SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART IAS MOTION 39EFM

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KISLEV PARTNERS, LLP, SIMON ELLIAS, IZAK SENBAHAR, NESIM BAHAR

Plaintiff,

- v -

SIDLEY LLP, RAYMOND RUBLE, DARIA GOGOLEVA,

Defendant.

INDEX NO. 152739/2018

MOTION DATE N/A

MOTION SEQ. NO. 001

DECISION AND ORDER

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HON. SALIANN SCARPULLA:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 25, 26, 27

were read on this motion to/for DISMISS.

In this action for fraud, defendant Sidley Austin, LLP ("Sidley") moves, pursuant to CPLR §§ 3211(a) (5) and (7), to dismiss the complaint on the grounds that the claims are time barred and that the complaint fails to state a cause of action.

Plaintiffs Simon Elias ("Elias"), Izak Senbahar ("Senbehar") and Nesim Bahar ("Behar") allege that they are "real estate investors that have a long-standing record of successfully developing residential projects" (complaint, ¶ 42). They are each a partner in plaintiff Kislev Partners, L.P. ("Kislev"). Defendant Sidley Austin LLP ("Sidley") is a law firm that is registered to do business in New York. Defendant Raymond James Ruble ("Ruble") marketed and sold Distressed Asset Debt or "DAD" tax shelters, which are at issue herein, to residents of New York.

Plaintiffs claim that, in late 2002, they identified a potential real estate project in Lower Manhattan. They anticipated earning substantial profits on the project, which ultimately resulted in a "16-story residential tower designed by the renowned architect Richard Meier." To shield themselves from tax liability on those profits, plaintiffs decided to acquire the project property through an entity that possessed embedded tax losses (complaint, ¶¶ 2, 5).

Plaintiffs were allegedly introduced to the idea of using a tax shelter to acquire the property by Lance Valdez ("Valdez"). Valdez convinced plaintiffs that, rather than acquire the property directly, they should instead assign the right to purchase the property to Valdez and ultimately close through Valdez's entity, Kislev. "In convincing Plaintiffs that the tax aspects of purchasing Kislev worked, Valdez relied heavily on a pre-prepared Sidley Opinion addressed to Kislev, which exhaustively detailed purported facts surrounding Kislev's formation and operation" (complaint, ¶ 5).

With respect to the Sidley opinion letter (the "Opinion Letter"), plaintiffs allege: "In or around July 2001, Valdez and Sidley developed a "Reliance Opinion" addressed to Valdez and entities controlled by Valdez, which opined on the 'tax bases' allegedly held by the Valdez entities" (complaint, ¶ 33). According to plaintiffs, Valdez shared with them the Opinion Letter, which concluded that Kislev had a $142 million tax basis in Euros and that it would incur an ordinary loss in that amount upon sale of the Euros. "Unknown to Plaintiffs, Valdez retained Sidley more than a year and half before the

transaction to create the legal opinion for Kislev Partners, which he intended to use to market to clients at a later date" (complaint, ¶ 5).

Of this alleged scheme between Sidley and Valdez, plaintiffs allege that, unknown to them, but known to Sidley lawyers, the Opinion Letter could not support the supposed tax treatment represented, including in particular the claimed basis in Euros purportedly held by Kislev and sold to plaintiffs. Plaintiffs allege that Valdez provided a copy of the Opinion Letter to them to induce them to pay Valdez the $5,000,000 fee he demanded. Plaintiffs further allege that, at their request, Sidley made various changes to the Opinion Letter, including agreeing to change the addressee of the original Opinion Letter from Valdez to "To Whom It May Concern" at Kislev Partners address."

According to plaintiffs, Sidley knew that the DAD transaction would never withstand IRS scrutiny; Sidley and its co-conspirators represented to plaintiffs that the DAD strategy was legitimate; and Sidley represented that the IRS was aware of and approved of the strategy.

