SCAN

MEMORANDUM

SUPREME COURT - STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:

HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 20

RIVERSIDE CAPITAL ADVISERS, INC., as investment advisor to Winchester Global Trust Company Limited, and WINCHESTER GLOBAL TRUST COMPANY LIMITED, as trustee of The Factored Receivables Trust, as successor in interest to Highlands Financial Services, Inc.,

Plaintiffs,

INDEX NO.: 020600/1999

- against -

FIRST SECURED CAPITAL CORPORATION, WET RESOURCES CORP., THE THOMAS B. DONOVAN FAMILY TRUST and THOMAS E. WYNNE,

Defendants.

PREAMBLE

This is the story of how 7.6 million dollars was loaned to a Long Island corporation by an off shore (Bermuda) trust , to purchase 45 distressed mortgages, and how none of the money (21 million including interest) ever made it back to the lender. It is important, as the court traces the transactions and the machinations of the parties, as well as the raised defenses, not to lose track of this core fact- 7.6 million went out and nothing came back.

FINDINGS OF FACT

The Cast

Riverside Capital - Financial Advisor to Winchester Global and Factored Receivables

Trust.

First Secured Capital - The borrower on all loans (45) to purchase distressed mortgages.

Factored Receivables Trust - An off-shore trust located in Bermuda and the funding source of all loans.

Winchester Global Trust Company, Ltd. - The trustee of Factored.

Highlands Financial Services, Inc. - The alleged lender of the money to First Secured Capital for the purchase of the distressed mortgages, but actually a "beard".

Thomas Ryan - Was the owner of Riverside Capital. Financial Advisor to Factored Receivables Trust. Declared personal bankruptcy. His assets, including Riverside Capital were sold at auction in Florida.

Michael Assef - Former Comptroller and CFO of Riverside, now head of Structured Asset Services LLC which now services the assets of Factored Receivables Trust.

Thomas B. Donovan - Once mistakenly called a defendant by this Court, he and his wife are the Thomas B. Donovan Family Trust, which is a guarantor of at least $400,000 of any monies owed by First Secured to Factored. He is also the owner of First Secured Capital, as well as at least 5 or 6 other corporations to which proceeds from the sale of the distressed mortgage properties were distributed. He was precluded from testifying due to disobeyance of court orders directing him to testify at a pretrial deposition. He was present, or one might say a presence, during the entire trial and actively assisted his attorney at counsel table.

Mrs. Pamela Donovan - Wife of Thomas Donovan. She did not testify. She was present in the court room during the entire trial. She went to Florida and purchased Riverside Capital at a Bankruptcy auction for $60,000. As new owner of Riverside she fired the lawyers who were representing the corporation and hired new counsel who attempted to settle the case against First Secured on the eve of trial. The court refused to accept the settlement in that it had serious doubts that Riverside had the authority to settle such an action on behalf of Winchester or Factored or that it had an independent claim separate and apart from the other plaintiffs.

Thomas Wynne - Attorney for First Secured at time of these transactions and at one time a defendant in this case.

Chris Chalavoutis - Accountant to Thomas B. Donovan, his corporations and the

Donovan Family trust.

Jon Tarbox - A non-practicing lawyer who worked for Ryan at Riverside during the eight month period that these transactions were carried out and for a period of time thereafter. He was quite familiar with the making of the deals. He was hired by Mrs. Donovan's corporation, Entrust, in November 2002, the month that this case was originally to go to trial. He was to provide consultant services for $60,000. He denies this was a substantial part of his income, though it was slightly less than his 2002 income from all sources. He testified on behalf of the defendants at trial.

* * *

The plaintiffs' submitted a 72 page Memo of Law and the defendants' a 94 page Memo of Law. The court has relied on these memos to support the positions raised by each party and as a foundation for the court's conclusions on these diverse issues.

* * *

At trial, plaintiff Winchester Global Trust Company Limited ("Winchester"), as Trustee of the Factored Receivables Trust ("Factored" or the "Trust"), established that during an eight-month period spanning December, 1997 through July, 1998, Factored advanced $7,618,655.86 directly to defendant First Secured Capital Corporation ("First Secured"), pursuant to the terms of a Loan Agreement entered into between Highlands Financial Services, Inc. ("Highlands"), as lender, and First Secured, as borrower (the "Loan Agreement") (Ex. 1) and evidenced by a series of forty-five (45) separate promissory notes executed by First Secured in favor of Highlands (collectively, the "Notes"). (Ex. 5(a) through 50(a), inclusive.) The notes were then individually assigned to Riverside as investment Advisor to Winchester Globe (sic) Trust Company, London, as Trustee for the Factored Receivables Trust by Highlands.

After twenty-two (22) days of trial, it is unrebutted that First Secured failed to make a single payment of interest or principal in accordance with the instruments it executed.

Plaintiff argues that defendant The Thomas B. Donovan Family Trust (the "Donovan Trust") failed to meet its obligations pursuant to the Limited Guaranty which it executed on December 23, 1997 (the "Guaranty"). (Ex. 2).

At trial it was established that First Secured caused proceeds of sale to either be paid to itself or to one or more entities controlled by Thomas B. Donovan ("Donovan"), and thereby, claims the plaintiffs, First Secured misappropriated the collateral which secured Factored in the repayment of its advances, notwithstanding the terms of the Loan Agreement which required each advance to be secured by assignments of First Secured's rights to certain underlying mortgages and notes (the "Distressed Loan Collateral"), and the proceeds of sale derived from such collateral. If there was such a misappropriation, the guaranty would not be limited to $400,000 as provided for within the guarantee, but the guarantor would be liable for the full amount of any loss suffered by the lender up to the full amount of the obligations.

The instant action was brought consisting of 45 causes of action on promissory notes, breach of guaranty (46th cause of action), breach of security agreement (47th cause of action), declaratory relief on the stock pledge (48th cause of action), breach of Loan Agreement (49th cause of action), attorney fees (50th cause of action), and declaratory relief seeking substitution based upon judgment pledge agreements and assignment of action agreements (51st cause of action).

After the close of Plaintiff's case, the Court, on motion of the Defendant, dismissed Plaintiffs' 47th and 51st causes of action as to all properties except East Gate (Exhibit "6c") and Midland (Exhibit "5c"). The dismissals were due to internal defects in the security agreements, not that the parties had not actually executed the agreements.

The defendant's answer asserted the affirmative defenses of (1) lack of standing, (2) usury and (3) failure to qualify to do business in the State of New York.

There are numerous questions that must be addressed before the court can determine if plaintiffs are entitled to a favorable judgement in this action and against whom.

The defendants argue that the Loan Agreement has no validity and cannot be relied upon to support any of plaintiffs' claims that go beyond the first 45 counts based upon the individual promissory notes. Defendants contend that the notes themselves are each defective in one or more ways. Though the court denied defendant's motion to dismiss at the end of the entire case the defendant argues that the court should still be able to review the plaintiffs' entire case based upon the entirety of the evidence and then, if necessary, consider the defendants' affirmative defenses. The court will decide accordingly, but first the facts as the court finds them from the testimony and the exhibits.

The Deal

Thomas Ryan, president of Riverside Capital Advisers, Inc., testified that the genesis of the transactions which form the essence of our case was a conversation which he had with Christopher Chalavoutis, an accountant for Donovan and certain of his entities, during a plane ride in the fall of 1997. (Tr. 68). Mr. Ryan, who has been in the investment advisory business for 33 years, is a long-time resident of Florida (Tr. 49) and a principal of Riverside Capital Advisors, Inc. ("Riverside"), a Florida corporation whose offices were located in Florida. (Tr. 53). Riverside acted as investment advisor to institutional clients, and a few individuals who invested in a series of offshore funds that all had high yield characteristics. (Tr. 52). Mr. Ryan testified that in such capacity he had caused the Trusts to invest in a series of non-traditional fixed income investments which included tax liens, structured settlements, high yield bonds and factored receivables. A separate trust was dedicated to each asset class. (Tr. 940). Factored, a Bermuda Trust, whose trustee Winchester, maintains offices solely in Bermuda, invested in loans secured by the receivables of its borrowers. (Tr. 56, 71) (Ex. 170 and 171).

Chalavoutis, an accountant, explained to Ryan that his client, Donovan, engaged in the business of acquiring distressed mortgages consisting generally of residential real property that were in foreclosure. (Tr. 69). Thereafter, Mr. Ryan and Steven Massey, another principal of Riverside, met with Donovan and Chalavoutis at Riverside's office in Ft. Lauderdale, Florida to discuss the possibility of doing business together. (Tr. 70). The parties met again at First Secured's office in New York so that Riverside could acquaint itself with First Secured's operations (Tr. 73) and to discuss the basic concept of a deal. Ryan also looked into the investment history of other of Donovan's corporations in that First Secured had only recently been formed and had no track record. He was provided with material by Chalavoutis (Ex. C) that provided an investment history of other Donovan corporations. Thereafter, the parties negotiated the terms of the Loan Agreement which was executed by First Secured on November 27, 1997 and by Highlands on December 9, 1997. (Tr. 74-78). (Ex. 1).

Highlands' Role in Each Transaction

It is important to address the role Highlands played in these transactions in order for the court to move on to other issues. Highlands is a financial advisory consulting firm located in Miami, Florida. (Tr. 527-529). Ryan testified that in order to obtain tax benefits for the trust beneficiaries, the transaction was structured such that a security, in the form of a promissory note, would be created between Highlands, as lender, and First Secured, as borrower. (Tr. 79-80, 105). Each note, in turn, would be acquired by Factored. (Tr. 80). The Loan Agreement provides that "Borrower and Guarantor acknowledge that Lender intends to assign the Loan and all of its rights in, to and under the Loan Documents to [__________] immediately after the execution of this Agreement by the parties, and Borrower and Guarantor hereby consents to such assignment." (Loan Agreement, Sec. 17(l)).

George Hester ("Hester"), a resident of Florida and the principal of Highlands, had been performing a variety of services for other Trusts for which Riverside acted as investment advisor. (Tr. 531-532). Ryan testified that he asked Hester to have Highlands generate the notes as lender. (Tr. 78-79, 112-113). Hester confirmed that he agreed to have Highlands do so in consideration for the payment of $1,000 per month based on one point of the $7 million loan amount. (Tr. 861). Accordingly, contemporaneous with the execution of the Loan Agreement, Hester executed an Irrevocable Assignment to Factored of all of Highlands' right, title and interest in and to the Loan Agreement "as well as all other documents and instruments executed in connection therewith." (Ex. AP) (Tr. 112-120). Consistent with such undertaking, Hester testified that he did not intend for Highlands to retain any right to the Loan Agreement, the Notes or the collateral. Highlands was merely an intermediary. Hester's intent was to originate the Notes and then assign them to the Trust. (Tr. 790). Consistent with such intention, Hester executed allonges of each of the Notes (Tr. 548, 636-788) (Ex. 5b-50b) and various assignments of the collateral to Factored (Tr. 550-555) (*See, e.g.*, Ex. 5h, 5j, 12e, 14e, 15e).

It should be clear that Highlands was used to shield Factored from direct involvement with the loan(s) and to protect Factored's investors from a possible taxable situation. Though the loans were apparently to go through Highlands it is undisputed that money was wired directly from Factored to First Secured on each of the 45 situations. In the words of Mr. Ryan, Highlands was an "artifact". None of the above, however bears any weight on the legality of each of the transactions or on the loan agreement that served as an umbrella under which the loans were transacted.

It is undisputed that the Loan Agreement is unambiguous in its terms. However the defendant argues that not all the terms were complied with and thus the agreement is not enforceable against any of the defendants. The Loan Agreement contemplated that Highlands would lend First Secured up to $2 million to permit First Secured to acquire a portfolio of distressed loans. (Loan Agreement, Sec. 2(a)) This was consistent with the amounts that Ryan testified they would like to put out as a "starter." (Tr. 75). The obligation to repay such debt was to be evidenced by a promissory note. (Loan Agreement, Sec. 2(b)) The distressed loans to be acquired were to be identified on a schedule. The Loan Agreement contemplated and provided for advances beyond $2 million. Although Highlands was not required to make such further advances, the Loan Agreement provided that if it did so, such advances would be subject to the terms of the Loan Agreement. (Loan Agreement, Sec. 2(c)). Further, the Loan Agreement required First Secured to seek advances from Highlands if it wished to acquire additional Distressed Loans. (Loan Agreement, Sec. 2(h)) Consistent with the provision that further sums might be advanced, the term "Obligations" is defined to include "all loans, advances, overdrafts, debts, liabilities, obligations, covenants and duties owing by Borrower to Lender of any kind or nature, present or future, whether or not evidenced by any note, guarantee or other instrument, whether arising under this Agreement, the Loan Documents or under any other agreement . . ." (Loan Agreement, Sec. 1(oo))

The Loan Agreement provides that "as a condition precedent for Lender to fund the Loan the Obligations shall be secured by, "among other things, the Assignment of Mortgages and Notes from Borrower to Lender, Judgment Pledge and Security Agreements, Limited Guaranty Agreement, Stock Pledge and Security Agreement, Assignments of Insurance and

Assignments of Action." (Loan Agreement, Sec. 5).

