

Principia Partners LLC v Swap Fin. Group, LLC

2020 NY Slip Op 31557(U)

May 8, 2020

Supreme Court, New York County

Docket Number: Index No. 656163/2019

Judge: Andrea Masley

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**SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY**

PRESENT: HON. ANDREA MASLEY **PART** **IAS MOTION 48EFM**

Justice

-----X

PRINCIPIA PARTNERS LLC,

Plaintiff,

INDEX NO. 656163/2019

MOTION DATE N/A, N/A

MOTION SEQ. NO. 001, 002

- v -

SWAP FINANCIAL GROUP, LLC, SYNCORA
INVESTMENT HOLDINGS LLC, SYNCORA GUARANTEE
INC., SYNCORA HOLDINGS US INC., SYNCORA
HOLDINGS LTD.,

**DECISION + ORDER ON
MOTION**

Defendants.

-----X

MASLEY, J.:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 9, 10, 11, 12, 13, 14, 15, 31, 32, 33, 34, 35, 36, 37, 38, 41

were read on this motion to/for DISMISS

The following e-filed documents, listed by NYSCEF document number (Motion 002) 28, 29, 30, 39, 40

were read on this motion to/for DISMISS

Upon the foregoing documents, it is

Plaintiff Principia Partners LLC (PPP) filed this breach of contract action on October 22, 2019 against defendants SWAP Financial Group, LLC (SFG), Syncora Investment Holdings LLC (SIH), Syncora Guarantee Inc. (SGI), Syncora Holdings US Inc. (SHU) and Syncora Holdings LTD (SHL) (collectively, Syncora or Syncora Entities). (NYSCEF Doc. No. [NYSCEF] 1, Complaint ¶¶14-17).

In motion 01, Syncora moves to dismiss pursuant to CPLR 3211 (a) (7) the entire complaint. In motion 02, SFG also moves pursuant to CPLR 3211 (a) (7) for partial dismissal.

Background

The following facts are alleged in the complaint unless noted otherwise, and for purposes of this motion, are accepted as true.

PPP and SFG entered into a contract (the Agreement) on March 17, 2004. (*Id.* ¶ 23.) Under the Agreement, PPP provided SFG with access to its proprietary software, PAS. (*Id.* ¶ 24.) PAS is software for portfolio analysis and risk management and was used by SFG to value swaps. (*Id.* ¶ 21.) In return for access to PAS, SFG agreed to (i) pay both a minimum quarterly fee, a portion of qualifying revenue from its use of PAS, and interest on late payments (*id.* ¶¶ 25-31), (ii) provide quarterly reports, certified for accuracy, of its qualifying revenue (Quarterly Reports) (*id.* ¶ 27), and (iii) allow PPP to audit SFG to verify the accuracy of its reports. (*Id.* ¶ 32.)

In 2015, SIH, a Delaware holding company, acquired an 80% interest in SFG (Acquisition). (*Id.* ¶ 41.) At the time, SIH was owned by SGI, a New York insurance company. SGI is owned by SHU, a separate holding company incorporated in Delaware, which in turn is owned by SHL, a Bermuda exempt holding company. (*Id.* ¶ 4.) SIH is a wholly-owned subsidiary of SGI, which is a wholly-owned subsidiary of Syncora US, which is a wholly-owned subsidiary of SHU. (*Id.* ¶¶ 14-17.)

PPP alleges that from the beginning Syncora exercised such control over SFG that SFG became a mere instrumentality of Syncora including: (i) officers and directors held dual positions within the Syncora Entities and SFG; (ii) SFG and Syncora shared common office space, address and telephone numbers; (iii) Syncora moved SFG from South Orange, New Jersey, where it had been located, to Syncora's New York headquarters, and SFG and Syncora have shared an office since then; (iv) SFG and

Syncora are regularly represented by the same legal counsel; (v) email correspondence purportedly related to SFG was sent to PPP from Syncora email addresses; and (vi) Syncora paid PPP for SFG's use of the PAS system pursuant to the Agreement. (*Id.* ¶¶ 42-49.) Scott Beinhacker, the Head of Investor Relations for SHL, also became SFG's Chief Operating Officer. (*Id.* ¶ 45.) Following the 2015 Acquisition, Mr. Beinhacker interfaced with PPP on behalf of SFG in his capacity as an SFG officer. (*Id.* ¶¶ 59-60.) PPP also alleges Syncora's payment of SFG's debts. (*Id.* ¶ 53.)

