SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 11

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PENY & CO.,

Plaintiff,

-against- Index No. 850011/13

936-938 CLIFFCREST HOUSING DEVELOPMENT FUND CORPORATION, THE DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT OF THE CITY OF NEW YORK, NEW YORK CITY ENVIRONMENTAL CONTROL BOARD, NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, AND JOHN AND JANE DOES\ 1-10, ABC LLC 1-10, XYZ CORP. 1-10,

Defendants.

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936-938 CLIFFCREST HOUSING DEVELOPMENT FUND CORPORATION,

Third-Party Plaintiff

-against-

THE WAVECREST MANAGEMENT TEAM LTD., COMMUNITY CAPITAL BANK n/k/a CARVER FEDERAL SAVINGS BANK, LEE WARSHAVSKY, SHUHAB HOUSING DEVELOPMENT FUND CORPORATION, JOHN AND JANE DOES 11-20, the identity of such persons being unknown to the Third-Party Plaintiff, but intended to describe those persons who corruptly influenced their employer, THE DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT OF THE CITY OF NEW YORK to look away from their defalcations of the Third-Party Plaintiff's funds,

Third-Party Defendants.

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JOAN A. MADDEN, J.

In this foreclosure action, defendant Cliffcrest Housing Development Fund Corporation

(Cliffcrest) moves, pursuant to CPLR 3025 (b), for leave to serve an amended verified answer, counterclaim, and third-party complaint (proposed pleading). Plaintiff Peny & Co. (Peny) and defendant and proposed third-party defendant The Department of Housing Preservation and Development of the City of New York (HPD) oppose the motion.[1]

Background

Cliffcrest is tenant owned development company and the owner of the property located at 938 St. Nicholas Avenue, New York, New York ("the property"). Cliffcrest became the owner of the property in connection with HPD's Third-Party Transfer Program ("TPT"), established by Local Law 37 of 1996, which provides an alternative to in-rem foreclosure. The goal of the program is to transfer tax-delinquent buildings in poor condition to new owners capable of rehabilitating the buildings and managing the buildings as low income housing.

Pursuant to that law, residential properties, with respect to which the City holds tax liens, are transferred, first, to a private not-for-profit entity and, then, to a sponsor which agrees to provide construction or permanent financing, typically, in conjunction with partial funding by HPD. In this case, the property was originally taken by the City in rem and transferred to a not-for-profit Neighborhood Restore Housing Development Fund Corporation ("Neighborhood Restore") on May 17, 2001. On December 19, 2002, Neighborhood Restore transferred the property to the sponsor, proposed third-party defendant Shuhab Housing Development Fund

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[1]After the motion was fully submitted, Carver Federal Savings Bank, as successor-in-interest to proposed third-party defendant Community Capital Bank (CCB), submitted a letter in opposition to the motion essentially adopting the opposition arguments of Peny and HPD. As CCB is not a party to the action, such opposition is improper. Moreover, CCB's opposition was submitted, without permission, subsequent to the submission date of the motion, and is also rejected on this ground. See Thermo Spas Inc. v. Red Ball Spas & Baths Inc., 199 AD2d 605 (3d Dept 1993); CPLR 2214(c).

Corp. (Shuhab). Proposed third-party defendant Wavecrest Management Team, Ltd. ("Wavecrest") is the managing agent appointed by Shuhab for the property.

HPD holds two mortgages on the property which were originally provided as part of a joint construction loan, originated in 2002, with Fleet National Bank ("Fleet"), to provide construction financing to rehabilitate the property (hereinafter "the HPD mortgages").[2] In connection with this financing, on December 19, 2002, HPD and Fleet National Bank ("Fleet") executed a Construction Loan Participation Agreement ("Participation Agreement") to fund HPD's share of the construction.

