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BRADLEY L. RICE
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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

1650 BROADWAY ASSOCIATES, INC., ELLEN STURM, GST EXEMPT STURM FAMILY TRUST, GST NONEXEMPT STURM FAMILY TRUST, ELLEN STURM, GST EXEMPT STURM FAMILY TRUST, GST NONEXEMPT STURM FAMILY TRUST,

Plaintiffs-Appellants,

—against—

KENNETH STURM, GETZEL SCHIFF & PESCE, LLP, JOHN DOES 1-10, ABC CORPORATIONS 1-10,

Defendants-Respondents.

CASE NO. 2023-02815

BRIEF FOR PLAINTIFFS-APPELLANTS

BRADLEY L. RICE
NAGEL RICE LLP
230 Park Avenue, Suite 1000
New York, New York 10169
(212) 551-1465
brice@nagelrice.com

NAGEL RICE LLP
103 Eisenhower Parkway
Roseland, New Jersey 07068
(973) 618-0400

Attorneys for Plaintiffs-Appellants

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PRELIMINARY STATEMENT

Plaintiffs-Appellants (i) Ellen Sturm, the GST Exempt Family Trust and the GST Non-Exempt Family Trust, derivatively on behalf of 1650 Broadway Associates Inc. d/b/a Ellen's Stardust Diner; (ii) 1650 Broadway Associates Inc. d/b/a Ellen's Stardust Diner (the "Diner"); and (iii) Ellen Sturm ("Ellen"), the GST Exempt Family Trust (the "Exempt Trust") and the GST Non-Exempt Family Trust (the "Non-Exempt Trust"), individually as shareholders of the Diner (collectively, "Plaintiffs") appeal from the decision and order of the of the Supreme Court, New York County (Hon. Andrew Borrok, J.S.C.) dated April 24, 2023 and entered April 28, 2023 (hereinafter referred to as the "Order"), which granted defendant Getzel Schiff & Pesce LLP's ("GSP") motion to dismiss the Amended Complaint of Plaintiffs.

This appeal arises from the dismissal of all of Plaintiffs' causes of action asserted against GSP, their former accountants who prepared Plaintiffs' yearly tax returns and financial statements, and served as Plaintiffs' financial advisor, including attending yearly meetings with Ellen to discuss the financial health of the Diner. However, GSP also served as the accountants for Ellen's son, co-defendant Kenneth Sturm ("Kenneth"), who stole substantial sums of money from the Diner through improper "loans" from the Diner to himself, and in forging Ellen's name on the guaranty of a bank loan to the Diner, the proceeds of all such actions were used in

part to fund numerous unrelated business ventures of Kenneth, for which GSP served as Kenneth's accountants. Despite the conflicts of interest posed by GSP's simultaneous representation of Plaintiffs and Kenneth and having sufficient information to know to that Kenneth was either stealing from the Diner and Ellen, or at a minimum, taking substantial cash from the Diner, year after year GSP admittedly never informed Ellen of Kenneth's conduct until Ellen herself finally learned what occurred when she retained a new accounting firm to review the Diner's books and records.

Despite GSP's admitted failure to be candid with their client Ellen, the motion court granted GSP's motion to dismiss in its entirety in a one paragraph opinion. Specifically, the motion court held that because Kenneth's "'loans' were properly disclosed in the [Diner's] financial statements … [Plaintiffs] fail[s] to otherwise state a claim as to how the Accountants deviated from the accepted standard of care for accountants in executing their duties and responsibilities pursuant to the Engagement Letters including how they aided and abetted Kenneth Sturm's clandestine extraordinary unauthorized salary increases, his alleged forgery of Ms. Sturm's signature on the Citibank loan documents and other alleged misappropriation of diner assets." This opinion is both brief and all together wrong and must be reserved.

First, the motion court's dismissal of the first amended complaint ("FAC") as against GSP contains an inherent logical inconsistency that requires reversal of the

Order. In dismissing, the case against GSP, the motion court stated that Kenneth's loans were fully disclosed in the Diner's financial statements and thus there was nothing to demonstrate that GSP deviated from the accepted standard of care of accountants. However, in the very next paragraph of the Order, the motion court acknowledges that "according to the Accountants, Ms. Sturm was not aware of Mr. Sturm's conduct until 2019" and "nothing appears to have put her on inquiry notice" of such conduct. As it is both admitted and alleged in the FAC that GSP never disclosed to Ellen that Kenneth was engaged in fraudulent conduct or even that he was taking millions in "loans" from the Diner that would have a material impact on the Diner's business at any of the yearly meetings at which GSP was supposed to walk Ellen through the Diner's financial statements and tax returns. It is impossible to conclude that the "loans" were "properly disclosed." This fact alone should have been the basis to deny GSP's motion to dismiss and permit the parties to pursue their claims and defenses in discovery.

Second, contrary to the motion court's Order, Plaintiffs' claim for accounting malpractice was not based on whether the "loans" were disclosed in the yearly tax returns and financial statements. Rather, as alleged in great detail in the FAC, Plaintiffs contend that GSP breached its duties to Plaintiffs based on the inherent conflict of interest posed by their simultaneous representation of Plaintiffs and Kenneth and GSP's failure to disclose to Ellen the insider loans Kenneth was taking

or that funds from the Diner (including a loan that Kenneth fraudulently obtained with Ellen's forged signature as a guarantor) were being used to fund Kenneth's independent business activities.

Third, given GSP's admission that Ellen never knew of Kenneth's loans prior to 2019 and that GSP was clearly aware of the same as they booked such loans on the Diner's yearly financial statements and tax returns, it was improper for the motion court to dismiss Plaintiffs' cause of action for aiding and abetting fraud. Based on the allegations in the FAC, GSP was aware (or should have been aware) that Kenneth was stealing from the Diner to fund his own personal business ventures or at a minimum was engaged in insider transactions that required the approval and consent of Ellen as the majority shareholder of the Diner. Further, GSP's silence over a seven year span substantially assisted Kenneth's theft of millions of dollars while Ellen was left completely in the dark, under the assumption that her son was properly running the family business.

