SFR Holdings Ltd. v Rice
2017 NY Slip Op 31974(U)
September 15, 2017
Supreme Court, New York County
Docket Number: 652367/2012
Judge: O. Peter Sherwood
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 49

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SFR HOLDINGS LTD., EDEN ROCK FINANCE MASTER LIMITED, EDEN ROCK ASSET BASED LENDING MASTER LTD., EDEN ROCK UNLEVERAGED FINANCE MASTER LIMITED, SHK ASSET BACKED FINANCE LIMITED, CANNONBALL PLUS FUND LIMITED and CANNONBALL STABILITY FUND LP,

Plaintiffs,

-against-

Index No. 652367/2012
Motion Seq. No. 007

JOHN RICE, JOSEPH INGRASSIA, JOHN BEASTY, CAPSTONE CAYMAN SPECIAL PURPOSE FUND, LP, CAPSTONE SPECIAL PURPOSE FUND LP, CAPSTONE CAPITAL MANAGEMENT, INC., CAPSTONE CAPITAL GROUP I, LLC, CAPSTONE TRADE PARTNERS, LTD., CAPSTONE BUSINESS CREDIT, LLC, AMINCOR OTHER ASSETS INC., AMINCOR, INC. and ROBERT L. OLSON,

Defendants.

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O. PETER SHERWOOD, J.:

Defendants John Rice, Joseph Ingrassia, Capstone Cayman Special Purpose Fund, LP, Capstone Special Purpose Fund LP, Capstone Capital Management, Inc., Capstone Capital Group I, LLC, Capstone Trade Partners, Ltd., Capstone Business Credit, LLC, Amincor Other Assets Inc., and Amincor, Inc. move, pursuant to CPLR 3212, for an order granting summary judgment in their favor, and dismissing the complaint in its entirety. Plaintiffs oppose the motion and cross-move, pursuant to CPLR 3212 (e), for partial summary judgment in their favor on the fraud claim.

Plaintiffs SFR Holdings Ltd., Eden Rock Finance Master Limited, Eden Rock Asset Based Lending Master Ltd., Eden Rock Unleveraged Finance Master Limited (collectively, the Eden Rock

entities), and SHK Asset Backed Finance Limited, Cannonball Plus Fund Limited and Cannonball Stability Fund LP (collectively, the Cannonball entities) are groups of investment funds consisting of limited partners in two investment partnerships. Capstone Cayman Special Purpose Fund and Capstone Special Purpose Fund (both, the Capstone Partnerships).

I. THE CLAIMS

Plaintiffs allege that defendants fraudulently induced them to invest in those partnerships by intentionally misrepresenting defendants' investment strategy as based on only asset-based lending, trade finance, and factoring. Plaintiffs further allege that defendants assured them that they would not invest plaintiffs' funds in real estate ventures.

Despite those assurances, defendants invested more than $150 million of plaintiffs' funds in subordinated loans to real estate development ventures that were illiquid and high risk, from approximately 2004 to 2008. Plaintiffs add that, without their knowledge or consent, defendants funded nonparty Capstone Realty Investment Partnership (CRIP) with loans from Capstone Business Credit that were funded by the Capstone Partnerships' investments. CRIP is allegedly a real estate development loan company formed by Rice and Ingrassia sometime prior to January 2007. Plaintiffs assert that defendants fraudulently concealed those unauthorized investments for almost one year after they made the investments, and continued to misrepresent to plaintiffs the true magnitude of those investments, even after plaintiffs submitted redemption requests. Plaintiffs further assert that defendants delayed complying with those requests, until no funds were left with which to repay plaintiffs.

In July 2012, plaintiffs commenced this action to recover monetary damages and legal fees on claims for fraudulent inducement, fraud, breach of fiduciary duty, unjust enrichment, actual and

constructive fraudulent conveyance, and breach of contract. Plaintiff also seek a declaratory judgment.

Defendants served answers in which they deny all allegations of improper conduct, and moved to dismiss the complaint. By decision and order dated November 24, 2014 and entered December 3, 2014 (prior order), The Honorable Melvin L. Schweitzer granted the motion in part, and dismissed all claims asserted in the complaint except for the fraudulent inducement claim asserted against Capstone Capital Management, Capstone Cayman Special Purpose Fund, and Capstone Special Purpose Fund (Capstone entities), Rice and Ingrassia.