The Loan Agreement further provides that as a condition precedent to the funding of the Loan, First Secured would execute, among others, "the Loan Documents and evidence that financing statements (form UCC-1) and all other instruments and documents which must be filed to perfect the security interests granted herein or in the other Loan Documents have been filed with all appropriate filing offices, the Original Distressed Note duly endorsed to Borrower with subsequent endorsement from Borrower to Lender and the original assignment of mortgages and notes assigning the Distressed Notes . . . with evidence that the same have been or will be recorded . . . ." (Emphasis added.) (Loan Agreement, Sec. 8(a), (f) (b) and (o)).

Each of the advances was also to be secured by "Collateral Proceeds" (Loan Agreement, Sec. 1(l)), which is defined as:

> "all payments, proceeds or funds in money or in kind paid, delivered or recovered in connection with the resolution or disposition of the Qualified Collateral including, without limitation, payment of principal or interest under the Distressed Loans or Performing Loans, proceeds paid or recovered in connection with the sale or rental of any Property or ORE, payments made or proceeds recovered with respect to actions on the Distressed Notes and/or Distressed Mortgages under any settlement agreement, judgment or bankruptcy plan or proceeding, all proceeds recovered in connection with the execution of judgments against Mortgagors and payments made or proceeds recovered under any policy of insurance applicable to the Distressed Mortgages, Performing Mortgages, Properties or ORE or with respect to any condemnation of a Property or ORE."

"Qualified Collateral" is, in turn, defined as the Qualified Distressed Loans, Performing Loans, ORE, Properties owned by Borrower and all funds held in the Escrow Account and Lockbox Account ("Loan Agreement, Sec. 1(zz)). In other words, the assets were to be acquired by First Secured with the money borrowed from Highlands pursuant to the Loan Agreement. Any doubt as to the scope of the collateral is put to rest by the definition of "Security Property" as "all properties (real or personal, tangible or intangible), rights, estates and interests now or at any time hereafter securing the payment of the Note and/or the satisfaction of the Obligations."

(Loan Agreement, Sec. 1(ccc)).

The Loan Agreement, as can be seen, is a complex document drawn to provide multi-layers of protection to the lender. From the testimony, the parties, both sides, did their best to follow the terms of the agreement. It was obviously important to First Secured that the money kept flowing and to Riverside that there was security for the large sums of money that was flowing out to First Secured. Ryan testified that as part of their procedures First Secured received a collateral assignment of the underlying mortgage and note that would, in turn, be assigned to Highlands, who would then assign it to Factored. (Tr. 227-228, 229). He further testified that these procedures were outlined in the Loan Agreement. (Tr. 228).

The testimony is unrebutted that no monies would be wired by Factored to First Secured until John Tarbox or Robert Moy, employees of Riverside, and Ryan or Massey signed an acknowledgment that the various security instruments had been obtained from First Secured as identified on a checklist. (Tr. 956, 964-965, Ex. W). Despite the testimony of Mr. Tarbox, testifying for defendant, that he never approved documents that were less than perfect (re: corrections or deletions within the promissory notes) it is clear that all 45 notes were funded by Factored and only after all the requirements of the Loan Agreement had been satisfied. In addition, no monies were advanced to First Secured until its attorney, Thomas Wynne, provided an escrow letter and opinion letter by which he confirmed that the security instruments which Factored was to receive would be obtained by him and recorded to protect and preserve Factored's secured interest. (Tr. 994, 948-949) (Ex. 101, 188).

Deviation from Loan Agreement

In performing pursuant to the terms of the Loan Agreement, the parties appear to have deviated in only one respect. Ryan testified that because Donovan had not identified all of the Distressed Loans he wished to acquire and, therefore, did not want to pay interest on the full $2 million advance until the funds were drawn down, he agreed to cause the monies to be advanced as the properties were identified. (Tr. 121-122). Consequently, each advance within the first $2 million was evidenced by a separate promissory note as were those advances beyond the initial $2 million. Other than the first promissory note (Ex. 5a), the remaining 44 promissory notes are identical in their terms with the exception of date and dollar amount. (Ex.-46a-50a). The terms of the first promissory note dated December 23, 1997 do not differ in any material respect from those that succeeded it and specifically references the $2 million loan.

Many of the notes bear alterations where there have been corrections to dates or amounts and some have initials where in other places there have been obvious white outs and changes. In five notes there is a blank space where there should be a date that would trigger default interest. Jon Tarbox, who worked for Riverside during the period of these transaction, testified with respect to his procedures while employed by Riverside during the time of the transactions in question. He testified that he reviewed each note as it came in and if it showed a note date which did not match the signature date, or if it showed any white out, interlineations, or alterations, he rejected it. None of the notes placed into the files by him, he contends, evidenced any of the irregularities which were evident before this Court. Mr. Tarbox testified that others, including Michael Asseff, had access to the instruments after they were received by Riverside. He presents no reason why someone would alter the notes after they were signed. The testimony is likewise clear that the documents were disassembled many times after they were received by Riverside for the purpose of copying within their offices and on even more occasions for the purpose of discovery and eventually preparation for trial. It must also be noted that there has been no proffer from the defendants of their copy of any of these instruments. At times it appears that the defense wishes the court to ignore the obvious, that the defendants received $7.6 million and have never repaid any of it. The defendant argues that the only conclusion which this Court can reach on the facts is that the alterations occurred after execution by First Secured and after receipt of the instruments by Riverside. The court concludes that whatever changes or corrections exist within the notes, they do not effect their enforceability. The parties executed the notes and the indicated amounts were wired to borrower by Factored on each and every occasion.

It should be noted that, apart from the above, there is no doubt that the parties considered the Loan Agreement to be operative during the period of funding and performed pursuant to its terms.

Ryan testified that the Loan Agreement was to be the umbrella document. (Tr. 123-124, 229). He further testified that at the time Donovan asked to be accommodated and not to be charged interest on the full $2 million, but instead to execute Notes separately on each draw down, Donovan did not ask Ryan to abandon or nullify the Loan Agreement. (Tr. 122). Nor did Donovan thereafter ask Ryan to return the Limited Guaranty or the stock that had been pledged to secure it. (Tr. 123).

The court agrees that the Loan Agreement was the umbrella document such that all of the operative documents refer to the Loan Agreement and incorporate its terms. As an example, the Limited Guaranty, which was executed by Donovan on behalf of the Donovan Trust on December 23, 1997, defines all capitalized terms as having the meaning set forth in the Loan Agreement and, accordingly, defines the obligation to which the guarantee pertains as the Promissory Note in the amount of $2 million "as well as all of the other Obligations, which may now be existing or may hereafter arise . . ." (Ex. 2, Sec. 1).

Likewise, the Stock Pledge and Security Agreement, executed on December 23, 1997 by Donovan, as Trustee, on behalf of the Donovan Trust, refer to a Loan Agreement of even date (sic) and recites that it secures the payment of the Donovan Trust under the Loan Agreement, the Limited Guaranty, and the $2 million Note. (Ex. 3, Preliminary Statement, ¶ 1, Section II).

Each of the 45 Notes, the last of which is dated July 29, 1998 (Ex. 5a-50a, inclusive), refers to that certain Loan Agreement of even date herewith by and among Borrower, the Thomas B. Donovan Family Trust, as Guarantor, and Lender (Sec. 1.07) and defines the Loan Documents to include "this Note, the Loan Agreement, Lockbox Pledge and Security Agreement, the Borrower Assignments and any other documents or instruments to or of which Lender is a party or beneficiary now or hereafter evidencing, securing, guarantying, modifying or otherwise relating to the indebtedness evidenced hereby." (Note, Sec. 1.08)

Because the Notes refer to a Loan Agreement of "even date," First Secured contends that the Notes cannot be interpreted to refer to Exhibit 1. However, Mr. Ryan, Mr. Asseff and Mr. Tarbox each testified that they knew of no other Loan Agreement executed by

Highlands, First Secured and the Donovan Trust. (Tr. 138, 148, 2504). Indeed, no such document was presented by defendants at trial. Any doubt as to what was meant by the Loan Agreement is put to rest by the Notes themselves.

The first in the series of Notes, dated December 23, 1997, in the amount of \$117,391, mistakenly states that it evidences First Secured's obligation to pay the principal sum of \$2 million. (Ex. 5a, *see* first paragraph). It is obvious that the draftsman carelessly used the \$2 million note referred to in Sections 2(a) and (b) of the Loan Agreement as a template without fully modifying the language. (No Academy Award for editing will go to anyone involved in these transactions.) More importantly however, each of the Notes, including the last in the series, refers to a specific provision of the Loan Agreement. Thus, Section 2.05, entitled "Allocation of Payment," provides that "payments received by the Lender shall be applied first to interest due on any advances made by Lender pursuant to Section 12 of the Loan Agreement...." Section 12 of the Loan Agreement provides that the Lender may make certain advances to protect the collateral if the borrower fails to do so.

So, too, the Judgment Pledge and Security Agreements each refer to the Loan Agreement and, indeed, are specifically called for by the Loan Agreement. (Ex. 5c, 6c).

Further evidence of First Secured's belief that the Loan Agreement was the operative document is provided by Donovan's execution and delivery of a Unanimous Written Consent of Directors and Shareholders of First Secured on January 28, 1998 (Ex. 179), a document required to be delivered pursuant to Section 8(g) of the Loan Agreement. This document was delivered after the first advance was made to First Secured and the first promissory note was delivered to Highlands and assigned to Factored a day before the second advance was to be made. (*See* Ex. 178). If, as Tarbox testified, the Loan Agreement was abandoned in early January, 1998, the Unanimous Written Consent would have served no purpose on January 28th.

Further, on March 9, 1998, Donovan delivered a memo to Tarbox in which he acknowledges that the \$2 million contract still exists. (Ex. 180). In response to a demand by Riverside for the payment of \$20,000 (representing a legal fee equal to 1% of the \$2 million), Donovan informs Tarbox that he has instructed Chalavoutis to pay $10,000 as part payment since they had "funded less than half of the Two Million Dollar contract." In fact, prior to that date, First Secured had drawn down $1,022,482, slightly more than one-half of the $2 million contract. (*See* Ex. 178). However, he assures Tarbox that he expects that the balance of the funding will be funded within the next 20 days. On March 30, 1998, Factored wired advances to Thomas Wynne's escrow account in the aggregate amount of $855,439, which permitted First Secured to acquire ten additional distressed loans. (Ex. 178). Accordingly, as anticipated by Donovan, within the next twenty days Factored had funded approximately $1,877,921 of the $2 million. Although approximately $122,000 short of his projection, Donovan exceeded the $2 million in his next draw down on April 29, 1998. Tarbox conceded that it was logical to conclude that the "$2 million contract" to which Donovan referred was the Loan Agreement. (Tr. 2537)

It is clear that throughout the eight-month funding period, the parties operated consistent with the terms of the Loan Agreement. Michael Asseff, a resident of Florida (Tr. 938) who served as controller and then Chief Financial Officer of Riverside (Tr. 940), testified that he was responsible for wiring the funds from the Factored Receivables account at Republic Bank, generally to the escrow account of Thomas Wynne, the attorney for First Secured. (Tr. 994, 948-949, Ex. 74). Asseff testified that before he would arrange for an advance, he would receive a form by which John Tarbox or Robert Moy, asset managers at Riverside, would verify that "this loan is being made in accordance with the approved procedures and guidelines of the loan criteria established for the distressed mortgage program of Riverside Capital Advisors." (Ex. W) (Tr. 956, 964-965). John Tarbox testified that this was essentially the form he used before he would submit a wire transfer to Ryan and Massey for their approval. (Tr. 2406-2407). He stated that he put the documents together, reviewed them and submitted them with his recommendation to Ryan and Massey. (Tr. 2407).

