RKA Film Fin., LLC v Kavanaugh
2018 NY Slip Op 31648(U)
March 5, 2018
Supreme Court, New York County
Docket Number: 652592/15
Judge: Charles E. Ramos
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

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RKA FILM FINANCING, LLC,

Plaintiff,

Index No. 652592/15

-against-

RYAN KAVANAUGH, COLBECK CAPITAL MANAGEMENT, LLC, COLBECK CAPITAL, LLC, COLBECK PARTNERS IV, JASON COLODNE, JASON BECKMAN, DAVID AHO, RAMON WILSON, ANDREW MATTHEWS, GREG SHAMO, and TUCKER TOOLEY,

Defendants.

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Hon. C. E. Ramos, J.S.C.:

In motion sequence numbers 009 through 014, defendants Ryan Kavanaugh (mot. seq. 009), Tucker Tooley (mot. seq. 010), Greg Shamo (mot. seq. 011), Andrew Matthews (mot. seq. 012), Ramon Wilson (mot. seq. 013), Colbeck Capital Management, LLC (mot. seq. 014), Colbeck Capital, LLC (mot. seq. 014), Colbeck Partners IV (mot. seq. 014), Jason Colodne (mot. seq. 014), Jason Beckman (mot. seq. 014), and David Aho (mot. seq. 014) move, pursuant to CPLR 3211(a)(7), to dismiss the Second Amended Complaint (SAC). The motions are consolidated for the purposes of this disposition.

Background

The following factual allegations are set forth in the SAC, and for the purposes of these motions are accepted as true.

This action arises out of a series of loans that RKA Film Financing, LLC (RKA) issued to Relativity Media, LLC (Relativity) in the time period between June 2014 and March 2015 (SAC, ¶¶ 5, 52). RKA is a limited liability corporation organized under Delaware law (*Id.*, at ¶ 8). Relativity is a privately-held global media company based in California, with numerous affiliates and subsidiaries (*Id.*, at ¶ 20). RKA alleges that its loans were intended to provide funding to Relativity for print and advertising (P&A) expenses related to the release of major motion picture films by special purpose entities (Film SPEs) (*Id.*, at ¶ 2). Each of the Film SPEs is named after a specific film, and finances, produces, advertises and distributes that particular film (*Id.*, at ¶ 20).

RKA's SAC was brought against individual defendants Ryan Kavanaugh, Jason Colodne, Jason Beckman, David Aho, Ramon Wilson, Andrew Matthews, Greg Shamo, Tucker Tooley and Steven Mnuchin, and corporate defendants Colbeck Capital Management, LLC, Colbeck Capital, LLC, and Colbeck Capital Partners IV, LLC (corporate defendants collectively, Colbeck, and together with individual defendants, Defendants). The complaint as against Mnuchin was dismissed in April 2017.

Kavanaugh is the founder and CEO of Relativity (SAC, ¶ 9). Colodne and Beckman are both founders and managing partners at Colbeck who served on Relativity's Board of Directors from 2012

until May 27, 2015 (*Id.*, at ¶¶ 11-12), although Beckman denies that he was a director (*Id.*, at n.2). Aho is a partner at Colbeck who recruited investors, including RKA, to loan money to Relativity (*Id.*, at ¶ 13). Wilson joined Relativity in 2006, and has served as its Interim President, Executive Vice President, and Head of Business Development (*Id.*, at ¶ 15). Matthews became Relativity's Chief Strategy Officer on May 28, 2013, and has also acted as its Chief Financial Officer and Co-Chief Operating Officer, roles from which he resigned on October 5, 2015 (*Id.*, at ¶ 16). Tooley was Relativity's President from September 30, 2011 until November 5, 2016 (*Id.*). Shamo joined Relativity in 2009, has been its Co-Chief Operating Officer since November 1, 2012, and has previously served as its Executive Vice President of Corporate Affairs and General Counsel (*Id.*, at ¶ 17).

Colbeck Capital Management, LLC is a financial advisory firm organized under Delaware law and headquartered in New York (SAC, ¶ 10). Colbeck Capital, LLC and Colbeck Capital Partners IV, LLC are limited liability companies organized under Delaware law, with their principal place of business in New York (*Id.*).

