Brean, Murray, Carrett & Co. v Morrison & Foerster LLP
2017 NY Slip Op 30602(U)
March 28, 2017
Supreme Court, New York County
Docket Number: 651024/2016
Judge: Saliann Scarpulla
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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BREAN MURRAY, CARRET & CO.,

Plaintiff,

-against-

MORRISON & FOERSTER LLP,

Defendant.

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DECISION/ORDER

Index No. 651024/2016

HON. SALIANN SCARPULLA, J.:

In this action to recover damages for legal malpractice and fraud, defendant Morrison & Foerster LLP ("Morrison") moves to dismiss the amended complaint.

Puda Coal, Inc. ("Puda") was a Delaware corporation listed on the New York Stock Exchange, which conducted its operations in China through Shanxi Puda Coal Group Co., Ltd. ("Shanxi Coal"). Puda reported in public filings that it owned a 90 percent interest in Shanxi Coal. In the Fall of 2010, Puda hired plaintiff Brean, Murray, Carret & Co. ("Brean") along with Macquarie Capital (USA) Inc. ("Macquarie"), to underwrite a public offering of Puda stock in the U.S. market to be conducted in December 2010. According to the allegations of the complaint, in November 2010, Macquarie hired Morrison, a law firm with substantial China-related expertise, as counsel for all underwriters, to conduct due diligence for the transaction and to provide legal advice regarding the offering.

Macquarie also hired international private investigation firm, Kroll Inc. ("Kroll") to investigate the character, integrity and reputation of the individuals associated with Puda. Brean was not aware of Macquarie's retention of Kroll at the time of the offering or for years thereafter. Kroll issued a report on December 2, 2010 ("the Kroll Report"), which disclosed that Puda did not own a 90 percent interest in Shanxi Coal, in contradiction of Puda's public representations and

reports. In fact, in September 2009, Puda's 90 percent ownership in Shanxi Coal had been transferred to Ming Zhao, who was Chairman of Puda's Board of Directors, a major Puda shareholder, and an 8 percent owner of Shanxi Coal. Puda conducted two public offerings in 2010 without disclosing the change in ownership structure. Puda raised millions of dollars from investors selling shares in what was essentially an empty shell company.

Kroll provided the Kroll Report to Macquarie via William Fang, an associate, who, on December 2, 2010, emailed the report to several other members of the Macquarie deal team, and then forwarded it to Morrison with a cover email that indicated "no red flags were identified." Neither Macquarie nor Morrison picked up on the finding in the Kroll report that Puda did not, in fact, own a 90 percent interest in Shanxi Coal.

On December 13, 2010, Morrison issued an opinion letter/negative assurance letter, confirming its due diligence findings, and indicating that "nothing has come to our attention" to cause Morrison to believe that the offering documents contained false or misleading statements. Macquarie signed the underwriting agreement with Puda as "representative of the several underwriters," which included Brean.

According to the allegations of the complaint, in April 2011, Puda's fraud was uncovered and made public by the financial press. Puda was removed from the New York Stock Exchange. On April 18, 2011, a Morrison partner called Brean's managing director to inform him that Morrison could no longer act as Brean's counsel in connection with any matters, including those relating to the December 2010 offering. That conversation was memorialized in a letter two days later.

A class action lawsuit was filed in the Southern District of New York, Civil Action No. 11-CIV-2598 (the "Southern District Action") in connection with the public offering. The Southern District Action included claims against Macquarie and Brean for violations of sections 11 and

12(a)(2) of the Securities Act, which claims were subsequently dismissed. According to Brean, a claim was added in January 2014 against Macquarie only for violation of section 10(b) of the Securities Exchange Act, based on the Kroll Report. That was when Brean first became aware of the existence of the Kroll Report. Later, the court granted plaintiffs leave to file all claims against all underwriters, including Brean. Brean and Morrison then entered into a tolling agreement on August 1, 2014, which made clear that it did "not operate to revive any claim that [was] barred by any statute of limitations, statute of repose or other time related defense or claim as of [August 1, 2014]." They extended that tolling agreement twice.

As to Brean, the plaintiffs in the Southern District Action alleged that shortly after Puda's fraud was exposed, Brean's chief executive officer wrote an email stating that he had heard "a while ago" that Puda no longer owned Shanxi Coal. The court found that "[c]onstrued in plaintiffs' favor" that email was "enough to show that Brean Murray was aware of the transfer and consciously disregarded it." The district court then denied Brean and Macquarie's motions to dismiss the amended complaint. Macquarie and Brean settled the case. The settlement was preliminarily approved on February 19, 2016.