PPP alleges that it fully performed under the Agreement. (*Id.* ¶ 136.) Until the end of 2017, PPP believed that SFG was performing too. (*Id.* ¶ 73.) SFG submitted Quarterly Reports throughout the contractual period that it certified for accuracy, and it made regular payments to PPP. (*Id.* ¶ 183.) However, in 2017, PPP discovered that SFG had clients that were not being reported to PPP, as SFG's website referred to customers that SFG had never included in its Quarterly Reports. (*Id.* ¶ 70.) PPP investigated the discrepancy and found evidence that SFG's Quarterly Reports were allegedly fraudulent in that certain SFG customers who had used PAS were not included in SFG's quarterly reports. (*Id.* ¶¶ 72-86.) PPP asserts a pattern of SFG underreporting revenue since 2005. (*Id.* ¶¶ 6, 139.)

On February 1, 2018, PPP contacted SFG to address the inconsistencies it had found in the Quarterly Reports. (*Id.* ¶ 103.) In its February 22, 2018 response, SFG admitted to omitting some clients from the Quarterly Reports. (*Id.* ¶¶ 106-107, 109.) However, SFG also allegedly made numerous material misstatements to PPP in its February 22, 2018 response. For example, SFG falsely stated that it did not provide valuation reports to certain of its customers when, in fact, it did and SFG

misrepresented the time frames in which valuation reports were actually provided to certain customers. (*Id.* ¶¶ 116, 118-120.) In addition, SFG represented to PPP that it exclusively used a non-party valuation and pricing service instead of PAS for many transactions; however, that too was false. (*Id.* ¶ 121.) SFG also knowingly misrepresented to PPP that it “always paid its bills,” which was materially false. (*Id.* ¶ 122.)

PPP requested an audit, as provided by the Agreement. (*Id.* ¶¶ 123, 124.) However, according to PPP, SFG delayed for months and ultimately refused to allow an audit, at which point PPP terminated the Agreement in June 2018. (*Id.* ¶¶ 125-131.)

PPP filed this action alleging breach of contract (Counts I and II), fraud and fraudulent inducement (Count III), unjust enrichment (Count IV), and aiding and abetting fraud (Count V).

Discussion

On a motion to dismiss pursuant to CPLR 3211 (a) (7), the court must “accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory.” (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994].) The court is not called upon to determine the truth of the allegations. (*See Campaign for Fiscal Equity v State of New York*, 86 NY2d 307, 318 [1995].) The court is required to “afford the pleadings a liberal construction.” (*Major League Soccer, L.L.C. v Fed. Ins. Co.*, 45 Misc 3d 1211(A), 2014 NY Slip Op 51538[U], *2 [Sup Ct, NY County 2014].) “The court’s role is limited to determining whether the pleading states a cause of action,

not whether there is evidentiary support to establish a meritorious cause of action.” (*Id.* citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977].)

Piercing the Corporate Veil

As a preliminary matter, the court finds that PPP’s allegations supporting its effort to pierce Syncora’s corporate veil are insufficient. PPP asserts a veil piercing theory in the first, second, third, and fourth causes of action against Syncora. Generally, “a corporation exists independently of its owners, who are not personally liable for its obligations.” (*East Hampton Union Free School Dist. v Sandpebble Bldrs., Inc.*, 66 AD3d 122, 126 [2d Dept 2009], *affd* 16 NY3d 775 [2011].) “The concept of piercing the corporate veil is an exception to this general rule, permitting, in certain circumstances, the imposition of personal liability on owners for the obligations of their corporation.” (*Id.*) “A plaintiff seeking to pierce the corporate veil must demonstrate that a court in equity should intervene because the owners of the corporation exercised complete domination over it in the transaction at issue and, in doing so, abused the privilege of doing business in the corporate form, thereby perpetrating a wrong that resulted in injury to the plaintiff.” (*Id.*)

“The party seeking to pierce the corporate veil must establish that the owners, through their domination, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against that party such that a court in equity will intervene.” (*Matter of Morris v New York State Dept. of Taxation & Fin.*, 82 NY2d 135, 140, 142 [1993].)

