SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 42

PROSPECT CAPITAL CORPORATION, Plaintiff, -against- DONALD LATHEN, JR., KATHLEEN LATHEN, DAVID JUNGBAUER, EDEN ARC CAPITAL MANAGEMENT LLC and EDEN ARC CAPITAL PARTNERS L.P., Defendants.	Index No. 156375/2014 Motion Sequence Nos. 012 and 013 **DECISION AND ORDER**

Nancy M. Bannon, J.S.C.:

In this action involving a dispute over certain corporate bonds which contain a survivor's option (Survivor's Option), also referred to as a "death put" (second amended complaint [complaint], ¶ 2 [NYSCEF Doc No. 149]), motions bearing sequence numbers 012 and 013 are consolidated herein for determination.

I. BACKGROUND

A. The Parties

Prospect Capital Corporation (Prospect) is a Maryland corporation which maintains its principal place of business in the County, City and State of New York (*id.* ¶ 19). Prospect is a publicly-traded closed-end investment company and acts as a business development company under the Investment Company Act of 1940 (*id.*). Defendant Donald Lathen, Jr. (Lathen) is a resident of Manhattan and the founder and control person of defendants Eden Arc Capital Management LLC (EACM) and Eden Arc Capital Partners L.P. (EACP) (*id.* ¶¶ 2, 20).[1]

[1] Lathen's wife, Kathleen Lathen, was named as a defendant in the original complaint, filed June 30, 2014 (NYSCEF Doc No. 1). She is not named as a party in the current pleading (NYSCEF Doc No. 149).

B. The Investment Scheme

Prospect alleges that Lathan, through EACM and EACP (EACM and EACP constituting Eden Arc), created "the 'EndCare' scheme" in March 2009, which it describes as a profit-making artifice dressed up as a financial assistance program for the terminally ill. Defendant David Jungbauer (Jungbauer), Lathen's father-in-law, also allegedly participated in the EndCare scheme (*id.* ¶ 2; plaintiff's statement of material facts [SOF] [NYSCEF Doc No. 163], ¶ 1).

In sum and substance, Prospect contends that Lathen improperly exploited the imminent deaths of hospice patients by paying them $10,000 to $15,000 toward their funeral costs and other end-of-life expenses in exchange for their agreement to open joint brokerage accounts with him and his business entities.

Defendants describe EndCare as an investment strategy based on an early-redemption feature called a Survivor's Option, available with certain corporate bonds and other debt securities, which permits the surviving joint owner of the bond to redeem it from the issuer before maturity at full par value, following the death of the other joint owner (see defendants' answer and counterclaims, ¶¶ 2-4).

To exploit this purported "loophole," Lathen identified Survivor's Option bonds trading in the secondary market at significant discounts to par (*id.* ¶ 7). Lathen also identified needy terminally-ill participants (Participants) for his "EndCare Financial Assistance Program" through "outreach" to hospice social workers (Burton affirmation in support of motion [Burton affirmation], exhibit 19 ¶ 16).

To qualify for EndCare, defendants required prospective Participants to be enrolled in a hospice or to be expected to live less than six months (SOF ¶ 3). Defendants opened brokerage accounts (EndCare Accounts) in the names of qualified Participants and Lathen, or Jungbauer or

another nominee, as joint tenants with right of survivorship, and then bought Survivor's Option bonds trading at discounts for deposit into those EndCare Accounts (*id.* ¶¶ 4-5).

After a Participant died, defendants would submit paperwork to the issuer of the bonds, such as Prospect, purporting to show that their nominee was the Participant's surviving joint tenant and requesting that the bonds be immediately redeemed at full par value (see *id.* ¶¶ 6-7).

The Survivor's Option requires the issuer, upon the death of a beneficial owner, to pay the full par value of the bond prior to maturity if certain requirements are met (complaint ¶¶ 2-3). For example, Prospect's offering documents state that the Survivor's Option in its bonds could only be exercised by the authorized representative of a beneficial owner after the death of that beneficial owner, and only if the bond was owned by the beneficial owner, or by the beneficial owner's estate, at least six months prior to the request for redemption (Burton affirmation, exhibit 4 at 4).

The parties agree that defendants are entitled to exercise the Survivor's Option on Prospect's bonds only if defendants' nominee held the bond with a deceased Participant as joint tenants with right of survivorship, and both the deceased Participant and defendants' nominee were beneficial owners of the bond (SOF ¶ 8, citing Lathen September 3, 2015 affidavit [Lathen Motion Seq. No. 005 aff], ¶ 19 [NYSCEF Doc Nos. 61 and 184]; Lathen December 21, 2018 affidavit [Lathen Motion Seq. No. 013 aff], ¶¶ 55-56 [NYSCEF Doc No. 205]). Indeed, earlier in this action, Lathen averred that, for a valid joint tenancy to be formed and for defendants' redemption claims to be honored, "the survivorship feature in the participant agreement must be fully active and bilateral, meaning that in the unlikely event that I predecease the participant, the account would pass to the participant" (Lathen Motion Seq. No. 005 aff, ¶ 19).