Plaintiffs appealed but did not appeal as to dismissal of claims asserted against defendants John Beasty and Robert L. Olson.

The Appellate Division, First Department modified, and otherwise affirmed, the prior order to deny the branches of the motion seeking dismissal of the cause of action for fraud asserted against Rice, Ingrassia, and the Capstone entities (*see SFR Holdings Ltd. v Rice*, 132 AD3d 424 [1st Dept 2015]).

II DISCUSSION

Following completion of discovery, plaintiffs filed a note of issue on April 5, 2016. In June 2016, the moving defendants filed this motion for summary judgment on the remaining causes of action for fraudulent inducement to contract and fraud.

A party moving for summary judgment must demonstrate that party's entitlement thereto as a matter of law, pursuant to CPLR 3212 (b) (*Smalls v AJI Indus., Inc.*, 10 NY3d 733, 735 [2008]; *Sumitomo Mitsui Banking Corp. v Credit Suisse*, 89 AD3d 561, 563 [1st Dept 2011]). The party moving for summary judgment has the initial burden of coming forward with admissible evidence

to support the motion, so as to warrant the court directing judgment in movant's favor; the burden then shifts to the opposing party to demonstrate, by admissible evidence, the existence of any factual issue requiring a trial of the action (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]; CPLR 3212). It is well established that summary judgment is a drastic remedy, and should not be granted if there are genuine material issues of disputed fact (*Sillman v Twentieth Century-Fox Film Corp.*, 3 NY2d 395, 404 [1957]).

A. The Fraudulent Inducement Claim

Defendants contend that summary judgment dismissing the fraudulent inducement claim must be granted on the ground that the record includes no credible objective evidence contemporaneous with plaintiffs' initial investments regarding the existence of fraudulent conduct by defendants that induced plaintiffs to invest. In opposition, plaintiffs contend that genuine triable issues of fact exist regarding whether the Capstone Partnerships and their principals, Rice and Ingrassia, intentionally made false and misleading representations that they would adhere to a particular investment strategy that did not include real estate development loans, in order to induce plaintiffs to invest.

That branch of defendants' motion on the fraudulent inducement claim is granted . To prove fraudulent inducement to contract, a plaintiff must demonstrate "the misrepresentation of a material fact, which was known by the defendant to be false and intended to be relied on when made, . . . justifiable reliance and resulting injury" (*Braddock v Braddock*, 60 AD3d 84, 86 [1st Dept 2009]; *Lama Holding Co. v Smith Barney*, 88 NY2d 413, 421 [1996]).

Plaintiffs have not demonstrated the element of justifiable reliance. Where, as here, the plaintiffs are sophisticated investors, they bore a duty to exercise ordinary diligence and conduct an

independent appraisal of the risk that they were assuming (*see First Nationwide Bank v 965 Amsterdam*, 212 AD2d 469, 471 [1st Dept 1995]). A plaintiff cannot claim reliance where the documentary evidence establishes that "he had accepted the risk of a speculative investment based on his independent investigation and without reliance on any representations" by the defendant (*Longo v Butler Equities II*, 278 AD2d 97, 97 [2000]). Here, there can be no disputing that plaintiffs are investment funds with significant resources, understood the investment market and, therefore, are sophisticated investors.

The written agreements executed by plaintiffs, or their predecessors-in-interest, and defendants include merger and disclaimer clauses that operate to bar the fraudulent inducement claim. "[W]here the party alleging fraud has made its own specific representation indicating that it is not relying on the alleged inducement, it is foreclosed from establishing its asserted reliance on the ground that it has misrepresented its true intention" (*First Nationwide Bank*, 212 AD2d at 471, citing *Citibank v Plapinger*, 66 NY2d 90, 94-95 [1985]).

The Capstone Partnerships' 2004 Amended and Restated Limited Partnership Agreements (LPAs) expressly provide that "[t]his Agreement constitutes the entire agreement among the parties pertaining to the subject matter hereof, and supersedes all prior agreements and understandings pertaining thereto. No covenant, representation or condition not expressed in this Agreement shall affect or be deemed to interpret, change or restrict the express provisions thereof" (LPAs, ¶ 14.07).