“In determining the question of control, courts have considered factors such as the disregards of corporate formalities; inadequate capitalization; intermingling of funds; overlap in ownership, officers, directors and personnel; common office space or telephone numbers; the degree of discretion demonstrated by the alleged dominated corporation; whether the corporations are treated as independent profit centers; and the payment of guarantee of the corporation's debts by the dominating entity ... [n]o factor is dispositive.”

(*Tap Holdings, LLC v Orix Fin. Corp.*, 109 AD3d 167, 174 [1st Dep't 2013][internal citation omitted].) To successfully plead veil-piercing, plaintiff must state facts “with the requisite ‘particularized statements detailing fraud or other corporate misconduct.’”

(*Sheridan Broadcasting Corp. v Small*, 19 AD3d 331, 332 [1st Dep't 2005].) Indeed, CPLR 3016 (b)'s “more stringent standard of pleading” applies. (*CIFG Assur. N. Am., Inc. v J.P. Morgan Sec. LLC*, 146 AD3d 60, 63 [1st Dep't 2016] [internal citation omitted].) Thus, to survive dismissal, PPP's veil-piercing and fraud claims must be pleaded with “particularity.” (*Sheridan Broadcasting Corp.*, 19 AD3d 331, 332.)

In accordance with New York's choice of law principles, “[t]he question of whether defendants' corporate veils should be pierced will be determined by the laws of each defendant's state of incorporation.” (*FLAME S.A. v Worldlink Intl (Holding) Ltd.*, 107 AD3d 436, 438 [1st Dep't 2013] [internal citation omitted], *lv denied* 22 NY3d 855 [2013].) Because SGI, SHU, SIH and SHL are incorporated in three different jurisdictions—New York, Delaware, and Bermuda—the adequacy of PPP's allegations must be evaluated under three different legal standards. (*Id.*) However, regardless of which jurisdiction's law is applied, PPP's allegations are substantively insufficient.

PPP's alter ego allegations include the following:

- Since on or about January 8, 2015, the Syncora Entities have completely dominated and controlled SFG such that the Syncora

Entities and SFG operate as a single business enterprise. (NYSCEF 1, Complaint, ¶¶ 4, 40-41.)

- The Syncora Entities moved SFG from South Orange, New Jersey, where it had been located, to the Syncora Entities' New York headquarters, and SFG and the Syncora Entities have shared an office since that time. (*Id.* ¶ 46.)
- SFG and the Syncora Entities share telephone numbers. (*Id.*)
- SFG and the Syncora Entities are represented by the same legal counsel. (*Id.* ¶ 47.)
- SFG and the Syncora Entities do not deal at arm's length, they are not treated as independent profit centers and SFG's property has been used by the Syncora Entities as if it were its own. (*Id.* ¶¶ 50-52.)
- There is an overlap of ownership, officers, directors and personnel between SFG and the Syncora Entities. For example, Frederick Hnat is both the President and CEO of SGI and sits on the board of SFG. Scott Beinhacker is both the Head of Investor Relations for Syncora Holdings and Chief Operating Officer of SFG. (*Id.* ¶ 45.)
- SFG is a mere instrumentality of the Syncora Entities. (*Id.* ¶¶ 42, 141.) For example, PPP received a 2017 Form 1099-MISC, which lists both SGI and 'Swap Financial LLC' together as the "Payee" of [PPP], with SGI's Federal Tax Identification Number listed. (*Id.* ¶ 49.)
- In January 2015 [PPP] was directed to begin sending its bills and queries regarding the SFG Agreement to Scott Beinhacker and Brian Molloy, both of Syncora. (*Id.* ¶ 54.)
- In January 2015, [PPP] was instructed to send a W-9 to Syncora, which likely was requested so that [PPP] could be entered into the Syncora Entities' accounting system and Syncora could pay [PPP's] bills. (*Id.* ¶ 53.)
- In April 2015, Mr. Beinhacker reached out to the CFO of [PPP], telling him that he worked for Syncora and that he wished to renegotiate the Agreement and requested a price reduction. (*Id.* ¶¶ 55, 56, 59, 65.) There is an absence of corporate formalities at SFG such that its corporate existence has become one and the same with the Syncora Entities.