Fourth, should this Appellate Court reverse the motion court, Plaintiffs respectfully submit that any claims that are remanded against GSP include as damages the entirety of the loans taken by Kenneth as Plaintiffs' forgiveness of the loans as to Kenneth did not waive or release any claims Plaintiffs have against GSP relating to those loans.

Accordingly, for these reasons as stated herein, the motion court's Order dismissing this matter as against GSP should be reversed and this matter should be remanded to the motion court so that the parties can pursue discovery.

STATEMENT OF QUESTIONS PRESENTED

1. Did GSP's admission that Ellen never knew of Kenneth's loans at the time they were taken warrant denial of GSP's motion to dismiss? *The motion court failed to address this issue in the Order as it relates to the causes of action against GSP, despite relying on this admission to deny Kenneth's motion to dismiss.*

2. Did Plaintiffs' FAC sufficiently state a cause of action for accounting malpractice based on GSP's conflict of interest in representing both Plaintiffs and Kenneth where Kenneth's "loans" were known to GSP and admittedly never disclosed to Ellen? *The motion court held that because the "loans" were disclosed in the financial statements, Plaintiffs could not state a cause of action for accounting malpractice.*

3. Did Plaintiffs FAC set forth sufficient allegations to survive a CPLR §3212 motion to dismiss of Plaintiffs' aiding and abetting fraud cause of action where GSP was aware of the loans taken by Kenneth and his use of monies from the Diner to fund his other business interests and failed to take any action, including advising Ellen of such conduct, which allowed Kenneth's fraud to continue unabated for seven years. *The motion court failed to address this question in any substantive*

manner other than stating that the disclosure of the loans on the financial statements precluded the cause of action.

4. Did Ellen's causing the Diner to forgive Kenneth's loans release or waive any claims Plaintiffs may have against GSP for the damages incurred by the improper loans? *The motion court did not address this in its Order but indicated in oral argument and its prior dismissal that the forgiveness of Kenneth's loan bars any claims related to such loans.*

STATEMENT OF FACTS AND PROCEDURAL HISTORY

A. The Diner

Ellen founded and opened the Diner in 1987, locating the restaurant in the Broadway district of midtown Manhattan, New York. R. 120 (FAC ¶17). The Diner was one of the first 1950s themed restaurants in New York City and is famous for its singing wait staff. R. 120 (FAC ¶18). On or about October 5, 1992, as part of Ellen's decision to move the location of the diner to its current location at 1650 Broadway, New York, New York, the Diner was incorporated as a New York corporation. R. 121 (FAC ¶20). On or about October 6, 1992, the Diner enacted by-laws to govern the operations of the business. R. 121 (FAC ¶21). The directors of the Diner were to be Irving Sturm ("Irving") (Ellen's husband), Ellen and Kenneth, with Irving serving as the Diner's president, Ellen as its vice-president, and Kenneth

as its treasurer and secretary. R. 121 (FAC ¶22). On September 18, 2010, Irving passed away. R. 121 (FAC ¶23).

Upon the death of his father, Irving Sturm, in 2010, Kenneth took control of the day-to-day management of the Diner, while his mother, Ellen acted only as a figurehead and was not involved in the Diner's operations or finances, which she trusted Kenneth to handle. R. 121-122 (FAC ¶¶ 24-27).

B. Kenneth's Fraudulent "Loans" Are Used To Fund Kenneth's Personal Non-Diner Business

Between 2012 and 2018, in addition to causing the Diner to pay him an ever-increasing salary, Kenneth caused the Diner to make distributions to him that were booked as loans made by the Diner to him. R. 122-123 (FAC ¶¶ 30-35). In addition, GSP booked numerous unexplained entries throughout each year that were created solely to evidence a reduction Kenneth's outstanding loan balance. R. 123 (FAC ¶35). As of the end of calendar year 2019, the unpaid balance owed on these "loans" was close to $12 million, representing approximately 90% of the Diner's balance sheet assets. R. 124 (FAC ¶ 38); R. 351.

These funds were used by Kenneth to finance his lifestyle and business opportunities separate and apart from the Diner.

In addition, to the foregoing, without Ellen's knowledge or consent, Kenneth fraudulently obtained a $2.5 million loan for the Diner from Citibank utilizing a forgery of Ellen's signature on a guaranty. After being contacted by Citibank about

repayment of this loan, Ellen personally repaid it. R.128-129 (FAC ¶¶58-62,64-66). Given that Kenneth did not have copies of her personal financial statements and tax returns to provide to Citibank, Ellen believed that Kenneth obtained those documents from GSP. R. 128-129 (FAC ¶ 63).

When Citibank sought repayment of the loan, it asked Ellen as the guarantor to ensure payment was made. R. 130 (FAC ¶69). Having no options to defend against the bank, given Kenneth's financial position, and the risk to the Diner, Ellen agreed to repay the loan personally. Id.

C. GSP Serves As Accountants To Both Plaintiffs And Defendants, But Fails To Disclose Kenneth's Conduct To Ellen

At all times during this misconduct, GSP served as accountants to each of the Diner, Ellen personally, the plaintiff Trusts, Kenneth personally, and various business entities that Kenneth created, owned or was otherwise invested in. R. 131 (FAC ¶¶ 77-79). The terms of GSP's retention were set forth in yearly engagement letters. R. 132 (FAC ¶80); R. 304-328. The engagement letters covering calendar years 2012 through 2018 provided for the preparation of Federal, New York State, and New York City tax returns for those years. R.304-328. In addition, those engagement letters provided for the preparation of compiled financial statements for 2012 through 2016 and reviewed financial statements for 2017 and 2018. R.304-328. A separate engagement letter dated February 23, 2019 provided for the preparation of "2018 income tax returns," and was in addition to a prior retainer

agreement dated February 7, 2018 providing for financial statements and tax returns for both 2017 and 2018. R. 320-328.