Defendants entered an "Investment Management Agreement (IMA)," dated as of May 2, 2011 (Burton affirmation, exhibit 20), to govern their EndCare business. Although this document, a foundation to their business plan, provides that Lathen and Jungbauer, as nominees for EACM, the "Investment Manager," would establish joint accounts with Participants, it also provides that they would hold "all right, title and interest" in the assets placed in each such joint account and hold the "benefit to be derived therefrom, as nominee for and on behalf of the Partnership [that is, EACP] only" (*id.* ¶ 4). The IMA also provides that nominees have no "legal or beneficial interest" in the EndCare Account assets and that "[a]ll other attributes of beneficial ownership. . . shall be and remain in [the] Partnership" (*id.*).

Similarly, the "Participant Agreements," which Lathen entered with the terminally ill people recruited for the EndCare program, also provide that those Participants would not hold the beneficial interests of joint tenants in the assets place in their EndCare Accounts.

One version of the Participant Agreement provides that, in the event Lathan or his designee, as joint tenant, dies before a Participant, assets in the EndCare Account would be liquidated, and the funds that had been contributed by "Investors" (defined as "Lathen and various third party investors. . . including [EACP]") would be returned to them. "The remaining value in the Account(s), if any, would then be divided 95% to Investors and 5% to Participant or their estate" (Burton affirmation, exhibit 6, ¶ 4).

A later version of the Participant Agreement no longer characterizes the funders as "Investors" holding a third-party equity stake in the EndCare Accounts. Instead, defendant EACP, again defined as the Partnership, is identified as a provider of an "Investment Loan" to Lathen, to fund the payment to a Participant and the investment in the Accounts. If Lathen were to die before the Participant, the Investment Loan would become due and payable, and the

Partnership would be authorized to liquidate the Accounts to pay off the loan balance and the Participant, or the Participant's estate, would be paid the remaining proceeds (*id.* exhibit 7, ¶ 4). These provisions make it unlikely, if not impossible, for Participants to recover more than a nominal amount from their EndCare Accounts, if Lathan should die first.

Prospect also notes that while the Participant Agreement indicates that no Participant would be "permitted to pledge, borrow against, or withdraw funds from the [EndCare] Account(s) without the express written permission of Lathen, which permission may be withheld in Lathen's sole discretion" (Burton affirmation, exhibit 6, ¶ 3), it grants Lathen the unfettered right to make transfers of cash, in and out of EndCare Accounts, without Participant's prior consent, "including to and from other accounts that Lathen and the Investors control" (*id.* ¶ 2 [d]). By reserving these controls over EndCare Account assets to himself and granting himself the right to move assets without restriction, Lathen ensured that a Participant's return to health would not impede defendants' recovery on their EndCare's investments. For example, one Participant joined the EndCare program in 2011 after being diagnosed with terminal cancer. That Participant's cancer later went into remission and she was diagnosed as cancer-free in 2013. Upon learning this, defendants transferred all $1.37 million in assets out of the Participant's EndCare Account and closed it (Burton affirmation, exhibit 16).

C. Prospect's Complaint

Prospect asserts six causes of action in its complaint. In its first cause of action, Prospect alleges that Lathen and Eden Arc committed fraud against it, in furtherance of their EndCare scheme by, among other things, failing to inform Prospect of their entry into the IMA and Participant Agreements and otherwise falsely representing to Prospect that they held Prospect's bonds as joint tenants. In its second cause of action, Prospect alleges that Lathen and Eden Arc aided and abetted each other in their fraud, in their operation of the EndCare scheme.

As its third cause of action, Prospect alleges that Lathen and Eden Arc's conduct in carrying out "the EndCare enterprise was to obtain improper proceeds [from corporate bond issuers like Prospect] through a fraudulent scheme and artifice" (complaint ¶ 74). Prospect alleges that the wrongful conduct of Lathen and Eden Arc, in violation of 15 USC Section 78j(b), constitutes a "pattern of racketing activity' within the meaning of 18 USC Section 1961 of the Racketeer Influenced & Corrupt Organization Act (RICO). Prospect also alleges that, in furtherance of their scheme, Lathen and Eden Arc used the United States Postal Service, private or commercial interstate carriers and wire communications in interstate commerce, to commit multiple acts of mail and wire fraud, in violation of 18 USC Sections 1341 and 1343.

In its fourth cause of action, Prospect alleges that Lathen and Eden Arc formed a conspiracy to engage in and profit from their racketeering activities by knowingly and intentionally agreeing and conspiring to commit at least two predicate acts in furtherance of their EndCare scheme, in violation of 18 USC Section 1962.

Prospect asserts in its fifth cause of action that defendants misrepresented to Prospect that Lathen, Jungbauer and Participants were beneficial owners of Prospect bonds and that the EndCare Accounts in which they were held formed valid joint tenancies. As a result, Prospect was allegedly tricked into honoring defendants' exercise of the bonds' Survivor's Option and overpaying for the bonds. Prospect asserts that defendants have been unjustly enriched by such overpayments and so must make restitution of those amounts, plus transaction fees Prospect incurred in redeeming these bonds.