(*Id.* ¶ 43.)

- Email correspondence related to SFG and the Agreement were sent to PPP from Syncora email addresses.

(*Id.* ¶ 48; see also ¶¶ 66, 67.)

(NYSCEF 31, PPP Memo of Law in Opposition to SWAP's Motion to Dismiss, 11-12.)

This is simply not enough. Although PPP offers many facts, it fails to offer particularized facts to show that Syncora both completely dominated SFG and did so for the purpose of committing the alleged fraud, as it must under New York law. Using piercing terminology such as “mere instrumentality” and “completely dominated and controlled” without any supporting facts is insufficient. Likewise, PPP fails under Delaware and Bermuda law. PPP must allege that SFG was a sham used for no purpose other than to commit fraud, but PPP makes no such allegation.

Accordingly, the alter ego claims against Syncora are dismissed.

Breach of Contract

In the first cause of action (NYSCEF 1, Complaint ¶¶ 133-145), PPP alleges breach of contract for underpayment of quarterly revenue fees against SFG. In the second cause of action (*id.* ¶¶ 146-154), PPP alleges breach of contract for failure to submit to an audit against SFG. “The elements of a breach of contract claim are formation of a contract between the parties, performance by the plaintiff, the defendant’s failure to perform, and resulting damage.” (*Flomenbaum v New York Univ.*, 71 AD3d 80, 91 [1st Dep’t 2009].) SFG does not challenge that PPP and SFG have a contract and that PPP has alleged a breach. However, SFG asserts that PPP fails to allege damages arising from the breach alleged in the second claim for breach of contract arising from the failed audit. Indeed, SFG insists that PPP cannot allege damages

because an audit would simply quantify the damages and the audit never occurred, in any case.

In Count 2, PPP alleges the following damages:

“As a result of Defendants’ breach of the Agreement, Principia has been damaged, as it has been unable to protect its rights through an audit of the full extent of SFG’s incorrect reporting as provided under the Agreement. Principia is entitled to recover from SFG the costs required to investigate and uncover SFG’s underreporting of revenue, including but not limited to the costs that were incurred in this and any related actions, given SFG’s refusal to submit to an audit. (NYSCEF 1, Complaint ¶¶ 153-154.)

Indeed, the audit provision in the Agreement provides for reimbursement of Principia’s “costs and expenses” where SFG underreports revenue by more than 10% in any quarter. (NYSCEF 2, Agreement § 3.5.) The alleged damages are real, unlike the potential tax penalties asserted in *Vista Food Exchange, Incorporated. v BenefitMall* (138 AD3d 535, 536 [1st Dept 2016] *lv denied* 28 NY3d 902 [2016]), a case cited by SFG. At this stage, on a motion to dismiss, PPP’s allegations are sufficient to state damages.

Fraud

In the third cause of action (NYSCEF 1, Complaint ¶¶ 155-195), PPP alleges fraud against SFG and Syncora, directly and as alter egos, because the Quarterly Reports, and defendants’ statements concerning the Quarterly Reports, were inaccurate. “The elements of a cause of action for fraud require 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].) Each element of fraud must be plead with particularity pursuant to CPLR 3016 (b). (*See id.*)

Here, the alleged misrepresentations are that SFG failed to disclose all relevant revenue and lied about using a different vendor. For the following reasons, the court finds that these allegations are not collateral or extraneous to the Agreement but rather directly flow from the Agreement.