RKA alleges that, in 2012, Kavanaugh, Colodne and Beckman, who were close friends, realized that Relativity was in financial trouble and needed additional capital to survive (SAC, ¶ 23). They therefore developed a plan to market a P&A credit facility (P&A Facility) for Relativity's Film SPEs (*Id.*, at ¶ 24). RKA

contends that, between April 2014 and April 2015, Defendants repeatedly and incorrectly marketed the P&A Facility to RKA, leading it to believe that its loans would only be used for P&A expenses (*Id.*, at ¶¶ 29-78), and causing RKA to suffer damages (*Id.*, at ¶¶ 88, 94, 100).

RKA argues that a film's P&A financing for theatrical releases should be separated from other expenses, and should not be used for general corporate loans or as working capital for corporate expenses (SAC, ¶¶ 21-22). P&A loans are ordinarily the last financing obtained after the film is completed and before it is released, and the first financing repaid from box office earnings (*Id.*). The repayment risk of a P&A loan is tied directly to box office receipts of a specific film, while the repayment risk of a general purpose loan is tied to the overall financial success of the SPE's parent company (*Id.*).

In June 2014, RKA agreed to loan $58.5 million for the P&A expenses of certain Relativity films (SAC, ¶ 38). The Funding Agreement, dated June 30, 2014, memorialized the investment terms (*Id.*, at ¶ 39). Defendants were not parties to the Funding Agreement (*Id.*). RKA alleges that some, but not all, of Defendants' misrepresentations were memorialized therein (*See generally, id.*), although the intended use of the funds for P&A expenses was explicitly written into the agreement (Section 1.3 of Funding Agreement, Frank Aff., Exh. 4). Based on additional

alleged misrepresentations made by Defendants to RKA through emails and telephone calls, RKA increased its loan by $22.5 million in August 2014 (SAC, ¶¶ 43-44).

Section 1.2 of the Funding Agreement required each Film SPE to submit a separate Borrowing Certificate to draw on RKA's money for P&A expenses ("[e]ach advance of a Loan shall be requested in writing by the applicable Borrower pursuant to a Borrowing Certificate") (Frank Aff., Exhs. 4, 7). Between June 30, 2014 and March 17, 2015, ten of Relativity's Film SPEs submitted Borrowing Certificates, signed by Kavanaugh, purportedly for the P&A of ten films (SAC, ¶ 52).

In the second half of 2014, the law firm of Jones Day issued an opinion regarding Relativity's debt facilities (SAC, ¶ 48). The opinion stated that the debt facilities, including the RKA P&A Facility, were being used for working capital (*Id.*). RKA alleges that, although Defendants knew that RKA's funds would not be used for P&A, they approved the loans and failed to disclose their real use (*Id.*, at ¶¶ 52-54, 66).

Between September 2014 and March 2015, Defendants drew $73.6 million from the P&A Facility, purportedly for four yet unreleased films (Unreleased Films) (SAC, ¶ 57). In February and April of 2015, Defendants allegedly falsely stated to RKA that the Unreleased Films would be released later that year (*Id.*, at ¶¶ 55-58), that RKA's money was safe and accounted for, and that

Relativity was financially stable (*Id.*, at ¶¶ 63, 66). On April 6, 2015, Wilson and Matthews provided RKA with information showing that only $1.7 million of the $73.6 million had been spent on P&A (*Id.*, at ¶ 60). RKA alleges that Defendants continually changed their story throughout April 2015 as to which of the Unreleased Films would be released and when (*Id.*, at ¶¶ 62-63), the whereabouts of RKA's money, and Relativity's financial stability (*Id.*, at ¶¶ 63, 65). RKA also alleges that Defendants' books and records are unreliable (*Id.*, at ¶¶ 59, 65).

