SUPREME COURT, APPELLATE DIVISION
FIRST DEPARTMENT

JULY 16, 2013

THE COURT ANNOUNCES THE FOLLOWING DECISIONS:

Mazzarelli, J.P., Acosta, Renwick, Richter, Gische, JJ.

9736-
9737-
9738-
9739-
9740

Index 601621/09

New Hampshire Insurance Company, et al.,
Plaintiffs-Appellants,

-against-

MF Global, Inc.,
Defendant-Respondent.

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Chicago Mercantile Exchange Inc. and
Futures Industry Association,
Amici Curiae.

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Quinn Emanuel Urquhart & Sullivan, LLP, New York (Kathleen M. Sullivan of counsel), for New Hampshire Insurance Company, Vigilant Insurance Company, Certain Underwriters of Lloyds of London, etc., Fidelity & Deposit Company of Maryland, Continental Casualty Company, Liberty Mutual Insurance Company, Great American Insurance Company and Axis Reinsurance Company, appellants.

Frenkel Lambert Weiss Weisman & Gordon, LLP, New York (Arthur N. Lambert of counsel), for St. Paul Fire & Marine Insurance Company, appellant.

Covington & Burling LLP, New York (P. Benjamin Duke of counsel), for respondent.

Skadden, Arps, Slate, Meagher & Flom LLP, New York (Prashina J. Gagoomal of counsel), for amici curiae.

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Order, Supreme Court, New York County (Bernard J. Fried, J.), entered October 5, 2010, which denied plaintiffs' motion for summary judgment declaring that they are not obligated under their fidelity bonds to cover defendant's loss sustained as a result of certain trading activity, and, upon a search of the record, granted summary judgment to defendant, unanimously modified, on the law, to vacate the grant of summary judgment to defendant, to grant defendant partial summary judgment to the extent of declaring that defendant sustained a direct financial loss under the fidelity bonds, and otherwise affirmed, without costs. Appeal from order, same court and Justice, entered March 25, 2011, which, to the extent appealable, denied plaintiffs' motion for renewal, unanimously dismissed, without costs, as academic.

Defendant MF Global, Inc. is a commodities futures broker and is subject to the regulatory rules and oversight of the various exchanges on which it executes trades, including the Chicago Mercantile Exchange (CME). The CME is registered with, and must comply with regulations of, the United States Commodities Futures Trading Commission (CFTC). MF Global is a Clearing Member of the CME, and is approved to clear trades through the CME Clearing House. To maintain the integrity of the market, the CME Clearing House and Clearing Members such as MF

Global become effective counterparties on each trade placed. In other words, the CME Clearing House assumes the position of direct legal counterparty to MF Global on all futures contracts submitted by MF Global to the Clearing House.

In addition, as a Clearing Member, MF Global assumes complete responsibility for the financial obligations attendant to all trades and orders executed, and for all trading activity routed through its electronic trading systems. Thus, at the end of each trading day, or sometimes intraday, MF Global has to settle with the CME Clearing House for all losses on trades cleared through MF Global accounts, regardless of whether the customers initiating those trades are able to meet their payment obligations. This arrangement protects the market from risk of default by individual traders by transferring that risk to Clearing Members such as MF Global.

Plaintiff New Hampshire Insurance Company issued a fidelity bond to MF Global's predecessor company covering the policy period from April 30, 2007 to April 30, 2008. The remaining plaintiffs are insurance companies that issued excess bonds to MF Global that incorporated the terms of the primary bond.

In the bonds, plaintiffs agreed to indemnify MF Global for losses "sustained at any time for . . . any wrongful act committed by any employee . . . which is committed . . . with the intent to obtain financial gain for [the employee]" (emphasis omitted). "Loss" means "the direct financial loss sustained by [MF Global] as a result of any single act, single omission or single event, or a series of related or continuous acts, omissions or events." The bonds exclude coverage for "[i]ndirect or consequential loss." A "[w]rongful act," with respect to trading in commodities and futures, is defined as "any . . . dishonest . . . act committed with the intent to obtain improper financial gain for . . . an employee" (emphasis omitted).

Nonparty Evan Brent Dooley was a commodities broker associated with MF Global's Memphis, Tennessee office who was paid on a commission basis. During the evening of February 26, 2008, Dooley began trading commodities futures on the CME from his personal trading account using MF Global's electronic trading system. Dooley entered into a large number of "sell contracts," primarily for May wheat, and in doing so, exceeded his available margin credit. These "sell contracts" created an aggregate open position that would be liquidated when corresponding "buy contracts" were executed. If the price of May wheat decreased, the trades would be profitable, but if the price increased, a loss would ensue.

After trading resumed the next morning, the price of May wheat rose quickly, and Dooley liquidated his positions, sustaining a loss over $141 million. Because of the large amount, the CME Clearing House requested an intraday settlement to cover the loss. By midday on February 27, 2008, MF Global transferred approximately $150 million from its settlement bank to the CME Clearing House. MF Global recorded the $141 million loss on its books as a bad debt, and thereafter submitted a claim under the bonds. Plaintiffs denied coverage asserting, inter alia, that MF Global did not suffer a "direct financial loss" and that Dooley was not an "employee."

Plaintiffs brought this declaratory judgment action seeking a declaration that the bonds do not provide coverage for MF Global's loss. In moving for summary judgment, plaintiffs argued that MF Global did not sustain a "direct financial loss" under the terms of the bonds. MF Global opposed the motion, but did not cross-move for summary judgment. In an order entered October 5, 2010, the motion court denied plaintiffs' motion and, upon a search of the record, granted summary judgment to MF Global. Despite the fact that the parties did not brief the issue, the court concluded as a matter of law that Dooley was an "employee," as that term is defined in the bonds. The court subsequently denied plaintiffs' motion seeking, among other things, renewal. Plaintiffs now appeal.

The motion court properly concluded that MF Global's loss constituted a “direct financial loss.” Although that term is not defined in the bonds, “[a] direct loss for insurance purposes has been analogized with proximate cause” (*Aetna Cas. & Sur. Co. v Kidder, Peabody & Co.*, 246 AD2d 202, 209 [1st Dept 1998], *lv denied* 93 NY2d 805 [1999]; *see Sorrentino v Allcity Ins. Co.*, 229 AD2d 481, 482 [2d Dept 1996] [using proximate cause as test for determining whether insurance loss was a direct loss]; *Granchelli v Travelers Ins. Co.*, 167 AD2d 839, 839 [4th Dept 1990] [“Direct loss is equivalent to proximate cause”]; *see generally Tonkin v California Ins. Co. of San Francisco, Inc.*, 294 NY 326, 329 [1945]).

Here, Dooley’s conduct in making unauthorized trades beyond his margin was the direct and proximate cause of MF Global’s loss.[1] Dooley’s trading activity resulted in a near instantaneous shortfall for which MF Global, as a Clearing Member, was automatically and directly responsible. To ensure the integrity of the market, MF Global was obligated to promptly pay the CME Clearing House for the loss. In light of the immediacy of the payment, which was made only hours after the discovery of Dooley’s trading, and the regulatory scheme upon

[1] On appeal, plaintiffs do not challenge the motion court’s finding that Dooley committed a “wrongful act” with the intent to obtain a financial gain for himself.

which it was premised, MF Global’s loss cannot be fairly viewed as simply satisfying a contractual liability to the CME. Contrary to plaintiffs’ view, the payment to the CME is not a third-party loss for which MF Global is liable, but rather a direct loss to MF Global under the bonds.