Each of the engagement letters specified that, in performing its services, GSP would provide its services in accordance with the Statements on Standards for Accounting and Review Services (the "SSARS") issued by the American Institute of Certified Public Accountants (the "AICPA"). R. 132 (FAC ¶¶81-94); R. 304-328. The retainer agreement dated February 7, 2018, covering 2017 and 2018 reviewed financial statements and tax returns, added that GSP also would "comply with applicable professional standards, including the AICPA's Code of Professional Conduct (the "AICPA Code"), and its ethical principles of integrity, objectivity, professional competence, and due care, when preparing the financial statements and performing the review engagement." R. 316-319. The February 23, 2019 retainer agreement specified that GSP would comply with U.S. Treasury Department Circular 230 ("Circular 230"). R. 320-328.

GSP was aware that Kenneth managed the day-to-day operations of the Diner, including its finances and was GSP's primary and sole point person to handle the Diner's tax returns and financial statements. R. 136 (FAC ¶100). As such, every year, the Diner's tax returns and financial statements were delivered to Kenneth, not Ellen. R. 137 (FAC ¶ 105).

In addition to preparing financial statements and tax returns for the Diner under written engagement letters with the Diner, GSP personnel (i) agreed to conduct period reviews of the Diner's financial statements and (ii) held annual meetings with Ellen that were not required by or mentioned in the engagement letters. R. 131, 137 (FAC ¶¶ 78, 107). At each annual meeting from 2002 through 2018, GSP managing partner Jeffrey A. Getzel met with Ellen at her residence and gave her a broad summary of the Diner's finances, as she relied on GSP to give her the information they believed she would need to have some oversight of the Diner. R. 137-138 (FAC ¶¶ 107-108). However, at no time between 2002 and 2019 did Mr. Getzel or anyone at GSP disclose to Ellen that Kenneth had taken almost $12 million in loans from the Diner or that GSP had booked those loans in the Diner's tax returns and financial statements and made certain balance adjustments to the loans without back up or support. R. 136-138 (FAC ¶¶ 102-104, 110).

While the financial statements and tax returns that GSP prepared showed the funds Kenneth had withdrawn and booked as loans, at the time these "loans" were made and later booked, Ellen was unaware of the distributions. R. 124 (FAC ¶40). In fact, Ellen did not learn of the loans until the summer of 2019 and Mr. Getzel admitted in an email that he sent on August 9, 2019 that he knew that Ellen was unaware of any of the loans when they were taken or at any time prior to the summer of 2019. R. 138-139 (FAC ¶ 112); R. 2434-2435.

D. In 2019, Ellen Finally Learns Of Kenneth's Embezzlement When She Hires New Accountants

In 2019, Ellen hired new personal accountants, and first learned about the loans from the Diner to Kenneth, as well as (i) hundreds of thousands of dollars in payments Kenneth caused the Diner to make to companies he operated and (ii) substantial salary increases Kenneth took for himself on top of the yearly distributions he received as a shareholder of the Diner. R. 124-126 (FAC ¶¶ 41-52). In light of the new accountants' concerns that leaving the loans to Kenneth outstanding created a risk that the IRS might revoke the Diner's status as an S corporation, which would have had devastating tax consequences to the shareholders, which was primarily Ellen and the Trusts, and Kenneth's lack of assets and pending litigation, Ellen elected to have the Diner forgive the loans. R. 127-128 (FAC ¶¶ 53-57). However, in forgiving the loans to Kenneth, neither Ellen nor any of the Plaintiffs entered into any agreement or made any statement that would evidence any intent to release any claims Plaintiffs may have against Kenneth (or ostensibly GSP). R. 127-128 (FAC ¶¶ 53-57).

E. Procedural History

Plaintiffs filed this action by a summons with notice on March 12, 2021. R. 16. On April 21, 2021, Plaintiffs filed the Complaint (NYSCEF Doc. No. 1). The defendants GSP and Kenneth filed initial motions to dismiss filed, which were granted without prejudice and the motion court permitted Plaintiffs to file an

amended pleading. R. 56, 97. Thus, on July 1, 2022, Plaintiffs filed the FAC. R. 116. On October 3, 2022 GSP filed a motion to dismiss R. 9. and Kenneth filed a motion to dismiss. R. 256. Plaintiffs filed opposition to the defendants' motions on December 9, 2022. R. 2446; R. 2475. Then on January 10, 2023, the defendants filed their reply briefs in further support of their motions to dismiss. R. 2500; R. 2518.

On April 24, 2023, the motion court issued the Order wherein the motion court dismissed Ellen's FAC against GSP in its entirety. R.4-6. Rather than detailing the various standards to be met and the arguments the parties had made for and against dismissal and why the Court deemed those arguments to justify dismissal, or not, the only explanation the Court gave for the dismissal was:

> Because Ken Sturm's extraordinary "loans" were properly disclosed in the financial statements, and AC fails to otherwise state a claim as to how the Accountants deviated from the accepted standard of care for accountants in executing their duties and responsibilities pursuant to the Engagement Letter including how they aided and abetted Kenneth Sturm's clandestine extraordinary unauthorized salary increases, his alleged forgery of Ms. Sturm's signature on the Citibank loan documents and other alleged misappropriation of diner assets.

R. 5. However, when addressing Kenneth's motion to dismiss, the Court held as follows:

> For the avoidance of doubt, the documentary evidence does not utterly refute the Plaintiffs' claims. Among other things, the financial statements which Mr. Sturm is alleged to have hidden from Ms. Sturm, did not disclose his extraordinary salary increases and other alleged misappropriation of diner asset, all taken without proper approval. Indeed, according to the Accountants, Ms. Sturm was not aware of Mr. Sturm's conduct until 2019. Although nothing appears to have put her

> on inquiry notice such that the claims could be said to be time barred, this is not properly resolved at this stage of the litigation in any event. Lastly, the Court notes that the Plaintiffs have standing.

R. 6.

On May 12, 2023, Plaintiffs filed a notice of appeal. R. 2.