RKA argues that the true purpose of the loan facility was always to provide general working capital for Relativity (SAC, ¶¶ 25-26). On April 1, 2015, Wilson allegedly told RKA that "all cash is fungible," that the P&A funds were untraceable, and that they were not necessarily earmarked, allocated, or used for P&A (*Id.*, at ¶ 59). In an April 13, 2015 telephone call with RKA, Beckman allegedly admitted that Kavanaugh and Relativity used the funds for improper purposes (*Id.*, at ¶ 64). On July 24, 2015, Relativity filed a complaint against RKA in this court, *Relativity Media, LLC v RKA Film Financing, LLC*, 652594/2015, where Relativity stated that RKA's suggestion that the loans "were supposed to have been specifically held earmarked for payment of particular incurred print and advertising expenses" was a "notion that contradict[ed]" the financing arrangement and the parties' past practices (*Id.*, at ¶ 26). RKA also cites a

January 22, 2016 Relativity press release stating that the Colbeck P&A Facility was a "working capital facility" that was "structured in precisely the same way as Relativity's previous two working capital facilities" (*Id.*, at ¶ 22, Clark Aff., Exh. A).

The Bankruptcy Action

On July 30, 2015, Relativity filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (*In re Relativity Fashion, LLC*, No 15-11989-MEW [Bankr. S.D.N.Y. 2015]). RKA participated in that action. On February 8, 2016, the bankruptcy court issued Findings of Fact, Conclusions of Law and Order Confirming, Pursuant to Section 1129 of the Bankruptcy Code, the Plan Proponents' Fourth Amended Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code (Bankruptcy Order) (Clark Aff., Exh. B). There, the bankruptcy court permitted RKA to bring its claims in New York State actions notwithstanding the bankruptcy proceedings (Bankruptcy Order, ¶ 66, Clark Aff., Exh. B). RKA also accepted replacement notes as its recovery in the bankruptcy proceedings (Tr. at 14-15, Frank Aff., Exh. 3).

RKA filed its first complaint in the present action on July 24, 2015. RKA filed the SAC on February 2, 2017, alleging fraud, fraudulent inducement and negligent misrepresentation, and seeking damages incurred and accruing in excess of $110 million,

plus fees. In motion sequence numbers 009 through 014, Defendants have brought motions to dismiss the SAC for failure to state a claim. For the reasons set forth below, Defendants' motions are hereby granted.

Discussion

On a CPLR 3211[a][7] motion to dismiss for failure to state a cause of action, the court accepts the facts in the complaint as true and affords plaintiff the benefit of every possible inference (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994]). The court's only role is to determine "whether the facts as alleged fit within any cognizable legal theory" (*Id.*). "Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBC I v Goldman, Sachs & Co.*, 5 NY3d 11, 19 [2005]).

Fraud Claims

Defendants move to dismiss RKA's fraud and fraudulent inducement claims, the elements of which are substantially the same. Fraud requires showing "a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff, and damages" (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). For fraudulent inducement, "plaintiffs must show misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of

inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury" (*Shea v Hambros PLC*, 244 AD2d 39, 46 [1st Dept 1998]).

For fraud-based claims, the New York Civil Practice Law and Rules (CPLR) additionally require that "the circumstances constituting the wrong shall be stated in detail" (CPLR 3016[b]). "[C]omplaints based on fraud which fail in whole or in part to meet this special test of factual pleading have consistently been dismissed" (*Megaris Furs, Inc. v Gimbel Bros., Inc.*, 172 AD2d 209, 210 [1st Dept 1991]). Conclusory allegations that fail to detail defendants' fraud with sufficient particularity are insufficient to withstand a motion to dismiss (*Carlson v Am. Int'l Grp., Inc.*, 30 NY3d 288, 310 [2017]). A cause of action must be dismissed where "sufficient factual allegations of even a single element are lacking" (*Shea v Hambros PLC*, 244 AD2d at 46).

Broadly, RKA alleges that Defendants made material misrepresentations to RKA relating to the use of RKA's money for P&A expenses, film release timelines and Relativity's financial health, which Defendants knew to be false when made, and which were intended to induce RKA to extend loans (*See generally,* SAC). RKA reasonably relied on the misrepresentations and, to its detriment, loaned $73.6 million to four Film SPEs for the Unreleased Films (*Id.*, at ¶ 57). Among other defenses,

Defendants argue that the SAC lacks the specificity required by CPLR 3016[b] to plead fraud-based claims, which in itself is sufficient to dismiss the fraud claims.