Nor is there any record support for plaintiffs’ claim that multiple intervening events resulted in a “protracted causal chain” between Dooley’s trades and MF Global’s loss. This case is distinguishable from *Aetna Cas. & Sur. Co. v Kidder, Peabody & Co.* (246 AD2d 202). In *Aetna*, we addressed whether the fidelity bonds at issue covered litigation settlement payments made by Kidder Peabody to third-party investors who sustained losses as a result of insider trading schemes conducted by a Kidder Peabody employee (246 AD2d at 204-205). The settlement payments were made by Kidder Peabody years after the employee’s misconduct (*id.* at 205-206). We concluded that the settlements were not direct losses because they were not the direct result of the employee’s dishonest conduct (*id.* at 210). Instead, the losses stemmed from the employee’s misconduct, which caused pricing irregularities in the stock, which led to losses to the investors, which led to litigation, which concluded in a settlement years after the employee’s misconduct (*id.*).

No such attenuated chain exists here. Dooley’s improper trading did not result in harm to a third party that subsequently sought redress from MF Global. Rather, the effect of Dooley's actions was immediate and direct — MF Global bore the responsibility for the losses occurring on its trading system, and made good on those losses within hours of the misconduct. Furthermore, unlike the bonds in *Aetna*, the bonds here did not have an exclusion for trading losses. Instead, they expressly provide coverage for losses associated with trading of commodities and futures. Accordingly, because MF Global suffered a direct financial loss under the fidelity bonds, it is entitled to a declaration on that issue in its favor.

The motion court acted improvidently, however, in searching the record and determining as a matter of law that Dooley was an "employee" under the bonds. A court deciding a motion for summary judgment is empowered to search the record and may, even in the absence of a cross motion, grant summary judgment to a nonmoving party (*Horst v Brown*, 72 AD3d 434, 437 [1st Dept 2010], *appeal dismissed* 15 NY3d 743 [2010]; CPLR 3212[b]). Such power, however, is not boundless (*Dunham v Hilco Constr. Co.*, 89 NY2d 425, 429 [1996]), and the court's search of the record is limited to those causes of action or issues that are the subject of the motion (*Castlepoint Ins. Co. v Moore*, 105 AD3d 472, 474 [1st Dept 2013]; *Filannino v Triborough Bridge & Tunnel Auth.*, 34 AD3d 280, 281 [1st Dept 2006], *appeal dismissed* 9 NY3d 862 [2007]).

Contrary to the motion court's finding, plaintiffs did not relinquish their claim that Dooley is not an employee when they initially moved for summary judgment. Plaintiffs' motion raised only the issue of direct financial loss, a discrete defense to coverage, and did not address the separate coverage defense of Dooley's employment status. Nor did MF Global cross-move for summary judgment, or otherwise seek a declaration that Dooley was its employee. Moreover, discovery in this matter was not complete at the time the court searched the record. Thus, in this case, it was premature for the court to grant MF Global summary judgment on the employee issue (*see Baseball Off. of Commr. v Marsh & McLennan*, 295 AD2d 73, 82 [1st Dept 2002]).

In any event, neither the submissions on the original motion, nor on the motion to renew, establish as a matter of law that Dooley was MF Global's employee, as that term is defined in the bonds. As relevant here, the bonds define an employee as (i) a person under an implied contract of employment or services with the insured; (ii) a person working under the direct control and supervision of the insured; or (iii) a person who is paid by the insured under their payroll system. Notably, the bonds contain an exception to these categories stating that "[t]he term employee does not mean any independent broker . . . remunerated on a sales or commission basis unless specifically agreed by the insurer and endorsed to this bond" (emphasis omitted).

Issues of fact exist as to whether Dooley qualified as an employee under these definitions. There is no dispute that Dooley did not receive a regular salary from MF Global, but instead was paid on a commission basis. All payments to Dooley were recorded on a 1099 Form, not a W-2 (*see Belt v Girgis*, 55 AD3d 645, 646-647 [2d Dept 2008] [issuance of Form 1099 was proof that individual was an independent contractor]). Thus, there are factual questions as to whether Dooley fell within the "independent broker" exception contained in the bonds.

Even if this exception did not apply, it cannot be said as a matter of law that Dooley worked under the direct control and supervision of MF Global. No evidence was presented as to who, if anyone, supervised Dooley, or in what capacity. MF Global argues that pursuant to CFTC regulations, Dooley was an "associated person" of MF Global, and that MF Global was obligated to supervise his trading activity. Although this is evidence of the requisite control and supervision, it is insufficient to determine that issue as a matter of law.

Finally, any determination of Dooley's status as an employee is premature in the absence of further discovery. Because the motion court improperly decided this issue without notice to the parties, plaintiffs were deprived of the opportunity to conduct discovery (*see Baseball Office*, 295 AD2d at 82 [error for court to grant summary judgment on issue as to which the evidence had not yet been fully developed]). Thus, principles of fairness dictate that plaintiffs should have discovery on matters underlying the employment question.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 16, 2013

CLERK

Andrias, J.P., Moskowitz, Freedman, Manzanet-Daniels, Feinman, JJ.

9790 Elizabeth Frances Kerrigan, as Executrix of the Estate of Thomas Connelly, deceased,
Plaintiff-Appellant,

Index 109042/04
591138/04
590316/05
590317/05
590170/06
590112/06

-against-

TDX Construction Corporation, sued herein as TDX Construction Corp., et al.,
Defendants-Respondents,

Bay Crane Service, Inc., et al.,
Defendants.

- - - - -

JEM Erectors, Inc.,
Third-Party Plaintiff,

-against-

Erin Erectors, Inc.,
Third-Party Defendant-Respondent.

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TDX Construction Corporation, et al.,
Fourth-Party Plaintiffs-Respondents,

-against-

Beton Prefabriques Dulac, Inc.,
Fourth-Party Defendant,

Erin Erectors, Inc.,
Fourth-Party Defendant-Respondent.

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TDX Construction Corporation, et al.,
Fifth-Party Plaintiffs-Respondents,

-against-

Elizabeth Frances Kerrigan, as Executrix of the Estate of Thomas Connelly, deceased,
Fifth-Party Defendant-Respondent.

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JEM Erectors, Inc.,
Sixth-Party Plaintiff,

-against-

Erin Interiors, Inc.,
Sixth-Party Defendant-Respondent.
- - - - -
Elizabeth Frances Kerrigan,
as Executrix of the Estate
of Thomas Connelly, deceased,
Seventh-Party Plaintiff-Respondent,

-against-

Genie Industries, et al.,
Seventh-Party Defendants-Respondents.

Sullivan Papain Block McGrath & Cannavo, New York (Brian J. Shoot of counsel), for appellant/respondent.

O'Connor, O'Connor, Hintz & Deveney, LLP, Melville (Brian T. Deveney of counsel), for TDX Construction Corporation and The Trustees of Columbia University in the City of New York, respondents.

DeCicco, Gibbons & McNamara, P.C., New York (Joseph T. Gibbons of counsel), for Koenig Iron Works, Inc., respondent.

Coughlin Duffy LLP, New York (Justin N. Kinney of counsel), for Erin Erectors, Inc. and Erin Interiors, Inc., respondents.

Gallagher, Walker, Bianco & Plastaras, Mineola (Robert J. Walker of counsel), for Genie Industries, respondent.

Harris Beach, PLLC, New York (Brian A. Bender of counsel), for United Rentals, respondent.

Law Offices of Charles J. Siegel, New York (Peter E. Vairo of counsel), for Total Safety Consulting, LLC, respondent.

Order, Supreme Court, New York County (Paul Wooten, J.), entered August 22, 2011, which, inter alia, granted the respective motions and cross motions of defendants and third-party defendants for summary judgment dismissing the complaint, and denied plaintiff's cross motion for partial summary judgment on the issue of liability on the claims under Labor Law § 240(1) and § 241(6), unanimously affirmed, without costs.

This litigation arose from the death of a construction worker after he was injured at a construction site when a 14,000-pound boom lift[1], which was being lifted off the roof by a crane, drifted out of position and pinned him against a wall.