The defendants presented Tarbox to discredit the efficacy of the Loan Agreement and tried to show it was never used by the parties nor did they operate within its terms, When presented with a document that he authored entitled "Distressed Mortgages Procedures: First Secured Capital Corporation" (Ex. 51), Tarbox denied that this was the "approved procedures and guidelines" referred to in Exhibit W and, instead, claimed that it was put together in July

1998 (Tr. 2409) as part of a "dog and pony show to be made to future investors." (Tr. 2409-2410). It was practically the terms of the Loan agreement, word for word, an agreement that Tarbox has testified he had put away or put in a drawer in December, 1997, and had not seen since.

Tarbox's testimony bordered on the incredible on this issue and was designed simply to avoid corroborating the testimony that he had already given on direct examination that among the documents he would receive in advance of authorizing a wire transfer was the Judgment Pledge and Security Agreement. (Tr. 2293).

Therefore, this court finds that these parties used the Loan Agreement as the controlling document for all their transactions. The funding of the initial $2 million in smaller pieces, but within a relatively short period of time does not diminish from the efficacy, viability and enforceability of the Loan Agreement.

The Lockbox Agreement

It is agreed by all parties that the Lockbox Agreement was not consummated. It is for this reason, along with the failure to make the $2 million purchase of distressed loans, that Tarbox stated that the Loan Agreement was not used or, in effect, was abandoned. Relying on these two key reasons, the defendants argue that any cause of action that relies upon the Loan Agreement must be dismissed.

Tarbox originally contended that the Lockbox Agreement was designed to permit funds to be deposited in the prospective account by the lender for the benefit of the borrower and would allow the borrower access to the funds to pay expenses incurred in the acquisition or development of the property. (Tr. 2383, 2417). Tarbox testified in order to find another way to funnel the funds to First Secured, Keith Stolzenberg, an attorney for Riverside in Florida, Massey and Moy, came up with an alternate procedure to use an opinion letter and escrow letter by Wynne (Tr. 2390, 2416). He stated in this way, Wynne would hold the funds in escrow coming and going. (Tr. 2391). His memory, allegedly sharp on some issues abandoned him here. Either that, or he created it or never read the Lockbox part of the Loan Agreement. His testimony was both at odds with the purpose of the Lockbox Agreement (Ex. 185) or the alternative procedures outlined in the Escrow Letter (Ex. 101) and Opinion Letter (Ex. 188).

Tarbox provided the Court with no explanation as to why the failure to enter into a Lockbox Agreement would have caused either First Secured or Highlands to abandon the Loan Agreement. Tarbox was forced to concede on cross that the Lockbox Agreement was for the protection of the lender, not the borrower (Tr. 2423-2424). The Loan Agreement specified that all Collateral Proceeds (*i.e.*, the funds derived from the disposition of the Distressed Loans), shall be deposited directly into the Lockbox Account. (Loan Agreement, Sec. 6(a)). This was designed to protect Factored against any misappropriation of the collateral by First Secured realized as a result of the disposition of a Distressed Loan. (It is obvious that such protection was needed considering the results of the transactions.)

The Loan Agreement further provided that Lender shall be entitled to automatically debit the Lockbox Account of the amount of interest, principal, late fees, expenses and all other amounts due to Lender under the Loan Documents on the due date thereof." (Loan Agreement, Sec. 6(b)). Again, this was a provision designed to protect Factored and to assure Factored that it would be paid what was due.

These terms are consistent with the Lockbox Agreement that was executed by Highlands and First Secured. (Ex. 185). That agreement provides that the borrower (First Secured) shall deposit or cause to be deposited in the Lockbox Account all of the collateral proceeds (Sec. 3A(ii)) (Tr. 2423). Tarbox conceded that Collateral Proceeds was the term defined in the Loan Agreement. (Tr. 2424). At first he stated that it was only one of the sources of funds to be deposited, he eventually agreed that the Lockbox Agreement did not refer to any other sources of funds to be deposited.

Turning to the so-called alternative procedures, it became clear through the cross examination of Tarbox that they had nothing to do with the Lockbox Agreement, although they, too, were undoubtedly for Factored's, and not First Secured's, protection. The escrow and opinion letters did not accomplish the funding of expenses to First Secured, which was Tarbox' premise for the Lockbox arrangement. Nor did they deal with the funds received upon the disposition of the Distressed Loans so as to protect the Lender, which was the actual intended purpose of the Lockbox Agreement. Nor did the escrow letter provide Factored with a source from which to have First Secured's obligations automatically met as they fell due. Ultimately, Tarbox conceded that although he understood that the funding of the loans was supposed to be dealt with in the Lockbox Agreement, there was never such a provision "because we terminated the use of the concept of the Lockbox. We never got there." (Tr. 2425). However, the Lockbox Agreement signed by First Secured and Highlands did not contain such a provision.

The escrow letters issued by Wynne for each transaction deal strictly with protecting Factored in funding the loans so that its funds are not released to the seller of the Distressed Loan until the collateral is in the hands of the escrow agent. Indeed, the escrow and opinion letters provide ample evidence of the parties' intent that the loans be secured. In the opinion letters, Wynne undertakes to record the security instruments to preserve and protect the lender's interest in the security. Tarbox ultimately had to admit that comparable provisions to those found in Wynne's letters could not be found in the Lockbox Agreement. (Tr. 2430-31).

Although Tarbox testified that it was ultimately determined that the Lockbox would not be used in early January, 1998 (Tr. 2424), Donovan's memo to Tarbox on March 9, 1998, discussed working to complete the arrangement (Ex. 180), and each Note executed by First Secured through July, 1998, referred to the Lockbox Agreement as part of the Loan Documents (probably because they did not even think about changing it or were unconcerned about it - fitting with each sides casual attitude toward the reams of documents that accompanied each loan).

The court finds the failure to establish a "lockbox" pursuant to the Loan Agreement does not effect its enforceability. The "lock box" was to protect the Lender and it in no way effected the rights of the borrower under the agreement.

Bulk Purchase of Distressed Loans

Tarbox attempted to justify his belief that the Loan Agreement had been abandoned by the parties because the bulk purchase of Distressed Loans was not going to take place. They then would have to qualify each loan separately, as opposed to looking at summary statistics for an entire portfolio. (Tr. 2397). The Loan Agreement did not, however, provide for this process described by Mr. Tarbox. Tarbox did agree that each Qualified Loan Category delineated in the Loan Agreement discussed qualifying the Distressed Loan in the singular. (Tr. 2401). The Loan Agreement does not say that in arriving at the qualification formula, one would look at the percentages in the aggregate of the loans presented. (Tr. 2401).

Having the original pretext for the alleged abandonment of the Loan Agreement evaporate on cross-examination, Tarbox on redirect, for the first time, came up with another pretext. He testified that the Qualification criteria set forth in the Loan Agreement would not permit First Secured to obtain qualified collateral. However, he failed to demonstrate how any of the Distressed Loans acquired through Factored's advances failed to qualify under the terms of the Loan Agreement; nor did he comment on the fact that 46 distressed mortgages were obtained in under eight months.

The overwhelming evidence presented at trial is that the Loan Agreement remained the operative document. It was not until the relationship between the parties deteriorated and First Secured needed a rationale to support its disregard of its obligations to its secured lender that it contrived its abandonment theory, amongst others.

Until the Termination of his Employment Tarbox Sought to Enforce the Loan Agreement

Due to the significant role Tarbox played in support of the positions taken by the defense it is important to comment somewhat further on the testimony of Mr. Tarbox. Tarbox testified that there came a time when he complained about the failure of First Secured to provide Riverside with reports. (Tr. 2520). He testified that he was not getting documents from Wynne's office after July or August 1998. (Tr. 2520). He complained that the reports he was getting from First Secured were vague and incomplete. (Tr. 2521). Tarbox also recalled having conversations with Moy concerning the fact that certain financial statements that were expected to be received from First Secured had not been received. (Tr. 2523-24). By memo dated November 4, 1998, Tarbox communicated with Jack Blumberg, a CPA retained by Riverside, concerning Factored's right to inspect the books and records of First Secured (Ex. 192). In so doing, Tarbox refers Mr. Blumberg to various provisions of the Loan Agreement which provide the basis for the examination of those books and records, *i.e.*, pp. 31, 36. (Tr. 2526-2528). When asked why he provided Mr. Blumberg with pages from a document that has no efficacy, Tarbox could only explain "I don't know, other than the fact I was probably told to do that." (Tr. 2528). In yet another memo, Tarbox explained to Mr. Blodin, an attorney retained to represent Factored, that Factored had funded the initial advances up to $2 million and Notes evidencing advances beyond the $2 million. (Ex. 191, Tr. 2532).

Finally, on November 4, 1998, nearly one year after Tarbox claims the Loan Agreement was abandoned, he made written demand upon First Secured to review their books and records pursuant to the terms of the Loan Agreement. (Tr. 2538-2539). After First Secured failed to comply with the demand, plaintiff filed its original complaint in this action seeking such access. As was abundantly clear during the testimony of Robert O'Brien, Esq.(an attorney used by First Secured to represent them in the majority of the closings of the properties that had been acquired by foreclosure on the distressed mortgages purchased with the funds loaned by Factored), First Secured ceased providing reports to Riverside because both Riverside and Factored ceased to exist in the corporate mind of First Secured; First Secured was too busy distributing the proceeds of these sales into a variety of corporations owned by Thomas Donovan and paying off secondary loans for which the property had served as security, apparently breaching the terms of the Loan Agreement and misappropriating the collateral.

Thus, it is clear that throughout the eight months during which Factored was advancing funds to First Secured, the parties operated pursuant to and consistent with the Loan Agreement. The sole departure was that in order to accommodate First Secured's desire that it not incur interest charges on monies not yet advanced, the parties would not execute a single note evidencing a $2 million debt, but would proceed serially, creating a separate promissory note to evidence each advance. Although it would appear that some of the forms of instruments contemplated by the Loan Agreement were not attached as exhibits, they nonetheless came into existence. The Notes, Allonges, Judgment Pledge and Security Agreements and UCC finance statements were all form documents created by the parties and used in each transaction. The uniformity of the documents is further evidenced by the checklist to which Tarbox and Asseff referred in their respective testimony and the Distressed Mortgage Procedures established by Tarbox which provides instructions on how to create uniform instruments.

Does Donovan's Failure to Testify Require the Court to Draw an Adverse Inference with Respect to Defendants' Contention that the Loan Agreement Was Abandoned?

The Plaintiff urges the Court to draw an adverse inference from Donovan's inability to testify and should conclude that if such testimony had been given, it would not have supported the conclusion that the Loan Agreement had been abandoned. Clearly, an adverse inference can be drawn "where one party to an action knowing the truth of a matter in controversy, and having the evidence in his possession, omits to speak, every inference warranted by the evidence offered will be indulged in against him." Dowling v. Hastings, 211 N.Y. 199, 202, 105 N.E. 194, 195 (1914). Said rule was restated by the Court of Appeals in Noce v. Kaufman, 2 N.Y.2d 347, 352, 161 NYS2d 1, 5 (1957), where a witness did testify but withheld evidence in his possession and the same rule was applied.

It is apparent that such a "rule" should be applied in this case. Donovan could have provided material, non-cumulative testimony with respect to defendants' claim that the Loan Agreement had been abandoned and that the Notes were executed as a series of unrelated transactions.

The only issue for the court under our circumstances is whether the same rule should apply when the failure to testify is at least facially due to a court order of preclusion arising out of witness' failure to testify at a pretrial deposition (disobeying two orders of this court). The court finds the same rule shall apply and it will draw an inference that if Donovan had testified it would have been in a manner inconsistent with the defendants' interest at this trial and <u>not</u> support the defense theory that the Loan Agreement was abandoned.