As to Syncora, PPP alleges: Syncora knew that its statements were fraudulent. PPP argues that the facts supporting its piercing theory also support an inference that Syncora was not merely a passive investor in the background. Rather, Syncora was allegedly an active and involved participant that took a dynamic roll in the management of SFG generally, and the Agreement specifically, suggesting Syncora's knowledge of fraud. However, PPP's alter ego theory is rejected as explained above. For the same reasons, the court rejects PPP's proposed inference.

A party is permitted to plead parallel fraud and contract claims if it can: "(i) demonstrate a legal duty separate from the duty to perform under the contract; or (ii) demonstrate a fraudulent misrepresentation collateral or extraneous to the contract; or (iii) seek special damages that are caused by the misrepresentation and unrecoverable as contract damages." (*Bridgestone/Firestone, Inc. v Recovery Credit Servs.*, 98 F3d 13, 20 [2d Cir 1996] [internal citations omitted].)

The Quarterly Reports were a contractual requirement. (NYSCEF 1, Complaint ¶ 27.) It was therefore a breach of the contract for the Quarterly Reports, and thus the Quarterly Revenue Fees, to allegedly be inaccurate. (*Id.* ¶ 140.) There is simply no duty extraneous to the contract at issue.

Likewise, PPP cannot maintain a fraud claim premised upon the defendant's concealment of a breach of contract. (See *MBW Adv. Network. v Century Bus. Credit Corp.*, 173 AD2d 306, 306 [1st Dep't 1991].)

PPP's reliance on *Kosowsky v Willard Mountain Inc.* (90 AD3d 1127, 1129 [3d Dep't 2011]) for the proposition that SFG had an independent duty of candor is misplaced because that case involved superior knowledge of the defendant that was unavailable to the plaintiffs. However, here PPP had the right to audit SFG's Quarterly Reports twice per year. (NYSCEF 1, Complaint ¶ 32.) Plaintiff attempted to exercise its right to an audit once, on March 6, 2018, but when SFG refused the audit, PPP terminated the Agreement. (*Id.* at ¶¶ 7, 9.)

Unlike *Kosowsky*, in which the defendant created an elaborate scheme to conceal its revenue, PPP learned of SFG's alleged errors through SFG's concurrent disclosures and comparing SFG's web site to its reports. (See *id.* ¶¶ 79, 80.) Here, most if any all of the pieces of information, albeit in different places, were provided to PPP except the amount of revenue SFG received from its clients.

PPP's fraud claim also fails for failure to factually support any special damages flowing from fraud. PPP alleges that PPP lost key market opportunities because SFG's fraud has concealed from PPP the scope of the derivatives advisors' market. (NYSCEF 1, Complaint ¶ 191.) PPP also alleges reputational harm because customers and competitors have become aware that one of PPP's major clients was stealing millions of dollars of earnings through a scheme. (*Id.*) Additionally, PPP alleges diminution in the esteem in which the PAS system has been held in the industry, as it is now apparent that dozens or hundreds of customers were given access to PAS without PPP receiving

any compensation. (*Id.*) Damages are not plead with sufficient particularity if plaintiff speculates concerning the causal connection between the tort and the harm—the plaintiff must plead (i) the precise harm, (ii) the cause, and (iii) specifically connect the two. (*Morrison v National Broadcasting Co.*, 19 NY2d 453, 458 [1967].) However, reputational harm cannot be plead based on mere surmise. (*Rager v McCloskey*, 305 NY 75, 81 [1953].) This is particularly true in a fraud case where reputational damages are alleged. (*See Rather v CBS Corp.*, 68 AD3d 49 [1st Dept 2009], *lv to appeal denied*, 13 NY3d 715 [2010].) PPP fails to allege one fact to support its assertion of actual damages to its reputation.

The third cause of action is dismissed in its entirety.