The owner, defendant The Trustees of Columbia University in the City of New York (Columbia), hired defendant TDX Construction Corp. (TDX) as general contractor, which in turn hired defendant Koenig Iron Works, Inc. (Koenig) to supply structural steel. Koenig contracted with the decedent to install the steel, and he in turn hired workers from defendants Erin Erectors, Inc. and Erin Interiors, Inc. (together known as Erin). Erin was wholly owned by plaintiff, the decedent's wife, who had no other construction experience and was barely involved in management of

[1]We use boom lift as a gender-neutral synonym for the terms manlift and man basket employed in the record.

the companies; it was the decedent who supervised Erin's workers and managed its operations. Although the only crane operator on the construction site was not an Erin employee, the decedent paid him to perform lifts on both June 14, 2002, and July 2, 2002; on both occasions he worked under the decedent's direct supervision.

The decedent supervised the initial "pick," or lift, of the boom lift to the roof on June 14, 2002, telling Erin employees how to rig the boom lift to the crane's cables. On July 2, 2002, the date of the accident, the decedent told the boom lift driver where to position the boom lift to be removed from the roof and acted as signal person, directing the crane operator via hand signals, though he did not personally direct the Erin employee who was rigging the boom lift to the crane.

The motion court resolved the competing motions and cross motions for summary judgment by determining, as a matter of law, that the decedent's conduct was the sole proximate cause of the accident that led to his death. In its decision, the motion court identified a number of contributing causes of the accident, including the misrigging of the boom lift by an Erin employee, the failure to use tag lines to steady the load, and the use of hand signals rather than the "squawk box" speaker in the crane's cab. The court credited each cause it addressed to the decedent's decisions or to his supervision of Erin employees, and dismissed the complaint in its entirety because decedent "alone defined the task at hand, chose the methods and means to be used," and made the decisions that led to the accident.

On this appeal, plaintiff asserts that the motion court did not address her claim that the lack of a licensed rigger was also a proximate cause of the accident, thereby defeating the "sole" proximate cause defense. More specifically, plaintiff contends that section 26-172 of the Administrative Code of the City of New York in effect at the time of the accident (now recodified at § 28-404.1) imposed a non-delegable duty on Columbia and TDX to hire a licensed rigger. That section made it unlawful to hoist or lower any article on the outside of a building unless the "work is performed by or under the supervision of a person licensed as a rigger." The Rules of the City of New York Department of Buildings (1 RCNY) also provide that this licensed rigger "must be continuously on site during critical picks and must personally perform or personally supervise all critical picks" (1 RCNY 9-01[e]). A "critical pick" includes a rigging operation involving a load that is asymmetrical or may present a problem because of clearance, drift, or other interference (1 RCNY 9-01[b]). Even if a pick is not "critical," the Rules provide that the licensed rigger must personally plan, and cannot delegate, the set-up and operation of all rigging operations (1 RCNY 9-01[d]).

Section 26-172 of the version of the Administrative Code in effect in 2002, however, was followed by an exemption in section 26-173: "The provisions of this article shall not apply . . . to the hoisting or lowering of any building materials or equipment, other than boilers and tanks, in the course of the construction or alteration of any building or structure." The accident occurred during the lowering of the boom lift, which was being used as equipment in the course of the construction of a building, and therefore the circumstances surrounding the accident squarely fell under this exemption and no licensed rigger was expressly required by the Code.[2] Plaintiff's arguments to the contrary, based on witnesses' opinions that a licensed rigger was necessary for this lift, are not persuasive in light of this clear statutory language.

For liability to attach, "the owner or contractor must breach the statutory duty under [Labor Law] section 240(1) to

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[2]We note that this exemption in the current version of the Administrative Code is significantly narrower in scope, and may lead to a different result in future cases with similar facts: "The provisions of this article shall not apply . . . to the *loading or unloading* of any building materials or equipment, other than boilers and tanks, *from a delivery truck*" (Administrative Code § 28-404.1 [emphasis added]).

provide a worker with adequate safety devices, and this breach must proximately cause the worker's injuries" (*Robinson v East Med. Ctr., LP*, 6 NY3d 550, 554 [2006]; *see Blake v Neighborhood Hous. Servs. of N.Y. City,* 1 NY3d 280, 290 [2003]). Here, plaintiff has not come forward with sufficient evidence to raise an issue of fact as to whether defendants breached this duty to provide safety devices that proximately caused the accident. As plaintiff has failed to overcome defendants' prima facie evidence that the decedent's conduct and decisions were the sole proximate cause of the accident, plaintiff's claims under common-law negligence and Labor Law §§ 200, 240(1), and 241(6) must all be dismissed.

In view of the foregoing, we need not reach the parties' remaining contentions.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 16, 2013

CLERK

Mazzarelli, J.P., Sweeny, Freedman, Gische, JJ.

10130 In re Luther Dempsey, Index 401935/11
Petitioner-Respondent,

-against-

The New York City Department of Education, et al.,
Respondents-Appellants.

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Michael A. Cardozo, Corporation Counsel, New York (Julian L. Kalkstein of counsel), for appellants.

South Brooklyn Legal Services, Brooklyn (Nicole Salk of counsel), for respondent.

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Judgment, Supreme Court, New York County (Robert E. Torres, J.), entered March 7, 2012, granting the CPLR article 78 petition to the extent of annulling respondent Department of Education's (DOE) determination, dated May 4, 2011, which denied petitioner's request for certification as a school bus driver, ordering that the DOE approve petitioner's application to be a certified DOE school bus driver, and remanding the remaining issues to the DOE, reversed, on the law, without costs, the petition denied and the proceeding dismissed.

In 2006, petitioner applied for certification as a school bus driver. In connection with his application, he disclosed two drug-related felony convictions in 1990, and three misdemeanors, the most recent in 1993. Petitioner acknowledges that he had a heroin addiction that began at age 15 and continued until 1994, when he stopped using drugs and entered a treatment program that he successfully completed in 1995. He avers that he has been drug free since then. With one exception, due to his employer at the time closing its business, petitioner has been steadily employed over the years, primarily as a private bus driver transporting school aged children.

In 2006, petitioner applied for certification as a New York City school bus driver, which would allow him to drive DOE buses. That application was denied. He and three other petitioners who, like petitioner, had prior criminal convictions, brought an Article 78 petition against the DOE (*Matter of Hasberry v New York City Dept. of Educ.*, 78 AD3d 609 [1st Dept 2010]), which resulted in petitioner being allowed to submit additional documentation in support of his application and his being interviewed by the director of the Office of Personnel Investigation (OPI) as well as other panel members. Following the interview, DOE issued a letter dated May 17, 2011 denying petitioner’s application for certification. Petitioner brought this proceeding on the basis that DOE’s determination was, among other things, arbitrary and capricious.

It is well settled law that a court may not substitute its judgment for that of the board or body it reviews unless the decision under review is arbitrary and unreasonable and constitutes an abuse of discretion or is contrary to law (see *Matter of Arrocha v Board of Educ. of City of N.Y.*, 93 NY2d 361, 363 [1999]; *Matter of Pell v Board of Educ. Of Union Free School Dist. No 1 of Towns of Scarsdale and Mamaroneck, Westchester County*, 34 NY2d 222, 231 [1974]).