In its sixth cause of action, Prospect asserts among other things that, under the terms of the "Supplemental Indenture" (Lathen supporting affidavit [Lathen aff], exhibit D [NYSCEF Doc No. 210]), Prospect must indemnify the trustee, U.S. Bank N.A. (U.S. Bank), for legal fees

it incurs in administering the trust, including the legal fees it incurs because of defendants' misconduct. Prospect asserts that it would be equitable to shift the burden of this indemnification liability to defendants.

Prospect seeks to recover damages against defendants, including treble and punitive damages, plus interest, costs, fees and disbursements. Prospect also seeks an order requiring that defendants disgorge all gains they received from the EndCare scheme because it would be inequitable and unjust for them to keep.

D. Defendants' Answer and Counterclaims

In their answer with counterclaims (answer), defendants generally deny Prospect's allegations and assert two counterclaims. First, defendants seek an order declaring that the joint tenancies they set up with Participants, and the Survivor's Option redemptions they sought, are valid.

In their second counterclaim, defendants pray that the court holds Prospect liable to Lathen and Jungbauer, as bondholders and intended third-party beneficiaries of the "Trust Indenture" and "Prospectus Supplement" entered into by Prospect, as issuer, and U.S. Bank, as trustee. Lathen and Jungbauer seek to recover for damages they suffered as a result of Prospect's alleged breaches of contract. Defendants also seek a declaration in their favor, finding that the joint tenancies are lawful, and the bond redemptions Prospect contested are all valid. Defendants pray for an award of damages and other relief due them under their counterclaims, plus an award of legal fees and other costs incurred in the defense of this action. Defendants fail to identify a statutory or contractual provision on which they base their fee claim.

II. DISCUSSION

To prevail on a summary judgment motion, the movant must produce evidentiary proof in admissible form sufficient to warrant the direction of summary judgment in its favor (*GTF Mktg.*

v Colonial Aluminum Sales, 66 NY2d 965, 967 [1985]; *see also Stonehill Capital Mgt. LLC v Bank of the W.*, 28 NY3d 439, 448 [2016], quoting *Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986] [proponent of summary judgment "'must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact'"]). If the moving party fails to make a prima facie showing of its entitlement to summary judgment, the motion must be denied, regardless of the sufficiency of the opposing papers (*William J. Jenack Estate Appraisers and Auctioneers, Inc. v Rabizadeh*, 22 NY3d 470, 475 [2013]).

Once this showing is made, the burden shifts to the opposing party to submit proof in admissible form sufficient to create a question of fact requiring a trial (*Kosson v Algaze,* 84 NY2d 1019, 1020 [1995]).

In deciding a motion for summary judgment, the court must view the evidence in the light most favorable to the non-movant (*Branham v Loews Orpheum Cinemas*, 8 NY3d 931, 932 [2007]). Party affidavits and other proof must be examined closely "because summary judgment is a drastic remedy and should not be granted where there is any doubt as to the existence of a triable issue" (*Rotuba Extruders v Ceppos*, 46 NY2d 223, 231 [1978] [citation and internal quotation marks omitted]). Still, "only the existence of a bona fide issue raised by evidentiary facts and not one based on conclusory or irrelevant allegations will suffice to defeat summary judgment" (*id.*).

A. Motion Sequence No. 012

Prospect moves for partial summary judgment, seeking an order declaring that the EndCare Accounts in which defendants held Prospect's bonds were not valid joint tenancies under New York law and dismissing defendants' counterclaims for a declaratory judgment and for breach of contract. Prospect also argues that defendants, and not Participants, were the sole

beneficial owners of the assets in the EndCare Accounts, disproving their entitlement to seek Survivor's Option redemptions. Prospect further requests dismissal of defendants' counterclaims, arguing that defendants produced no evidence that Lathen or Jungbauer suffered any legally cognizable damage and that defendants' cause of action for declaratory relief should be dismissed because it is duplicative of their breach of contract claim. Prospect also contends that defendants' cause of action for breach of contract is untenable because valid joint tenancies are a condition precedent for such claims.

Defendants oppose, arguing that not only should Prospect's motion for summary judgment be denied but summary judgment should be granted in their favor, declaring that the EndCare Accounts are valid joint tenancies. Thus, this motion turns on the issue of whether the parties established valid joint tenancies in the EndCare Accounts.

Joint Tenancy and Beneficial Ownership

"New York defines '[a] joint tenancy [as] an estate held by two or more persons jointly, with equal rights to share in its enjoyment during their lives, and creating in each joint tenant a right of survivorship'" (*Smith v Bank of Am., N.A.*, 103 AD3d 21, 23 [2d Dept 2012], quoting *Goetz v Slobey*, 76 AD3d 954, 956 [2d Dept 2010]).

"Foremost, in a joint tenancy, the joint tenants take and hold property as though they together constitute one person. In order to create and maintain a joint tenancy, the four unities – of time, title, interest, and possession – must exist" (*Smith*, 103 AD3d at 23-24 [citation omitted]).