ARGUMENT

I. STANDARD OF REVIEW

In analyzing an appeal of a motion court's decision on a motion to dismiss pursuant to CPLR 3211, the inquiry is limited "to the four corners of the pleading, the allegations of which … must [be] give[n] a liberal construction and accept[ed] as true." Johnson v. Proskauer Rose LLP, 129 A.D.3d 59, 67 (1st Dep't 2015) (citation omitted). The plaintiff in the underlying matter (in this case, the Respondent) must be afforded "the benefit of every possible favorable inference." Id. "Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining" whether a motion to dismiss was properly granted or denied. Id. (citing EBC I, Inc. v. Goldman, Sachs & Co., 5 N.Y.3d 11, 19 (2005)). This deferential standard applies not only to a motion to dismiss for failure to state a cause of action under CPLR 3211(a)(7), but also a motion to dismiss based on the statute of limitations pursuant to CPLR 3211(a)(5). Id. (citing New York Tel. Co. v. Mobil Oil Corp., 99 A.D.2d 185, 192 (1st Dep't 1984)).

"[I]t is firmly established that the court's inquiry on a motion to dismiss the complaint for failure to state a cause of action and on a summary judgment motion . . . are drastically different. Higgins v. New York Stock Exch., Inc., 10 Misc. 3d 257, 282 (N.Y. Sup. 2005) (citing Tenzer v. Capri Jewelry, Inc., 128 A.D.2d 467, 469 (1st Dep't 1987)). A claim that a pleading lacks "sufficient facts" or that there is a "lack of evidence" to support a claim "confuse[s] the pleading requirements applicable to a motion to dismiss, pursuant to CPLR 3211(a)(7), with the evidentiary standard of review applicable to a summary judgment motion, pursuant to CPLR 3212." Abimola v. Metro. Transp. Auth., 37 Misc. 3d 1221(A) (N.Y. Sup. Ct. 2012).

The Appellate Departments of New York review motion court decisions for motions to dismiss pursuant to CPLR 3211, *de novo*, and like the motion court, the Appellate Court must "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory." Leon v. Martinez, 84 N.Y.2d 83, 87–88 (1994). On the other hand, on a motion for summary judgment the court necessarily "searches the record and looks to the sufficiency of the underlying evidence." Tenzer, 128 A.D.2d at 469. Thus, unless a party invokes CPLR 3211(c) and the court notifies the parties that it intends to treat the motion to dismiss as one for summary judgment, it is improper to consider evidence beyond

the pleadings in adjudicating the motion to dismiss. See Four Seasons Hotels Ltd. v. Vinnik, 127 A.D.2d 310, 318 (1987).

II. THE MOTION COURT COMITTED REVERSIBLE ERROR IN DISMISSING PLAINTIFFS' COMPLAINT AGAINST GSP

A. THE MOTION COURT ERRED IN IGNORING GSP'S ADMISSION THAT ELLEN NEVER KNEW OF KENNETH'S FRAUDULENT CONDUCT FOR EACH TAX YEAR AT ISSUE

The most glaring and obvious error in the motion court's Order is how the motion court ignored GSP's admission that Ellen had no knowledge of the loans prior to 2019 in dismissing GSP from the suit, but in the very next paragraph, relied on that admission to deny Kenneth's motion to dismiss. R. 4-5. GSP's partner, Mr. Getzel, admitted that Ellen was unaware of any of Kenneth's loans before 2019. R. 2434-2435. In light of that admission, the FAC's allegations that all tax documents and financial statements of the Diner were provided to Kenneth, not Ellen (R. 134, FAC ¶¶104-106) and that Ellen was never advised of the loans during the yearly meetings Mr. Getzel had with her (R. 137, FAC ¶ 107), it was reversible error to hold that these loans had been disclosed to Ellen in any fashion.

The FAC makes clear that GSP knowingly provided only Kenneth with the disclosure of the loans, took no steps to ensure Ellen was made aware of the loans by either providing her copies of the tax returns and financial statements (as opposed to assuming that Kenneth would do so) or by disclosing the loans during their meetings. Yet, none of these facts are addressed by the motion court. As such, the

motion court's holding that the loans were "properly disclosed" was erroneous and should be reversed.

B. THE MOTION COURT ERRED BY NOT ACCEPTING PLAINTIFFS' ALLEGATIONS OF ACCOUNTING MALPRACTICE AS TRUE GIVEN THE CLEAR CONFLICTS OF INTEREST POSED BY GSP'S ROLE AS ACCOUNTANTS TO PLAINTIFFS AND KENNETH AND ADMITTED FAILURE TO DISCLOSE KENNETH'S IMPROPER LOANS

The basis of the motion court's Order dismissing Plaintiffs' accounting malpractice cause of action is premised solely on the fact that "because Ken Sturm's 'extraordinary loans' were properly disclosed in the financial statements … AC fails to otherwise state" a claim for accounting malpractice. R. 4. Yet the motion court's Order completely fails to address the detailed allegations of the FAC that assert how the irreconcilable conflict of interest between GSP's representation of Plaintiffs and Kenneth fail to properly allege a "deviation from the accepted standard of care for accountants in executing their duties and responsibilities pursuant to the Engagement Letter[s]." As set forth herein, because Plaintiffs' FAC clearly alleges how GSP's failure to raise the conflict of interest to Ellen or otherwise take reasonable steps to protect Plaintiffs in the face of such conflicts constitutes breach of AICPA standards, the accountants' own standards of practice, the motion court's Order must be reversed.