Where the applicant seeks employment with the New York City Department of Education, the School Chancellor's regulations apply and Regulation C-105 establishes procedures to be followed by OPI for background investigations of pedagogical and administrative applicants. Regulation C-105 incorporates by reference article 23-A of the Correction Law. Correction Law §752 (*et seq.*) prohibits unfair discrimination against a person previously convicted of a crime "unless: (1) there is a direct relationship between one or more of the previous criminal offenses and the specific license or employment sought or held by the individual; or (2) the issuance or continuation of the license or the granting or continuation of the employment would involve an unreasonable risk to property or to the safety or welfare of specific individuals." Correction Law §753(a) - (h), which set forth eight factors a public agency must consider in connection with an application for a license, include the person's duties and responsibilities, the bearing, if any, the criminal offense(s) will have on the person's "fitness or ability" to perform his or her duties, the time that has elapsed since the occurrence of the crime(s), the seriousness of the crime, information about the applicant's reputation, etc., and the legitimate interest of the agency in protecting the safety and welfare of specific individuals or the general public. Regulation C-105 provides further that in reviewing the record of an applicant who has a prior criminal conviction, DOE is particularly concerned with offenses, among others, that involve the possession, distribution or selling of controlled substances. The Chancellor's Regulation, like the Corrections Law, provides that where the applicant has a certificate of relief from disabilities, that certificate "shall" also be considered (Correction Law §753[3]). The certificate, however, only creates a "presumption of rehabilitation" with respect to the crime the individual was convicted of, it does not create a prima facie entitlement to the license the person is applying for (*Matter of Bonacorsa v Van Lindt,* 71 NY2d 605, 614 [1988]).

Petitioner's application included a Fingerprint Referral Form in which he responded "yes" to the question of whether he had been convicted of an offense, a copy of his commercial driver's license, character and employment references, a certificate of relief from disabilities issued in 2002 and certificates showing he had successfully completed the drug treatment and other programs. Although the form requires an explanation to any “yes” response, petitioner did not provide one at first, but explained the response in a sworn affidavit he later provided.

The DOE’s May 4, 2011 determination that petitioner’s prior drug-related convictions as an adult bore on his fitness and/or ability to perform his school bus duties was rationally based, and it shows DOE gave due consideration to the relevant factors under Correction Law §753 before denying his application. Although petitioner avers he has been drug free since 1994, and his crimes were directly related to his drug addiction at the time, the offenses were not youthful indiscretions (he was 41 years old), but were of a serious nature since each involved narcotics.

While DOE may not have stated with specificity its detailed analysis with respect to the factors it considered in its denial letter to petitioner, and he claims this shows DOE failed to consider his Certificate of Rehabilitation, the record created before the DOE amply demonstrates that all the relevant factors were considered by respondent in making its determination denying him certification as a school bus driver (see *Matter of Acosta v New York City Dept. of Educ*., 16 NY3d 309, 318 [2011]). The position for which petitioner seeks certification would place him in direct daily contact with school aged children and require him to closely monitor and supervise them (*compare Matter of Acosta*, 16 NY3d 309 with *Matter of Arrocha, 93 NY2d 361*).

In granting the petition and reversing the agency's determination, the court below improperly re-weighed the factors set forth in the Correction Law and substituted its own judgment (*see Acosta*, 16 NY3d at 318 [*citing Arrocha*, 93 NY3d at 367]). The nature of criminal conduct for which petitioner was convicted has a direct bearing on his fitness or ability to perform one or more of the duties or responsibilities.

All concur except Freedman, J. who dissents in a memorandum as follows:

FREEDMAN, J. (dissenting)

I respectfully dissent and would affirm the judgment below. I agree with the Supreme Court that the denial was arbitrary and capricious and violated Article 23-A §§ 752 and 753 of the Correction Law and the New York State and New York City Human Rights Laws (Executive Law § 296[15]); (New York City Admin. Code § 8-107[10]).

Petitioner was convicted of two drug-related class D felonies approximately 23 years ago, and three misdemeanors, the most recent in 1993. In 1994, he entered a drug treatment program which he successfully completed in 1995, and since that time, he has not only remained drug-free but remained close to the director of the program. He also entered a nine month program at the Bowery Mission Transitional Center which he completed in November 1995, has remained a member of its alumni group and has received a certificate of achievement for his continued participation. In 1996, petitioner obtained a Commercial Driver's License and a certificate of completion from Model Bus Driving School, and in 2002 he was issued a certificate of relief from disabilities by the Supreme Court, Kings County.

Since 1996, petitioner has been steadily employed as a school bus driver transporting both young and high school age pupils, including children with special needs. There have been no incidents, and he has been highly regarded by his employers, students, and parents. References note that he was punctual and related well to students ages K through 12. A letter from Thomas Buses Inc., dated September 19, 2008, informs that petitioner "worked for Thomas Buses from September 29, 2004 through August 11, 2006...was valued employee...is reliable...[and] loved driving children to and from school." A letter from Gagnon Bus, Inc., dated September 20, 2008, his employer from 2006 to 2008, stated that petitioner "always communicated and interacted well with his coworkers...is willing to help and do extra work." Letters from other school bus companies for whom petitioner worked were similarly laudatory.

In 2005, petitioner received a Certificate of School Bus Driver Training from the Education Department of the State of New York indicating that he had successfully completed the New York State Education Department's School Bus Driver 30-hour course.

In 2008, petitioner, at the behest of Thomas Buses, Inc., for whom he was again working, applied for certification as a New York City school bus driver. Certification would enable him to get health and other benefits. The application was denied based on petitioner's list of convictions, and the motion court dismissed the petition challenging DOE's determination.

In 2010, this Court modified the motion court's order (*Matter of Hasberry v New York City Dept. of Educ.*, 78 AD3d 609 [2010]), reinstated the petition, and remitted the matter to DOE because it did not properly accord petitioner (and two other applicants) an opportunity to review the information upon which DOE had made its determination and submit statements and documents, as required by Chancellor's Regulation C-105. Upon remand, petitioner was asked to appear for an interview with the Office of Pupil Transportation (OPT) during which time he presented his driver's license, various certificates including his training and bus driver certificates, his drug treatment program certificates and letters of reference from his employers. He was asked about his drug history and told the investigators that he had not used drugs since 1994 and was involved with caring for his daughter. The chief investigator recommended denial and, on March 17, 2011, DOE adhered to its previous position with no reasons stated.

Petitioner's counsel requested a written statement pursuant to Correction Law § 754. On May 4, 2011, the Executive Director of OPT, Matthew Berlin, wrote that OPT had considered the elements of Correction Law § 753 and determined that petitioner was unsuitable for the position of school bus driver, which required close supervision of school children in the relatively unsupervised environment of a school bus. The letter further stated that the certification related to the duties of the job, noting the seriousness of the criminal offenses, their direct relationship to fitness to perform those duties, and the relatively mature age of petitioner when the offenses were committed. The letter also indicated that petitioner had not been completely truthful in his application. As noted by the trial court, there was no basis for that statement. Petitioner had listed all of his convictions and the sentences received (mostly conditional discharges and a one year incarcerative sentence).

In response to petitioner's article 78 proceeding, the Executive Director again referred to the criminal convictions and added that there was a "lengthy gap" in petitioner's employment history from 1999 to 2002. Although he noted that it was the public policy of the State to encourage employment of persons with previous convictions, Berlin stated that OPT had serious concerns about exposing children to individuals who had been convicted of crimes involving sale of controlled substances. He added that petitioner provided no community recommendations except from the ministry and rehabilitation programs, and that the 18 years that had elapsed since petitioner's last conviction was not that long. Berlin concluded that after balancing the factors and weighing the seriousness and nature of the criminal convictions against petitioner's rehabilitation, positive references, work history, and age at the time of the convictions, it was determined that petitioner posed an unreasonable risk to the safety of young children.

Petitioner replied by denying that there had been any gap in his work history, stating that he had worked for Lifeline Transportation Services from 1998 to 2002 but they had gone out of business, and that he had not been asked for community references, but could provide them from his church and pastor. He repeated that his past criminal history was not a reflection of who he had become and that he took his driving responsibilities very seriously, stating he drove "as though I were driving my own children."