> "'The four unities of (1) time – *that they acquire their interests at the same moment*, (2) title – *that they acquire their interests by the same deed or will*, (3) interest – that each have an interest identical with the interest of each of the other cotenants, and (4) possession – that they each be entitled to the common possession of the entire property, grow out of this one essential, the fictitious unity of the tenants, they holding together as though they were one'"

(*Moore Lbr. Co. v Behrman*, 144 Misc 291, 292 [Mun Ct, NY County 1932], quoting Walsh, Law of Real Property at 345).

> "Under the common law, as Sir William Blackstone explained, joint tenants have one and the same interest, accruing by one and the same conveyance, commencing at one and the same time, and held by one and the same undivided possession. Thus, the concept of unity of interest, which is pivotal to our inquiry, refers to the requirement that all joint tenants' interests must be identical in nature, extent, and duration"

(*Smith*, 103 AD3d at 24, citing, inter alia, 2 William Blackstone, Commentaries on the Law of England, at 180).[2]

A joint tenancy will terminate upon the destruction of any one of its unities, because they are all necessary to its existence (24 NY Jur 2d Cotenancy and Partition § 33, citing *Matter of Schrier v Tax Appeals Trib. of the State of NY*, 194 AD2d 273 [3d Dept 1993] and *Matter of Cotter*, 159 Misc 324 [Sur Ct Kings County 1936]). A joint tenancy may be destroyed or "severed" in a variety of ways, including by mutual agreement (*Matter of Cotter*, 159 Misc at 327, quoting *Williams v Hensman*, 70 ER 862, 1 John. & H. 546, 557 [Queen's Bench 1861]). Here, Lathen's imposition of the IMA and Participation Agreements destroyed the unities in each putative joint tenancy by depriving Participants of their identical interests in, and common, undivided possession of, the assets in their EndCare Accounts.

Similarly, by denying Participants any interest in, or possession of, the assets in their EndCare Accounts, defendants vitiated their right to exercise the Survivor's Option in Prospect's bonds. Under the terms of the "Indenture" for Prospect's bonds, "[t]o be valid, the Survivor's Option must be exercised by or on behalf of the person who has the authority to act on behalf of

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[2] The chapter of Blackstone's Commentaries referenced above is available at https://avalon.law.yale.edu/18th_century/blackstone_bk2ch12.asp.

the deceased beneficial owner of the Note" (Burton affirmation, exhibit 4 at 5 and exhibit 5 at S-15 [NYSCEF Doc Nos. 169 and 170]). Defendants assert that Lathen or Jungbauer, as the surviving joint tenant, properly exercised the Survivor's Option on behalf of each Participant after their death. Prospect, however, asserts that Participants were never beneficial owners of the assets in the EndCare Accounts. First, Prospect contends that, by operation of the IMA and Participant's Agreements, Participants had no pecuniary interest in the EndCare Account assets, much less the common undivided interest that is an *essential* element of joint tenancy; second, Prospect asserts that Participants lacked the right to invest or dispose of those assets.

"Beneficial ownership" means not just a financial interest in an asset but also control, such as "voting, investment and dispositional power over" it (*Artcorp, Inc. v Citirich Realty Corp.*, 2018 WL 1043982,*2 [Sup Ct NY County, Feb 20, 2018] [Bannon, JSC], *affd* 168 AD3d 515 [1st Dept 2019]; *see also GKK 2 Herald LLC v City of N.Y. Tax Appeals Trib.*, 154 AD3d 213, 226 [1st Dept 2017], quoting *Matter of CBS Corp. v Tax Appeals Trib. of State of N.Y.*, 56 AD3d 908, 910 [3d Dept 2008] [in tax dispute, "beneficial ownership encompasses command and control over property in addition to financial or economic interest [and] also includes entitlement to profits, dividends and bonuses"] [citations and internal quotation marks omitted]; *Friedman v Airlift Intl., Inc.*, 44 AD2d 459, 461 [1st Dept 1974] [bonds' registration in name of nominee did not preclude plaintiff, the bonds' beneficial owner and holder, from recovering defaulted interest]).[3]

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[3] Black's defines "beneficial owner" as "[o]ne recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else; esp., one for whom property is held in trust. — Also termed *equitable owner*" (Black's Law Dictionary [11th ed 2019]).

Defendants assert Prospect's motion must be denied because case law construing Section 675 (b) of New York's Banking Law holds that, absent fraud, undue influence, lack of capacity, or a finding that the account was created as a "convenience account," it is presumed that their EndCare Accounts were valid joint tenancies with right of survivorship.

A party challenging the presumption of joint tenancy must meet its burden with clear and convincing evidence (*Matter of Grancaric*, 91 AD3d 1104, 1105 [3d Dept 2012]). This "presumption may be rebutted if it is shown that the party opening the account established it 'for [his own] convenience and not with the intention of conferring a present beneficial interest on [his] cotenant" (*Matter of Estate of Zecca*, 152 AD2d 830, 830-31 [3d Dept 1989], quoting *Matter of Friedman*, 104 AD2d 366, 367 [2d Dept], *affd* 64 NY2d 743 [1984]).

