send payment to McCann, the court is at a loss as to how this constitutes fraudulent concealment. Even where the plaintiffs base its allegation on the "special facts" doctrine, where "a duty to disclose arises where one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair" (*Swersky*, 219 AD2d at 327 [internal citations and quotations omitted]), the court fails to see how the fact that Morgan Stanley remitted moneys to McCann constituted an essential fact which the defendants "had a duty to disclose" (*P.T. Bank Cent. Asia*, 301 AD2d at 376). The court also notes that the plaintiff has failed to specify how the defendants intended to mislead or defraud the plaintiff by withholding this information. There is no indication that McCann ever provided such information to the plaintiff. Even taking the Complaint liberally, the court finds that the plaintiff has not demonstrated a cause of action for fraudulent concealment.

For the foregoing reasons, the Fahey and McMahon's motion to dismiss the second cause of action for fraudulent concealment is granted.

CONCLUSION

Accordingly, it is hereby

ORDERED that defendant Platzer, Swergold, Karlin, Levine, Goldberg & Jaslow, LLP's motion to dismiss (Motion Sequence 001) the Complaint is granted and the Complaint is dismissed as to defendant Platzer, Swergold, Karlin, Levine, Goldberg & Jaslow, LLP, with costs and disbursements to defendant Platzer, Swergold, Karlin, Levine, Goldberg & Jaslow, LLP as taxed by the Clerk of the court; it is further

ORDERED that defendants Bruce Fahey and Brian McMahon's motion to dismiss (Motion Sequence 002) the Complaint is granted to the extent that the second cause of action for fraudulent concealment is dismissed, and it is otherwise denied; and it is further

ORDERED that defendants Bruce Fahey and Brian McMahon is directed to serve an Answer to the Complaint within 10 days after service of copy of this order with notice of entry.

Dated: March 8, 2006

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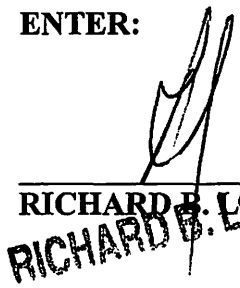

RICHARD B. LOWE, III, J.S.C.

RICHARD B. LOWE III

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