In granting the petition and annulling the determination, the trial court found respondent's decision to be arbitrary and capricious because it failed to consider all of the factors set forth in Correction Law § 753. The court found that respondent only looked at petitioner's criminal history and considered arrests that were dismissed and did not balance those factors with the extensive evidence of petitioner's rehabilitation. It also noted that it failed to identify the alleged "untruthfulness" in petitioner's application and improperly identified a “gap” in his employment.

Correction Law § 752 provides that “No application for a license or employment, to which the provisions of this article are applicable, shall be denied by reason of the applicant’s having been previously convicted of one or more criminal offenses, or by reason of a finding of lack of ‘good moral character’ when such finding is based upon the fact that the applicant has previously been convicted of one or more criminal offenses, unless (1) there is a direct relationship between one or more of the previous offenses and the specific license or employment sought; or (2) the issuance of the license or the granting of the license would involve an unreasonable risk to property or to the safety or welfare of specific individuals or the general public. “Correction Law § 753 enumerates eight specific factors to be considered in making determinations under § 752.

The eight factors are as follows: (a) recognition that the public policy of this state is to encourage licensure and employment of persons previously convicted of one or more offenses; (b) the specific duties and responsibilities related to the license or employment; (c) the bearing, if any, the criminal offenses will have on fitness or ability to perform the duties; (d) the time which has elapsed since the occurrence of the criminal offenses; (e) the age of the person at the time of the occurrence of the criminal offenses; (f) the seriousness of the offenses; (g) any information produced by the person or in his behalf in regard to his rehabilitation and good conduct; (h) the legitimate interest of the public agency or private employer in protecting property, and the safety and welfare of individuals or the general public.

Petitioner's argument that DOE's review was inadequate and that it did not properly consider the eight factors and that the only reasons given for rejecting petitioner's application were based on inaccurate information, has merit. The May 4, 2011 letter denying petitioner's application, after remand for reconsideration by this Court, merely states that OPT considered the age at which petitioner committed his last criminal offense, the seriousness of the offenses, and the welfare of the children whom petitioner would have to supervise. It made no reference to the time that had elapsed since the last conviction (now 20 years), petitioner's lengthy experience successfully driving school buses with the very same children or type of children he would be driving and supervising were the license granted, or the extensive evidence of complete rehabilitation that petitioner furnished. The letter's reference to "untruthfulness" is totally unsupported by any evidence. The conclusion reached by the

Executive Director of OPT that he had “grave doubt about his [petitioner’s] moral character and reliability” is belied by petitioner’s impeccable record of steady employment since 1994, and his employment as a school bus driver for public and private school pupils for 12 years without incident, his certificate of relief from disabilities, and his significant record of community service.

In *Matter of Acosta v New York City Dept. of Educ.* (16 NY3d 309 [2011]), the Court of Appeals specified that “‘[i]n making a determination as to whether either the direct relationship exception or the unreasonable risk exception applies,’” “[a] failure to take into consideration each of these factors results in a failure to comply with the Correction Law’s mandatory directive” (*id.* at 316 [internal quotation marks omitted]). Based on his now 20-year record, all evidence demonstrates that petitioner has been completely rehabilitated and is able to reliably perform the duties of the position for which the license is sought.

As petitioner points out, the pertinent parts of the State (Executive Law § 296[15]) and City (Administrative Code of the City of NY § 8-17[10]) Human Rights Laws both provide that it is an unlawful discriminatory practice to deny a license or employment based on a criminal conviction when such a denial is in violation of the provisions of Article 23-A of the New York State Correction Law.

Accordingly, I agree with the motion court's finding that respondent's determination denying petitioner's application for certification as a DOE school bus driver failed to account for petitioner's rehabilitation, was arbitrary and capricious, and violated Article 23-A of the Correction Law.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 16, 2013

CLERK

Tom, J.P., Acosta, Renwick, DeGrasse, Richter, JJ.

10145- Files 3833/05
10146 In re Gregory Stewart Trust, et al. 4776/05
- - - - - 4775/05
Barbara Stewart, 4777/05
Petitioner-Respondent-Appellant,

-against-

William P. Stewart, et al.,
Respondents-Appellants-Respondents.

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Thompson Hine, LLP, New York (Simon Miller and Richard De Palma of counsel), for appellants-respondents.

Marcus & Cinelli, LLP, Williamsville (David P. Marcus of counsel), for respondent-appellant.

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Decree, Surrogate's Court, New York County (Nora S. Anderson, S.), entered March 21, 2012, which, to the extent appealed and cross-appealed from, granted petitioner's request for statutory annual trustee commissions for the year 2005 to the extent of awarding her two-thirds of the 2005 annual commissions on the trusts' principal pursuant to SCPA 2309(2) in the total amount of $695,960, payable by each of the four family trusts in the amount of $173,990, based on the established value of each of the four trusts at $85,695,000, and denied, with prejudice, petitioner's request for annual commissions on the trusts' principal for the years 2003 and 2004, as well as annual commissions on the trusts' income for the years 2003, 2004 and

2005, unanimously affirmed, without costs. Appeal and cross appeal from order, same court and Surrogate, entered February 15, 2012, which adopted the findings and recommendation of the Special Referee granting petitioner's claim to annual commission on the trusts' principal for the year 2005 and denying petitioner's claims for commissions for 2003 and 2004, rejected that portion of the recommendation denying said claims without prejudice to renewal, and dismissed said claim with prejudice, unanimously dismissed, without costs, as subsumed in the appeal from the decree.

Barbara Stewart (trustee) was removed as cotrustee of four trusts, the beneficiaries of which are her four children, in 2012 for misconduct that occurred primarily after 2005. The trustee was denied annual commissions from 2006 to the time she was removed. On appeal, she is seeking commissions pursuant to SCPA 2309(2) for 2003, 2004 and 2005. Respondents-appellants, three of the trustee's children and beneficiaries of the trusts (beneficiaries), oppose granting her commission for these years.

The Referee's report recommended that the trustee be denied commissions for 2003 and 2004 for failure to provide competent evidence as to the value of the trusts for those years. As to the annual commission for 2005, the Referee determined that, absent controlling precedent in this state on the issue, trustee misconduct that occurred after the period for which a commission is sought cannot be considered in determining whether to grant the commission. The Referee therefore recommended the trustee be granted her annual commission for 2005, and the Surrogate adopted these recommendations.

We conclude that courts have the discretion to take into consideration all of a trustee's misconduct in determining the grant of annual commission, even conduct that occurred after the period applicable to the commission. Although there are no appellate cases on point, no New York case holds otherwise. As a basic principle, the Surrogate has broad discretion to deny commission to a trustee if the trustee has engaged in misconduct (*see generally Matter of Donner*, 82 NY2d 574, 587 [1993] [concerning co-executor commissions]; *Matter of Tydings, [Ricki Signor Grantor Trust]*, 32 Misc 3d 1204[A] [Sur Ct, Bronx County 2011] [trustee seeking income, annual and compensation commission]). In determining if a commission should be denied, misconduct that is not directly related to the commission being sought may be taken into consideration (*see Tydings,* 32 Misc 3d 1240[A] [court denied trustee commission for services unrelated to the misconduct, finding that her overall mismanagement of the trust did not obligate the trust to pay her commission]; *Smith's Estate*, 24 Pa D 435, 440-441 [Orphan's Ct Pa, Philadelphia County

1915] [court denied trustee commission for years prior to his misconduct, concluding that it would be unjust to allow him to earn the commission]). The Restatement (Second) of Trusts § 243 supports this conclusion with a multi-factor analysis (Comment *c*). Among the factors to be considered under the Restatement in determining if a commission should be denied are whether the trustee acted in good faith, whether the misconduct related to management of the whole trust and whether the trustee completed services of value to the trust (*id.*). We conclude, therefore, it is within the court's discretion to determine whether the trustee's later misconduct bars her from receiving commission.