The *Matter of Zecca* court recognized that the unities of interest and possession are elements necessary to create and maintain a true joint tenancy:

> "In a true joint account, each party has the right to withdraw one half of the funds during the lifetime of both tenants; in other words, at the time the account was opened, there must have been a present gift from the original donor to the cotenant of one half of the account which each could withdraw unilaterally while both were alive."

(152 AD2d at 831 [citations omitted]; see also *Matter of Friedman*, 104 AD2d at 366 [aunt's account shown to be opened as convenience, despite naming herself and niece as joint tenants with right of survivorship, where account opened with aunt's money, and aunt "exercised complete dominion and control" over account, by keeping possession of passbook and personally making all deposits and withdrawals]).

Defendants have sought to portray their investment scheme as exploiting a "loophole" (Lathen Motion Seq. No. 013 aff, ¶ 46),[4] but that characterization fails. The facts of this action fit squarely within *Matter of Zecca*'s exception to Section 675 (b)'s joint tenancy presumption. It is beyond cavil that defendants, seeking to serve their own purposes through their for-profit scheme, opened EndCare Accounts in the *form* of joint tenancies, hoping to exploit the presumption of survivorship, but they did not intend to make a present gift to Participants of an equal, undivided interest in their investments (see *Matter of Estate of Zecca*, *supra*). Although they named Participants as joint tenants, defendants were the sole source of deposits and maintained complete control and dominion over their EndCare Accounts and the assets they placed in them (see *Matter of Friedman*, *supra*). As a result, defendants did not establish the unities of interest or possession necessary to create a valid joint tenancy.

Relying on the *Matter of Estate of Grancaric*, *supra*, defendants assert that the EndCare Accounts cannot be deemed convenience accounts merely because defendants may have made contractual promises regarding account assets or otherwise encumbered their interest in the joint tenancy. This argument is inapposite. The validity of the putative joint tenancies in the EndCare Accounts has not been questioned because defendants allegedly encumbered their interests. New York is a lien theory state and so a joint tenant taking a mortgage on his moiety – that is, his interest – will not vitiate an otherwise valid joint tenancy (see *Smith*, 103 AD3d at 26-27). Under the Participant Agreements, defendants denied Participants any beneficial interest or property

[4] Black's defines "loophole" as "[a]n ambiguity, omission, or exception (as in a law or other legal document) that provides a way to avoid a rule without violating its literal requirements; esp., a tax-code provision that allows a taxpayer to legally avoid or reduce income taxes" (Black's Law Dictionary [11th ed 2019]).

right in the joint tenancy, after their receipt of the initial payment. The EndCare Accounts are convenience accounts because they are created to serve only defendants' interests.

Defendants also contend that as neither Banking Law Section 675 nor the cases construing it mention them, the common law of joint tenancy and the four unities rule have no application to this dispute. This is not true (*see Matter of Estate of Zecca* and *Matter of Friedman*, *supra; see also Matter of Coddington*, 56 AD2d 697 [3d Dept 1977] [one depositor's withdrawal of most of money in account deemed some evidence that no true joint tenancy intended]).

Furthermore, nothing in the Banking Law suggests that the statute was intended to abrogate the common law. Indeed, the legislative history of Section 675 indicates that the provision was adopted for the sole purpose of standardizing the treatment of putative joint tenancy accounts in savings and commercial banks (*see* McKinney's Cons Laws of NY, Banking Law Section 675, Historical and Statutory Notes, L.1964, c. 157 [predecessor of Section 675 replaced savings bank "conclusive evidence" rule with commercial bank "rebuttable presumption" rule]).

Finally, defendants contend that, as "holders" of Prospect's bonds under the Indenture, they have the absolute and unconditional right to receive payment of the principal and interest due thereunder and to institute suit for enforcement of such payment. This is generally true but, in the absence of a valid joint tenancy, defendants' putative status as holders does not entitle them to early redemption of bonds under the Survivor's Option.

B. Motion Sequence Number 013

Defendants move for summary judgment, seeking dismissal of all of Prospect's causes of action and to be granted judgment on all their counterclaims. Defendants rely heavily on an August 16, 2017 initial decision (Initial Decision) rendered by Administrative Law Judge Jason

S. Patil in a proceeding at the Division of Enforcement of the Securities and Exchange Commission (SEC) brought against Lathen and Eden Arc captioned *Matter of Donald F. ["Jay"] Lathen, Jr., Eden Arc Capital Mgt., LLC and Eden Arc Capital Advisers, LLC* (Initial Decision Release No. 1161, File No. 3-17387, Aug 16, 2017) (Lathen Motion Seq. No. 013 aff, exhibit A [NYSCEF Doc No. 207]) (SEC Proceeding).

Defendants maintain that the Initial Decision proves they did not defraud any issuers of Survivor's Option securities, including Prospect (defendants' memorandum in support at 1), noting that ALJ Patil found "Lathen lacked intent to defraud. . . [and] acted in good faith" (*id*). Defendants also contend that, among other rulings, the SEC failed to show that defendants made material misrepresentations about their joint tenancies or beneficial ownership, or that Participants lacked beneficial interest in Prospect's bonds (*id.*). The ALJ also found that the SEC failed to rebut the presumption that Lathen intended to create joint tenancies and failed to show defendants had any duty to disclose the IMA or Participant's Agreements (*id.*).