"Accounting malpractice … contemplates a failure to exercise due care and proof of a material deviation from the recognized and accepted professional

standards for accountants ….." Board of Trustees of IBEW Local 43 Elec. Contractors Health & Welfare, Annuity & Pension Funds v. D'Arcangelo & Co., LLP, 124 A.D.3d 1358, 1359, 1 N.Y.S.3d 659, 661 (2015). A claim of malpractice requires proof that there was a departure from the accepted standards of practice and that the departure was a proximate cause of the injury. See Friedman v. Anderson, 23 A.D.3d 163, 164-65, 803 N.Y.S.2d 514, 516 (1st Dept. 2005). Where a plaintiff alleges that the accountant deviated from an accepted standard of practice and that deviation caused plaintiff's damages, then the plaintiff has sufficiently plead a cause of action for accounting malpractice. See Board of Trustees of IBEW, 124 A.D.3d at 1359, 1 N.Y.S.3d at 661; Schwartz v. Leaf, Saltzman, Manganelli, Pfeil, & Tendler, LLP, 2013 WL 10208474 (Sup Ct. May 13, 2013), *aff'd in part* Schwartz, 123 A.D.3d at 902, 999 N.Y.S.2d at 445-46.

New York courts have held that the failure to withdraw representation in the face of a conflict of interest can constitute accounting malpractice, among other causes of action. See Warshaw v. Mendelow, 2011 WL 11100990 (Sup. Ct. Dec. 16, 2011) ("With respect to defendants' alleged failure to reveal a conflict of interest, the record demonstrates that defendants benefitted from the purported failure to disclose this information, and that this failure to disclose was a causative factor in the injury sustained by plaintiffs. Based on these allegations, plaintiffs have adequately alleged a claim of accounting malpractice against Mendelow and KW.");

see also, Nate B. & Francis Spingold Foundation v. Wallin, Simon, Black and Co., 184 A.D.2d 464, 585 N.Y.S.2d 416 (1st Dept. 1992) ("where the allegations include knowledge and concealment of illegal acts and diversions of funds and failure to withdraw in the face of a conflict of interest, as in the case at bar, such a cause of action against an accountant will be permitted to stand."). Separately, ignoring suspicious activities of a client that evidence fraud is itself a separate form of malpractice. See 1136 Tenants' Corporation, Respondent, v. Max Rothenberg & Company, 36 A.D.2d 804, 319 N.Y.S.2d 1007 (1st Dept. 1971) (accounting firm retained to perform unaudited services committed professional malpractice by ignoring suspicious circumstances and failing to inform its client of missing invoices).

One source of professional standards applicable to accountants is the AICPA Code. R. 132 (FAC ¶¶ 84-87). These standards are not only developed and maintained by the accounting profession, but are incorporated into GSP's obligations to Plaintiffs in the yearly engagement letters. R. 132 (FAC ¶¶81-94); R. 304-328. The AICPA Code emphasizes the need for accountants to "maintain objectivity and be free of conflicts of interest in discharging professional responsibilities." R. 132 (FAC ¶ 84). As alleged in the FAC, the AICPA Code also contains express provisions that govern what accountants must do when they identify "threats" that create conflicts of interest between their clients. R. 133-135

(FAC ¶¶ 86-93). Importantly, AICPA provides guidance and a standard of care that requires accountants to disclose conflicts of interests to their clients and obtain the consent of the clients to continue performing the accounting services regardless of the nature of the conflict that arises. R. 135 (FAC ¶ 94). Thus, contrary to the motion court's opinion, the issue at bar as to Plaintiffs' accounting malpractice claim was not whether the loans were "properly" disclosed in the financial statements and tax returns, but rather whether GSP owed Plaintiffs an obligation to disclose the conflict of interest presented by Kenneth's loans and other self-serving actions that were detrimental to Plaintiffs.

In the FAC, Plaintiffs clearly allege that GSP served as accountants to each of the Diner, Ellen personally, the plaintiff Trusts, Kenneth personally, and various business entities that Kenneth owned. R. 131 (FAC ¶¶ 77-79). Hence, GSP owed to each of these clients, including Ellen and the plaintiff Trusts, duties separate and apart from the duties GSP owed to the Diner. Yet, despite their independent obligations of "professional and moral judgment" to identify and disclose any conflicts of interest to each of their clients, GSP repeatedly breached these obligations over the many years that Kenneth stole the Diner's funds to pursue unrelated personal business ventures.

As is noted above, Mr. Getzel admitted that, prior to the summer of 2019, Ellen did not know about the millions of dollars that Kenneth had taken from the

Diner and invested in failing business ventures and that were reported as loans on the financial statements and tax returns until she hired a new accountant in 2019. R. 2434-2435. Because he served as the accountant for Kenneth personally, as well as those various ventures, Mr. Getzel presumably also was aware of Kenneth's precarious financial condition and the fact that Kenneth would be unable to repay the Diner for the loans he took, as such funds were invested in unrelated projects. Moreover, this conflict became more serious every year, as the amount of corporate income that Kenneth was appropriating to his own use (new loans were 71% of taxable income in 2015, 85% of taxable income in 2016, roughly four times taxable income in 2017, and close to 100% of taxable income in 2018), and the percentage of the Diner's total assets that consisted of loans to Kenneth (63% in 2015, 73% in 2016, 87% in 2017, and 89% in 2018), grew exponentially. R. 122 (FAC ¶ 31); R. 348; R. 950; R. 1063; R. 1178.

Further, GSP's yearly meetings, which went beyond GSP's obligations under its engagement letters (R. 304-328), make crystal clear GSP's breach of its duties through its silence crystal clear. GSP admits that Jeffrey Getzel met with Ellen Sturm on an annual basis. R. 154 at ¶16. Mr. Getzel indicated that the purpose of the meetings was "to go over the tax returns and financial statements." Id. Ellen, however, indicated that the purpose of these meetings was "to discuss my financial affairs and the Diner's business." R. 2428 at ¶ 19. Clearly, Ellen reasonably believed

that the meetings were held so GSP could provide her, personally, with information and advice. Yet, year after year, Mr. Getzel sat across from Ellen, knowing that Ellen had no idea that Kenneth was looting the Diner and had no idea of the consequences and risks of Kenneth's conduct, and said nothing. Under the precedent and AICPA Code provisions cited above, GSP had an obligation to disclose Kenneth's conduct to Ellen even if GSP had done nothing more than preparing financial statements and tax returns and mailing them to the parties to this litigation.[1]

Given the amounts of the loans taken by Kenneth (not even including his ever increasing salary and other misdeeds), it was or should have been clear to GSP that Kenneth's loans were (i) depriving the dinner of cash for its ordinary business operations and (ii) limiting the dividends that could be distributed to Ellen and the Trusts. In other words, Kenneth (one of GSP's clients) was taking actions that were having material, negative financial effects on three of GSP's other clients. Yet, as alleged in the FAC, and as admitted by Mr. Getzel, the loans were never disclosed to Ellen until she found out about them in 2019 upon the retention of a new accounting firm. As such, given these allegations, the motion court clearly erred in

[1] Separately, the motion court also did not address the fact that the FAC alleged that pursuant to Section 714 of the New York Business Corporation Act, any loan to Kenneth, as a director of the Diner, required Board or shareholder approval for it to be lawfully issued. However, the FAC alleges, and Mr. Getzel admits, that Ellen was never consulted on these loans and thus could not have given board or shareholder approval of the loans as the controlling shareholder of the Diner.

finding that Plaintiffs failed to allege how GSP breached generally accepted standards of care for accountants.

Separately, the motion court also failed to address how GSP's laissez faire attitude in the treatment of Kenneth's loans jeopardized the Diner's status as an S corporation and resulted in unfair allocation of income taxes on the funds distributed to Kenneth as loans. R. 126, 139 (FAC ¶¶ 50, 116). The Diner is an S corporation, and therefore a pass-through entity for tax purposes. As such, Diner profits that were "loaned" to Kenneth were taxed 11% to Kenneth and 89% to the other shareholders even though Kenneth had pocketed 100% of those profits. This disparate treatment created risk that the Diner would lose its S corporation status because of the loans. R. 126 (FAC ¶ 50). In response to this analysis, GSP did not deny that the loans might be treated by the IRS as a second class of stock, but, rather, asserted that, given the low rate of IRS audits, a loss of S corporation status was not a concern; i.e., "audit roulette." R. 126, 140 (FAC ¶¶ 50, 118); R. 2435. Ellen's new accountants, however, felt that the risk was of such significance that it was necessary to address the issue with GSP directly. R. 126 (FAC ¶ 50).

C. THE MOTION COURT ERRED IN HOLDING THAT PLAINTIFFS FAILED TO STATE A CAUSE OF ACTION FOR AIDING AND ABETTING FRAUD WHERE GSP ACTED IN A CONFLICTED MANNER AS ACCOUNTANTS TO BOTH KENNETH STURM AND PLAINTIFFS AND FAILED TO DISCLOSE KENNETH STURM'S FRAUD

To sustain an aiding and abetting fraud cause of action, plaintiffs must plead: "(1) the existence of a fraud; (2) a defendant's knowledge of the fraud; and (3) that the defendant provided substantial assistance to advance the fraud's commission." JP Morgan Chase Bank v. Winnick, 406 F.Supp.2d 247, 252 (S.D.N.Y.2005) (internal quotation marks omitted). As set forth in the FAC, Plaintiffs sufficiently stated this cause of action.

As an initial matter, there is no dispute that Plaintiffs adequately pled the existence of Kenneth's fraudulent conduct, both through his receipt of millions of dollars in improper "loans", as well as through his forgery of Ellen's signature as guarantor for a Citibank loan and the unilateral salary raises Kenneth awarded himself. As such, this prong is not subject to this appeal.

Separately, the motion Court's Order is insufficiently detailed to fully ascertain how Plaintiffs' aiding and abetting cause of action was improperly or insufficiently pled as to GSP's knowledge of Kenneth's fraud and how that silence substantially assisted Kenneth's embezzlement of Diner funds year after year. Rather, the motion court states only as follows:

> Because Ken Sturm's extraordinary "loans" were properly disclosed in the financial statements, and AC fails to otherwise state a claim as to how the Accountants deviated from the accepted standard of care for accountants in executing their duties and responsibilities pursuant to the Engagement Letter including how they aided and abetted Kenneth Sturm's clandestine extraordinary unauthorized salary increases, his alleged forgery of Ms. Sturm's signature on the Citibank loan documents and other alleged misappropriation of diner assets.

R. 5.

In stating that Plaintiffs do not allege how GSP aided and abetted Kenneth's "clandestine" actions, the motion court appears to imply that Plaintiffs failed to plead both that GSP was unare of Kenneth's fraud and how GSP "substantially assisted" Kenneth in his fraud. However, the FAC makes specific allegations establishing both prongs of an aiding and abetting cause of action.

First, with respect to Plaintiffs' allegations of "actual knowledge," direct evidence of knowledge is not required; rather, a plaintiff is entitled of to rely on circumstantial knowledge since "[t]he element of scienter ... is ... most likely to be within the sole knowledge of the defendant and least amenable to direct proof." Harbinger Capital Partners Master Fund I, Ltd. v. Wachovia Capital Markets, LLC, 2010 WL 2431613, at *9 (Sup. Ct. 2010) . At the pleading stage, plaintiffs "need not, at this time, establish the truth of their knowledge allegations, they need only allege specific facts from which it is possible to infer defendant's knowledge" of the fraud alleged. Houbigant, Inc. v. Deloitte & Touche, LLP, 303 A.D.2d 92, 99, 753 N.Y.S.2d 493, 499 (1st Dep't 2003). Moreover, allegations of "willful blindness" or

"conscious avoidance" are sufficient. See, e.g., Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC, 479 F. Supp. 2d 349, 374 (S.D.N.Y. 2007).

Moreover, allegations in a complaint that allege the defendant "knew or should have known" of the underlying fraud are not automatically deemed conclusory so long as the remainder of the complaint sets forth sufficient allegations for a court to infer that the defendants had actual knowledge of the fraud. See Weinberg v Mendelow, 113 A.D.3d 485 (1st Dep't 2014). In Weinberg, the Court concluded that the complaint sufficiently actual knowledge, stating:

> Contrary to their contention that the complaint does not allege actual knowledge of the fraud, the complaint alleges that "Konigsberg knew, or certainly should have known, that KW and Mendelow fraudulently induced Plaintiff's investments" and that KW "knew that [the monthly] statements [for FGLS, which Mendelow and KW forwarded to plaintiff,] were false."