Trustees can be denied commission "where their acts involve bad faith, a complete indifference to their fiduciary obligations or some other act that constitutes malfeasance or significant misfeasance" (*Tydings*, 32 Misc 3d 1240[A], *10). The denial of a commission, however, should not be "in the nature of an additional penalty" (Restatement (Second) of Trusts § 243, Comment *a*). Rather, it should be based on the trustee's failure to properly serve the trust (*see id.*). Indeed, even the beneficiaries in this case state that it will be rare that a trustee's later misconduct will serve as the basis for a denial of commission.

In his report, the Referee cites *Matter of Williams* (631 NW2d 398, 409 [Minn Ct App 2001]) for the proposition that the court cannot consider later misconduct. *Williams*, which is not binding on us, addressed whether a professional trustee was required to refund fees it had received for an accounting period during which the district court found it breached its duties to the trust. In determining whether the trustee should refund fees, the court found "that the fees to be reduced or denied [must] relate to a failure by [the trustee] to render services or to render services properly" (*id.*). This case does not explicitly hold that the court cannot consider misconduct which occurs after the period for which commissions are sought. Rather, it underscores the principle that denying a trustee fees cannot be a punishment unrelated to the trustee's actions and, citing the Restatement (Second) of Trusts, it concludes that a court has discretion to reduce fees of the trustee who failed to render service properly. Finally, we note that the court in *Williams* did not decide whether the trustee's compensation should be reduced, but merely remanded to the district court for further proceedings on the issue.

We conclude, in our discretion, that the nature of the trustee's misconduct, both during 2005 and afterwards, does not warrant denial of an annual commission for 2005. There is no evidence that the trust suffered any significant loss due to the trustee's actions (*cf. Smith's Estate*, 24 Pa D at 435 [commission denied where trustee engaged in embezzlement schemes related to the rental of the trust properties]). There are still substantial assets in the trusts, and based on the Surrogate's decision, which we uphold here, the trustee will not receive a commission for any other year besides 2005. On the record before us, we conclude denying her the 2005 commission would serve only as punishment. Further, the trustee is only receiving two-thirds of the annual commission for 2005. Although the Referee noted that he would recommend that the trustee be denied a commission for 2005 if his legal conclusion about misconduct after 2005 were reversed and the case came back to him, we are not bound by the Referee's statement (CPLR 4403; *see Shultis v Woodstock Land Dev. Assoc.*, 195 AD2d 677, 678 [3d Dept 1993]).[1]

[1] There is no need to remand nor is it the primary relief sought by the parties. We have the complete record of the proceedings before the Referee and we accept his credibility determinations. Thus, we can resolve the 2005 commission based on the briefs and record on appeal.

We have considered parties' remaining arguments and find them unavailing.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 16, 2013

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CLERK

Mazzarelli, J.P., Saxe, Moskowitz, Manzanet-Daniels, JJ.

10071 Tap Holdings, LLC, et al., Index 600691/10
Plaintiffs-Respondents,

-against-

Orix Finance Corp., et al.,
Defendants-Appellants.

____

Crowell & Moring LLP, New York (Edwin M. Baum of counsel), for Orix Finance Corp., Maps CLO Fund I, LLC, Maps CLO Fund II, Ltd., Wells Fargo Bank, N.A., Union Bank of California, N.A., CIT Lending Services Corporation, Bank Midwest, N.A., Brown Brothers Harriman & CO., Prudential Insurance Company of America, OFS Funding, LLC, OFSI Fund III, Ltd., and CIT CLO I Ltd., appellants.

Fulbright & Jaworski L.L.P., Los Angeles, CA (Robert E. Darby of the bar of the State of California, admitted pro hac vice, of counsel), for Tap Automotive Holdings, LLC, appellant.

Friedman & Wittenstein P.C., New York (Stuart I. Friedman of counsel), for respondent.

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Order, Supreme Court, New York County (Charles E. Ramos, J.), entered April 12, 2012, affirmed, without costs.

Opinion by Mazzarelli, J.P. All concur.

Order filed.

SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT,

Angela M. Mazzarelli, J.P.
David B. Saxe
Karla Moskowitz
Sallie Manzanet-Daniels, JJ.

10071
Index 600691/10

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Tap Holdings, LLC, et al.,
Plaintiffs-Respondents,

-against-

Orix Finance Corp., et al.,
Defendants-Appellants.

____x

Defendants appeal from an order of the Supreme Court, New York County (Charles E. Ramos, J.), entered April 12, 2012, which denied their motions to dismiss the eighth cause of action in the second amended complaint for failure to state a claim and on the ground of res judicata.

Crowell & Moring LLP, New York (Edwin M. Baum, Daniel D. Edelman and Elizabeth A. Figueira of counsel), for Orix Finance Corp., Maps CLO Fund I, LLC, Maps CLO Fund II, Ltd., Wells Fargo Bank, N.A., Union Bank of California, N.A., CIT Lending Services Corporation, Bank Midwest, N.A., Brown Brothers Harriman & Co., Prudential Insurance Company of America, OFS Funding, LLC, OFSI Fund III, Ltd., and CIT CLO I Ltd., appellants.

Fulbright & Jaworski L.L.P., Los Angeles, CA (Robert E. Darbs of the bar of the State of California, admitted pro hac vice, of counsel), and Fulbright & Jaworski L.L.P., New York (James H. Neale of counsel), for Tap Automotive Holdings, LLC, appellant.

Friedman & Wittenstein P.C., New York (Stuart I. Friedman, Ivan Kline and Ashwini Jayaratnam of counsel), for respondent.

MAZZARELLI, J.P.

The defendants in this action, other than defendant Tap Automotive Holdings, LLP, are a group of lenders[1] (the Senior Lenders) that extended loans, primarily via a "Senior Secured Credit Facility," to nonparty Tap Operating Company, LLC (Tap), in connection with Tap's acquisition of an automotive company. The arrangement provided, among other things, for the Senior Lenders to take a security interest in substantially all of Tap's assets. In addition, plaintiff Tap Holdings, LLC (Holdings) granted to the Senior Lenders a security interest in 100% of its Tap membership units. Holdings is alleged to own 100% of Tap and made a substantial investment in the acquisition. Holdings is in turn substantially owned by the three "Irving Place Capital" plaintiffs as well as plaintiff The BSC Employee Fund VII, L.P. (collectively IPC). In addition to the credit facility and the equity investments, the acquisition was financed by Tap's issuance of senior subordinated notes, the rights under which have been assigned to plaintiff IPC Manager II, LLC (Manager). Manager is the only plaintiff seeking relief under the eighth cause of action at issue herein.

Plaintiffs allege that Tap never defaulted on its payments

[1] Defendant Orix Finance Corp. also acted as administrative agent for the Senior Lenders.

to the Senior Lenders, but that it did violate certain "technical" covenants. Instead of declaring Tap in breach of the entire arrangement based on those violations, the Senior Lenders and Tap entered into a series of forbearance agreements pursuant to which, in exchange for additional equity infusions by IPC, the former agreed not to exercise their rights to seek payment of the full loan amount or to enforce their security interests. At the expiration of the final forbearance agreement, however, the Senior Lenders refused to enter into a new one, leading to Tap's defaulting on certain obligations related to the automotive business and to the Senior Lenders' alleged refusal to permit Tap to make payments to holders of the subordinated notes.