As a threshold matter, this court will not give the Initial Decision dispositive effect, as defendants wish. First, it would be unfair to do so, considering that Prospect was not a party to that prior proceeding (*Matter of Sharon Towers v Bank Leumi Trust Co. of N.Y.*, 250 AD2d 509, 511 [1st Dept 1998], quoting *D'Arata v. New York Cent. Mut. Fire Ins. Co.*, 76 NY2d 659, 664 [1990] [party invoking collateral estoppel must show, among other things, that other party had "full and fair opportunity to contest the prior determination"]).

Defendants concede that Prospect was not a named party to the SEC Proceeding, but they contend that Prospect "participated extensively in the investigatory phase and in the trial itself" and, although Prospect's "claims and arguments received a full airing, [they] were rejected" (defendants' memorandum, at 14). In a footnote, defendants cite to about 100 pages of the

hearing transcript (which is apparently thousands of pages long), that they allege reflect Prospect's "voluminous document productions, meetings with the SEC, the testimony of its general counsel and other active participation" in the SEC Proceeding (*id.* n 15). This showing, however, does not establish that Prospect had a "full and fair opportunity" to contest the determination in the SEC Proceeding.

Second, ALJ Patil's findings and conclusions were largely shaped by his reluctance to address the issue of whether, under New York law, the Participant Agreements prevented the creation of valid joint tenancies, which he described as "unsettled" (*see* Initial Decision at 50). This court faces no such impediment.

Third, not surprisingly, defendants do not support consideration of the widely divergent findings and conclusions made in the Financial Industry Regulatory Authority (FINRA) extended hearing panel decision of September 6, 2017, rendered in the matter captioned *Department of Enforcement v C.L. King & Assoc. Inc. and Gregg Alan Miller* (Disciplinary Proceeding No. 2014040476901) (Burton opposition affirmation, exhibit 17 [NYSCEF Doc No. 284]) (FINRA Decision). This FINRA Decision, which Prospect submitted in opposition, presents a cogent analysis of New York's law regarding joint tenancies and convenience accounts.

In the FINRA Decision, the hearing panel censured and fined defendants' broker/dealer, C.L. King, with which defendants maintained its EndCare Accounts, for negligently making material misrepresentations and failing to disclose all material facts to issuers, including Prospect, in connection with its redemptions of debt securities on behalf of its customers Lathen and Eden Arc, in violation of Sections 17(a)(2) and (3) of the Securities Act of 1933 and FINRA Rule 2010 (FINRA Decision at 1).

The FINRA Decision found, among other things, that, under New York law, the EndCare Accounts were not true joint tenancies:

> "In New York, the law presumes that an account is a joint account if it is titled as one. . . This presumption can be rebutted by a showing that an account is missing one of the two characteristics of a true joint account – (i) sharing equally in the assets during the life of the cop-tenancy, and (ii) having rights of survivorship."
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> "The presumption that these were true joint accounts is rebutted by the evidence presented at the hearing. Even before an account was opened and assets place in the account, Lathen and the Participants intended that Participants would have no access or control over the assets in the accounts. In a sales brochure, Lathen told prospective Participants that all they would receive financially 'comes in the form of a one-time cash payment made within 15 days of enrollment.' By the terms of the Participant Agreements, Participants gave up ownership in the investment or other assets held in the accounts. Participants permitted Lathen to transfer cash and securities from the accounts, without their prior consent. They further agreed that they could not pledge, borrow against, or withdraw funds from the accounts without Lathen's consent, which he could withhold at his sole discretion. They also gave Lathen power of attorney to buy, sell, exchange, convert, tender, trade, lend, and otherwise dispose of or acquire any securities in the account. *Participants therefore were stripped of all rights to the account.*"
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> "Under these circumstances, the accounts were not true joint accounts. Under New York law, they were 'convenience' accounts despite being styled as JTWROS accounts in C.L. King's new account documents. A 'convenience' account exists when a depositor does not intend to give a present beneficial interest in the assets of the account to the co-tenant. An account created for convenience rebuts the presumption that it is a true joint account. . . [The Department of] Enforcement proved [by clear and convincing evidence] that Lathen did not intend to give Participants a beneficial interest in the assets held in the accounts. He intended to do the exact opposite – ensure that that they could not get their hands on the accounts. *Accordingly, the accounts Lathen opened with Participants were not valid joint tenancies.*"

(FINRA Decision at 19 [emphasis added], citing, inter alia, *Matter of Friedman*, 104 AD2d at 367 and *Matter of Grancaric*, 91 AD3d at 1105).