Indeed, a lack of specificity plagues the SAC. Although this is RKA's third version of the complaint, not once has RKA listed the name of a single person to whom Defendants' alleged misrepresentations were made. While there are many other instances in which RKA failed to provide sufficient specificity, we need not address them here, as this issue is relevant to all Defendants. The global failure to name a party to whom alleged misrepresentations were made is fatal to the complaint (*See Gregor v Rossi*, 120 AD3d 447, 447 [1st Dept 2014] ("Fraud and fraudulent inducement are not pleaded with requisite particularity under CPLR 3016[b], because the words used by defendants and the date of the alleged false representations are not set forth."); *Ferro Fabricators, Inc. v 1807-1811 Park Ave. Dev. Corp.*, 127 AD3d 479, 480 [1st Dept 2015] (holding that third party complaint's general allegations of "fraud/negligent misrepresentation[s]" without supporting information as to when and by whom they were made were insufficient); *First Nationwide Bank v 965 Amsterdam, Inc.*, 212 AD2d 469, 472 [1st Dept 1992] (dismissing claim for conspiracy to commit fraud based on a lack of particularity pursuant to CPLR 3016[b])).

RKA's omnibus opposition to Defendants' motions cites a number of cases in support of its contention that the SAC had properly alleged Defendants' misrepresentations and sufficiently put Defendants on notice of the factual bases of RKA's claims (Opp., at 17). Although those cases held that their facts permitted a reasonable inference of the alleged misconduct to be made, they did not address the requirement that a plaintiff must state to whom any alleged misrepresentations were made (*See Pludeman v N. Leasing Sys., Inc.*, 10 NY3d 486, 489-90, 492-94 [2008] (permitting a "reasonable inference" of fraud where plaintiffs' allegations were not directed at individual defendants); *Loreley Fin. (Jersey) No. 28, Ltd. v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 117 AD3d 463, 468 [1st Dept 2014] (holding that patterned scheme relating to collateralized debt obligations where one of the two defendants' involvement had been concealed should survive a motion to dismiss despite a lack of specific allegations because interrelated events portrayed a fraudulent scheme); *DDJ Mgmt., LLC v Rhone Grp. LLC*, 78 AD3d 442, 444-45 [1st Dept 2010] ("These inferences are supported by the surrounding circumstances, as well as numerous e-mails tending to establish the individual defendants' knowledge of the alleged misrepresentations ...."); *Houbigant, Inc. v Deloitte & Touche, LLP*, 303 AD2d 92, 99 [1st Dept 2003] (discussing at length a letter evidencing defendant's accounting deficiencies and noting

that plaintiffs must allege "specific facts from which it is possible to infer defendant's knowledge of the falsity of its statements"). A court may not make such inferences absent firm factual pleadings (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d at 560).

If RKA had direct contact with Defendants, as it alleges, then RKA has direct access to specific information regarding the parties involved in the communications, and their specific misrepresentations (*DDJ Mgmt., LLC v Rhone Grp. LLC*, 78 AD3d 442, 444-45 [1st Dept 2010]). RKA's reliance on *Pludeman v N. Leasing Sys., Inc.*, 10 NY3d 486 at 493 to argue that specific details need not be alleged because "sometimes such facts are unavailable prior to discovery" is therefore unavailing. In our ruling on a prior motion in this case, RKA received clear instructions that its amended pleading must identify "who said what to whom and what was false" (Tr. at 23, Ex. 3 to Complaint). RKA has not done so. RKA also received a warning that this would be RKA's final opportunity to plead ("The complaint is a mess, as far as I am concerned, and when I see a complaint like that, I see that somebody is trying to get over on me and I don't like it ... We are going to see something new. It better be specific. This is their last shot at it.") (*Id.*, at 28-29). RKA's fraud claims must therefore be dismissed, with prejudice.

Negligent Misrepresentation Claims

Defendants also move to dismiss RKA's negligent misrepresentation claims. In order to assert a claim for negligent misrepresentation, the plaintiff must show that "(1) the existence of a special or privity-like relationship imposed a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information" (*Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 180 [2011]). With regard to the first element, "liability for negligent misrepresentation has been imposed only on those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified" (*Kimmell v Schaefer*, 89 NY2d 257, 263 [1996]). Failure to plead specific allegations demonstrating the existence of a special relationship mandates dismissal of the complaint (*Mandarin Trading Ltd v Wildenstein*, 16 NY3d at 180).