Unjust Enrichment

In the fourth cause of action (NYSCEF 1, Complaint ¶¶196-203), PPP alleges unjust enrichment against SFG. “The existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter.” (*Clark-Fitzpatrick, Inc. v Long Is. R. R. Co.* 70 NY2d 382, 388 [1987]).

“The essential inquiry in any action for unjust enrichment ... is whether it is against equity and good conscience to permit the defendant to retain what is sought to be recovered.’ A plaintiff must show ‘that (1) the other party was enriched, (2) at that party’s expense, and (3) that ‘it is against equity and good conscience to permit [the other party] to retain what is sought to be recovered’”

(*Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 182 [2011] [internal citations omitted].) Here, the breach of contract claim against SFG precludes this claim.

The fourth cause of action is dismissed in its entirety.

Aiding and Abetting Fraud

In the fifth cause of action (NYSCEF 1, Complaint ¶¶ 204-211), PPP alleges aiding and abetting fraud against Syncora. In light of the dismissal of the fourth cause of action for fraud, the claim for aiding and abetting fraud must be dismissed too.

The court has considered the parties' remaining arguments and finds them unavailing without merits or otherwise not requiring an alternate result.

Accordingly, it is

ORDERED that the action is dismissed against defendants Syncora Investment Holdings LLC, Syncora Guarantee Inc., Syncora Holdings US Inc. and Syncora Holdings LTD in its entirety with costs and disbursements to these defendants as taxed by the County Clerk, and the Clerk is directed to enter judgment; and it is further

ORDERED that the third and fourth causes of action are dismissed against SWAP Financial Group, LLC and the action otherwise continues; and it is further

ORDERED that the action is severed and continued against the remaining defendant SWAP Financial Group, LLC (SFG); and it is further

ORDERED that the caption be amended to reflect the dismissal and that all future papers filed with the court bear the amended caption; and it is further

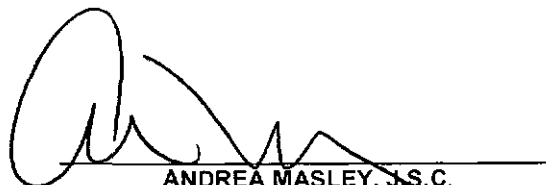
ORDERED that counsel for movants shall serve a copy of this order with notice of entry upon the County Clerk and the Clerk of the Trial Support Office, in accordance with the procedures set forth in the Protocol on Courthouse and County Clerk Procedures for Electronically Filed Cases, who are directed to mark the court's records to reflect the change in the caption herein.

ORDERED that any stays on discovery are lifted; and it is further

ORDERED that the parties shall notify the court every 30 days from the date of this order as to their discovery progress. If court intervention is needed, the parties may request a conference by contacting the court at SFC-Part48@nycourts.gov.

Motion Seq. No. 01:

5/8/2020
DATE


ANDREA MASLEY, J.S.C.

CHECK ONE:

CASE DISPOSED
GRANTED DENIED
SETTLE ORDER
INCLUDES TRANSFER/REASSIGN

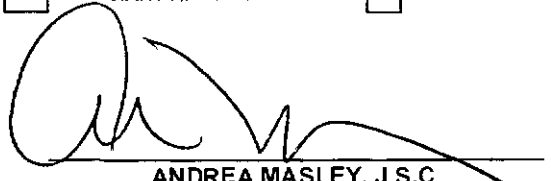
NON-FINAL DISPOSITION
GRANTED IN PART OTHER
SUBMIT ORDER
FIDUCIARY APPOINTMENT REFERENCE

APPLICATION:

CHECK IF APPROPRIATE:

Motion Seq. No. 02:

5/8/2020
DATE


ANDREA MASLEY, J.S.C.

CHECK ONE:

CASE DISPOSED
GRANTED DENIED
SETTLE ORDER
INCLUDES TRANSFER/REASSIGN

NON-FINAL DISPOSITION
GRANTED IN PART OTHER
SUBMIT ORDER
FIDUCIARY APPDINTMENT REFERENCE

APPLICATION:

CHECK IF APPROPRIATE: