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

PRESENT: BARBARA R. KAPNICK PART 39

Index Number : 600573/2009
DIAMOND, DAVID J
vs
ERNST & YOUNG LLP
Sequence Number : 001
DISMISS ACTION

INDEX NO. 600573/09
MOTION DATE
MOTION SEQ. NO. 001
MOTION CAL. NO.

The following papers, numbered 1 to ____ were read on this motion to/for ____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 7/14/11

BARBARA R. KAPNICK J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 39

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DAVID J. DIAMOND, as Liquidating Trustee of the Bricolage Capital LLC Liquidating Trust,

Plaintiff,

- against-

ERNST & YOUNG LLP,

Defendant.

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DECISION/ORDER
Index No. 600573/09
Motion Seq. No. 001

BARBARA R. KAPNICK, J.:

Defendant Ernst & Young LLP ("E&Y") moves, pursuant to CPLR 3211(a)(5)(a)(7), and CPLR 3016(b), to dismiss the Complaint.

BACKGROUND

According to the Complaint, Bricolage Capital LLC ("Bricolage") was a Registered Investment Advisor which provided investment advice to individuals, S-corporations, partnerships, trusts and limited liability companies, and also executed trades on behalf of such persons and entities (Complaint, ¶ 7). Bricolage never employed a tax attorney to work on its PICO transactions (discussed further *infra*) or a certified public accountant until 2001 but, allegedly, relied exclusively on outside financial and tax advisors (Complaint, ¶¶ 8-9). Further, Bricolage asserts that it never provided tax advice to its clients, but, like every other

investment advisor, took tax consequences into consideration in managing client assets (Complaint, ¶ 10.)

In early 2000, Bricolage began working with E&Y and the law firm of Arnold & Porter ("A&P") on a concept called a Personal Investment Corporation ("PICO"),[1] allegedly entering into an oral joint venture with E&Y and A&P to develop and structure PICO (Complaint, ¶¶ 15-16). Bricolage contends that it relied on the special knowledge and expertise of E&Y and A&P to determine whether PICO had to be registered with the Internal Revenue Service ("IRS") as a tax shelter, and to structure PICO so that it complied with the appropriate provisions of the Internal Revenue Code ("IRC"). (*Id.*, ¶ 16).

In the Complaint, Bricolage alleges that E&Y took the lead in marketing PICO, and that both E&Y and A&P determined and represented to Bricolage that PICO did not need to be registered as a tax shelter, pursuant to section 6111 of the IRC (Complaint, ¶¶ 17, 20). Specifically, Bricolage asserts that in late August or early September of 2000, E&Y, through Robert Coplan ("Coplan") and/or Richard Shapiro ("Shapiro"), represented to A&P that PICO

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[1] The term "PICO" applies to all such investment vehicles, but, for the purposes of this decision, "PICO" is used to denote the specific investment that is the subject of this lawsuit.

did not have to be registered with the IRS, and that PICO was structured in a conservative manner (*Id.*)

Bricolage maintains that throughout the development of PICO, Bricolage, E&Y and A&P, as alleged joint venturers, worked together to determine whether PICO was a tax shelter (Complaint, ¶ 23). Bricolage states that numerous telephone calls and e-mails were exchanged between E&Y and A&P during this period, with respect to the registration of PICO, and discussing, among other things, redemption of stock. Bricolage insists that, through Coplan and Shapiro, E&Y conveyed to A&P that PICO was structured in a conservative manner and did not need to be registered (Complaint, ¶ 24).

On or about May 20, 2000, Bricolage received a draft opinion letter from A&P, which it forwarded to E&Y for input, allegedly relying on E&Y's expertise (Complaint, ¶ 25). On August 22, 2000, Shapiro, then a partner at E&Y, e-mailed Bricolage stating: "One other item we need to come to closure very soon is the question of shelter registration. In reality, EY and Arnold & Porter need to agree on this." (Complaint, ¶ 26). Shortly thereafter, E&Y and A&P agreed that PICO did not need to be registered (Complaint, ¶ 27).

Bricolage maintains that E&Y should have known, because of its expertise, that the conclusion that PICO did not have to register was incorrect, and it should have been structured differently to comport with the IRC (Complaint, ¶ 28).

The Complaint goes on to state that in the late fall of 2000, after the deadline allegedly set by E&Y and A&P for PICO transactions to begin for that year, E&Y informed A&P and Bricolage that it had located an additional investor for PICO. A&P, however, informed E&Y and Bricolage that it would not be able to write an opinion for this potential investor for several reasons, including the fact that A&P was not comfortable with the number of trading days PICO would have before the end of the year. Allegedly, E&Y asked Bricolage whether it would participate in this particular transaction if E&Y could locate another law firm to write an opinion for this investor, and Bricolage, asserting that it relied on E&Y's expertise and prior opinion that PICO did not need to be registered, agreed to that transaction (Complaint, ¶ 31).

In or about December, 2001, the IRS announced a program under which taxpayers who had engaged in tax shelters could voluntarily disclose those transactions in exchange for amnesty from penalties that might otherwise be imposed if the IRS were to audit the transactions and determine an underpayment (Complaint, ¶ 32). E&Y

drafted a form letter to be sent to each of its clients that had invested in PICOs, advising them of the amnesty program and suggesting that they participate in the program, and also advised Bricolage that it was making that recommendation to its other clients (Complaint, ¶ 33).

In May of 2002, the IRS requested information from Bricolage and certain of its affiliates under section 6112 of the IRC, which provides that an organizer or seller of a "potentially abusive tax shelter" must maintain a list of investors in such shelter (Complaint, ¶ 36). On or about August 2, 2002, the IRS wrote to Bricolage notifying it that it was commencing an examination of Bricolage's list maintenance registration obligation (Complaint, ¶ 37). On or about February 24, 2005, based on its examination, the IRS informed Bricolage that PICO was required to be registered, and that the IRS was charging Bricolage with tax penalties for its allocable share in PICO, which was eventually determined to be $29,755,778.00, out of a total penalty of $92.3 million (Complaint, ¶¶ 38-39).

In large part as a result of the imposition of this penalty, legal fees it incurred in responding to numerous IRS summonses, as well as several investor lawsuits, on October 14, 2005, Bricolage filed a voluntary petition for relief under Chapter 11 of the

Bankruptcy Code (Complaint, ¶ 42). As of the date of the instant Complaint, Bricolage asserts that the aggregate value of PICO-related claims against Bricolage was in excess of $5.25 million (Complaint, ¶ 43). In addition, Bricolage claims that it spent in excess of $5 million responding to the IRS investigation and defending PICO and other transactions (Complaint, ¶ 46).

Four E&Y partners, including Coplan and Shapiro, were indicted in connection with PICO and other transactions, which were alleged to be fraudulent tax shelters, and were also charged with providing false information to the IRS and obstructing justice (Complaint, ¶ 47). The parties were eventually found guilty on May 8, 2009 (Complaint, ¶ 52). The Complaint states that, during the criminal trial, testimony revealed the following:

> *E&Y and A&P discussed on numerous occasions, particular Code sections that might be problematic and might result in PICO having to be registered:
> *E&Y participated extensively in the review, drafting and distribution of the opinion letter that might be provided to an investor in a PICO company;
> *E&Y repeatedly requested drafts of that opinion letter;
> *E&Y drafted a sample set of representations to be included in the opinion letter that would be provided to an investor in PICO;
> *Those sample set of representations were being used by E&Y in other transactions that E&Y had done, which transactions were later challenged by the IRS;
> *E&Y suggested that the vehicle for PICO be an S-Corporation;
> *E&Y discussed particular Code sections and technical tax issues with A&P;

*E&Y identified several legal issues that might be problematic for PICO and investors for PICO;
*E&Y conveyed legal cases to A&P that were relevant to structuring PICO and whether PICO had to be registered; and
*E&Y found and conveyed a law review article addressing a major issue relating to one of the Code provisions.

(Complaint, ¶ 50).

Additionally, the Complaint asserts that E&Y was required to pay over $15 million in fines and penalties relating to its oversight of the tax shelter program, and was required to change its way of doing business, including, but not limited to, the creation of a "Quality and Integrity" program (Complaint, ¶ 2).

The Complaint asserts five causes of action: (1) fraud, based on alleged misrepresentations and omissions of material fact made by E&Y; (2) breach of fiduciary duty, based on an oral joint venture agreement and Bricolage's reliance on E&Y's superior knowledge; (3) breach of the joint venture agreement and the covenant of good faith and fair dealing; (4) contribution for the $5.25 million in claims against Bricolage; and (5) common law indemnification for the $5.25 million in claims against Bricolage.

In support of the instant motion, E&Y has submitted copies of a motion filed by Bricolage in the bankruptcy proceeding pending in the Southern District of New York (Case No. 05-469914[JMP]), in

which Bricolage sought to compel examination and production of documents from A&P. In its motion, Bricolage states, in paragraph 32, that its actions relating to PICO "were based solely upon representations from Arnold & Porter." Additionally, E&Y provides a copy of a document entitled "Motion for Approval of Agreement Settling Controversy Pursuant to Bankruptcy Rule 9019," filed by Bricolage in the bankruptcy proceeding, which states, among other things, in paragraph 12 that "[b]ased upon the representations of Arnold & Porter, [Bricolage] did not register certain of the Investment Strategies to investors." Bricolage eventually released A&P in exchange for a payment of $3,050,000.00 and forgiveness of over $2 million in unpaid legal fees. E&Y further asserts that it has settled claims and obtained a good faith general release from 35 of the 36 investors in PICO who filed proofs of claim against Bricolage's bankruptcy estate.

DISCUSSION

CPLR 3211(a), governing motions to dismiss a cause of action, states that "[a] party may move for judgment dismissing one or more causes of action asserted against him on the ground that:

* * *

> (5) the cause of action may not be maintained because of ... release, ... statute of limitations, ...
>
> * * *
>
> (7) the pleading fails to state a cause of action, ..."

On a motion to dismiss pursuant to CPLR 3211, the pleading should be liberally construed, the facts alleged by the plaintiff should be accepted as true, and all inferences should be drawn in the plaintiff's favor, *Leon v Martinez*, 84 NY2d 83, 87 (1994); however, the Court must determine whether the alleged facts "fit within any cognizable legal theory." Id. at 87-88. Further, "[a]llegations consisting of bare legal conclusions ... are not presumed to be true [or] accorded every favorable inference [internal quotations marks and citation omitted]." *Biondi v Beekman Hill House Apt. Corp.*, 257 AD2d 76, 81 (1st Dep't 1999), aff'd 94 NY2d 659 (2000).

Fraud

CPLR 3016 (b) provides that "[w]here a cause of action or defense is based on misrepresentation, fraud, mistake, wilful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail."

> The purpose of section 3016(b)'s pleading requirements is to inform a defendant with respect to the incidents complained of. We have cautioned that section 3016(b) should not be so strictly interpreted "as to prevent an otherwise valid cause of action in situations where it may be 'impossible to state in detail the circumstances constituting a fraud.'" (citations omitted). Thus, where concrete facts "are particularly within the knowledge of the party" charged with the fraud (citation omitted), it would work a potentially unnecessary injustice to dismiss

> a case at an early stage where any pleading deficiency might be cured later in the proceedings (citations omitted).

Pludeman v Northern Leasing Systems, Inc., 10 NY3d 486, 491-492 (2008).

> Although there is certainly no requirement of "unassailable proof" at the pleading stage, the complaint must "allege the basic facts to establish the elements of the cause of action" (quoting *Pludeman, supra* at 492) ... CPLR 3016(b) is satisfied when the facts suffice to permit a "reasonable inference" of the alleged misconduct (*id.*). And, "in certain cases, less than plainly observable facts may be supplemented by the circumstances surrounding the alleged fraud" (quoting *Pludeman, supra*).

Eurycleia Partners, LP v Seward & Kissel, LLP, 12 NY3d 553, 559 (2009).

"In order to state ... a cause of action [for fraud], a plaintiff must allege misrepresentation or concealment of a material fact, falsity, scienter by the wrongdoer, justifiable reliance on the deception, and resulting injury." *Waggoner v Caruso*, 68 AD3d 1, 4 (1st Dep't 2009), *aff'd* 14 NY3d 874 (2010).

In support of its motion to dismiss the fraud claim, E&Y argues that Bricolage fails to articulate an actionable cause of action for fraud for the following reasons: the Complaint (1) fails to plead any actionable misrepresentation; (2) fails to plead that

E&Y intended to defraud Bricolage; (3) fails to plead that Bricolage justifiably relied on E&Y's statements; and (4) does not articulate how E&Y caused Bricolage any damages.

In the first instance, E&Y argues that the statements attributed to it are mere opinions as to the tax consequences of PICO and, as such, do not constitute misstatements or concealment of material facts. It is true that "opinions...puffery [and] ultimately unfulfilled promises" are not actionable as fraud. *Jacobs v Lewis*, 261 AD2d 127, 128 (1st Dep't 1999). However, in making this argument, E&Y is only addressing the allegations appearing in the first part of the Complaint. As indicated above, the Complaint goes on to point out that Coplan and Shapiro, E&Y principals, were indicted and convicted of providing false information to the IRS with respect to tax shelters, and E&Y itself was required to pay fines and penalties with respect to its tax shelter programs. Although certainly not conclusive evidence of E&Y having misrepresented the facts upon which it based its opinion regarding the registration of PICO, at this initial point in the proceedings, it does raise a reasonable inference of misconduct. Further, Bricolage need not "produce evidence at this stage of the proceedings to support its contentions as to what [E&Y] knew about the true [registration requirement]." *P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V.*, 301 AD2d 373, 377 (1st Dep't 2003).

The Court also finds E&Y's second contention that the Complaint fails to plead scienter on the part of E&Y with respect to its statements, unpersuasive. The Complaint, by alleging Coplan's and Shapiro's criminal convictions and the fines and penalties imposed on E&Y for its tax shelter actions, provides "a rational basis for inferring that the alleged misrepresentation ... was knowingly made [internal quotation marks and citation omitted]." *Knight Sec. v Fiduciary Trust Co.*, 5 AD3d 172, 173 (1st Dep't 2004).

E&Y also argues that Bricolage cannot maintain a fraud action when the alleged misstatements were made to A&P, not Bricolage. However,

> New York law does permit recovery for misrepresentations made to third parties under limited circumstances. ... [T]o recover in New York for misrepresentations made to a third party, the plaintiff must establish that he or she relied to his or her detriment on the misrepresentations and that the defendant intended those misrepresentations to be communicated to the plaintiff [internal citation and quotation marks omitted].

Arnold Chevrolet LLC v Tribune Company, Newsday, Inc., 418 F Supp 2d 172, 189 (ED NY 2006).

It is clear from the pleadings that E&Y both knew and intended that the statements it made to A&P were to be communicated to

Bricolage for Bricolage to make its determination as to the appropriate structure for PICO. Therefore, this Court concludes that sufficient detail has been pled to provide a reasonable inference that E&Y intended its statements to be conveyed to Bricolage.

Moreover, the Court finds that the Complaint is replete with allegations that Bricolage relied on E&Y's statements. E&Y contends that, even if Bricolage were deemed to have relied on E&Y's statements, Bricolage had a duty to further scrutinize the statement, and, without such further inquiry, justifiable reliance cannot be found. *Elghanian v Harvey*, 249 AD2d 206 (1st Dep't 1998). Furthermore, E&Y points to Bricolage's papers filed in the bankruptcy proceeding in which Bricolage stated that it relied solely on representations of A&P. However, A&P was, to at least some extent, relying on representations made by E&Y, and the issue of reasonable reliance "[generally] implicates factual issues whose resolution would be inappropriate at this early stage [internal quotation marks and citation omitted]." *Knight Sec. v Fiduciary Trust Co., supra* at 173; *see also DDJ Mgt., LLC v Rhone Group L.L.C.*, 15 NY3d 147 (2010).

Finally, the Complaint alleges that, but for its reliance on E&Y's statements that PICO need not be registered, Bricolage would

have registered or restructured PICO, and, hence, would not have been assessed penalties by the IRS and sued by its investors. Such allegations are adequate to support the cause of action for fraud. Therefore, based on the allegations appearing in the Complaint, this Court concludes that Bricolage has met its burden at the pleading stage so as to withstand E&Y's motion to dismiss the first cause of action for fraud.

Breach of Fiduciary Duty and Breach of the Joint Venture Agreement/Covenant of Good Faith and Fair Dealing

The Complaint alleges a fiduciary relationship between Bricolage and E&Y as joint venturers, based on an alleged oral joint venture agreement.

"A joint venture is an association of two or more persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, effects, skill and knowledge [internal quotation marks and citation omitted]." *Kaufman v Torkan*, 51 AD3d 977, 979 (2nd Dep't 2008). To establish a claim of breach of a joint venture, Bricolage must sufficiently set forth facts to establish its contribution of property, skills, or control over the venture or a sharing of possible financial losses.

> The ultimate inquiry is whether the parties have so joined their property, interests, skills and risks that for the purpose of the particular adventure their respective contributions have become as one and the commingled property and interests of the parties have thereby been made subject to each of the associates of the trust and inducement that each act would act for their joint benefit [internal quotation marks and citation omitted].

Matter of Steinbeck v Gerosa, 4 NY2d 302, 317 (1958), *appeal dism.* 358 US 39 (1958).

In the case at bar, Bricolage merely alleges that it, E&Y and A&P had an oral joint venture agreement, but other specifics of that alleged relationship have not been stated. Bricolage makes reference to PowerPoint presentations prepared by E&Y and made to potential investors in PICO, one slide of which is included in paragraph 17 of the Complaint. However, this slide was actually put into the Complaint at a point where plaintiff was alleging that it was E&Y that was to provide tax advice as to PICO and that Bricolage had no role in the tax issues. Moreover, this slide makes reference to parties other than E&Y and A&P, namely Proskauer Rose and an unnamed "Bank/Custodian" who would execute the trade and maintain the accounts, yet they are not alleged to be part of the joint venture.