In the Capstone Partnership's Subscription Agreements for the Purchase of Limited Partnership Interests (Subscription Agreements), plaintiffs acknowledged that they carefully read the subscription documents and the Capstone Partnerships' Confidential Private Placement Memoranda (CPPMs) (*see* Subscription Agreements, ¶ 1 [b]). In relevant part, the Subscription Agreements

further provide that plaintiffs "acknowledge[] that he or she has received no representation or warranties from the Partnership or its respective employees or agents in making this investment decision other than as set forth in the Disclosure Materials" (*id.*). Plaintiffs also acknowledged that they were "aware that the purchase of the Interests is a speculative investment involving a high degree of risk, and that there is no guarantee that he or she will realize any gain from this investment, and that the entire investment could be lost" (*see id.*, ¶ 1 [c]). The CPPMs provide, in relevant part, that "[a]n investment in the Partnership involves significant risks, which could result in the loss of all or a substantial part of a Limited Partner's investment in the Partnership" (CPPMs at 10).

Moreover, plaintiffs have failed to identify any pre-investment representations by defendants, and have produced no witnesses with first-hand knowledge regarding the factors influencing plaintiffs' decisions, or the decision by Cannonball Stability's predecessor-in-interest, Broyhill, to invest in the Capstone Partnerships. "It is well settled that affidavits devoid of evidentiary facts and consisting of mere conclusions, speculation and unsupported allegations are insufficient to defeat a motion for summary relief" (*Castro v New York Univ.*, 5 AD3d 135, 136 [1st Dept 2004]).

Plaintiffs produced two individuals for deposition. Michael Staveley, Eden Rock Capital Management's chief executive officer, testified that he was hired by that company in April 2006 (*see* plaintiffs by Michael Staveley Mar. 16, 2016 tr at 8, lines 16-23). Therefore, he had no first-hand knowledge and could not testify about the start of Eden Rock's investments in 2004 and 2005, and did not know that other Eden Rock entities made investments as early as August 2004 (*see id.* at 23, line 20 through 28, line 10). Staveley did not recall the timing of the due diligence reports, and could not state that he saw an Eden Rock report prior to its initial investment with defendants, testifying that he could "only speculate" because he was not employed by Eden Rock at that time (*see id.* at 28,

lines 5-10; at 38, line 9 through 39, line 12). He could not identify any Eden Rock entities employees who had communications with defendants, or any representations made by defendants to Eden Rock, prior to the initial investments (*see id.*, at 39, line 13 through 41, line 9). He admitted that, as an investment advisor, he would not accept sales marketing materials as a fundamentally sound basis upon which to evaluate an investment opportunity (*see id.* at 43, lines 5-10).

Similarly, Andrew Hoffman, the owner of nonparty Globefin U.S. Advisors, LLC, the Cannonball entities' current investment advisor, was unable to provide support for the Cannonball entities' fraudulent inducement claim. Hoffman testified that he had no knowledge or evidence regarding the Cannonball entities' decision to invest in the Capstone Partnerships in the first instance (*see* Hoffman May 11, 2016 tr at 119, line 23 through 120, line 3). Hoffman was not the Cannonball entities' investment advisor in 2005 or 2006, was not present at the meetings when investment strategies were discussed, and has no first-hand knowledge as to what ultimate investment decisions were made by plaintiffs or why (*see id.* at 52, lines 9-14; at 55, line 2 through 58, line 21).

In view of the lack of credible objective evidence regarding defendants' alleged fraudulent inducement and plaintiffs' own representations that they did not base their initial decision to invest on defendants' representations, summary judgment in defendants' favor is granted on the fraudulent inducement claim, and that claim is dismissed.

B. The Fraud Claim

Next, defendants seek summary judgment on the fraud claim on the grounds that the undisputed record conclusively demonstrates that plaintiffs are highly sophisticated investors which, between October and November 2007, had every piece of information necessary to withdraw from the investments, yet chose not to act until the beginning of February 2008. Defendants further

contend that plaintiffs cannot demonstrate that defendants' actions were a proximate cause of plaintiffs' alleged damages.

In opposition, plaintiffs seek summary judgment in their favor on the fraud claim, contending that the undisputed evidence conclusively demonstrates that, following execution of the subscription documents, defendants intentionally misrepresented that the Capstone Partnerships would engage in only an asset-based lending and trade-finance investment strategy (ABL investment strategy), and failed to timely disclose that, instead, the Capstone Partnerships made improper real estate development loans totaling more than $150 million. Plaintiffs further contend that the undisputed record conclusively demonstrates that defendants' fraud caused irreparable financial damage to the Capstone Partnerships, and, thus, to plaintiffs. Plaintiffs contend that the record also demonstrates that, even after defendants disclosed the fact of the improper loans, they repeatedly reassured plaintiffs that those loans would be moved to a new real estate fund, which would allow the Capstone Partnerships to recoup their losses. Plaintiffs contend that the record demonstrates that, in reliance on those false assurances, they delayed their redemption requests until they were left with worthless investments.