Plaintiffs claim that, between 1999 and 2004, Valdez, Ruble, and others at Sidley worked together to structure, design and execute illegal tax shelters, including DAD transactions, where Valdez introduced clients, like plaintiffs, to the transactions.[1]

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[1] In the complaint plaintiffs allege that "Sidley provided Valdez dozens and dozens of signed, "should" legal opinions on Sidley letterhead supporting the validity of Valdez's DAD tax shelters with the understanding Valdez would use those legal opinions to market his tax shelters to clients. Valdez did exactly that with Plaintiffs – using the Sidley opinion addressed to Kislev to convince Plaintiffs to go forward with the transaction" (Complaint, ¶ 30).

On or about May 2003, Sidley formally terminated Valdez as a client in connection with Sidley's investigation of Ruble's involvement in abusive tax shelters. Ruble – a former partner at Sidley who authored and issued the Opinion Letter for plaintiffs' Distressed Debt Strategy – was convicted in 2009 on ten counts of federal tax evasion.

Ruble's conviction arose in connection with his involvement in "a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters" (complaint at ¶ 61). As to Ruble's 2009 conviction, the complaint further states:

> According to the Superceding Indictment against Ruble (for which he was convicted), Sidley Austin 'provided clients with opinion letters containing false and fraudulent representations and statements and claiming that the tax shelter losses were 'more likely than not' to survive IRS challenge." Plaintiff also received a 'more likely than not' opinion letter in this case. The Superseding Indictment against Ruble further states that the legal opinions Sidley Austin issued were 'false and fraudulent

(*id.*).

Plaintiffs allege that as a result of the convictions and admissions by Valdez and Ruble, plaintiffs had no choice but to settle with the IRS in September 2012, agreeing to pay more than $7 million in federal and state penalties, nearly $12 million in "punitive interest" as well as repayment of the tax, in addition to wasted transaction fees and cleanup costs. Plaintiffs allege that, until settlement with the IRS in 2012, their claims against defendants were not yet ripe, because they had suffered no actual damages. Plaintiffs and Sidley executed a tolling agreement , effective December 4, 2014 through March 23, 2017 (when the parties' mediated settlement effort was unsuccessful).

On June 22, 2017, plaintiffs filed a lawsuit in New Jersey against Sidley and other defendants relating to the conduct alleged in the complaint. On February 16, 2018, that lawsuit was dismissed on the grounds of lack of personal jurisdiction, but the Court expressly preserved plaintiffs' right to pursue defendants in New York courts. Plaintiffs commenced this action in March of 2018, alleging claims for aiding and abetting of Valdez's fraud, fraud, and unjust enrichment. Sidley now moves to dismiss all claims as time barred.

Discussion

Legal Malpractice or Fraud-Based Claims

Sidley argues that plaintiffs' claims all essentially sound in professional malpractice and, therefore, have a three-year statute of limitations, which passed long before this action was commenced. In their reply, Sidley elaborates: "plaintiffs' claims must be treated as malpractice claims for timeliness purposes even if a potential malpractice claim might fail on the merits. The malpractice limitations period applies whenever the facts underlying a party's claims are of the sort properly pursued as malpractice, *i.e.*, are based on an 'alleged failure to exercise due care or abide by general professional standards" (defendants' reply at 3).

Plaintiffs argue in opposition that they have not pled a malpractice claim against Sidley, and that, instead, their claims are premised on intentional fraud, not simple professional negligence. Plaintiffs assert that their claims against Sidley cannot sound in malpractice because: 1) plaintiffs have never had an attorney client relationship with

Sidley; (2) plaintiffs' claims for fraud and aiding and abetting fraud each allege facts that go beyond legal malpractice and seek damages distinct from what is available for malpractice; and (3) plaintiffs' unjust enrichment claim does not seek recovery of attorneys' fees and is based on facts unrelated to legal representation.