The rehabilitation of the property was purportedly completed in September 2006. On September 28, 2006, Shuhab conveyed the property to Cliffcrest for consideration of $10.00. The individual units in the Property were sold to the current unit owners as low-income co-ops at a price of $2,510.00, which is below market value. As part of the transfer, Cliffcrest assumed the obligations under all the mortgages on the property including the HPD mortgages. On September 28, 2006, Cliffcrest executed and delivered to Community Capital Bank ("CCB") a Mortgage Note ("the Note") evidencing a commercial loan made to it in the principal amount of $1,650,000, plus interest a set forth in the Note. Simultaneously with the execution of the Note, Cliffcrest executed and delivered to CCB a Mortgage, Assignment of Leases and Rents and

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[2]According to HPD, on September 29, 2006, three mortgages originally made and dated December 19, 2002, in the principal amount of $2,512,103, were consolidated into one mortgage under which Cliffcrest was required to pay interest at a rate of .62% per annum starting on November 1, 2006, in monthly installments through November 1, 2036. Also, on September 29, 2006, two mortgages originally made and dated December 19, 2002 in the principal amount of $947,500, were consolidated into a second HPD mortgage, which is "a standing loan" with no interest or payments required with the debt to be forgiven barring a default. Cliffcrest paid the interest under the first HPD mortgage until April 2012 but has not made any payments since that time.

Security Agreement (the Mortgage). That same day, CCB assigned to Peny the Note and the Mortgage (together "the Loan Documents"). The documentary evidence shows Peny paid CCB $1,650,000 for the assignment of the Note and the Mortgage. *See* NYC Department of Finance, Office of the City Registrar Recording and Endorsement, Slama affirmation, exhibit E. The HPD mortgages are subordinate to the Peny mortgage.[3]

Peny alleges that beginning in March 2012, Cliffcrest ceased making monthly payments of principal and interest due under the Loan Documents. It further alleges Cliffcrest failed to make payments for real estate taxes assessed against the property and failed to provide proof of insurance covering the property. After Peny notified Cliffcrest of these defaults and Cliffcrest failed to cure them, Peny commenced this foreclosure action, and filed an application for the appointment of a temporary receiver.[4]

Motion to Amend

Cliffcrest now moves for leave to serve an amended verified answer, counterclaims, and third-party complaint. The proposed pleading alleges that agents of HPD and Shuhab, and their co-conspirators "pilfered the rehabilitation loan proceeds for their own personal gains," and "funneled the monies to general contractors who did not perform the repairs necessary to [the Property] required to make [the Property] livable." (Proposed Amended Verified Complaint, ¶'s 133, 135). It is further alleged that the HPD mortgage and the CCB mortgage were "nothing

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[3]Specifically, on September 29, 2006, HPD and CCB entered into a subordination agreement whereby HPD agreed that the HPD mortgages, shall be subject and subordinate in time and payment and to the liens, terms and covenants in the Loan Documents.

[4]While the application was made ex parte, this court required that Peny give notice of the application to Cliffcrest which has opposed the application.

more than a sham," and that "to conceal the fraudulent CCB mortgage, Shubab caused its agent, Lee Warshavsky (Warshavsky) to act as Secretary and Treasury of Cliffcrest so that Cliffcrest's independent existence would remain a sham and Cliffcrest would act solely on behalf of Shubab" (*Id,* ¶'s 137, 138). It is further alleged that on the date CCB mortgage was filed, Warshavsky, purportedly acting on behalf of Cliffcrest, assigned the CCB mortgage to Peny (*Id,* ¶ 139). It is also alleged that "HPD officials were co-conspirators, together with Shuhab, in accepting bribes and kickbacks from construction loan proceeds, as they have now notoriously done in similar instances" (*Id,* ¶ 144).

In support of its motion, Cliffcrest submits the affidavit of its President, Carlton Burroughs ("Burroughs"). Burroughs states that the construction work on the property began in 2002, and that the work was "shoddy" and complaints to both Shuhab and HPD regarding the poor quality of the work were ignored. According to Burroughs, HPD and Shuhab induced the tenants to invest their life savings in the purchase of the property and warned the tenants that if they did cooperate fully they would lose their investments. He also states that HPD and Shuhab managed the selection of contractors who were suppose to rehabilitate the property but instead stole the funds, and Cliffcrest received no value for the proceeds.