RKA's cause of action for negligent misrepresentation is premised upon it having formed a special or privity-like relationship with Defendants during the marketing, negotiation, and other correspondence between the parties (SAC, ¶ 98). RKA alleges that Defendants' communications, unique knowledge and special expertise were used to gain RKA's trust, which imposed a duty for Defendants to impart correct information on RKA (*Id.*).

Defendants allege that theirs was an arm's-length transaction that never created a special or privity-like relationship with RKA.

RKA has failed to show that it had a special relationship with Defendants. In this case, we are dealing with a sophisticated lender, and Defendants who purportedly acted to procure loans for a sophisticated borrower. The First Department has "repeatedly held" that an arm's length borrower-lender relationship between sophisticated parties does not support a negligent misrepresentation action (*Dobroshi v Bank of Am., N.A.*, 65 AD3d 882, 884 [1st Dept 2009]; *see AJW Partners LLC v Itronics Inc.*, 68 AD3d 567, 568 [1st Dept 2009] ("[T]here can be no fiduciary obligation in a contractual arm's length relationship between a debtor and note-holding creditor."]). Arm's length transactions are "not of a confidential or fiduciary nature," and therefore do not create a duty for one party to impart correct information on another (*CIFG Assur. N. Am., Inc. v Bank of Am., N.A.*, 41 Misc. 3d 1203(A), at 13-14 [Sup Ct NY Cnty 2013]) (dismissing negligent misrepresentation claim where defendants allegedly held exclusive control of mortgage-related documents, including loan files, servicing practices, and how credit ratings were obtained). The rule applies even where the parties are familiar or friendly (*Greenberg, Trager & Herbst, LLP v HSBC Bank USA*, 17 NY3d 565, 578 [2011]).

Likewise, Defendants' superior knowledge of a business does not give rise to a special relationship between sophisticated business parties (*Sebastian Holdings, Inc. v Deutsche Bank AG*, 78 AD3d 446, 447 [1st Dept 2010] ("Plaintiff's alleged reliance on defendant's superior knowledge and expertise in connection with its foreign exchange trading account ignores the reality that the parties engaged in arm's-length transactions pursuant to contracts between sophisticated business entities that do not give rise to fiduciary duties.")). This is true even where the business is defendant's own (*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 296-97 [1st Dept 2011]). Superior knowledge of defendants' own misrepresentations is also not the type of unique or specialized expertise that creates a special relationship (*Greentech Research LLC v Wissman*, 104 AD3d 540, 540-41 [1st Dept 2013]).

RKA inappropriately relies on *Brass v Am. Film Techs., Inc.*, 987 F.2d 142, 150 [2d Cir 1993], to argue that Defendants had a duty to speak because one party was in possession of superior knowledge, not readily available to the other, and knew that the other was acting on the basis of mistaken knowledge (Opp., at 30). The Second Circuit's discussion related to fraud-based claims, not negligent misrepresentation (*Brass v Am. Film Techs., Inc.*, 987 F.2d at 150), and RKA has failed to show that Defendants' alleged superior knowledge was of the type that could

give rise to a special relationship. Moreover, RKA's allegation that, after Relativity became insolvent, defendants had a fiduciary duty to avoid depleting assets that could be used to repay RKA (Opp., at 31) is irrelevant. At the time that Relativity became insolvent, Defendants' alleged misrepresentations that caused RKA to loan money to Relativity had already been made. Under New York law, "the requisite relationship between the parties must have existed before the transaction from which the alleged wrong emanated, and not as a result of it" (*Gregor v Rossi*, 120 AD3d at 448). RKA has failed to show that its dealings with Defendants gave rise to more than an arm's length, borrower-lender relationship, and its negligent misrepresentation claim must be dismissed.

Accordingly, it is hereby

ORDERED that the motions to dismiss are granted and the complaint is dismissed in its entirety, with prejudice; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: March 5, 2018

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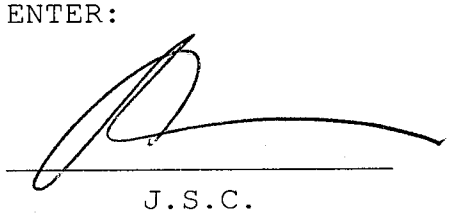

J.S.C.

CHARLES E. RAMOS