Id. at 487–88.

The FAC makes repeated allegations as to how GSP knew that Kenneth was engaged in conduct that was fraudulent or, at a minimum, raised sufficient red flags indicating a fraudulent scheme. Specifically, GSP served as accountants to each of the Diner, Ellen personally, the plaintiff Trusts, Kenneth personally, and various business entities that Kenneth created, owned or was otherwise invested in. R. 131 (FAC ¶¶ 77-79). In this position, GSP was in a unique position to observe Kenneth's receipt of loans, salary, and other compensation from the Diner, which would be evidenced in the Diner's financial statements and tax returns, and how those monies

were then funneled into Kenneth's other businesses, which would be evident in GSP's work papers and the tax documents it prepared for Kenneth's entities. R. 131 (FAC ¶ 79). In fact, the FAC expressly alleges that Kenneth likely informed GSP that he was using the monies he obtained from the Diner to fund his personal business ventures. R. 141 (FAC ¶ 128). The FAC also goes on to explain how GSP knew or should have known of Kenneth's fraud when it booked his loans in the Diner's financial statements and created balance adjustment to those loans despite the fact that none of the loaned monies were ever repaid to the Diner. R. 142 (FAC ¶ 130).

Separately, despite GSP's principals' denials (R. 300 at ¶19; R. 1366 at ¶19), the FAC does allege that either GSP knew Kenneth had forged Ellen's signature for the guaranty of the Citibank loan, or should have known it given that the only source by which Ellen's personal financial information could have been provided to Citibank was through GSP as her accountants and GSP never sought or obtained Ellen's consent to provide such documentation to guaranty the loan. R. 138 (FAC ¶¶ 111, 132-133).

Given these allegations, it was reversible error for the Court to hold that Kenneth's fraud was "clandestine" and therefore imply that GSP had no knowledge of the embezzlement.

Second, as it relates to substantial assistance "[t]he critical test is not, as [Defendants] would have it, whether the alleged aiding and abetting conduct was routine, but whether it made a substantial contribution to the perpetration of the fraud." JP Morgan Chase Bank, 406 F.Supp.2d at 257. allegations of "willful blindness" or "conscious avoidance" are sufficient to meet Plaintiff's pleading obligations for aiding and abetting fraud. See, e.g., Cromer Fin. Ltd. v. Berger, 2003 WL 21436164, at *9 (S.D.N.Y. June 23, 2003); Fraternity Fund Ltd., 479 F. Supp. 2d at 368 ("the Court sees no reason to spare a putative aider and abettor who consciously avoids confirming facts that, if known, would demonstrate the fraudulent nature of the endeavor he or she substantially furthers"); see, also Houbigant, 303 A.D.3d at 100, 753 N.Y.S.2d at 500 ("[t]he foregoing allegations similarly support the cause of action claiming that Deloitte aided and abetted the alleged fraud by the individual 'insider' defendants, as that cause of action merely requires that the defendant affirmatively assisted, **concealed**, or **failed to act when required to do so**, in order to enable others' acts of fraud to proceed.").

This Court's decision in Weinberg is especially instructive:

> Contrary to their contention that the complaint does not allege that Konigsberg and KW rendered substantial assistance in the achievement of the fraud, the complaint alleges that plaintiff relied on the representations on KW's website about Mendelow's qualifications when deciding to invest in FGLS. It also alleges that, at Mendelow's and Konigsberg's direction, KW (FGLS's accountant) ignored irregularities in FGLS's books and records; that, if KW had reviewed

> such books and records, it would have discovered Madoff's fraud; and that plaintiff "would have redeemed his investment [in FGLS] if Defendants had informed him of the numerous warning signs of [Madoff's] fraud."

Weinberg, 113 A.D.3d at 488.

Moreover, New York courts have allowed aiding and abetting fraud claims to proceed in situations similar to the one at bar, where accountants were aware of a fraud and their silence allowed the fraud to continue. See, e.g., New York State Workers' Comp. Bd. V. Fuller & LaFiura, CPAs, P.C., 146 A.D.3d 1110, 1112, 46 N.Y.S.3d 266, 269–70 (3d Dept. 2017).

Here, under the prevailing case law of New York, GSP's admitted silence concerning Kenneth's loans and other suspicious actions constitute sufficient acts of substantial assistance that satisfy the pleading standards required to defeat a motion to dismiss under CPLR 3212. The examples of GSP's willful silence litter the FAC, including the following allegations: (i) GSP knew Kenneth, not Ellen, received the Diner's tax returns and financial statements (R. 136-137, FAC ¶¶ 100, 104-106); (ii) during GSP's annual meetings with Ellen, partner Mr. Getzel never advised her of Kenneth's loan activities or even asked if she was aware that Kenneth was taking hundreds of thousands, if not more than a million, dollars in loans on an annual basis (R. 137, FAC ¶¶ 107, 109); (iii) GSP did not confirm with Ellen whether she was aware of the Citibank loan or if she would allow her personal financial records to be shared with the bank (R. 138, FAC ¶ 111).

Moreover, GSP's silence not only permitted Kenneth to continue his fraud year after year, but violated their duties under AICPA and the Circular 230 to ensure that any potential conflicts of interest between their clients is properly disclosed in a timely manner. R. 132-135 (FAC ¶¶ 84-94). Finally, contrary to the motion court's Order, the FAC expressly includes a section of allegations on "proximate cause" that allege "how" their deliberate silence prevented Ellen from learning of Kenneth's fraud and deprived her of the ability to stop her son from stripping the Diner of monies for his own personal interests. R. 143 (FAC ¶¶ 135-137).

Accordingly, the motion court erred in dismissing Plaintiffs' aiding and abetting fraud cause of action as against GSP and this Court should reverse the motion court and remand the matter back to the Commercial Division.