Cliffcrest also submits the affidavit of John D. Nakrosis, R.A., who attended the inspection of the property in November 2013, and states that he reviewed the portions of the relevant construction contract and some rehabilitation drawings. Nakrosis states that his "inspection of the [property] revealed a host of glaring deficiencies, construction defects and life safety hazard, which lead me to believe within a reasonable degree of engineering and architectural certainty that the work that was called for in the contract was never done and what

little work was done was wholly deficient." Nakrosis, Affidavit ¶ 6.

The proposed pleading asserts counterclaims, cross claims and third party claims for (1) rescission of the Note and Mortgage that are the bases of Peny's action on the ground that Cliffcrest was fraudulently induced into entering the Note and Mortgage; (2) fraud; (3) a permanent injunction barring Peny from proceeding to a judgment of foreclosure and sale and enjoining HPD, and the proposed third-party defendants to take all steps necessary to satisfy and discharge the note and mortgage and the notice of pendency filed in this action; (4) violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 USC § 1961 *et seq.;* and (5) violation of 42 USC § 1983 based on allegations that the RICO scheme specifically targeted African-Americans, Latino and immigrant citizens.

Cliffcrest also seeks to interpose the following four affirmative defenses: (1) failure to name a necessary party; (2) fraud; (3) failure to state a cause of action; and (4) unclean hands. With respect to the first proposed affirmative defense, Cliffcrest fails to identify any necessary party that has not been named. As for the affirmative defense of failure to state a cause of action, such affirmative defense is a "mere surplusage," as it may be asserted any time even if not pleaded. Bernstein v. Freudman, 136 AD2d 490 (1st Dept 1988). With respect to the affirmative defenses of fraud and unclean hands, as these defenses are based on the allegations made in connection with the counterclaims and cross claims, they will be discussed below.

As against Peny, the proposed counterclaims and affirmative defenses of fraud and unclean hands are based upon the allegations that: (1) Warshavsky, who acted in the interest of Shuhab, and not Cliffcrest, assigned the CCB mortgage to Peny; (2) the assignment to Peny was made on the same day that CCB filed its mortgage; (3) the assignment of the mortgage from

CCB to Peny was "for the purpose of creating a false front to enable [Peny] to claim holder in due course status even though it had actual knowledge or notice of the corrupt transactions that were the genesis of the mortgage and note" (*Id,* ¶ 106, 185); and that (4) Peny, or its predecessor (i.e. CCB) participated in HPD's scheme of defalcation and knew or should have known that Shuhab and Warshavsky were engaged in theft and fraud particularly as "HPD's corruption was routine and well known in banking circles" (*Id,* ¶ 103), and "[Peny] was advised by Shuhab that the mortgage payments were to be made directly to the New York City Preservation Corporation ("CPC") an affiliate of [Peny], [and that] upon information and belief CPC has knowledge of rampant fraud in the TPT Program, which is fairly imputed to [Peny] (*Id,* ¶ 127-128).

"Leave to amend a pleading should be 'freely given' (CPLR 3025[b]) as a matter of discretion in the absence of prejudice or surprise." *Zaid Theatre Corp. v. Sona Realty Co.*, 18 AD3d 352, 355-356 (1st Dept 2005)(internal citations and quotations omitted). That being said, however, "in order to conserve judicial resources, an examination of the underlying merits of the proposed causes of action is warranted." *Eighth Ave. Garage Corp. v. H.K.L Realty Corp.*, 60 AD3d 404, 405 (1st Dept), *lv dismissed*, 12 NY3d 880 (2009). At the same time, leave to amend will be granted as long as the proponent submits sufficient support to show that proposed amendment is not "palpably insufficient or clearly devoid of merit." *MBIA Ins Corp. v. Greystone & Co., Inc.,* 74 AD3d 499 (1st Dept 2010)(citation omitted). Here, at this early stage in the action, there is no basis for denying the amendment on the grounds of prejudice or surprise. Thus, the only issue is whether the proposed pleading is of sufficient merit.