On February 8, 2016, Brean notified Morrison that it was terminating the tolling agreement, which then expired on February 23, 2016. On February 26, 2016, Brean commenced this action. Brean alleged a claim of malpractice, maintaining that Morrison failed to advise Brean of any issues regarding Puda's stated ownership of Shanxi Coal. It sought damages based on (i) "any damages or settlement costs" it incurred in the securities class action; and (ii) any attorney's fees or other litigation costs associated with the securities class action or the related SEC investigation. Morrison moved to dismiss that complaint.

In May 2016, Brean filed an amended complaint adding a claim for fraud, in which Brean alleged that Morrison had actual or constructive notice of the falsity of its opinion letter, in which it

misrepresented to Brean that it had completed the work necessary in order to form its opinion and it had not obtained any information contradicting Puda's stated ownership interests in Shanxi Coal. Brean justifiably relied on that misrepresentation to its detriment. Additionally, Brean pled that Morrison failed to disclose the falsity of the opinion letter when it terminated the attorney-client relationship with Brean and in fact, it sought to conceal its misconduct by resigning as counsel.

Morrison now moves to dismiss the amended complaint. It first argues that Brean's malpractice claim is time barred because the claim accrued no later than December 16, 2010, the time of the Puda offering. Further, the statute of limitations was not tolled by the continuous representation doctrine because even if Brean had alleged a "mutual understanding" of the need for continued representation after December 2010, which it did not, the continuous representation doctrine would, at most, toll the statute of limitations from December 2010 to only April 18, 2011, which was when Morrison informed Brean that it would no longer act as Brean's counsel. Therefore, at the very latest, the statute ran from April 18, 2011 through April 18, 2014, when it expired. Brean had not commenced this action by that date. In addition, when the tolling agreement was executed on August 1, 2014, the statute of limitations had already expired.

Morrison also argues that the doctrine of equitable estoppel, which tolls the statute of limitations where the defendant's affirmative misconduct precludes the filing of a timely suit, does not apply. Morrison maintains that Brean was on "inquiry notice" of a potential malpractice claim as of April 8, 2011, when Puda's fraud was disclosed in a public report. According to the report, the incident occurred as a result of a basic due diligence failure, and the relevant government records had been available to any lawyer. Brean was certainly on inquiry notice a week later when the first class action complaint was filed against it. In addition, in an April 10, 2011 email, Brean senior executives indicated "once it goes into litigation, we'll break off from them [Macquarie] as we may be going after [Morrison]." Morrison also contends that for the same reasons, Brean

cannot claim that it reasonably relied on Morrison's nondisclosure of any alleged malpractice and that Morrison's silence prevented it from discovering a potential malpractice claim. Finally, Brean can not avail itself of equitable estoppel because even if the statute of limitations began to run in April 2011, Brean learned of the Kroll Report in January 2014, within the statutory time period, and only sought a tolling agreement in August 2014.

Morrison next maintains that its conduct was not the proximate cause of Brean's liability to the SEC or legal fees it incurred. Proximate cause cannot be established through an attorney's failure to inform its client of information that was in the client's possession. Here, Macquarie was in possession of the Kroll report, and Macquarie's knowledge – actual or constructive – is imputed to Brean, because Macquarie was Brean's representative.

In addition, Morrison contends that a legal malpractice claim re-pled as a fraud claim to avoid the limitations period must be dismissed as duplicative. In any event, in its fraud claim, Brean fails to plead that the opinion letter contained any actionable misrepresentation, and fails to plead that Morrison had any intent to deceive. In addition, Brean's claim that Morrison committed fraud by terminating the attorney-client relationship with Brean without disclosing the falsity of the opinion letter is also insufficiently pled because (1) failures to disclose malpractice are not grounds for fraud liablity; (2) the letter was not false; (3) there was no reasonable reliance; and (4) no damages arose as a result of anything Morrison stated or did not state in the letter, which was written three days after the securities litigation had begun and months after the end of the subject transaction.

Finally, Morrison argues that Brean may not recover damages based on its settlement costs from the securities class action because (1) Brean's damages claim is a disguised claim for indemnification of securities liability, which is preempted by the federal securities laws; and (2) as a matter of law, Brean cannot establish that Morrison was the "but for" cause of the settlement

costs, which are solely attributable to the Section 10(b) claim. Further, Brean will not succeed on its claim for attorneys fees or other litigation expenses it incurred in connection with the securities action or the SEC investigation, because it is merely another form of disguised contribution and/or indemnification, and the American Rule precludes recovery of attorneys fees and litigation expenses in instances like this where its injury was caused, at least it part, by its own wrongdoing.