Fraud

Defendants move for summary judgment, seeking dismissal of all of Prospect's causes of action. With respect to Prospect's fraud claims,[5] for the most part, defendants rely on the argument that "the undisputed facts" of the Initial Decision show that there was no fraud, that defendants made no statement that was false, and that there is no evidence which would give rise to a reasonable inference that defendants intended to defraud Prospect. Indeed, relying further on the Initial Decision, defendants contend that ALJ Patil "thoroughly examined" Mr. Lathen's "state of mind" to find that "all indicia. . . reflected good faith not scienter" and "that it is not possible to maintain that Lathen knowingly defrauded issuers" (defendants' memorandum in support at 15, 17 [NYSCEF Doc No. 206]). From these contentions alone, drawn entirely from the Initial Decision, without addressing any of Prospect's factual allegations, defendants assert that Prospect has not shown fraud or that defendants acted with scienter. These assertions do not set forth the evidentiary proof in admissible form sufficient to warrant a grant of summary judgment in defendants' favor (*GTF Mktg.*, 66 NY2d at 967), and therefore defendants' motion must be denied, as they have failed to meet their prima facie burden.

Defendants also assert that they are entitled to summary judgment, dismissing Prospect's fraud claims, because "evidence supports the view" that, "[a]ssuming" Prospect's proprietary investments yielded certain amounts, Prospect's net earnings "likely increased" during the period in which defendants made Survivor's Option redemptions (defendants' memorandum, at 12). From this, defendants conclude that even if they were able to make out the other elements of

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[5] In Count I of the complaint, Prospect asserts a cause of action for fraud against Lathen and Eden Arc. In Count II of the complaint, Prospect asserts a cause of action against Lathen and Eden Arc for aiding and abetting fraud.

their fraud causes of action, Prospect cannot maintain its claims because it suffered no loss (*id.* at 17).

Even if this argument were not premised on conjecture and speculation, which is fatal in and of itself (see *Tungsupong by Tungsupong v Bronx-Lebanon Hosp. Ctr.*, 213 AD2d 236, 238 [1st Dept 1995] ["Rank speculation is no substitute for evidentiary proof in admissible form"] [citations omitted]), Prospect's ability to turn a profit during the period in question, despite defendants' alleged fraud, does not mean that it must suffer any harm defendants may have caused it without recourse. The measure of damages for fraud "is indemnity for the actual pecuniary loss sustained as the direct result of the wrong' or what is known as the 'out-of-pocket' rule" (*Connaughton v Chipotle Mexican Grill, Inc.*, 29 NY3d 137, 142 [2017] [citations omitted]). "Under that rule, '[d]amages are to be calculated to compensate plaintiffs for what they lost because of the fraud…'" (*id.* [citations omitted]).[6]

In sum, defendants' motion for summary judgment, dismissing Prospect's fraud claim, must be denied for failure to tender "sufficient evidence to demonstrate the absence of any material issues of fact" (*Stonehill Capital Mgt. LLC*, 28 NY3d at 448).

Racketeering Influenced and Corrupt Organization Act

Defendants also move for summary judgment dismissing Prospect's causes of action under the Racketeering Influenced and Corrupt Organization Act (RICO) (18 USC Section 1961 *et seq.*). In its third cause of action, Prospect asserts a cause of action for violation of RICO by

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[6] If Prospect sustains its burden with respect to the other elements of its fraud causes of action, it would only need to show its out-of-pocket loss with respect to each allegedly invalid bond redemption, measured by the difference between the bond's full par value and the market value of the bond at the time of its redemption.

Lathen and Eden Arc. In its fourth cause of action, Prospect alleges Lathen and Eden Arc engaged in a conspiracy to violate RICO.

"[T]he four major elements of a RICO claim are (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity" (*Riverbay Corp. v Steiner*, 144 Misc 2d 530, 539 [Sup Ct Bronx County 1989], citing *Sedima S.P.R.L. v Imrex Co.*, 473 US 479, 496 [1985]).

18 USC Section 1962 states, in pertinent part:

> "(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.
>
> (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt."

Defendant's principal argument in support of summary judgment with respect to RICO is that the Initial Decision is dispositive on all of Prospect's claims. Defendants assert that dismissal of Prospect's RICO claims is warranted because the Initial Decision established "that there is no plausible allegation of misconduct *of any kind*, let alone one that would rise to the level of criminal racketeering required to sustain a RICO claim" (defendants' memorandum at 18) (emphasis in original). Again, these assertions do not set forth the evidentiary proof in admissible form sufficient to warrant a grant of summary judgment in defendants' favor (*GTF Mktg.*, 66 NY2d at 967), and so defendants have failed to meet their prima facie burden.

The only substantive argument defendants offer to counter Prospect's RICO claims is their assertion that Prospect failed to show that the "person" and the "enterprise" allegedly involved in a pattern of racketeering activity constituting the alleged violation were sufficiently

distinct to satisfy the statute. Defendants based this contention on *Bennett v U.S. Trust Co.* (770 F2d 308, 315 [2d Cir 1985] ["a corporate entity may not be simultaneously the 'enterprise' and the 'person' who conducts the affairs of the enterprise through a pattern of racketeering activity"]), and *Riverwoods Chappaqua Corp. v Marine Midland Bank, N.A.* (30 F3d 339, 344 [2d Cir 1994] [plaintiff may not circumvent distinctness requirement "by alleging a RICO enterprise that consists merely of a corporate defendant associated with its own agents carrying on the regular affairs of the defendant"]).