The Senior Lenders did agree, as a condition of avoiding default under the credit facility, to enter into a "Participation Agreement" with IPC. Pursuant to that agreement, IPC guaranteed $7 million of Tap's obligations to the Senior Lenders on a "last out" basis, meaning that any loans still outstanding and owing to the Senior Lenders under the credit facility would have to be paid, up to $7 million, before IPC would receive any payments for their contributions to Tap. Following that arrangement, the Senior Lenders granted additional forbearance periods while the parties attempted to restructure the financing. However, negotiations failed to bear fruit, and the Senior Lenders refused a final forbearance. Instead, it is alleged that the Senior Lenders exercised their security interests in Holdings' membership units in Tap, terminating Holdings' voting rights and replacing the entire board of Tap, save one person. Tap and Holdings advised the Senior Lenders that their actions were ineffective under both Delaware law and Tap's operating agreement because Holdings, as sole member, did not have any presently exercisable right to remove the members of Tap's board, and the Senior Lenders could have no greater rights than Tap Holdings. It is further alleged that, in response, the Senior Lenders simply amended Tap's operating agreement to allow for the removal of members of the board at any time, with or without cause, removal of all existing board members except the one the Senior Lenders had elected to keep, and to specifically allow the appointment of two new members.

A few months later, citing Tap's defaults under the credit facility, the Senior Lenders accelerated payment of $7 million in loans, triggering IPC's obligation under the Participation Agreement. After IPC made the payment, the Senior Lenders withdrew the acceleration and Tap continued in business. Plaintiffs allege that Tap's financial condition improved dramatically thereafter. Nevertheless, under the constructive control of the Senior Lenders, Tap entered into a "Foreclosure

Agreement" with the Senior Lenders which provided that (1) Tap would transfer all its assets (and those of its subsidiaries) to a newly formed entity, controlled by the Senior Lenders, to be named defendant Tap Automotive Holdings, LLC (New Tap); (2) New Tap would assume all liabilities either incurred by Tap in the ordinary course of business or specifically agreed to in the Foreclosure Agreement; (3) New Tap would employ all employees of Tap on substantially similar terms; and (4) New Tap would fund the wind-up and dissolution of Tap. Pursuant to this arrangement, New Tap acquired Tap's assets for $66 million, via Tap's issuance of a new note. This amount covered the Senior Lenders' outstanding loans (minus the $7 million owed to IPC by reason of their loan purchase pursuant to the Participation Agreement), and left nothing for the holders of Tap's subordinated debt or equity. Indeed, at the time of the transaction, Tap still carried approximately $38 million worth of subordinated indebtedness, including interest. New Tap did not assume responsibility for the subordinated notes. However, as alleged by plaintiffs, New Tap was no different than Tap, using the same trade names, physical assets and website. Further, Tap executives assumed the same positions with New Tap, and received equity in New Tap equivalent to or in excess of their equity in Tap, which they held through Tap Holdings.

Plaintiffs demanded that Tap bring claims against the Senior Lenders for rendering Tap insolvent, but the demand was refused. Accordingly, plaintiffs themselves commenced this action, naming Tap as a nominal defendant, and seeking to recover on the subordinated notes and the participation interests, and to have the transferred assets returned to Tap. Tap moved to dismiss the claims against it, and the court granted the motion, finding that plaintiffs had no standing to assert derivative claims on behalf of Tap and that plaintiffs failed to show that Tap's refusal to institute litigation was unjustified.

Plaintiffs then filed a second amended complaint, which did not name Tap, but which included the eighth cause of action at issue on this appeal. That cause of action alleged that, after the transfer of Tap's assets to New Tap, "New Tap's management, personnel, physical location, good will, web domain, phone number, and general business operation, etc. were (and remain) all the same." It further asserted that: (1) the transaction "was specifically structured with the intention to shear Tap of its assets while leaving it with its liability to the Subordinated Noteholders, even though the Tap business continued as a going concern in a seamless manner"; (2) "New Tap has engaged in a defacto merger with Tap, and exists as a mere continuation of Tap and its subsidiaries"; (3) "Senior Lenders formed New Tap solely for the purpose of receiving the assets and business of Tap”; and (4) “[a]s a result, New Tap, as the successor to Tap, and the Senior Lenders, as New Tap’s alter ego, are each jointly and severally liable for all obligations and amounts owed by Tap and its subsidiaries to the Subordinated Noteholders on the Subordinated Notes.”

Both New Tap and the Senior Lenders moved to dismiss the eighth cause of action, arguing that it was precluded by the doctrine of res judicata and waiver, and by Manager’s failure to adequately plead alter ego and successor liability claims. The res judicata defense was based on New Tap’s position that the successor liability claim against it depended on a finding that Tap was liable on the subordinated notes, which they argued had been decided on the merits by Tap’s dismissal from the action. They argued further that Manager’s failure to raise successor liability in the earlier complaints precluded them from raising it in the new complaint. The Senior Lenders also relied on a provision in a subordination agreement which provided that

> “the holders of Subordinated Indebtedness waive any right to ... challenge the appropriateness of any action the Senior Agent and Senior [Lenders] take with respect to the Senior Debt and hereby consent to the Senior Agent and Senior [Lenders] exercising or not exercising such rights and remedies as if no other debt existed.”

Finally, the Senior Lenders argued that Manager failed to adequately plead alter ego liability.

The court denied both motions in their entirety. It found that Tap's dismissal was not on the merits of any claim against New Tap, and was preclusive only on the issue of Manager's derivative standing to assert claims on behalf of Tap. The court found further that the successor claim was substantially similar to plaintiffs' previous claims against New Tap and thus could not form the basis of any surprise to defendants which would otherwise preclude the claim. The court rejected New Tap's argument that the successor claim failed to state a claim for recovery against it, finding that Manager had sufficiently alleged three alternative theories for the imposition of successor liability, to wit, "mere continuation," de facto merger and fraudulent transfer.

The court also rejected the Senior Lenders' arguments that Manager did not adequately allege alter ego liability, finding the issue resolved by a previous determination that such claims presented fact issues that could not be resolved on a motion to dismiss. Finally, the court rejected the Senior Lenders' argument that the successor claim was barred by the waiver provision in the subordination agreement, finding the provision inapplicable because Manager asserted intentional and bad faith misconduct, which could not be waived.

To the extent that defendants have moved pursuant to CPLR 3211(a)(7), we address only the pleading itself, keeping in mind that the motion should be denied if the facts alleged by Manager fit within any cognizable legal theory (*see Leon v Martinez*, 84 NY 83, 87-88 [1994]). Further, we must afford the pleading a liberal construction, accept the facts as alleged as true, and accord Manager the benefit of every possible favorable inference (*id.*).

To make out a cause of action for liability on the theory of piercing the corporate veil because the corporation at issue is the defendant's alter ego, the complaining party must, above all, establish that the owners of the entity, through their domination of it, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against the party asserting the claim such that a court in equity will intervene (*see ABN AMRO Bank, N.V. v MBIA Inc.*, 17 NY3d 208, 229 [2011]). Piercing of the corporate veil is not a cause of action independent of that against the corporation; it is established when the facts and circumstances compel a court to impose the corporate obligation on its owners, who are otherwise shielded from liability (*Matter of Morris* v *New York State Dept. of Taxation and Fin.*, 82 NY2d 135, 141 [1993]). "Because a decision whether to pierce the corporate veil in a given instance will necessarily depend on the attendant facts and equities, the New York cases may not be reduced to definitive rules governing the varying circumstances when the power may be exercised" (*id.*). Indeed, this Court has observed:

> "In determining the question of control, courts have considered factors such as the disregard 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 or guarantee of the corporation's debts by the dominating entity . . . [n]o one factor is dispositive" (*TNS Holdings v MKI Sec. Corp.*, 243 AD2d 297, 300 [1st Dept 1997], *revd on other grounds*, 92 NY2d 335 [1998]).