In opposition, Brean argues that equitable estoppel applies to toll the statute of limitations because Morrison's misconduct prevented it from timely filing an action. Brean maintains that Morrison's withdrawal as counsel did not exempt it from its professional obligation to disclose its malpractice, and Brean reasonably relied on Morrison's silence about its due diligence failures in discovering Puda's fraud, and the existence of the Kroll report (which it only became aware of in January 2014). In addition, contrary to Morrison's contention, Brean was not on inquiry notice of the malpractice as of April 8, 2011. The disclosures at that time merely revealed Puda's fraud, not Morrison's malpractice. Further, the email referred to by Morrison, from a securities litigation partner at Brean to two employees at Brean and Macquarie that Brean was considering "going after MoFo" provides no basis for concluding that Brean had notice of the misrepresentations in Morrison's opinion letter and its due diligence failures in discovering Puda's fraud. The fact that Brean, in fact, did not "go after" Morrison at that time is further proof that the email was of no consequence. If anything, the interpretation of that email requires further discovery. Further, Brean contends that it acted reasonably in entering the tolling agreement only a few months after it became aware of the existence of the Kroll Report.

Brean next argues that it adequately pled causation. First, it cannot be charged with Macquarie's knowledge of the Kroll Report because Macquarie was not Brean's authorized agent. Second, it maintains that Morrison's responsibility as underwriter's counsel included independently investigating Puda's purported ownership in Shanxi Coal. As part of its legal due diligence work,

Morrison was tasked with using its legal expertise and knowledge of China-based transactions to gain a full understanding of the ownership and operating structure of Puda and its subsidiaries in China, and bringing any information that was contrary to Puda's representations to Macquarie's and Brean's attention. Morrison failed to do so, both before and after its receipt of the Kroll Report, which it was duty bound to review. Brean contends that had Morrison properly conducted the due diligence with which it was charged, raised the ownership issue with Brean and not issued the false opinion letter, Brean would have determined that it should withdraw from the Puda deal.

In addition, Brean argues that its fraud claim is not duplicative of its malpractice claim. Its malpractice claim states that Morrison was negligent in conducting its due diligence and in issuing its opinion letter without discovering Puda's true ownership in Shanxi. Brean's fraud claim alleges that (1) Morrison made misrepresentations in the opinion letter, in "affirmatively represent[ing] to Plaintiff that the firm had completed the work necessary in order to form its opinion" when in fact, it was issued with actual or constructive knowledge of its falsity; and (2) Morrison committed fraud by withdrawing as counsel without revealing its professional misconduct.

Finally, Brean argues that it has properly pled damages, in that (1) it may receive damages for sums expended in the SEC action; (2) it is permitted to seek recovery from an attorney in a legal malpractice case for damages incurred by its client through a separate securities action; (3) the American Rule does not apply here because a plaintiff is permitted to seek damages for legal costs it was compelled to expend in another litigation that results from the malpractice committed by its attorney; and (4) it is seeking restitution of legal fees paid to Morrison in connection with its retention and work as underwriter's counsel.

Discussion

The statute of limitations for malpractice is three years, and the limitations period begins to run on the day an actionable injury occurs, even if the aggrieved party is then ignorant of the wrong or injury. CPLR 214; *McCoy v. Feinman*, 99 N.Y.2d 295, 301 (2002).

The doctrine of equitable estoppel is an extraordinary remedy which may bar a defendant from asserting a statute of limitations defense, when the plaintiff was prevented from filing an action within the applicable time period due to its reasonable reliance on defendant's fraud, misrepresentations or deception. *Putter v. North Shore Univ. Hosp.*, 7 N.Y.3d 548 (2006); *Pahlad v. Brustman*, 33 A.D.3d 518, 519 (1st Dept. 2006) *affd* 8 N.Y.2d 901 (2007). The party seeking estoppel must demonstrate due diligence on its part in trying to ascertain the facts and commence this action. *Walker v. New York City Health & Hosps. Corp.*, 36 A.D.3d 509 (1st Dept. 2007). Equitable estoppel will not toll a limitations statute, however, where a plaintiff possesses timely knowledge sufficient to have placed it under a duty to make inquiry and ascertain all the relevant facts prior to the expiration of the applicable statute of limitations. *Rite Aid Corp. v. Grass*, 48 A.D.3d 363 (1st Dept. 2008).