To plead a viable cause of action for fraud, it must be alleged that party charged with fraud made a misrepresentation of a material existing fact or a material omission of fact, which

was false and known to be false by the defendants when made, for the purpose of inducing plaintiff's reliance, justifiable reliance on the alleged misrepresentation or omission by the plaintiff, and injury (*Lama Holding Company v Smith Barney Inc.*, 88 NY2d 413, 421 (1996)). Additionally, CPLR 3016 (b) requires that the complaint set forth the misconduct complained of in sufficient detail to clearly inform each defendant of what their respective roles were in the incidents complained of (*see P.T. Bank Central Asia v ABN AMRO Bank N.V.*, 301 AD2d 373, 376 (1st Dept 2003)).

Here, the proposed pleading is insufficient to provide a basis for asserting a claim or defense of fraud against Peny. Notably, there are no allegations, or proof, that Peny made any material misrepresentations or omissions that induced any reliance by Cliffcrest. At best, the allegations in the proposed pleading can be read as suggesting that Peny knew or had reason to know about the alleged fraud committed by HPD or other entities and nonetheless took the assignment the Note and Mortgage from CCB. Moreover, while the proposed pleading contains conclusory allegations that Peny participated in the fraud, Cliffcrest submits no evidence that Peny had anything to do with the alleged scheme, which purportedly relates to the original financing for the property in 2002, as opposed to the CCB mortgage in 2006, that was assigned to Peny. Nor does Cliffcrest deny that it received the funds from the CCB mortgage, or that Peny paid $1,650,000 for the assignment of the mortgage, or that Cliffcrest paid the mortgage until it defaulted in 2012.

Accordingly, the first and second counterclaims, which are based on allegations of fraud, and the affirmative defenses of fraud and unclear hands are devoid of merit and leave to amend to include these counterclaims and defenses as against Peny is denied.

The third counterclaim, for a permanent injunction, is also without merit. To state a claim for a permanent injunction a party must allege "violation of a right presently occurring, or threatened and imminent; that the plaintiff has no adequate remedy at law; that serious and irreparable injury will result if the injunction is not granted; and that the equities are balanced in the plaintiff's favor." *Elow v. Svenningsen,* 58 AD3d 674, 675 (2d Dept 2009). In this case, Cliffcrest has not alleged a sufficient basis for injunctive relief against Peny. Significantly, Cliffcrest has not identified any right that Peny violated nor has Cliffcrest shown that any equities weigh in its favor.[5]

The fourth counterclaim is for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 USC § 1961[6]. Under RICO "it is unlawful to use income from a 'pattern of racketeering activity' (1) to acquire an interest in or to establish or operate an enterprise engaged in or affecting interstate commerce (18 USC § 1962 [a]), (2) to acquire or maintain an interest in such an enterprise through a pattern of racketeering activity (§ 1962 [b]), (3) to conduct or participate in the conducting of such an enterprise through a pattern of racketeering activity (§ 1962 [c]) and (4) to conspire to do any of the foregoing acts (§ 1962

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[5] Peny also argues that Cliffcrest waived its right to seek injunctive relief under the Loan Documents. *See* Note, § 14 (providing that "Maker hereby expressly and unconditionally waives, in connection with any suit, action, or proceeding brought by the Lender on this Note, any and every right it may have to (i) injunctive relief..."; Mortgage, § 4.17 ("The Mortgagor hereby expressly and unconditionally waives, in connection with any foreclosure or similar action or procedure brought by the Mortgagee asserting an Event of Default, any and every right to may have to ...(i) injunctive relief." The court makes no determination as to the merits of this argument.

[6]While Cliffcrest argues in reply that it has stated a cause of action under New York Penal Law § 460.00, as the proposed pleading does not allege a cause of action under this section, the court has not considered this argument.

[d])." *Simpson Elec. Corp. v. Leucadia, Inc.*, 72 NY2d 450, 453 (1988).