The Senior Lenders insist that Delaware law applies in this case; however, the standard is not materially different under Delaware law, which has been interpreted as providing that "no single factor could justify a decision to disregard the corporate entity, [rather,] some combination of them [i]s required, and [] an overall element of injustice or unfairness must always be present, as well" (*see Harco Natl. Ins. Co. v Green Farms, Inc.*, 1989 WL 110537,*5 1989 Del Ch LEXIS 114, *12 [Del Ch 1989] [citation and quotations omitted]). Under Delaware law, "the standard may be restated as: "whether the two entities operated as a single economic entity such that it would be inequitable for [a c]ourt to uphold a legal distinction between them" (*Harper v Delaware Val. Broadcasters, Inc.*, 743 F Supp 1076, 1085 [D Del 1990], *affd* 932 F2d 959 [3d Cir 1991]).

Here, constrained as we are by the allegations contained in the pleadings, we find that Manager has asserted sufficient facts to state a cause of action based on piercing the corporate veil. The second amended complaint plainly and specifically alleges that the Senior Lenders, in a scheme engineered for the sole purpose of extinguishing the note holders' claims against the subordinated notes, and aided by their having obtained all of the voting rights of Tap, established one corporation, New Tap, in order to siphon off the funds belonging to another, Tap. The pleading can reasonably be interpreted as asserting that there was no legitimate business purpose for setting up New Tap, and that the establishment of New Tap was simply a sham intended to cut off the note holders' ability to collect.

That it was Tap, and not New Tap, that was left in an undercapitalized state is not in dispute, but in our view that fact is irrelevant. Indeed, that argument by the Senior Lenders is indicative of their insistence that alter ego liability only exists under precise and technical circumstances. To the contrary, such liability exists when any abuse of the corporate form is exercised for the purpose of working an inequity on another (*Matter of Morris*, 82 NY2d at 141). The mere fact that New Tap continues to operate as a legitimate automotive business should not relieve the Senior Lenders of liability when they are alleged to have caused the creation of the entity specifically to harm the note holders. Further, we reject the Senior Lenders' argument that Manager failed to allege sufficient facts to pierce the veil of non-party TAPL, LLC, which the Senior Lenders formed in connection with the foreclosure of Tap. The second amended complaint adequately alleges that the formation of that entity was just another element of the Senior Lenders' scheme.

We further hold that Manager has adequately alleged a successor liability claim as against New Tap under three of the exceptions to the general rule that a corporation that acquires another's assets is not liable for the other's torts (*see Schumacher v Richards Shear Co.*, 59 NY2d 239, 244-245 [1983]). The first exception they identify falls under the "mere continuation" doctrine, and is based on New Tap's having acquired Tap's "business location, employees, management and goodwill" (*see NTL Capital, LLC v Right Track Rec., LLC*, 73 AD3d 410, 411 [1st Dept 2010]). New Tap contends that no mere continuation claim can exist because Tap still exists, albeit in some meager form. However, New Tap has failed to account for the fact that Manager alleges that Tap's sole employee is a "dissolution officer," and that Tap is no longer in good standing in Delaware for having failed to pay a tax assessment. It can reasonably be inferred from those allegations, for purposes of a 3211(a)(7) motion, that Tap has been effectively extinguished for purposes of application of the doctrine.

Manager adequately alleges another exception to the general rule of successor liability, de facto merger, by asserting that the ordinary business of Tap ceased and that Tap was dissolved as soon as possible, that New Tap assumed "the liabilities ordinarily necessary for the uninterrupted continuation of [Tap's] business," and that there was "continuity of management, personnel, physical location, assets and general business operation" (*see Fitzgerald v Fahnestock & Co.*, 286 AD2d 573, 574-575 [1st Dept 2001]). Further, assuming that continuity of ownership is a necessary element of de facto merger, we reject New Tap's reliance on the fact that its executives derived their interest in Tap through Tap Holdings, and not Tap itself. After all, the question whether a de facto merger exists is "analyzed in a flexible manner that disregards mere questions of form and asks whether, in substance, "it was the intent of [the successor] to absorb and continue the operation of [the predecessor]"

(*Nettis v Levitt*, 241 F3d 186, 194 [2d Cir 2001], *overruled on other grounds by Slayton v American Express Co.*, 460 F.3d 215 [2d Cir 2006]).

Finally, Manager sufficiently alleges a fraudulent transfer (*see Schumacher*, 59 NY2d at 245). The complaint does not merely assert that Tap was insolvent at the time of the allegedly fraudulent transfers. Rather, it asserts that Tap was *rendered* insolvent by defendants' actions. That allegation takes this case out of the purview of *Ultramar Energy v Chase Manhattan Bank, N.A.* (191 AD2d 86 [1st Dept 1993] [reiterating the rule that "[e]ven though insolvent, a debtor may properly assign assets to a creditor as security for an antecedent debt although the effect of the transfer will be to prefer that creditor"]), on which defendants rely.

The doctrine of res judicata does not preclude the successor liability claim since the prior dismissal was premised on lack of standing to bring a derivative claim on behalf of Tap, and not on the relevant merits. Manager correctly argues that, to the extent the previous decision was on the merits, such merits extend only to the propriety of the derivative action, and not to the propriety of any action actually taken by Tap. Thus, while Tap's decision to deny plaintiffs' demand to take action against New Tap was protected by the business judgment rule, no other decision made by Tap is shielded from the purview of the courts. Further, this Court has held that "[a] dismissal premised on lack of standing is not a dismissal on the merits for res judicata purposes" (*Tico, Inc. v Borrok*, 57 AD3d 302 [1st Dept 2008]).

Moreover, contrary to New Tap's argument, advanced to circumvent the rule that res judicata principles do not apply when the two determinations are made in the same action (*see Moezinia v Damaghi*, 152 AD2d 453, 457 [1st Dept 1989]), the dismissal of the derivative claims against Tap did not operate as a severance, creating a new action. New Tap cites no legal authority for the unwieldy proposition that the dismissal of a claim or a party from an action results in a new action separate and apart from the "old" action.

The Senior Lenders' argument that the successor liability/alter ego claim is precluded by the waiver contained in the subordination agreement is without merit. Where, as here, intentional misconduct is alleged, there can be no waiver (*see Banc of Am. Sec. LLC v Solow Bldg. Co. II, L.L.C.*, 47 AD3d 239, 244 [1st Dept 2007]). Further, the second amended complaint can reasonably be read as alleging that defendants' actions had no legitimate business interest and were instead taken in bad faith and calculated solely to circumvent any obligation to pay back the note holders. Accordingly, at this point the Senior Lenders' reliance on *Devash LLC v German Am. Capital Corp.* (104 AD3d 71 [1st Dept 2013]), in which the defendants did act in furtherance of a legitimate business interest, is unavailing.

Finally, we reject New Tap’s request that, if we sustain the eighth cause of action, we declare that Manager’s damages are limited to the amount, if any, by which the value of the secured assets of Tap prior to their transfer to New Tap exceeded the value paid by the Senior Lenders for those assets. New Tap claims that this would be consistent with the IAS court’s previous directive limiting damages on plaintiffs’ claim pursuant to the Delaware Fraudulent Transfer Act. However, New Tap has cited no authority holding that the remedies under that statute and under a common law successor liability claim are identical in all circumstances.

The eighth cause of action, viewed in the context of all the other allegations in the second amended complaint, unquestionably paints a picture of complex machinations carried out by defendants with the singular goal of shirking the obligation to make payments on the notes which were assigned to Manager. Under the standard of review governing motions to dismiss pursuant to CPLR 3211(a)(7), that is sufficient to state a claim for successor and alter ego liability. Because these claims were not decided on the merits when Tap was dismissed from the case, it was perfectly proper for the IAS court to permit them to go forward.

Accordingly, the order of the Supreme Court, New York County (Charles E. Ramos, J.), entered April 12, 2012, which denied the motion by defendant Tap Automotive Holdings, LLC and the motion by the Senior Lenders to dismiss the eighth cause of action in the second amended complaint for failure to state a claim and on the ground of res judicata, should be affirmed, without costs.

All concur.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JULY 16, 2013

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CLERK