To recover on a claim for fraud, the plaintiff must demonstrate a representation of a material existing fact, falsity, scienter, deception and injury (*New York Univ. v Continental Ins. Co.*, 87 NY2d 308, 318 [1995]; *Nicosia v Board of Mgrs. of Weber House Condominium*, 77 AD3d 455, 456 [1st Dept 2010]).

Summary judgment in favor of either side on the fraud claim is denied. There are genuine triable issues of material fact regarding whether, after execution of the Subscription Agreements, defendants expressly stated that they would follow an ABL investment strategy and refrain from

investing plaintiffs' funds in real estate ventures, yet invested plaintiffs' funds in such ventures without plaintiffs' knowledge and consent, and hid the fact of such improper investments from plaintiffs for a period of, perhaps, 11 months.

For example, Hoffman attests that the Cannonball entities did not discover until November 2007 that defendants improperly had invested plaintiffs' funds in real estate ventures prior to June 2007 (*see* Andrew Hoffman July 14, 2016 aff, ¶ 22; Hoffman tr at 116, lines 10-15). Hoffman also attests that, in August 2007, when he met with Ingrassia to discuss the Capstone Partnerships,

> "Ingrassia made no mention of the real estate loans already made by the Capstone Partnerships; instead, he said they 'already plan[ned]' on putting six to seven real estate deals in the real estate fund once up and running. However, there was no mention of the fact that Capstone Credit used funds of the Capstone Partnerships to make a loan of $39.3 million for [a real estate] project several months prior[,] in April 2007, nor of the $19.5 million loan for [another real estate] project in May 2007. As subsequently disclosed in the [Capstone Partnership Portfolio Summary Reports (PSRs)], these deals were already funded by the Capstone Partnerships and without Cannonball's knowledge"

(Hoffman aff, ¶ 26; *see* Cannonball Funds Due Diligence Report [Office Visit], Aug. 16, 2007).

Similarly, Staveley, on behalf of the Eden Rock entities, attests that plaintiffs later learned that, as early as June 2007, the Capstone Partnerships invested over 20% of plaintiffs' Assets Under Management in unauthorized and improper commercial real estate development loans (*see* Michael Staveley July 21, 2016 aff, ¶ 23).

Staveley and Hoffman each attest in detail that Rice and Ingrassia actively failed to disclose the fact, and extent, of such unauthorized real estate development loans in meetings, conference calls, and emails with plaintiffs throughout 2007, and that plaintiffs were not aware of the scope of the improper investments until November 2007, when defendants released the June 2007 PSR (*see*

id., ¶¶ 93-104; Hoffman aff, ¶¶ 26-30).

On the other hand, the record includes evidence that plaintiffs knew as early as June 2007 that defendants had invested some of plaintiffs' funds in real estate ventures sometime between 2005 and 2008, depending on the fund. Defendants cite to plaintiffs' reference to 20% of the Capstone Business Credit investment in bridge loans in the August 2007 Cannonball Funds Due Diligence Report [Office Visit], as demonstrating that the Cannonball entities were aware, as early as June 2007, of the investments at issue (*see* Cannonball Funds Due Diligence Report [Office Visit] at 4; Joseph Ingrassia June [no date], 2016 aff, ¶ 8).

Triable issues or fact also exist regarding the timing of, and the reason for, plaintiffs' requests for redemption of their investments, and whether defendants' alleged fraudulent conduct was a proximate cause of plaintiffs' damages. A plaintiff must demonstrate that its damages consist of actual pecuniary losses caused by the alleged fraud (*see Pope v Saget*, 29 AD3d 437, 441 [1st Dept 2006]).

Staveley and Hoffman each attest that plaintiffs delayed their redemption requests until February 2008, in reliance on defendants' repeated assurances that the improper real estate venture loans would be transferred from the Capstone Partnerships' books to CRIP (*see* Staveley aff, ¶¶ 93-107; Hoffman aff, ¶¶ 28-37). For example, Staveley attests that, in a meeting held on November 26, 2007, Rice and Ingrassia confirmed that the Capstone Partnerships' assets had been used for loans for seven real estate deals totaling $52.5 million, then 22% of the total investment portfolio, including the sole financing of a low income housing development in the Bronx (*see* Staveley aff, ¶¶ 98, 99). Staveley attests that Ingrassia and Rice further represented that 90% of these loans would be transferred to CRIP in or about December 2007, and that the profit from the real estate

development loans was being used to build a 10% capital loss reserve in the fund to ensure the profitability of the Capstone Operating Entities (*see id.*).

Staveley and Hoffman attest that plaintiffs suffered actual pecuniary loss, and that, had defendants never entered into unauthorized real estate development loans, the Capstone Partnerships would not have suffered any losses, Eden Rock would not have sustained a loss of at least $48,130,711.42 and Cannonball would not have lost at least $3,771,100 (*see* Staveley aff, ¶¶ 119-124; Hoffman aff, ¶¶ 34, 35, 46).

On the other hand, the record contains evidence in support for defendants' contention that plaintiffs, particularly the Eden Rock entities, were suffering financial difficulties, and had requested redemption of their investments in 2007 and 2008, solely in order to solve liquidity problems caused by then current economic conditions (*see* Ingrassia aff, ¶¶ 10-12; John R. Rice III June 20, 2016 aff, ¶¶ 8-10; Vanessa Shia Aug. 30, 2007 email to Ingrassia, Rice).

The parties dispute whether the fraud claim is barred by the Appellate Division, First Department's holding that defendants were not prohibited by any of the contracts between the parties from investing plaintiffs' funds in real estate ventures. This court rejects that argument on the ground that the First Department decision addressed only the adequacy of the pleadings, not the merits of the fraud claim. In its October 6, 2015 decision and order, the First Department affirmed Justice Schweitzer's dismissal of the breach of contract and declaratory judgment claims, "since the contracts at issue do not specifically prohibit the [real estate venture] investments or . . . distribution[s] at issue" (*SFR Holdings Ltd. v Rice*, 132 AD3d at 426).

Significantly, however, the First Department held that plaintiffs' real estate investment allegations supported a claim for fraud at the pleading stage, in view of plaintiffs' allegations that:

> "defendants defrauded them by inducing their investment in funds by promising that the funds would only invest in short-term, liquid asset-based loans, that these defendants improperly caused the funds to invest in real estate, and that these defendants repeatedly failed to disclose and actively concealed the real estate investments. Plaintiffs claim that, had they known about the real estate investments, they would have never invested with these defendants, or they would have redeemed much earlier than they did, thereby sparing them loss"

(*id.*, at 425). The First Department decision is not germane to the summary judgment motions now before the court. As described above, defendants have failed to identify any pre-investment representations by defendants and have produced no witnesses with first hand knowledge regarding the factors that influenced the decisions to invest. Moreover, plaintiffs' own representations of non-reliance undermine their allegations in the complaint. As to the fraud claim which relates to post-investment representations and as discussed above, plaintiffs have made out a prima facie case and defendants have responded by presenting admissible evidence showing the existence of factual issues requiring a trial (*see Zuckerman*, 49 NY 2d at 562).

III. CONCLUSIONS

The court has considered the parties' remaining arguments, and finds them to be without merit.

Accordingly, it is

ORDERED that defendants' motion for summary judgment is granted to the limited extent that summary judgment is granted in favor of defendants as to the First Cause of Action for fraudulent inducement and that claim is dismissed, and the motion is otherwise denied; and it is further

ORDERED that plaintiffs' cross motion for summary judgment is denied; and it is further

ORDERED that the action shall continue as to the Second Cause of Action for fraud; and it is further

ORDERED that counsel are directed to appear for a status conference in Part 49, 60 Centre Street, Room 252 on October ~~21~~ 24, 2017, at 10:30 AM.

This constitutes the decision and order of the court

DATED: September 15, 2017

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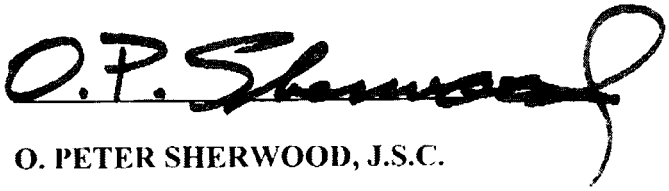

O. PETER SHERWOOD, J.S.C.