Courts have "imposed a heightened pleading requirement" for civil RICO violations as such claims have been "found to be 'an unusually potent weapon—the litigation equivalent of a thermonuclear device " *See Besicorp, Ltd. v. Kahn,* 290 AD2d 147, 151 (3d Dept), *lv denied*, 98 NY2d 601 (2002), quoting *Katzman v. Victoria Secret Catalogue*, 167 FRD 649, 655 (SDNY 1996), *affd,* 113 F3d 1229 (2d Cir 1997)(citations and internal quotations omitted). Moreover, since the "mere assertion of a RICO claim ... has an almost inevitable stigmatizing effect on those named as defendants, ... courts should strive to flush out frivolous RICO allegations at an early stage of the litigation." *Katzman v. Victoria Secret Catalogue*, 167 FRD at 656 (internal citation and quotation omitted).

The elements that must be pleaded to state a civil RICO claim are "(1) conduct (2) of an enterprise (3) through a pattern... (4) of racketeering activity" *Podraza v. Carriero,* 212 AD2d 331, 335 (4th Dept), *lv dismissed*, 86 NY2d 885 (1995)(internal citation and quotation omitted). The elements must be established as to each individual participant. *United States Fire Ins. Co. v. United Limousine Service, Inc.*, 303 FSupp2d 432, 451 (SD NY 2004).

The court finds that the proposed counterclaim based on an allege violations of civil RICO is of insufficient merit to permit its addition. In the first place, the proposed pleading fails to establish the four elements as to each of the purported participant in the RICO scheme but, rather, alleges the scheme in terms of collective activity of the participants. Thus, while Peny is identified as one of the "RICO Conspirators," there are no specific allegations against it. *See DC Media Capital LLC v. Sivan*, 2009 WL 1030808 (Sup Ct NY Co. 2009)(dismissing RICO claims as they fail to specify the individual misconduct attributable to each defendant).

Next, to establish a pattern of racketeering activity, the complaint must allege at least two related predicate acts of racketeering activity as defined under 18 USC § 1961 (5); *Id; Pinnacle Consultants, Ltd. v Leucadia Natl. Corp.* 101 F3d 900, 904 (2d Cir 1996). Section 1961(1) enumerates the different predicate offenses which constitute "racketeering activity," including, inter alia, mail fraud and wire fraud. See 18 U.S.C. § 1961(1). Here, the alleged racketeering activity engaged in furtherance of the scheme includes using the mail to send out various notices among themselves and to others, and utilizing telephone and wire equipment to further the scheme. However, the proposed pleading inadequately alleges how the mailings and the use of the telephone and wires contributed to the fraudulent scheme. *See Besicorp Ltd. v. Kahn*, 290 AD2d 147 (3d Dept 2002)(dismissing claims seeking civil liability under RICO where complaint failed to allege "the manner in which any mailing or wiring was fraudulent and how the purpose of each such mailing fit within defendants' fraudulent scheme"); *DC Media Capital LLC v. Sivan*, 2009 WL 1030808 (dismissing claims for civil RICO for failure to establish sufficient predicate acts where the complaint failed to assert "whether the documents allegedly mailed or transmitted were false or how they otherwise contributed to defendants' alleged fraudulent scheme"). Furthermore, while in reply, Cliffcrest maintain the racketeering activity alleged includes commercial bribery (Penal Law §§ 180.03 and 180.08) and extortion (Penal Law § 155.05), the proposed pleading does not specifically allege such violations of these statutes, nor does it connect them with any activity of Peny. Accordingly, the request to add the RICO counterclaim is denied.

The fifth counterclaim purports to state a claim under 42 USC § 1983. This section creates a private cause of action in favor of persons who have been subjected to the "deprivation

of any rights, privileges, or immunities secured by the Constitution and laws" against "[e]very person who, under color of any statute, ordinance, regulation, custom, or usage, of any State" has caused such deprivation. The section is not applicable to "merely private conduct." *American Mfrs. Mut. Ins. Co. v Sullivan*, 526 US 40, 50 (1999). Cliffcrest does not allege that Peny has, in any way, acted other than in a purely private capacity. Accordingly, this counterclaim must be dismissed as well.