D. ELLEN'S FORGIVENESS OF KENNETH'S LOANS DID NOT RELEASE OR WAIVE ANY CLAIMS PLAINTIFFS MAY HAVE AGAINST GSP FOR THE DAMAGES INCURRED BY REASON OF THE IMPROPER LOANS

In its Order dismissing Plaintiff's complaint against GSP, the motion court did not address the issue of whether the Diner's forgiveness of Kenneth's obligation to repay the loans from the Diner in and of itself barred claims against GSP relating to those loans. However, it may be implied from the motion court's Order that it did in fact hold that Plaintiffs were barred from making any claims against GSP relating to the loans in characterizing Kenneth's actions as relating to "Kenneth Sturm's clandestine extraordinary unauthorized salary increases, his alleged forgery of Ms.

Sturm's signature on the Citibank loan documents and other alleged misappropriation of diner assets." Thus, should this Court decide to reverse the motion court's Order, Plaintiffs respectfully submit that it is necessary that the Court make clear that any causes of action against GSP that are remanded to the motion court included claims and damages resulting from the improper loans taken by Kenneth.

Specifically, as the motion court focused on during the parties' initial motions to dismiss, the Diner's forgiveness of Kenneth's loans was done in an email from Ellen to Kenneth on January 21, 2021, which stated in relevant part as follows:

> To maintain harmony within the family, I am forgiving the approximately $12 million dollar loan balance you owe to the Diner. Based on the records you have produced, I have determined that you are insolvent and unable to repay the balance. I had the accountants prepare the required forms and have forwarded a copy to you.

R. 217.

This writing cannot constitute a release or waiver of any claims Plaintiffs may have against GSP concerning those loans. In other words, just because Ellen chose to cause the Diner to forgive the loans vis-à-vis Kenneth, does not mean she is not entitled to pursue the Diner's, her own, and the other Plaintiffs' rights against GSP. Specifically, Ellen's email of forgiveness is clear on its face: Ellen (on behalf of the

Diner)[2] forgave a debt runs from the Diner to Kenneth, and no person, and no claim, is being released or waived other than Kenneth's personal obligation to repay the loans he took from the Diner.

First, this email cannot constitute a waiver of any rights any Planitff may have agaisnt GSP. "Under principles of New York jurisprudence, a waiver is a voluntary relinquishment of a known right that should not be lightly presumed." JP Morgan Chase Bank, N.A. v. Ilardo, 36 Misc. 3d 359, 376, 940 N.Y.S.2d 829, 841 (Sup. Ct. 2012) (citations omited). Nothing in the January 27, 2021 email from Ellen contains any statement that Ellen, personally or in her capacity as Trustee of the Plaintiff Trusts, is waiving any right or releasing any claim that Ellen or the Trusts may have against Kenneth, GSP, or anyone else.

Second, as to the possibility of the foregoing email constituting a release, under New York law, "[a] release is a contract, and its construction is governed by contract law." Burnside 711, LLC v. Amerada Hess Corp., 175 A.D.3d 557, 559, 106 N.Y.S.3d 368, 371 (2nd Dept. 2019) (internal quotation and citation omitted). To

[2] As to whether the forgiveness of debt came from the Diner or Ellen, while Ellen wrote in her email, "I" … am forgiving" the loan, this is simply an unfortunate but understandable lack of formality from a layman. Only the Diner could forgive Kenneth's debts, as the Diner, not Ellen, was the lender. To prove this point, the email refers to, and the parties filed, a Form 1099C "Cancellation of Debt" showing that "1060 Broadway Associates, Inc." had canceled a "note receivable" owed to it by Kenneth Sturm. R. 224.

constitute a release, a writing must contain an expression of a present intention to renounce a claim. Carpenter v. Machold, 86 A.D.2d 727, 727, 447 N.Y.S.2d 46, 46–47 (3d Dept. 1982) (citation omitted). Moreover "[w]hether a release discharges a particular party depends, in the first instance, upon the intention of the parties to the instrument and the purpose for which it was given." Schuman v. Gallet, Dreyer & Berkey, L.L.P., 180 Misc. 2d 485, 488, 689 N.Y.S.2d 628 (Sup. Ct. 1999), *aff'd,* 280 A.D.2d 310, 719 N.Y.S.2d 864 (2001) (citation omitted).

Ellen's email is clear that only Kenneth is to benefit; it refers only to forgiving the loans to Kenneth and related tax issues such as filing a Form 1099C and confirming that Kenneth is insolvent. No mention is made of GSP, or anyone else, and the email is clear that its intent is to remove Kenneth's obligation to repay the loans. As such, it is clear that Ellen's "forgiveness email" did not release any person or entity other than Kenneth vis-à-vis the Diner, and that Ellen's email was not a release of any of her or the plaintiff Trusts' personal rights, but a forgiveness of debt by the Diner only. At most, the email is ambiguous on the issues of who is giving or receiving a release, which would require examination of the facts surrounding the email and, thus, dismissal would not be appropriate on this basis. Bank of Am. Nat. Tr. & Sav. Ass'n v. Gillaizeau, 766 F.2d 709 (2d Cir. 1985); Pierot v. Marom, 172 A.D.3d 928, 930, 100 N.Y.S.3d 364, 366 (2d Dept. 2019); Kass v. Kass, 91 N.Y.2d 554, 566, 673 N.Y.S.2d 350, 356-57, 696 N.E.2d 174, 180–81 (1998)

CONCLUSION

For the foregoing reasons, Plaintiffs-Appellants respectfully request that the Court reverse the Order of the motion court and remand this matter as against GSP on all causes of actions asserted against it in the FAC.

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NAGEL RICE LLP

Bradley L. Rice
230 Park Avenue
Suite 1000
New York, New York 10029
Phone: (212) 551-1465

103 Eisenhower Parkway
Roseland, New Jersey 07069
Phone: (973) 618-0400
(Please respond to the NJ Office)