In opposition, Prospect maintains that a recent Supreme Court decision abrogated defendants' authorities on this "distinctiveness" requirement. In *Cedric Kushner Promotions, Ltd. v King*, the Supreme Court sustained a RICO cause of action where the plaintiff alleged that a corporate employee violated the statute:

> "While accepting the 'distinctness' principle, we nonetheless disagree with the appellate court's application of that principle to the present circumstances –
> circumstances in which a corporate employee, 'acting within the scope of his authority,' allegedly conducts the corporation's affairs in a RICO-forbidden way. The corporate owner/employee, a natural person, is distinct from the corporation itself, a legally different entity with different rights and responsibilities due to its different legal status. And we can find nothing in the statute that requires more 'separateness' than that."

(533 US 158, 163 [2001] [citation omitted]).

Prospect asserts that, upon the reasoning of *Cedric Kushner Promotions, Ltd.*, Lathen is a corporate owner sufficiently distinct from his business entities to satisfy the RICO statute. In their reply, defendants fail to address Prospect's opposition argument. Considering the *Cedric Kushner* decision, the court denies defendants' motion with respect to Prospect's third and fourth causes of action.

Unjust Enrichment and Restitution

Defendants also move to dismiss Prospect's fifth cause of action, seeking recovery for unjust enrichment and restitution. Among other things, defendants argue that Prospect cannot make quasi-contractual claims like these because their relationship, as issuer and holder of Prospect bonds, is governed by the Indenture (see Lathen Motion Seq. No. 013 aff, exhibit C). Defendants are correct, even though they are not signatories to the Indenture which Prospect entered with U.S. Bank, as trustee. The Indenture defines the rights and obligations of Prospect and defendants, as holders of its bonds (*id.*), which is the subject matter of this dispute. Accordingly, this cause of action "cannot be maintained, since there can be no quasi-contract claim against a third-party non-signatory to a contract that covers the subject matter of the claim" (*Maor v Blu Sand Intl. Inc.*, 143 AD3d 579, 579 [1st Dept 2016], citing, *inter alia*, *Randall's Is. Aquatic Leisure, LLC v City of New York*, 92 AD3d 463, 464 [1st Dept 2012]). As a result, Prospect's fifth cause of action must be dismissed.

Indemnity

Defendants also seek summary judgment, dismissing Prospect's sixth cause of action for indemnity, to offset the amounts Prospect was contractually obliged to pay U.S. Bank, as trustee under the Indenture, for legal fees allegedly incurred in responding to defendants' "illegitimate redemption requests" (complaint ¶ 94). Prospect asserts it would be equitable to hold defendants liable for these amounts, because their misconduct caused U.S. Bank to incur such fees (*id.* ¶ 97).

Defendants contend that this cause of action must be dismissed because they never made any illegitimate redemption requests and never committed any other misconduct. They further assert that Prospect is not entitled to indemnity because it has acted with unclean hands and equity available only to non-culpable parties. Defendants' motion must be denied, as it has again

failed to show prima facie entitlement to judgment as a matter of law (*Stonehill Capital Mgt. LLC*, 28 NY3d at 448).

Defendants' Counterclaims

Defendants also seek summary judgment with respect to their two counterclaims.

First, defendants seek a declaration that defendants formed and maintained joint tenancies, valid under the laws of the State of New York, in the EndCare Accounts at issue in this action. This application, of course, has been mooted by the court's determination of Prospect's first cause of action, as to which the court declares those same alleged joint tenancies in the EndCare Accounts are invalid under New York law.

Second, defendants seek summary judgment, holding Prospect liable for its alleged breach of its contractual duties owed to Lathen and Jungbauer as third-party beneficiaries under the "Indenture" (see answer ¶¶ 142-154). While it appears to be beyond dispute that Mr. Lathen and Mr. Jungbauer are third-party beneficiaries under the "Indenture" and would otherwise be entitled to enforce their rights as such, including redemption rights, their putative joint tenancies in the EndCare Accounts are invalid under New York law and so defendants have not named any contractual duty owed to them which has been breached by Prospect.

Accordingly, both of defendants' counterclaims must be dismissed.

III. CONCLUSION

For the foregoing reasons, it is hereby

ORDERED that Prospect's motion for summary judgment on its first cause of action, seeking a declaratory judgment, is granted; and it is further

ADJUDGED AND DECLARED that the putative joint tenancies defendants created in their EndCare Accounts are invalid under the law of the State of New York; and it is further

ORDERED that Prospect's motion for summary judgment, seeking dismissal of defendants' counterclaim for a declaratory judgment and for breach of contract, is granted; and it is further

ORDERED that defendants' motion for summary judgment is granted in part with respect to Prospect's fifth cause of action, for unjust enrichment and restitution, but is denied with respect to Prospect's other causes of action and with respect to defendants' counterclaims; and it is further

ORDERED that counsel are directed to appear at a status/settlement conference in Part 42 of this Court on March 4, 2020, at 2:30 p.m..

This constitutes the Decision and Order of the court.

Dated: January 8, 2020

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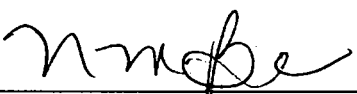

J.S.C.

HON. NANCY M. BANNON