At oral argument, Brean acknowledged that its malpractice claim accrued in December 2010, when the Puda public offering of stock occurred. It was then on inquiry notice of a potential malpractice claim as of April 2011, when Puda's fraud was disclosed to the public. At that time, and certainly shortly thereafter when the first class action lawsuit was commenced against it, Brean was charged with making further inquiry and ascertaining all relevant facts and possible failures that occurred on Morrison's part in failing to discover Puda's actual ownership interest in Shanxi.

In the April 10, 2011 email, Brean senior executives indicated "once it goes into litigation, we'll break off from them (Macquarie) as we may be going after [Morrison]," which demonstrates that, at least, Brean was aware of the possibility that malpractice may have occurred, even before

Brean became aware of the existence of the Kroll Report and Morrison's lack of awareness of the contents thereof. That awareness triggered Brean's duty to make further inquiry and ascertain all relevant facts.

Finally, Brean was unequivocally on notice of a potential malpractice claim when it became aware of the existence of the Kroll Report in January 2014, and yet still did not exercise due diligence in commencing this action, or even executing a tolling agreement, which was only executed in August 2014. Brean then commenced this action in February 2016. Based on the foregoing, the doctrine of equitable estoppel does not apply here to bar the statute of limitations defense. This is not an instance where a plaintiff was prevented from filing an action within the applicable time period due to its reasonable reliance on defendant's fraud, misrepresentations or deception. The three year statute of limitations bars Brean's malpractice claim.

Brean's fraud claim must also be dismissed. Brean's fraud claim alleges that Morrison made misrepresentations in the opinion letter, in "affirmatively represent[ing]to Plaintiff that the firm had completed the work necessary in order to form its opinion" when in fact, it was issued with actual or constructive knowledge of its falsity, and by withdrawing as counsel without revealing its professional misconduct. While the fraud claim timely falls within the six year statute of limitations period, Brean's allegations of fraud are insufficient to state a cause of action.

First, it is well settled that concealment by a professional, or failure to disclose his or her own malpractice, does not give rise to a cause of action in fraud or deceit separate and different from the customary malpractice action, thereby entitling the plaintiff to bring his action within the longer period limited for such claims. *Weiss v. Manfredi*, 83 N.Y.2d 974 (1994); *Simcuski v. Saeli*, 44 N.Y.2d 442, 452 (1978). Here, Brean filed its malpractice complaint, and only after Morrison moved to dismiss the complaint on statute of limitations grounds, did Brean file an amended

complaint alleging fraud. Brean's allegation of Morrison's concealment of its malpractice by resigning as counsel does not give rise to a claim for fraud.

Further, the remaining basis for the fraud claim is duplicative of the legal malpractice claim because it arose from the same underlying facts and alleged similar damages. *See Dinhofer v Medical Liab. Mut. Ins. Co.*, 92 A.D.3d 480 (1st Dept. 2012). The key to determining whether a claim is duplicative of one for malpractice is discerning the essence of each claim. *Johnson v. Proskauer Rose LLP*, 129 A.D.3d 59, 68 (1st Dept. 2015). In the remaining basis for its fraud claim, Brean alleges that Morrison made misrepresentations in the opinion letter, in "affirmatively represent[ing] to Plaintiff that the firm had completed the work necessary in order to form its opinion" when in fact, it was issued with actual or constructive knowledge of its falsity. Its malpractice claim states that Morrison was negligent in conducting its due diligence and in issuing its opinion letter without discovering Puda's true ownership in Shanxi. The allegations in both of those claims arise from the same underlying facts and allege similar damages.

In accordance with the foregoing, it is hereby

ORDERED that defendant Morrison & Foerster LLP's motion to dismiss the complaint is granted and the complaint is dismissed; and it is further

ORDERED that the Clerk of the Court is directed to enter judgment accordingly.

This constitutes the decision and order of the court.

Dated: New York, New York
March 28, 2017

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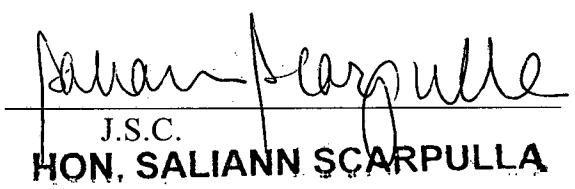

J.S.C.
HON. SALIANN SCARPULLA