As for HPD, the proposed pleading alleges that HPD was involved in a scheme to defraud Cliffcrest by allowing its employees and contractors to steal funds intended for rehabilitation of the property, and based on this conduct asserts cross claims against HPD for fraud, permanent injunction, violation of RICO, and violation of 42 USC § 1983.[7] HPD opposes the motion to amend, asserting, inter alia, that the proposed cross claims are without merit as HPD did not oversee the rehabilitation of the property or the distribution of funds to contractors and/or subcontractors, and that its role under the Participation Agreement was to fund the construction loan by paying Fleet the HPD mortgage proceeds. HPD further points to provisions under the Participation Agreement, under which Fleet was responsible for management of the funds and administration of progress payments used to rehabilitate the property including the HPD Mortgages.

HPD also argues that the proposed cross claims for fraud, for violation of RICO, and for violation of 42 USC § 1983 are barred by the applicable statute of limitations. In particular, HPD notes that the limitations period for fraud is six years, for a RICO violation is four years,

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[7]As the claim for rescission relates only to the Peny Note and Mortgage, it does not appear to state a claim against HPD.

and for a violation of 42 § 1983 is three years, and that the events underlying the proposed pleading occurred in 2002, or shortly thereafter. However, as HPD acknowledges, a cause of action for fraud is timely when commenced not only within six years of the fraud, but also within two years of the date the fraud was, or with reasonable diligence could have been, discovered. *See, Rite Aid Corp. v. Grass*, 48 AD3d 363, 364 (1st Dept 2008). Similarly, with respect to the RICO and section 1983 claims, the statute of limitations accrues on these clams from the time the alleged injured party knew or should have known of the injury. *See Podraza v. Carriero*, 212 AD2d 331, 339 (4th Dept 1995)(four year statute of limitations for RICO runs from the time that injured party knew or reasonably should have known of th injury); *Way v. City of Beacon*, 96 AD3d 829 (2d Dept 2012)(causes of action asserted pursuant to section 1983 have a three-year statute of limitations in New York, and accrue "when the plaintiff knows or has reason to know of the injury which is the basis of [the] action")(internal citations and quotations omitted).

While HPD argues that any fraud or wrongdoing should have been discovered by Cliffcrest by 2006, when it obtained title to the property, and the defects in construction became apparent shortly thereafter, it cannot be said on this record that the purported fraud and/or wrongdoing should have been discovered at that time. In his reply affidavit, Burroughs states that although he was aware of the "shoddy repairs" at the property, he did not know of the "complex RICO Rehabilitation Scam," until he learned of guilty pleas in 2012 and 2013 by HPD officials in connection with the development of affordable housing." He also states that recent evidence has come to light that the contractor, which received a substantial portion of the rehabilitation funding from the 2002 loans, received a lump sum of $3,562,350, as opposed to progress payments, as required by the relevant Rehabilitation Contract. Thus, the motion to

amend cannot be denied on statute of limitations grounds.

As for the substantive merit of the proposed cross claims against HPD, in light of the court's April 8, 2014 order which directed HPD to provide certain documents to the court for in camera inspection that may be pertinent to whether there is any basis for proposed cross claims against HPD, the court denies the motion as premature in light of ongoing discovery. Cliffcrest will be permitted to renew the motion to amend with respect to the cross claims against HPD upon completion of this discovery. Such motion shall detail the factual allegations in support of each cross claim in accordance with the law articulated in this decision and order.

In view of the above,

ORDERED that the motion to amend is denied as to the proposed counterclaims and affirmative defenses, as asserted against plaintiff Peny & Co.; and it is further

ORDERED that the motion to amend to add cross claims against The Department of Housing Preservation and Development of the City of New York, and Cliffcrest is denied as premature without prejudice to renewal in accordance with this decision and order ; and it is further

ORDERED that the motion is granted as to proposed third-party defendants Shuhab Housing Development Fund Corporation, The Wavecrest Management Team Ltd., Community Capital Bank n/k/a Carver Federal Savings Bank, Lee Warshavsky, and John and Jane Does 11-20; and it is further

ORDERED that defendant 936-938 Cliffcrest Housing Development Fund Corporation shall serve an amended pleading in conformance herein within 45 days of this order without prejudice to further order of this court addressing the proposed cross claims against HPD.

Dated: June 7, 2014

J.S.C.

HON. JOAN A. MADDEN
J.S.C.