There is no indication that Bricolage, A&P and E&Y held themselves out as a single venture or "so joined their property,

skills and risks that for the purpose of the particular adventure their respective contributions have become as one." *Matter of Steinbeck v Gerosa, supra* at 317. The allegation that each party received a share of the PICO profits only supports the fact that each party contributed its own expertise (investment and trading advice, tax advice and legal advice) and was paid for their individual contributions.

Bricolage has "failed to sufficiently set forth facts to establish such elements as [the parties]' contribution of property, skills, etc., control over the venture or a sharing of possible financial losses." *Langer v Dadabhoy*, 44 AD3d 425, 426 (1st Dep't 2007). Given this Court's finding that inadequate facts have been alleged to maintain a cause of action for breach of a joint venture agreement, Bricolage's argument that E&Y breached its fiduciary duty pursuant to this joint venture agreement must also fail.

Therefore, that portion of E&Y's motion to dismiss the second and third causes of action is granted.

Contribution and Indemnification

E&Y argues that the last two causes of action for contribution and indemnification are barred by General Obligations Law ("GOL")

15-108 and fail to state a claim. GOL 15-108 provides in relevant part that:

> (b) Release of tortfeasor. A release given in good faith by the injured person to one tortfeasor ... relieves him from liability to any other person for contribution as provided in article fourteen of the civil practice law and rules.
>
> (c) A tortfeasor who has not obtained his own release from liability shall not be entitled to contribution from any other person.

E&Y argues that because it has obtained releases for PICO-related claims from Bricolage's investors, it is not subject to a claim of contribution from Bricolage for the same injuries.

Bricolage asserts, in the first instance, that E&Y's motion is procedurally defective because it does not contain actual copies of all the releases but merely relies on an attorney's affidavit which plaintiff claims "purports" to selectively quote from those releases. In support of this contention, Bricolage cites *Tsimerman v Janoff*, 40 AD3d 242 (1st Dep't 2007) in which the actual documents were required to support a motion to dismiss a complaint based on documentary evidence, pursuant to CPLR 3211 (a)(1).

Bricolage also argues that GOL 15-108(C) does not apply here because Bricolage is not a co-tortfeasor with E&Y, but rather a victim of E&Y's torts.

In reply, E&Y argues that even if Bricolage were an innocent victim, as it now claims, it could not bring a claim for contribution at all, because a claim for contribution is, at its core, a claim between co-tortfeasors. *See Trump Vil. Section 3 v New York State Hous. Fin. Agency*, 307 AD2d 891, 896-897 (1st Dep't 2003), *lv den* 1 NY3d 504 (2003).

Since this Court has not yet determined whether Bricolage is a co-tortfeasor with E&Y or a victim of a fraud perpetrated on it by E&Y as alleged in the Complaint, it would be premature to dismiss plaintiff's cause of action for contribution over and against E&Y at this time.

Finally, as to plaintiff's claim for indemnification,

> [i]n the absence of an express agreement to indemnify, an obligation to indemnify may be implied to prevent unjust enrichment. Since the predicate of common-law indemnity is vicarious liability without actual fault on the part of the proposed indemnitee, it follows that a party who has itself actually participated to some degree in the wrongdoing cannot receive the benefit of the doctrine [emphasis added] [internal quotation marks and citations omitted].

Broyhill Furniture Indus., Inc. v Hudson Furniture Galleries, LLC, 61 AD3d 554, 556 (1st Dep't 2009); *Trump Vil. Section 3 v New York State Hous. Fin. Agency, supra*.

Again, because plaintiff's fraud claim has survived E&Y's motion to dismiss, it would be premature to dismiss the cause of action for indemnification at this time.

CONCLUSION

Accordingly, Ernst & Young's motion to dismiss is granted only to the extent of dismissing the second and third causes of action of the Complaint. The first, fourth and fifth causes of action are severed and continued.

Defendant is directed to serve an Answer to the remaining causes of action in the Complaint within 30 days after proof of entry of a copy of this order is e-filed.

Counsel are directed to appear for a preliminary conference in IA Part 39, 60 Centre Street - Room 208 on September 14, 2011 at 10:00 a.m.

This constitutes the decision and order of this Court.

Dated: July 19, 2011

BARBARA R. KAPNICK
J.S.C.