In separating a malpractice claim from a fraud claim, the First Department, in *Johnson v Proskauer Rose LLP* (129 AD3d 59, 68 [1st Dept 2015]), recognized that a plaintiff may try to circumvent the three-year statute of limitations for professional malpractice by characterizing the defendants' "failure to meet professional standards as something else" (*id.* at 68). In describing the distinction between a fraud claim and one for professional malpractice, the Court stated:

> Thus, in *Mitschele*, the fraud claim was considered independent of the malpractice claim for statute of limitations purposes even though the harm arose out of the accountant's failure to properly protect its client. The situation here is no different. Plaintiffs allege not only that defendants failed to adequately advise them with respect to the tax strategy. They also claim that Proskauer pressured them into the scheme because, *at the outset*, Proskauer's paramount concern was preserving its lucrative arrangement with TDG, which presumably intended to continue to work with Proskauer to sell the scheme to other high net worth individuals and entities

(*id.* at 69); *see also Hoffman v RSM US* LLP, 169 AD3d 522, 523 [1st Dept 2019] ("to the extent the aiding and abetting fraud claim alleges that defendant gave Thompson specific advice that allowed him to perpetrate a fraud, it is not duplicative of the malpractice claim").

Like in *Johnson v Proskauer Rose LLP,* here plaintiffs' fraud-based claims rely upon facts that go beyond professional negligence and include allegations that Sidley and the other defendants purposefully created and/or aided Valdez in creating an illegal scheme, which included the Opinion Letter, to market the allegedly criminal tax shelter to unwitting investors. Because plaintiffs' fraud-based claims are not disguised claims for professional malpractice, the professional malpractice statute of limitations is inapplicable.

Statute of Limitations on the Fraud-Based Claims

In New York, a plaintiff must file a fraud claim within six years of the fraud, or within two years from the time that the plaintiff discovered the fraud or could with reasonable diligence have discovered it, whichever is greater (CPLR 213 [8]). Likewise, because it is an "action based upon fraud," plaintiff must file a claim for aiding and abetting such fraud within the same time periods (*id.*)

This action was commenced more than six years from the time Sidley issued the Opinion Letter upon which plaintiffs' fraud claim rests. Recognizing this fact, plaintiffs rely on the two year discovery extension set forth in CPLR 213(8). Thus, to be timely, the action must have been brought within two years of the plaintiffs' discovery of the alleged fraud, or from when it could have discovered the fraud in the exercise of reasonable diligence.

"'The test as to when a plaintiff should have discovered an alleged fraud is an objective one.' Thus 'plaintiffs will be held to have discovered the fraud when it is

established that they were possessed of knowledge of facts from which [the fraud] could be reasonably inferred'" (*Gorelick v Vorhand*, 83 AD3d 893, 894 [2d Dept 2011]). On a motion to dismiss, the burden is on the defendant to establish that plaintiff discovered the fraud or was on inquiry notice of the fraud more than two years prior to the commencement of the action:

> [W]here the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded, a duty of inquiry arises, and if he omits that inquiry when it would have developed the truth, and shuts his eyes to the fact which call for investigation, knowledge of the fraud will be imputed to him.

(*Aozara Bank, Ltd. V Credit Suisse Group*, 144 AD3d 437, 438 [1st Dept 2016][internal quotation marks and citations omitted]).

A court may find that plaintiffs were on inquiry notice where there is information concerning the fraudulent acts available to the plaintiffs in the public domain (*Aldrich v March & McLennan Cos., Inc.*, 52 AD3d 435, 436 [1st Dept 2008]["a finding that plaintiffs were on inquiry notice of the alleged fraud . . . is supported by the extensive information that was available to plaintiffs in the public domain. Such information included the lawsuits commenced in the early 1980's . . . involving nondisclosure of material information").

Sidley argues that plaintiffs brought the fraud claim in 2017 in New Jersey, more than two years after they either knew or were on inquiry notice of the facts underlying their claim. Sidley first argues that plaintiffs were on inquiry notice of their fraud claim by 2009 at the latest. In support, Sidley notes that, in their complaint, plaintiffs allege

that the superseding indictment against Ruble (for which he was convicted in 2009), stated that Sidley had provided clients with opinion letters containing false and fraudulent representations and statements claiming that the tax shelter losses were "more likely than not" to survive IRS challenge. Further, plaintiffs allege in their complaint that their Opinion Letter was one of the "more likely than not" opinion letters. Sidley thus argues that in 2009, when Ruble was convicted, "well-publicized media coverage of multiple events had cast significant doubt on the validity of Plaintiffs' tax-shelter transaction" (*id.* at 8).

Sidley additionally argues that plaintiffs were on inquiry notice in 2009 because, at that time, plaintiffs received a "Final Partnership Administrative Adjustment" from the IRS "confirming what was by then obvious--that the Kislev transaction was viewed as an abusive tax shelter by the IRS" (defendant's memorandum in support at 13).

Finally, Sidley argues that plaintiffs admit that they knew of their potential claim by September 2012 at the latest. In the complaint, plaintiffs allege that they had "no choice but to settle with the IRS in September 2012, agreeing to pay over $7 million in federal and state penalties, nearly $12 million in punitive interest as well as repayment of tax . . ." (complaint, ¶ 8). Plaintiffs claim that they did not "have the requisite knowledge [of their claims] until discovery was obtained . . . in the IRS litigation" (*id.*), and plaintiffs allege: "[u]ntil settlement with the IRS in 2012, Plaintiffs' claims against Defendants were not yet ripe since no damages were suffered" (defendants memorandum of law at 12, citing complaint, ¶ 8).

Sidley argues that, given plaintiffs' own admission that they had knowledge of their claims in 2012, this complaint is untimely because, "[p]laintiffs did not pursue their claims within two years of that date (*i.e.*, by September 2014)" (*id.*). Sidley concludes that because plaintiffs entered into the tolling agreement with Sidley in December 2014, more than two years from September 2012, their fraud claim is untimely.

In opposition, plaintiffs argue that they did not learn "until the midst of their litigation with the Department of Justice that Sidley's tax opinion, which was emphasized in Valdez's marketing to Plaintiffs, was hopelessly compromised by Sidley's involvement in the pre-transaction design of hundreds of illegal tax shelters and by its conflicted representation of the promoter Valdez, as far back as 1999" (plaintiffs' memorandum of law in opposition at 2). Second, plaintiffs argue that: "[u]ntil settlement with the IRS in 2012, Plaintiffs' claims against Defendants were not yet ripe since no damages were suffered. The Plaintiffs then obtained a tolling agreement with Sidley, effective December 4, 2014 through March 23, 2017 (when the parties' mediated settlement effort was unsuccessful)" (*id.* at 4).

Any alleged fraudulent act surrounding Sidley's issuance of the opinion letter in 2002 took place well more than six years, and upwards of 16 years, prior to the commencement of this action. The claim is, therefore, time-barred unless plaintiffs commenced this action within two years of discovery of the fraud, which could not reasonably have been discovered earlier. On this issue, I find that plaintiffs were, at a minimum, on inquiry notice of the fraud, more than two years prior to the

commencement of this action. The significant amount of information in the public domain in 2009 concerning Ruble's indictment, and the details of that indictment, revealing the lack of validity of the relevant tax shelter (set forth in the Opinion Letter), put plaintiffs on notice of the fraud plaintiffs allege in this action. Indeed, the plaintiffs were on inquiry notice of their fraud-based claims more than five years before the parties entered into the tolling agreement, and more than eight years before commencement of the lawsuit.

Moreover, plaintiffs, according to their own submissions, had actual notice of the alleged fraud in September 2012 when they settled with the IRS. It was not until December of 2014, more than two years later, that the parties entered into the tolling agreement. Plaintiffs commenced this action in March of 2018. Thus, under either standard of actual or inquiry notice, plaintiffs' fraud-based claims are time-barred.

Like the fraud-based claims, plaintiffs' unjust enrichment claim is barred by the applicable statutes of limitations. Accordingly, I grant Sidley's motion to dismiss, pursuant to CPLR 3211 (a) (5) and dismisses the complaint in its entirety as against it.

In accordance with the foregoing it is

ORDERED that the motion of defendant Sidley Austin LLP to dismiss the complaint against it is granted, the complaint is dismissed in its entirety as against Sidley Austin LLP, and the Clerk is directed to enter judgment accordingly; and it is further

ORDERED that the action is severed and shall continue against the remaining defendants.

This constitutes the decision and order of the Court.

6/27/2019
DATE

SALIANN SCARPULLA, J.S.C.

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
	X	GRANTED		DENIED		GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN				FIDUCIARY APPOINTMENT	REFERENCE