Authenticity of the Promissory Notes

Much cross examination at trial was devoted to the authenticity of the promissory notes that were proffered and admitted into evidence at trial. There was unrebutted evidence at trial that during the eight-month period between December 23, 1997 and July 29, 1998, First Secured executed forty-five Notes evidencing advances that permitted it to acquire forty-six Distressed Loans. Donovan executed each of the Notes on behalf of First Secured. Each of the Notes maintained by Riverside and subsequently by Structured Asset Services LLC is an original. Although First Secured contends that these notes are not authentic, it presented nothing but conjecture to support its argument. With the exception of the first note executed on December 23, 1997, each of the notes consists of eight pages containing identical terms. Each of the Notes corresponds to the amounts wired to First Secured. (Ex. 178). The wire transfer records presented by Mr. Asseff correlated to the amounts advanced by Factored to permit First Secured to acquire the Distressed Loan and the advance of operating expenses. The advances, in each instance, in turn, matched the amount of each Note. (Ex. 74, Ex. 178)

Asseff testified that he would not fund a loan unless he had a facsimile of the Note in his possession, and that ultimately the original of the Note would follow and be maintained in his files. (Tr. 965, 967-968) The facsimile would be accompanied by the Wynne escrow letter. (Tr. 967) (See, e.g., 74A)

First Secured did not present an alternative version of the Note to establish that the Notes retained by Asseff and introduced into evidence varied from the terms of any note that Donovan signed. It is clear that the defense has no burden of proof on these authenticity issues, but it cannot be forgotten that Mr. Donovan was not examined on this issue and had been precluded from testifying at trial due to his own actions in failing to appear for pre-trial depositions.

The only testimony upon which defendants rely is that of Tarbox, whose testimony again borders on the incredible, and, on occasion, crosses that border. Tarbox testified that he meticulously compared the dates of each Note to the date of the verification, and that if they did not match, he rejected the Note. He also testified that if the Note contained an alteration or a date whited out, he rejected the Note. (Tr. 2497-2498)

Tarbox explained that when he rejected a Note, he either returned it to First Secured or destroyed it. (Tr. 2498-2499) He conceded that no borrower would permit multiple notes to exist evidencing the same debt. (Tr. 2500-2501) He could not explain, however, how after allegedly either returning or destroying the allegedly defective original notes, forty-five original notes nonetheless were contained in the files delivered to the Court. (Tr. 2499) The inference that the defense seemingly wanted the court to draw was that the plaintiffs in some fashion created these documents where none previously existed.

The meticulousness for which Mr. Tarbox wishes to be known seems to be belied by the documents for which he was responsible. Mistakes abounded. When presented with the Notes, which were executed with blanks, he stated that he ignored this issue because allegedly he was told to do so. (Tr. 2497-2498)

There seems to be an inconsistency why Tarbox would "bounce" a note because the date of verification did not match the date of the Note, but not "bounce" it because it was incomplete. Why does Tarbox "bounce" a Note on which a change had been made and initialed, but not "bounce" it because it contained duplicate provisions or language that did not track from one page to the other?

The apparent answer is that Mr. Tarbox has bent the truth, carefully and skillfully, with the intent to significantly support the defendants case. He became an interested party, bought and paid for by the Donovans via his contract entered into with Mrs. Donovan's corporation, Entrust, which had purchased Riverside. His consulting contract with Entrust was entered into in November, 2002, the original time this trial was to have commenced.

After reviewing the testimony, the court is satisfied with the authenticity of the promissory notes and related documents that have been admitted into evidence on this matter.

Causes of Action 1-45 Breach of Promissory Notes and Cause of Action 49, Breach of the Loan Agreement

The court will address all causes of action prior to considering the affirmative defenses.

Each of the Notes executed by Donovan, on behalf of First Secured, provided that interest at the rate of 18% per annum on all amounts outstanding would be paid annually, and that the entire principal balance of the Loan would become due on the third anniversary of the date of the Notes. (Note, Sec. 2.02)

Asseff testified that no installments of interest or principal were paid by First Secured or the Donovan Trust when such sums became due. Similarly, no payments were received after default notices were sent to First Secured. Using the terms of the Notes and dates derived from Factored's wire transfer records, Asseff created a chart which set forth for each advance the accrued interest prior to the event of default calculated at 18% per annum (Ex. 178, col. "I," Tr. 1045-1046), the accrued interest after default calculated at the default rate of 23% per annum (Ex. 178, col. "L," Tr. 1047-1048), and the Total accrued interest plus principal (Ex. 78, col. "M"). Based on such calculation, as of March 3, 2003, First Secured would have been indebted to Factored in the amount of $21,712,399.59. (Ex. 78)

The total principal amount of these promissory notes is $7,618,655.86. Said amount is supported by the wire transfer records (Ex. 74A-H), as well as the Audit Response form dated December 16, 1998 (Ex. 73). This was allegedly submitted by Riverside (by Tarbox) to Donovan and returned by First Secured to Factored in connection with a Pricewaterhouse Coopers LLC audit and reflects $7,618,655 as being due from First Secured.

Why even mention this piece of evidence? The other evidence supports the total amount loaned and in fact the defendant's accountant (John Bonoura) used it as a starting point in determining the interest it argues is owed (Ex. AW). It is the response to this document(ex. 73) that the court found probative of the credibility of Tarbox and Chalavoutis.

Although Tarbox conveniently could not recall having previously seen the document, he did not deny having sent a letter to Chalavoutis in which he cautions Chalavoutis to review the numbers and, if accurate, return it. (Ex. 190, Tr. 2511) So too, Chalavoutis' denial that he signed the audit response on February 4, 1999 or printed his name underneath the signature was nothing short of an exercise in evasion. (Tr. 2910-2911). Especially since the document was faxed back to Riverside from Chalavoutis' fax number.

Chalavoutis described himself as an accountant with two employees who had been doing work for Donovan since about 1987-88. Though neither an officer or share holder of First Secured he attended closings on their behalf and apparently had signed documents on their behalf. He has done work for other Donovan corporations including Secured Capital and Secured Partners.

He was asked on cross about other exhibits (Exhibits 199, 200, 201) that allegedly contained his signature. He agreed the signature on Ex. 199 was his and that he was at the closing. With reference to the signature on Ex. 200 which refers to the closing of 595 Westbury Ave, which he also attended, he stated the signature "could be mine" but he usually signs with more detail. It was an affidavit from the closing at 595 Westbury Ave (produced by the defendants as part of discovery). He then stated it "Looks like it might be my signature". " I can't definitively tell". As to Ex. 201, which also contained a signature of Chalavoutis, the testimony was as follows (excluding questions): "Looks like it could be my signature" "Could be my signature", "I told you it looks like my signature" and finally "Yes, it looks like it could be my signature". This was a document from Stewart Title with respect to the premises at 595 Westbury Avenue, the closing of which, as stated, was attended by Mr. Chalavoutis for First Secured.

There then followed one of the most amazing re-direct examinations ever witnessed by the court (Tr. 2933-2942) as Mr. Hulse, on re-direct, led his witness through the letters of the signature, one by one, culminating with the following questions:

> Q. Directing your attention to Plaintiff's 201, is there anything in the mark which is being offered as your signature which appears to you to be your signature?

A. I don't usually sign my name that way.

[Not being satisfied with that answer, Mr. Hulse continued.]

Q. Is there anything in this mark which appears to you to be your signature? Yes or no?

A. No.

The court then found and continues to find at this time that the testimony of Chalavoutis on the issue of his signature was "absolutely amazing". Now added is the term "incredible" to my earlier conclusion.

The defendants' expert, John Bonoura, testified on the issue of what interest would be due on the loans. He presented and testified to Ex. AW-1 and AW-2, the alternative damage charts. Although Bonoura's math cannot be challenged, nevertheless, the assumptions he used in making his calculations are quite suspect. First, he accepted assumptions provided to him by First Secured's attorney for which there is no support in the record. For example, and perhaps most importantly for our purposes, he assumes that Factored had been given credits on certain properties that had been resolved, although there was no evidence presented to that effect. Based upon this assumption, he does not accrue interest at either the 18% or 23% rates after the disposition of the distressed loan, nor does he include the amount of principal owed.

Mr. Bonoura assumed that interest does not accrue until Maturity on any Note which contains a blank in Section 2.02. Plaintiff argues that said assumption is flawed in that the Note provides that "Interest calculated as provided in Section 2.03 below, shall be due and payable annually, in arrears . . . ." The court considers plaintiff's argument a non-sequitur when referring to default interest.

With regard to interest, Mr. Bonoura ignores the terms of Section 2.03 of each Note and calculates interest by dividing by 365 the applicable rate of interest, although the Note provides that it shall be calculated by dividing by 360 the applicable rate of interest of 18%. It must be pointed out that there is a conflict between Section 2.01 and 2.03 of the Agreement, with Section 2.03 calling for daily compounding and Section 2.01 for monthly compounding. However, that does not effect the use of 360 as the denominator. Even if the court is to use the damage figure of the defense you still have a figure of $17,062,586, with the defendants in default of its obligations under each note as well as under the Loan Agreement.

The court calculates interest pursuant to the content of the Notes as found in Plaintiffs' exhibit 178a except as to exhibits 5, 6, 8, 7, and 11 (Notes 1, 2, 3, 4 and 20), which are, respectively, the 10th, 38th, 44th and 18th causes of action. The Notes for these causes of action contained a blank space where there should have been a specified default interest payment date. The plaintiff had chosen to use 5 days after the 1st anniversary date of the Note where there was a blank space. Relying on its interpretation of Sec. 2.02 and 2.03, the defendant chooses to use the maturity date of the Note (see Defendant's exhibit AW-2). The court adopts the defendant's methodology of interest calculation. The 23% rate shall not be applied to those properties until the maturity date of the Note and the 18% rate shall continue to the maturity date in each of those cases.

The court recalculates the interest on the above properties as seen in the chart below. The funded amount remains the same as in Ex 178a and the values in the columns "I", "L"and "M" below will replace those in 178a in reaching new totals.

Properties	Amt. Funded/ Operating Exps. (E)	Accrued Int. Prior to Default (I)	Accrued Int. After Default (L)	Total Accrued Interest plus Principal (M)
5587 Amboy	$ 108,000.00	$ 76,587.07	$ 118,389.02	$ 302,976.09
	$ 9,371.00	$ 6,138.46	$ 9,917.94	$ 25,427.40
53 Sunset	$ 143,500.00	$ 101,761.52	$ 149.229.45	$ 394,490.97
	$ 12,478.00	$ 8,492.07	$ 12,845.39	$ 33,815.46
2468 Bellmore	$ 77,500.00	$ 54,958.31	$ 78,847.48	$ 211,305.79
	$ 6,739.00	$ 4,656.08	$ 6,783.07	$ 18,178.15
12 Flo	$ 209,000.00	$ 148,210.16	$ 212,298.53	$ 569,508.69
	$ 18,174.00	$ 12,534.50	$ 18,243.59	$ 48,952.09
641 Seaman's Neck	$ 150,000.00	$ 106,370.93	$ 130,469.96	$ 386,840.89

	$ 13,043.00	$ 9,249.31	$ 11,344.80	$ 33,637.11

Under New York law, a plaintiff suing on a promissory note can make a prima facie showing of entitlement to judgment by demonstrating the existence of the note executed by the defendant, the unconditional terms of repayment, and the defendant's default thereunder. Key Bank of Maine v. Lisi, 225 AD2d 669, 669, 639 NYS2d 482, 483 (2d Dept. 1996); O'Brien v. O'Brien, 258 AD2d 446, 446, 685 NYS2d 254, 254 (2d Dept. 1999) (proof of note and defendant's failure to make payments according to its terms). A defendant who has signed a note clearly establishing his liability to plaintiff for a stated amount must present evidence of a very high order to overcome the presumption that a deliberately prepared and executed written instrument manifests the true intent of the parties. Capparelli v. Vitiritti, 228 AD2d 403, 404, 643 NYS2d 656, 657 (2d Dept. 1996). At trial, Winchester demonstrated its entitlement to judgment by demonstrating that it holds the 45 Notes executed by First Secured. Each of the Notes has a provision (§ 2.04) titled "Unconditional Payment," which states:

> Borrower is and shall be obligated to pay principal, Interest and any and all other amounts which become payable hereunder or under the other Loan Documents absolutely and unconditionally, and notwithstanding any defense, counterclaim or setoff, and without abatement, postponement, diminution or deduction, and free and clear of, and without deduction for, any and present and future taxes, levies, imposts, duties, fees, charges, deductions or withholdings of any nature.

Section 4.02 of the Notes provide that if First Secured should default in the payment of principal or interest, and such default shall continue for a period of five (5) days, or should any Event of Default occur under any of the other Loan Documents, then it will be considered a default under the Note and, at the option of the Lender and without notice to First Secured, the entire amount will become due and payable. It is unrebutted that First Secured paid neither interest nor principal on the dates they fell due nor after it received written Notices of Default.

The defendant has argued that even if the court was to find for the plaintiffs on each Note the plaintiffs would still not be able obtain judgment on breach of the Loan Agreement. Essentially, they argue that the Loan Agreement was not in effect pursuant to various defects, including the failure to establish the lock box and the failure to fund a lump sum $2 million. The Court has concluded the Loan Agreement was in full force and effect at the time the promissory notes were negotiated.

A default under the Note constitutes a default under the terms of the Loan Agreement. Section 13(a)(I) provides that if First Secured fails to make payment when due of interest and/or principal under the Note and such failure continues for five (5) consecutive days, it will constitute a default. To the extent that *each* Note is referable to the Loan Agreement, the court finds a default has occurred.

First Secured makes the argument that the Note referred to in the Loan Agreement is the $2 million Note that was never executed and, accordingly, no default could occur thereunder. Even if this argument were accepted - notwithstanding that it is contrary to the weight of the evidence -- it would be of no avail. Section 13(a)(x) of the Loan Agreement specifically provides that a default will occur if there exists any Event of Default under any of the other Loan Documents. The definition of "Loan Documents" includes "all other documents, instruments and agreements delivered or to be delivered in connection with the Loan, as the same may be amended, supplemented, renewed or restated." (Loan Agreement, Sec. 1(gg)). Further, Section 13(a)(xi) of the Loan Agreement provides that an event of default will occur "if there exists any default or Event of Default under any of the documents, instruments or agreements given by or entered into by Borrower or its Affiliates or Subsidiaries in connection with any Other Loan."

Accordingly, whether each Note is viewed as being in substitution for the $2 million Note identified in the Loan Agreement, or a document or instrument delivered in connection with the Loan , or a document, instrument or agreement given by the Borrower in connection with any other Loan, First Secured has breached the terms of the Loan Agreement.

First Secured contended at trial that the Notes were not negotiable instruments because each Note contained a provision for the allocation of payments. First Secured contends that because the Note refers to obligations to repay certain advances which might be made by the Lender pursuant to the Loan Agreement to preserve the Lender's collateral, the Note is no longer for a sum certain. In so arguing, First Secured ignores the fact that the provision relied on does not expand First Secured's obligation to repay the amount specified by the Note with interest at the stated rate of 18%. That amount remains fixed. The Note merely provides that payments by First Secured will not be credited against the obligation set forth in the Note until such advances have been repaid.

UCC 3-112 specifically recognizes that the negotiability of an instrument is not affected by a promise or power to maintain or protect collateral or to give additional collateral. Section 12 of the Loan Agreement referenced in Section 2.05 of the Note does nothing more. Thus, Section 12(b) permits the Lender to advance funds on behalf of the borrower if the borrower shall fail to pay any tax, assessment, government charge or levy or fail to purchase and maintain insurance or to discharge any lien, etc. Such a provision is designed to protect the Lender's collateral against claims by third parties. Section 2.05 of the Note provides that any payments by the borrower will first be applied to repay the lender interest on any of the aforesaid advances. It does not in any manner expand First Secured's obligation to pay the face amount stated in the Note nor does it make such amount uncertain within the meaning of UCC 3-106.

The Historical Notes to UCC 3-112(1)©)) explain that this section was rewritten in order that clauses customarily included in many instruments may not be considered as impairing negotiability.

The defense argument seems more suited to a third party, one that is neither the original obligor or obligee. UCC 3-119 provides that between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by another written agreement executed as part of the same transaction, and that the separate agreement does not affect the negotiability of an instrument. The Official Comment notes that the separate writing is most commonly an agreement creating or providing for a security interest. Further, the Commentary notes that the section applies to negotiable instruments the ordinary rule that writings executed as part of the same transaction are to be read together as a single agreement.

"As between the immediate parties a negotiable instrument is merely a contract, and is no exception to the principle that the courts will look to the entire contract in writing." It is quite clear that the reference in the Note to a provision of the Loan Agreement does not effect the Lender's rights to enforce the Note. It merely informs the borrower or one who takes from the borrower that no payments will be applied against the Note until interest on advances that have been made to protect the collateral have been satisfied.

Regardless of the negotiability status of the Notes, in that each Note was irrevocably assigned to Factored by Highlands, First Secured is in no position to argue that Factored does not have the right to enforce the Note(s). However, First Secured argues that lack of negotiability forces the plaintiffs to explain irregularities in the Note(s)that have been demonstrated at trial. This may be so, however, the court agrees with plaintiff that the fact that a borrower signs a Note on a date other than that printed on the Note itself does not constitute an irregularity. Nor does a change in a date that has been initialed constitute an irregularity.

The court has the absolute right to view the totality of evidence on this issue and determine if there are irregularities in the notes of a material nature. The amount of time spent on *voir dire* by defense counsel was extensive. He has produced a chart within his Memo of Law carefully setting forth the alleged irregularities in the Note. He points out staple holes variances in number and pattern, Notes dated after document was acknowledged , a date in an allonge that does not match up with a date in a note, an allonge signed in Florida on the same date the Note was signed in New York, white outs and written alterations. Having examined all these arguments, the court finds that whatever irregularities may exist within any one of these Notes they are not material and do not effect their negotiability.

The court finds for the plaintiff on counts 1-45 (the individual promissary notes) and on count 49 (the Loan Agreement), in the amount of $7,618,655.86, plus interest pursuant to the Notes and exhibit 178a as modified by the court.

Did First Secured Misappropriate the Collateral of the Loans, making the Donovan Family Trust Liable on the Guaranty and providing the basis for a permanent injunction?

It was clear from the evidence presented that each Note was secured by assigning the underlying mortgage, mortgage note and collateral proceed as evidenced by the UCC-1 statements. Proof of such security was provided through the testimony of Asseff and Tarbox and what has been called the escrow and opinion letters of attorney Thomas Wynne. If these issues were not so serious it would have become almost humorous as Robert O'Brien testified about how he handled the closings for many of the properties related to the distressed loans or the distressed loans themselves. As such, he was aware of Factored's security interest in the Distressed Loans or real estate, usually as a result of a Title Report obtained in connection with a proposed transaction. (See, e.g., Ex. 81, Tr. 1168, 1179-1181). These title reports contained exceptions which referenced such security interest. In order to clear title, O'Brien communicated with the title company expressing his opinion that the exception should not interfere with the disposition of the asset because of his belief that the security interest merged with the Referee's sale and any such security interest was extinguished. (See e.g. Ex. 82, Tr. 1181). Plaintiffs argue that Mr. O 'Brien's belief was mistaken and in our state the UCC-1 confers upon the creditor not only an interest in the real estate but in the personalty which in our case is the proceeds of the sales. (See Board of Managers v. Glick Development Affiliates, 276 AD2d 386, 387 (1st Dept. 2000). It is irrelevant for our purposes (not considering any action that might be appropriate against the title company by the plaintiffs) who is correct on the law. What is abundantly clear is that First Secured had actual knowledge of Factored's security interest both in the real estate and the proceeds of sale and chose to disregard it. O'Brien testified that in numerous instances, he followed Donovan's instructions and paid the proceeds of sale or in some instances transferred the real estate to First Secured or another Donovan entity. (*See, e.g.,* Ex. 97, Tr. 1522-1523).

At trial, numerous exhibits were introduced by plaintiff Factored that consisted of Nizza & O'Brien escrow account checks that were drawn to Donovan entities other than defendant, First Secured Capital Corp. First Secured, acting through its President and principal, Donovan, directed the law firm of Nizza & O'Brien to disburse monies representing proceeds of plaintiff Factored's collateral to no fewer than five other Donovan related entities bearing remarkably similar names to that of the defendant, First Secured Capital Corp. Despite defendants' determined and steadfast attempts to prevent plaintiffs from uncovering the degree of defalcation committed by the defendants herein, it was ultimately established at trial that defendant First Secured had directed payments from the Nizza & O'Brien escrow account to First Secured Lien Corp. in the amount of $73,719.28 (Exhibit "177a"), to Secured Lien Corp. in the amount of $35,058.52 (Exhibit "177p") to Secured Partners Corp. in the amount of $629,012.49 (Exhibit "177c,d,j,q") and to Secured Property Corp. in the amount of $346,666.42 (Exhibit "120, 177g,j,"). Prior to trial the court was required to threaten Nizza and O'Brien and defense counsel with contempt before they (Nizza & O'Brien) would agree to be deposed .

On two of the closings of property upon which plaintiffs had an interest, 45 Carlyle Green and 34 Drake Street, part of the proceeds of the sale were paid to Kelly Lucas and Pacifico, from whom First Secured had borrowed funds secured by the these properties, $90,800.00 from Carlyle Green and $170,680.00 from 34 Drake St. This same use of property, mortgage borrowings done by defendants or one of its related entities, is found in five other instances. The total from these properties is $952,000.00, which directly represents proceeds from the Factored collateral and security interest.

First Secured had no right under the Loan Agreement or any other document in this case to so encumber Factored's interest with undisclosed mortgage borrowings. As to the reasons for these transfer of funds from the sale of properties to other Donovan corporations, alter egos of First Secured or perhaps Donovan himself, the court will never know. As the court pointed out during trial, one who receives the proceeds of the sale of property has the right to "deposit" the funds where they wish. There may have been valid reasons. Perhaps all the banks were closed that day. Perhaps these corporate fronts were in need of some cash infusion to stay in business. Whatever the reason, said maneuvers violated borrowers' duty owed to lender.

First Secured cannot credibly argue that the UCC-1 financing statements were insufficiently detailed to provide it with constructive notice of Factored's rights as a secured creditor. Here, First Secured had actual notice that Factored was a secured creditor. It knew that in connection with each loan, it had provided its lender with a security interest in all of the Collateral Proceeds, Assignment of Mortgage and Notes, Judgment Pledge and Security Agreements, Assignment of Actions and Security Property as those terms are defined in the Loan Agreement

To protect against an impairment of Factored's collateral, First Secured affirmatively covenanted that it would not pay or disburse any funds, dividends or other distributions unless no Event of Default existed under any of the Loan Documents. (Loan Agreement, Sec. 11(n)). Further, that immediately upon entry of a judgment of foreclosure or otherwise in its favor, the execution of a settlement agreement or First Secured's making the high bid at any foreclosure sale with respect to the disposition of the Distressed Loan, First Secured at Factored's option would execute and deliver to Factored "such duly executed assignments . . ., financing statements and notices as Lender deems necessary to evidence and perfect its security interest in such judgments, settlement agreements and bids . . . ." Of course, as we now know, First Secured chose to hide from Factored all such dispositions. (Loan Agreement, Sec. 10(h)).

Nor can First Secured argue that transactions among its affiliates were merely business as usual and does not constitute a misappropriation of the collateral. Section 10 of the Loan Agreement specifically required First Secured to "Disclose to Lender in writing all proposed transactions with any of its Affiliates and enter into such transactions only with Lender's consent and only if such transactions are on an arm's length basis." First Secured not only failed to obtain such consent but until the eve of trial prevented the affiliated transactions from being discovered by Factored.

Finally the court must determine if what First Secured did was "misappropriation" of the collateral. Misappropriation is nothing more than the tort of conversion. A wrongful intention to possess the property of another is not an essential element of the tort. It is sufficient if the owner has been deprived of his property by the defendant's unauthorized act in assuming dominion and control. Glass v. Weiner, 104 AD2d. 967, 480 NYS2d 760 (2d Dept. 1984); General Elec. Co. v. American Export Isbrandtsen Lines, 37 AD2d 959, 327 NYS2d 93 (2d Dep't 1971).

In order to establish a cause of action for conversion, a plaintiff must prove legal ownership of a specific identifiable piece of property and the defendant's exercise of dominion over or interference with the property in defiance of plaintiff's rights. In Edwards v. Horsemen's Sales Co., Inc., 148 Misc.2d 212, 560 NYS2d 165 (Sup. Ct. N.Y. Co. 1989), the Court held that an auctioneer, to whom property had been entrusted for auction, had improperly misappropriated and converted the proceeds from the auction. The Court observed that officers and directors of the auction house would be personally liable for causing the proceeds of sale to be used to pay bills, salaries and general obligations of the auctioneer, instead of turning the money over to plaintiff. The Court noted that "[it] is of no moment that defendants did not personally benefit from the diversion. They directed the conversion of the funds." Id. at 165.

In Lake Ontario Production Credit Association of Rochester v. Partnership, 138 AD2d 930, 526 NYS2d 985 (4th Dept. 1988), a secured creditor brought an action against a defendant who had purchased collateral from the debtor and against the law firm which had obtained proceeds from sale of the collateral from the debtor in exchange for legal services. The Court concluded that the defendants had converted the secured creditor's assets in the collateral, notwithstanding that the personalty had been sold, observing that "[a] security interest continues in collateral notwithstanding sale (UCC 9-306[2]), and the secured creditor may maintain an action for conversion against the transferee."

Even were intent an ingredient of the tort, there is more than enough evidence present in this case from which the court could infer such intent. Obviously, First Secured and Donovan were at all times aware of Factored's interest as a secured creditor in the Loan Collateral and specifically in the proceeds of sale. Donovan was aware that such proceeds were to be applied against the outstanding Obligations in accordance with the Loan Agreement. Yet, in disregard of Factored's rights as a secured creditor, he directed his attorney to either pay the proceeds to First Secured or to one of his related entities; and on some occasions to pay off loans which the property had secured. Further, he hid his activities from Factored by failing to permit inspection of First Secured's books and records, as requested by Tarbox, failing to provide the requisite periodic reports, failing to testify at deposition and by providing schedules required by court order which did not disclose all of the proceeds he had diverted. Based on the aforesaid acts which the court concludes were misappropriation, the court finds that the Donovan Family Trust is now fully liable under the terms of the Limited Guaranty for all of the obligations of First Secured to Factored.

Attorneys O'Brien, Wynne and Noreen Donovan testified that they had each represented First Secured in the disposition of one or more of the Distressed Loans in which Factored had a secured interest. O'Brien identified twenty such transactions, Wynne testified as to twelve dispositions and Noreen Donovan as to one. Although it is difficult to know precisely how many of the properties have not yet been disposed of, it would appear that defendants continue to hold at least twelve such properties and may continue to control others which have been transferred to related entities, at Donovan's direction. Of course, this can only be supposition on the court's part due to the lack of cooperation by defendants in the discovery process as noted above. More than sufficient basis has been provided to this Court to justify the imposition of a permanent injunction preventing First Secured and the Donovan Trust, and their respective officers, directors, agents, employees or affiliates, from making any further transfers or from disposing of any of their assets, whether in the ordinary course of business or otherwise. Subject to the court's findings on defendant's affirmative defenses, such an injunction would be appropriate.

Does the breach by the Donovan Trust Entitle Plaintiff to Judgement the 48th Cause of Action Relating to the Stock Pledge?

On December 23, 1997, Donovan, as trustee of the Donovan Trust, executed and delivered the Limited Guaranty Agreement. (Ex. 2) To secure the Donovan Trust's obligations under the Guaranty, Donovan and his wife, Pamela Donovan, as trustees, executed a Stock Pledge and Security Agreement (the "Stock Pledge") (Ex. 3) pursuant to which it pledged as collateral shares in First Secured, of which the Donovan Trust is the sole owner. Section II of the Pledge Agreement specifically provides that the pledge secures the payment of all obligations of the Donovan Trust under the Pledge Agreement, the Loan Agreement, the guaranty on the Note, whether for principal, interest, fees, expenses or otherwise.

Pursuant to Section IV of the Pledge Agreement, the Donovan Trust represented and warranted, among other things, that the pledge and delivery of the Pledged Shares pursuant to the Pledge Agreement creates a valid and perfected first priority security interest in the Pledged Collateral, and secures the payment of the Obligations (a term defined in the Loan Agreement). (Section IV, (7))

Both the Guaranty and Stock Pledge refer to the Loan Agreement. Defendant argues that the Loan Agreement has no validity and therefore anything that relies upon it also has no validity. Earlier in this decision, this court ruled upon the efficacy of the Loan Agreement. The court has found the Loan Agreement to be valid and enforceable and will now discuss the issues of the Guaranty and Stock Pledge.

The Guaranty provides that unless an event described in Section 2(a) or 2(b) of the Guaranty has occurred, the scope of the Guaranty is limited to $400,000 of the outstanding balance of the sums loaned. However, Section 2(b) provides for full liability "in the event of the misappropriation of the Collateral Proceeds or the interests therein."

Here, the Court has found First Secured both defaulted in its loan obligations, thereby rendering the Donovan Trust liable for $400,000, **and** misappropriated the collateral, thereby triggering the Donovan Trust's liability "to immediately pay the Obligations in full." (Guaranty, Sec. 2(b)).

The Court finds for the plaintiff on the 48th Cause of action and also finds that the plaintiff may exercise all rights pursuant to the Stock Pledge, including its rights to dispose of said stock.

Before the plaintiffs can go and collect their judgement they must overcome the defenses and affirmative defenses raised by the defense.

The Defense of Criminal Usury

In defense of the Plaintiff's various claims, the Defendant, First Secured Capital Corporation, has alleged that each and every loan made to the Defendant was illegal and in contravention of the usury laws of the State of New York. If sustained, such defense bars Plaintiff from recovering both interest and principal with respect to each such transaction. General Obligations Law § 5-501(2) provides, in pertinent part, that

> no person or corporation shall, directly or indirectly, charge, take or receive any money, goods or things in action as interest on the loan or forbearance of any money, goods or things in action at a rate exceeding [16%],

Although a corporate borrower is precluded from interposing this defense of usury, General Obligations Law § 5-521(1), such bar does not apply to interest on loans in excess of 25% in contravention of Penal Law §190.40. General Obligations Law § 5-521(3).

It is clear that First Secured Capital Corp. is entitled to raise the defense of usury if the interest charges imposed exceed 25%. See Nikezic v Bela, 184 AD 2d 684 (2d Dept. 1992), Tides Edge Corp. v. Central Federal Savings, FSB, 151 AD 2d 741 (2d Dept. 1989).

Does General Obligations Law Section 5-501(6)(b) Preclude The Criminal Usury Defense?

Defendant argues that Section 5-501 (6)(b) of the General Obligations Law does not preclude the usury defense interposed by the Defendant for several reasons.

First, the Plaintiff failed to raise such statutory exemption in its reply to the Defendant's answer with counterclaim. Although the Defendant raised usury as an affirmative defense in its responsive pleading, the Plaintiff did not respond by asserting the exemption now sought to be raised. Having failed to do so, defendant argues, Plaintiff has waived the right to assert this defense to the usury claim. As pointed out by the court in the preamble, 7.6 million went out and nothing came back. The Court will allow said defense to be raised by plaintiffs based upon the evidence produced at trial.

Second, Defendants also argue that the plain language of GOL § 5-501 (6)(b) indicates that it does not apply to the transactions in issue in any event. Section 5-501 (6)(b) provides that:

> No law regulating the maximum rate of interest which may be charged, taken or received, including section 190.40 and section 190.42 of the penal law, shall apply to <u>any loan or forbearance</u> in the amount of <u>two million five hundred thousand dollars or more</u>. Loans or forbearances aggregating two million five hundred thousand dollars or more <u>which are to be made or advanced to any one borrower in one or more installments pursuant to a written agreement</u> by one or more lenders shall be deemed to be a single loan or forbearance for the <u>total amount which the lender or lenders have agreed to advance or make pursuant to such agreement</u> on the terms and conditions provided therein. (emphasis added)

Accordingly, two circumstances are presented which may give rise to an exemption from the usury prohibitions.

1 In the case of a single loan or forbearance in the amount of two million five hundred thousand dollars or more.

2 In the case of multiple loans or forbearances where,

- a The loans or forbearances aggregate to two million five hundred thousand dollars or more, <u>and</u>
- b Each and every loan or forbearance is made pursuant to a single written agreement, <u>and</u>

c The agreement provides that the aggregate loan amount being in excess of two million five hundred thousand dollars is agreed to be made in advance as part of the terms of the agreement.

Defendant argues that there was no Loan Agreement. They further argue that the Loan Agreement is inapplicable to the notes that have been sued upon, and further that the agreement had a cap of 2 million and would thus be inapplicable to the series of notes in this matter. They argue that Highlands never agreed to "advance or make" such additional loans within the Loan Agreement. Thus the provisions of G.O.L 5-501 (6) (b) would not apply to the instant loans.

Whether the Loan Agreement is a prerequisite to to the safe harbor provided to the lender by 5-506(6) (b) is addressed in Matter of Carla Leather, Inc., 44 B.R. 457 (Bkr. S.D.N.Y. 1984), aff'd, 50 B.R. 764 (S.D.N.Y.)1985). It is worth reciting the facts in Carla to understand the thinking of the court in that case. In Carla, the statute was applied to a series of loans which exceeded \$2.5 million. The debtor, Carla, had entered into a factoring arrangement with Meritum Corp. which provided for revolving loans at an interest rate of 9% over prime, compounded monthly. Neither the debtor not the lender knew from the outset what the amount of the advances would ultimately aggregate. By April 1982, the loan balance had reached \$6,675,000. Although Meritum agreed to restructure, Carla was unable to obtain sufficient financing, and both companies filed for bankruptcy. Meritum thereupon initiated a fraudulent conveyance action against Carla. 44 B.R. at 461. The trustee appointed for Carla concluded that although the interest charged to Carla had risen above 25% due to increases in the prime rate, a usury defense was untenable because of the statutory exemption of GOL § 5-501(6)(b). The court agreed, pointing out that "the \$6,675,000 *agreed to as owed* far exceeded the statutory floor of \$2.5 million." *Id.* at 469 (emphasis added).

Carla makes clear that to qualify under the usury exemption, the parties need not enter into an agreement to lend the required "floor" amount of \$2,500,000, or contemplate making a series of advances up to \$2,500,000, as long as the sums actually advanced in installments which aggregate at least that amount are made pursuant to a written agreement. Any argument by the instant defendants that the statute does not apply because the Loan Agreement initially contemplated a loan of up to $2 million is without merit, since the Loan Agreement itself envisions and applies to advances to First Secured in excess of the original principal amount. (Exhibit 1, §§ 2 (e), (h).)

It is quite clear that the interest rate in the Loan Agreement and in each of the notes is 18%. Thus no matter what mathematical magical tricks might be bought forth by the defendants the usury defense will not lie without including into the calculations as disguise interest, the oral agreement by the defendants to pay a servicing fee to Riverside of 3% and a contingent interest equal to one-third of the profits derived from the disposition of the collateral, also payable to Riverside.

The Court has concluded that the Loan Agreement was in effect and controlled the business conducted by these parties. Thus the court must determine if the above oral agreements between Riverside and the defendants may modify the Loan Agreement. In conducting such a review the court is bound to consider the parol evidence rule.

The parol evidence rule bars extrinsic evidence of a prior or contemporaneous oral agreement "when offered to contradict, vary, add to, or subtract from the clear and unambiguous terms of a valid, integrated written instrument." Congress Financial Corporation v. John Morrell & Co., 790 F. Supp. 459, 468 (S.D.N.Y. 1992); see West, Weir & Bartel, Inc. v. Mary Carter Paint Company, 25 N.Y.2d 535, 540, 307 NYS2d 449, 451 (1969) (circumstances extrinsic to agreement not considered when the intention of the parties can be gathered from the instrument itself). Moreover, both the Loan Agreement and the Notes contain merger clauses which bar any modification except in writing.

Section 17(e) of the Loan Agreement states:

> This Agreement contains the entire agreement between the parties hereto, and may not be modified or changed in any way except in a writing signed by the Lender/and all the parties hereto. No representations, understandings, and/or agreements, oral or otherwise, *made prior to or contemporaneous with this Agreement* are included herein or as part of the agreement between the parties

> unless expressly set forth herein in writing. *All prior or contemporaneous agreements and understanding, oral or written, are merged into this Agreement* (emphasis added).

Similarly, § 4.03 of each of the Notes provides that "[t]his Note may not be changed orally, but only by an agreement in writing signed by the party against whom enforcement of any waiver, change, modification or discharge is sought." Merger or integration clauses such as these are routinely enforced as written. Kleartex (U.S.A.), Inc. v. Matex, Inc. 1992 WL 96340 (S.D.N.Y., April 24, 1992); Hart v. East Plaza, Inc., 62 AD2d 113, 116, 403 NYS2d 928, 929 (4th Dept. 1978) (no enforcement of oral agreement affecting property which is subject of license agreement containing merger clause).

It is clear from the testimony of Tarbox and Chalavoutis, and very little also is clear from their testimony, that the discussions to which they were privy between Ryan and Donovan would call for the 18% interest as well as the above servicing fee and the profit sharing element. It is clear that the Loan Agreement was entered into after these discussions were held. Yet it does contain any reference to servicing fees or profit splits. Nor have the defendants introduced any additional agreements reflecting these oral agreements.

Plaintiffs argue that even were the court to find that the contingent interest in profits should not be precluded as parol evidence, it should not be considered in arriving at the effective rate of interest charged to First Secured. It has long been the law in New York that "an agreement to pay an amount which may be more or less than the legal interest, depending upon a reasonable contingency, is not *ipso facto* usurious because of the possibility that more than the legal interest will be paid." Hartley v. Eagle Ins. Co., 222 N.Y. 178, 184, 118 N.E.2d 622, 624 (1918). In Hartley, the plaintiff assigned to the defendant, in consideration for a loan of $9500, the sum of $18,400 at an interest rate of 6%, to be paid on the death of plaintiff's grandmother. The plaintiff claimed the loan was usurious because the present value of $18,400, based on his grandmother's life expectancy, was over $11,470, or $2000 more than the loan he had actually received. The Court of Appeals held that because there was no certainty as to the grandmother's life expectancy and, therefore, no certainty as to the values to be realized on her life, it could not be the basis for a finding that the interest paid would be usurious. 222 N.Y. at 184, 118 N.E.2d at 624.

In an even earlier case, cited in Hartley, the Court of Appeals concluded that a loan for the purchase of 200 lumber wagons, at an interest rate of 5 1/4 % plus one-quarter of the profits realized on the sale of the wagons, was not usurious because there was no certainty that the profits ultimately realized, together with the stated interest charged, would exceed or even equal the legal rate of interest. Richardson v. Hughitt, 76 N.Y. 55, 59 (1879).

The defendant on the other hand argues that this argument lacks merit for several reasons. First, the law is well established that where a lender enters into an agreement which requires the repayment of principal and interest and then, in addition, exacts an additional agreement to pay an additional, albeit contingent, sum the agreement is usurious. Whether the contingent arrangement is guaranteed to produce additional payments, or not, it is the contingent obligation added to the loan which, of itself, creates the usury. Second, in any event, the facts of this case show quite clearly that there was a reasonable certainty that profit would be created and that the profit split anticipated by the plaintiff would have driven plaintiff's receipts to a usurious level.

In the seminal case of Browne v. Vredenburgh, 43 N.Y. 195, (1870), the lender struck a deal which provided for the repayment of principal plus interest at the maximum legal rate. Without more, the loan was not usurious and no defense to enforcement would have existed. In addition to the repayment of principal the parties agreed that the lender would be paid the greater of (1) the interest agreed upon, or (2) one quarter (1/4) of the profit from the running of the borrower's business. Since, as here, there was no guaranty that profit would exist, the contingency might result in only the repayment of principal and legal interest. Nevertheless, the Court held that

> when a lender stipulates for a contingent benefit beyond the legal rate of interest, and has the right to demand the repayment of the principal sum with the legal interest thereon, in any event, the contract is in violation of the statute prohibiting usury, and void. Browne, at 197.

Almost 50 years later, in Diehl v. Becker, 227 N.Y. 318 (1919), the Court of Appeals reaffirmed this holding. There, the parties agreed that the borrower would repay principal plus interest and, in addition, if the borrower sold certain inventions and patents under certain circumstances the lender would be paid a bonus. Even though the borrower might never sell or licence his patents thereby leaving the lender to be paid only the original principal and legal interest, the Court held that it was the giving of the contingent rights which created the usurious agreement. See also Heller v. Yaeger, 258 AD 139, 15 NYS2d 771 (1st Dept. 1939), rev'd oth grds., 283 N.Y. 19 (1940) where the Court stated that

> Whenever the lender stipulates even for the chance of an advantage beyond the legal interest, the contract is usurious, if he is entitled by the contract to have the money lent with the interest thereon repaid to him in all events.
> Heller, at 141.

The defense thus argues that it is clear that the Defendant does not have to prove that certainty existed as to whether the ultimate sale of property would yield a profit nor that such profit would produce a yield sufficient to raise the aggregate interest, including profit split, to exceed the usury threshold.

Plaintiffs further argue and refers the court to Phlo Corporation. v. Stevens, 2001 WL 1313387 (S.D.N.Y., Oct. 25, 2001), wherein the defendant loaned the plaintiff $250,000 in exchange for a note with interest of 14%. The parties also agreed that the defendant would receive warrants for up to 200,000 shares of stock if plaintiff elected to extend the note's maturity date. The court rejected the plaintiff's defense of criminal usury against defendant's counterclaim, holding that because the value of the warrants was uncertain, it was not certain that an effective interest rate in excess of 25% would ever have to be paid. Id. at *5.

Plaintiffs argue that it is clear that where there is no certainty that potential profits will be realized, and no certainty that even if realized, the profits plus the stipulated interest will exceed the legal rate of interest, the loan is not usurious. See Cusick v. Ifshin, 70 Misc.2d 564, 334 NYS2d 106 (N.Y. City Civ. Ct. 1972), *aff'd*, 73 Misc.2d 127, 341 NYS2d 280 (N.Y. Sup. App. Term 1973) (collecting cases). The facts in Cusick are instructive. In that case, the plaintiff loaned $10,000 to a corporation headed by defendants' decedent at a 20% interest rate.

The corporation, a construction firm, had agreed that if certain real estate were sold during a two-year period, the lenders would receive an additional payment of $4000. The defendants argued that this "bonus" arrangement raised the effective rate of interest to 30%. The court pointed out that the loan could not be considered usurious on these facts. Since the property was not sold, "there could hardly be any 'certainty' that the interest plus bonus would exceed the legal rate of interest (25%)." 70 Misc.2d at 567, 334 NYS2d at 110.

In determining the effective rate of interest may the court aggregate to the lender's rate fees payable to other entities?

The court concludes that the answer to this question must be NO.

The Tax Lien Services Corp., owned directly or indirectly by Thomas Ryan, was to collect the fees, which were only billed once. First Secured then decided to service its own loans. The Notes were payable to Factored via Highlands. The Court cannot aggregate fees for services to be paid to an entity other than the Lender in arriving at the effective rate of interest. As an example, a lender cannot be charged with usury on account of a commission paid to an independent broker for services in negotiating or procuring a loan if the lender had no interest in such payment. Kovian v. Fulton County Bank and Trust Company, 647 F. Supp. 830, 838 (N.D.N.Y. 1986); 72 N.Y. Jur.2d § 114. Even where the commission is paid to the lender's agent, the loan is not rendered usurious by such payment where the charge is made for the agent's own benefit and is not ratified by or shared by the lender. 72 N.Y. Jur 2d § 117.

There is no evidence that Factored would have shared in such fees, or that Tax Lien Services Corp. was acting on behalf of Factored. The record is devoid of any evidence that the servicing fee to be paid to Tax Lien Services was disguised interest.

Furthermore, Asseff testified that when they started this transaction, "Tax Lien Service Corp. was going to pay checks, pay for insurance, pay the taxes and control all the accounting and servicing for each distressed mortgage". (Tr. 1963). Clearly it is the law in New York that reasonable commissions, expenses or servicing fees charged by lender to a borrower in connection with a loan transaction, does not make a loan usurious when such amounts are added to interest. In Matthews v. Coe, 70 N.Y. 239, 242 (1877), the defendant, a commission merchant, agreed to advance funds to a dealer in produce at the legal rate of interest, plus a commission of 2½ % for the sale and management of the plaintiff's property. The Court of Appeals held that the evidence fell far short of proving that the transaction was a cover for usury or that the commission was fixed with the intent of securing compensation for the loan in excess of the legal rate.

In a more recent decision upholding the same principle, the Court of Appeals stated that "a borrower may pay reasonable expenses attendant on a loan without rendering the loan usurious." Lloyd Capital Corp v. Pat Henchar, Inc., 80 N.Y.2d 124, 126, 589 NYS2d 396, 397 (1992) (no showing by defendants that fees charged were a pretext for criminally usurious interest).

Servicing fees may be substantial in relation to the loan amount without being considered disguised interest. Thus, in Gratton v. Dido Realty Co., Inc., 89 Misc.2d 401, 403-404, 391 NYS2d 954, 956 (Sup. Ct. Queens Co. 1977), *aff'd*, 63 AD2d 959, 405 NYS2d 1001 (2d Dept. 1978), the court concluded that commitment and processing fees of over $30,000 and a reserve fund of over $100,000 on a loan of $1,250,000 were reasonable, actual expenses of the transaction which the lender was entitled to pass on the borrower.

In the case at bar, the testimony by Asseff remains unrebutted that Tax Lien Services Corp. intended to perform services directly related to the distressed mortgages. Thus, even if the service charges could be linked to Factored and the Court finds they have not, there has been no evidence that said charges are disguised interest.

Consequently, servicing fees billed by Tax Lien Services Corp. to First Secured would be excluded from any consideration of the interest rate applicable to the transactions at issue.

The defense has no real counter to the plaintiff's parol evidence argument. What defense does say is that this case, unlike most cases before the Courts, presents special circumstances which compel this Court to look beyond the limits sought to be imposed by the Plaintiff. A strong public policy exists in favor of enforcement of the usury laws in the State of New York. Hammelburger v. The Foursome Inn Corp., 76 AD 2d 646, 437 NYS2d 356 (2d Dept. 1980), rev'd oth grds., 54 N.Y.2d 580, 446 NYS2d 917 (1981).

Defendants argue that the courts have held that it is the very nature of usurious agreements that compel the Court to look beyond the face of the written agreements.

> Courts always look to the actual nature of the transaction and not to the form which the parties may have given to it. (Smith v. Cross, 90 N.Y. 549) In the great majority of usurious transactions a subterfuge of one kind or another is resorted to for the purpose of giving it a legal appearance. Such appearance, however, never deters the court from pronouncing the transaction usurious, once that fact appears. (Braine v. Rosswog, 13 App. Div. 249) The rule is well stated in Knickerbocker Life Insurance Co. v. Nelson (78 N.Y. 137), wherein the court stated: It has been said and reiterated by the courts from the time the schemes and contrivances of lenders became the subject of judicial examination, that there is no contrivance whatever by which a man can cover usury . . . and that no subterfuge shall be permitted to conceal it from the law. Schanz v. Sotscheck, 160 AD 798, 801, 145 NYS 778 (1st Dept. 1914)

Thus, the defendant argues, absent such authority, the law would become a tool of the unscrupulous lender. "Were this not the rule, parties would have the power to make illegal agreements enforceable simply by reducing them to writing, using such terminology as would conceal their illegal objectives." Niman v. Niman, 15 Misc. 2d 1095, 1097, 181 NYS2d 260 (Sup. Ct. 1958), aff'd, 8 AD2d 793, 188 NYS2d 948 (1st Dept. 1959).

In the case at bar, defendants argue that parol evidence can and should be considered in determining whether the transactions sued upon were tainted by usury. This Court, so defendant argues, can and should find that both the servicing fees and the profit sharing were covers for what was in fact a series of usurious transactions which violated both the spirit and the letter of the usury laws of the State of New York.

When the court looks behind the face of these transactions as defendant suggests, it sees a group of investors in an off-shore trust trying to avoid taxes on the income of their investments, a very sharp financial advisor in Riverside (Ryan) who knows how to make things happen and get his piece of the pie, and an even sharper borrower and investor in Thomas Donovan who must have written the book on How to make Money with Other Peoples Money With No Risk, who knew exactly what he was doing. Thus for Mr. Donovan to cry out to the court for its assistance in support of a usury defense and to avoid the parol evidence rule is somewhat amusing. This is an argument made by a defendant, and the Court is now referring to Mr. Donovan though he is not an individually named defendant, who refused to be deposed and who in the opinion of the court, put all possible hurdles in the road to discovery and who played a major role in preventing his attorneys who handled the closings of the distressed loans and sale of same from being deposed until the eve of trial. If the court was to remove Mr. Donovan from this scenario then it would only leave his attorney as the cause for all the problems that have emanated from the defense in this case and the court would rather not believe that.

Justice would not be served in this case if the court was to ignore the parol evidence rule. Mr. Ryan may have played fast and loose with his attempt to make more off the deal as he negotiated with Mr. Donovan, but he truly met his match in Mr. Donovan. Let us not forget that 7.6 million went out and nothing came back; that no interest was ever paid or any service charges collected (though once billed); nor, that it is Mr. Ryan who went into bankruptcy and it was Mrs. Donovan who bought Riverside at a bankruptcy sale.

The court finds there is insufficient evidence that Riverside was acting for Factored when it made the oral agreements with First Secured (Donovan) as to a service fee and/or the contingent profit split. The service charges were payable to Tax Lien and the profit split, apparently to Riverside. It is <u>not</u> clear to the court that the contingent infuturo profit split is too speculative to be included in the interest rate calculation. However, the court finds that the parol evidence rule precludes the addition of the servicing fee and contingent profits split to the 18% interest rate of the Loan Agreement. The defendants have failed to prove by clear and convincing evidence the level of proof needed when one relies on the criminal usury statute, <u>French-American Banking Corporation v. Dulong Importers, Inc.</u>, 63 AD2d 632, 633, 405 NYS2d 251, 252 (1st Dept. 1978), that plaintiff Factored or, in fact, any named plaintiff knowingly charged, took or received interest on the loan at a rate exceeding 25%.

Clear and convincing evidence is evidence that makes the fact to be proved "highly probable." Abernathy-Thomas Engineering Co. v. Pall Corporation, 103 F. Supp.2d 582, 595 (E.D.N.Y. 2000) (citing 1A *New York Pattern Jury Instructions - Civil* § 1:64). The evidence presented by defendants does not meet this standard. Far from showing that it is "highly probable" that plaintiffs even entered into an agreement to charge First Secured additional interest in the form of servicing fees and a profit split, defendants failed to place in evidence a single document memorializing such an agreement. The testimony of defendants' witnesses that prior to entering into the Loan Agreement the parties discussed a deal that included servicing fees and a profit split does not provide clear and convincing evidence that plaintiff intended to make criminally usurious loans, particularly where, as here, such servicing fees were to be paid for services actually rendered to an entity other than the lender.

The defense of usury is denied.

As an aside, if there was to be a usury finding in this case there would not be a voiding of the loan but a reduction of the rate to the lawful maximum of 25%.

While the civil usury statute provides for a voiding of the agreement we are not proceeding under that statute (GOL 5-511, 5-501). GOL 5-501 does not apply to loans to corporations. The criminal usury statute does not have a similar voiding provision. In fact since GOL § 5-521 permits corporations to interpose a defense of criminal usury for loans under $2.5 million means that a successful defense would result in the voiding of the criminally usurious loan and the Second Circuit concluded that it was an open question. In re Venture Mortgage Fund, L.P., 282 F.3d 185 , 189 (2d Cir. 2002).

Does Winchester have standing to Maintain this action on behalf of Factored?

Plaintiff argues that Winchester, as holder and assignee of the promissory notes and as assignee of the loan documents has standing to maintain this action on behalf of the factored receivable trust. First Secured's Second, Third and Fourth Affirmative Defenses allege that Factored lacked standing to bring this action because Factored allegedly is not the holder of the Notes, and that Factored is not bona fide holders for value.

At trial, First Secured argued that Highlands' irrevocable assignment to Factored of all its interest in the Loan Agreement as well as all other documents and instruments executed in connection therewith was ineffective because it was not countersigned by the assignee. (Ex. AP).

This exhibit (Ex. AP) was originally presented by the plaintiffs without the bottom portion. When the defense presented the same document which now contained a bottom portion, reflecting that George Hester had started to sign the exhibit in this second portion, but then realized he was not supposed to sign there and discontinued his signature. The defense appropriately argues that this was an attempt to deceive the court, presenting a document that did not have the portion that would have been signed by the party accepting the assignment, not merely the top section signed by the party making the assignment. In its legal argument the plaintiff does not address the issue of an attempt to deceive the court, but rather addresses the issue of whether the document itself is defective without the countersignature of the assignee of the note. Though the attempt at deception disturbs the court greatly, it agrees with the position taken by the plaintiff that in order for assignment to be effective, even where no consideration is given, GOL 5-1107 requires only that the assignment be in writing and that it be assigned by the assignor or by his agent. The court is quite satisfied that the assignment was, in fact, signed by Hester on behalf of the assignor Highlands. Mr. Hester's signature or the beginning of his signature in the area that would have been signed by the assignee does not make the document defective nor provide the defense with evidence that the assignment would only be effective when signed by the assignee. This method of practice of the parties, where only the assignor would sign the document without a countersignature of the assignee was used on each of the allonges as well as the UCC finance statements. Highlands' assignment of its rights pursuant to the loan Agreement and the Notes became effective upon the execution by Highlands as assignor of these instruments.

The defense has argued that since various instruments were made to or assigned to Riverside, as investment advisor, Winchester, as Trustee of Factored, lacked standing to pursue claims under the loan documents. Plaintiffs argue that this claim lacks merit.

Plaintiffs point out that, Winchester, as trustee, does not merely have standing to bring this action on behalf of Factored, as legal owner of Trust assets, but must be named as a plaintiff. See Orentreich v. Prudential Insurance Company of America, 275 AD2d 685, 713 NYS2d 330 (1st Dept. 2000) (affirming dismissal of suit on insurance policies owned by trust which did not name trustee as plaintiff). Even had Winchester assigned the Notes to Riverside in a representative capacity for the purpose of collecting on a debt, Winchester would be entitled to pursue the claims as Trustee of Factored. See Agni Finance, Inc. v. Senter, 105 AD2d 560, 561 481 NYS2d 504, 506 (1st Dept. 1984).

The court further finds that Winchester is both a "holder" and a "holder in due course" of the Notes under UCC article 3. As assignee of the Notes with an endorsement from the assignor, Highlands, in the form of both an irrevocable assignment of the Loan Agreement and Allonges, Winchester qualifies as holder of the Notes because, as was shown at trial, it is in possession of the Notes payable to Winchester's order as trustee of Factored. In accordance with UCC 3-307(2), the production of a properly signed instrument entitles a holder to recover on it unless the defendant establishes a valid defense. DH Cattle Holding Company v. Reno, 196 AD2d 670, 601 NYS2d 714 (3d Dept.1993); Lipkowitz & Plaut v. Affrunti, 95 Misc.2d 849, 857-858, 407 NYS2d 1010, 1015 (Sup. Ct. N.Y. Co. 1978), citing UCC 1-201 (20) (definition of "holder"). Winchester qualifies as a holder in due course because it is a holder which has taken the instrument (a) for value; (b) in good faith; and without notice of any defense.

The court finds that Winchester Global Trust Company, LTD, on behalf of Factored Receivables Trust has the absolute right to bring this action. This finding however does not necessarily mean that either Winchester or Factored may maintain this action.

Were the Plaintiffs Doing Business in New York pursuant to General Associations Law Article 4, Section 18 and Business Corporations Law Section 1312?

By its Eighth Affirmative Defense, First Secured alleges that plaintiffs may not maintain this action in New York because Factored was a foreign entity "doing business" in New York "at all times material hereto." Verified Answer ¶¶ 38-40. In order to succeed in this defense, defendants are required to establish at trial that Factored's activities in New York were *permanent, continuous and regular, i.e.*, evidence that Factored has localized some portion of its business activity in New York. Netherlands Shipmortgage Corporation, Ltd. v. Madias, 717 F.2d 731, 735 (2d Cir. 1983).

The presumption is that a plaintiff is doing business in its state of incorporation and not in New York. Airline Exchange, Inc. v. Bag, 266 AD 414, 415, 698 NYS2d 694, 695 (2d Dept. 1999). The burden is on the party asserting the defense to overcome the presumption with proof that the foreign corporation's business activities in New York were so systematic and regular as to manifest continuity of activity in the jurisdiction. Alicanto, S.A. v. Woolverton, 129 AD2d 601, 602, 514 NYS2d 96, 97 (2d Dept. 1987).

In the instant case, the evidence is that during an eight-month period, Factored, a Bermuda trust, made a series of investments in distressed loans on properties located in New York. These loans were arranged through Riverside, its Florida-based investment advisor. From its offices in Florida, Riverside caused moneys to be wired to defendants or their attorneys from Factored's bank account in New York. From time to time, agents of Riverside visited New York to perform due diligence on the Distressed Loans prior to funding. Plaintiffs argue that none of this activity supports the conclusion that Factored was doing business in New York. The defendants point out that there was due diligence on each distressed loan. Further that according to the testimony of George Hester, Factored also made loans to Morgan Stephens in Rochester. That these loans, along with those to First Secured, amounted to 50% of Factored's business (volume and amount loaned) and thus would constitute doing business in New York.

In Colonial Mortgage Company v. First Federal Savings and Loan Association of Rochester, 57 AD2d 1046, 395 NYS2d 798 (4th Dept. 1977), a dispute arose after defendant bank agreed to purchase $4,000,000 in GNMA mortgage-backed certificates from plaintiff. The Fourth Department, reversing the trial court, held that the fact that plaintiff had sold $40,000,000 worth of certificates in New York and that the contract in this case was made in New York was not controlling. Plaintiff's only other New York activity was to employ a New York firm as middleman in the transaction. The Court concluded that Colonial's activities in New York were not permanent, continuous, or regular.

So too, in Netherlands, 717 F2d at 731, the making of a series of loans was found to be insufficient to constitute doing business in New York. In Netherlands, plaintiff, a Bermuda corporation which was engaged in financing the purchase of vessels to be used in foreign trade, made a $1,550,000 loan to the defendants' corporation in exchange for a note backed by a ship mortgage and defendants' personal guaranty (defendants were residents of New York), and secured by real property in New York. The plaintiff had made a total of twenty loans over a two-year period, nineteen of which were partially closed in New York. In addition, its president traveled to New York to solicit business and negotiate loans. The court concluded that in the aggregate, these activities did not constitute doing business in New York, since plaintiff had no office in New York, made no loans directly to New York residents, and had not transacted any loans guaranteed by a New York resident except for the loan at issue in the case. 717 F.2d at 740. The court in Netherlands pointed out that no court has found a foreign corporation to be doing business in New York based on as little business activity as plaintiff's.

The defense argues that Conklin Limestone Co. v. Linden, 22 AD 2d 63, 253 NYS 2d 578 (3rd Dept. 1964), which is discussed by the Netherlands case, is more analogous to our facts. In Conklin, the plaintiff was a Connecticut company that sold limestone in interstate commerce. Conklin Limestone had no office in New York and employed no salesman in New York. However, the court in Conklin noted that "in the same year in which it made this contract with the defendant, plaintiff's similar sales to New York purchasers amounted to 30% of its total sales, and in most of these cases, plaintiff's trained employees used plaintiff's own vehicular spreading devices on the New York farms." Id. at 578. The court determined that, although the company was engaged in interstate activity, "the spreading of the lime over extensive farm acreage from especially equipped motor vehicles was strictly local activity within the state's regulatory authority." Id. citing Browing v. Waycross 237 U.S. 16 (1914).

The defense further argues that the intrastate activity of Factored is directly analogous to the intrastate activity in Conklin. In this case, Ryan testified that before each loan to First Secured was made he conducted due diligence in New York, which involved inspecting each property. Moreover, in his testimony Hester stated that with respect to the loans by

Factored to Morgan Stephens, he traveled to Rochester, New York, to perform the required due diligence.

Plaintiffs argue that the same reasoning of Netherlands applies even more forcefully to Factored. Both Asseff and Lewnowski testified that Factored has no assets in New York (exclusive of their bank account), has no employees in New York, and does not have and never has had an office in New York or anywhere other than Bermuda for the transaction of business. (Tr. 1061; Tr. 1229.) The Court disagrees with defendants position on Conklin and finds Netherlands more akin to our scenario. Defendants have failed to establish that Factored engaged in any New York activity beyond approving the wiring of funds from its account at Republic Bank to allow First Secured to purchase distressed mortgages with said funds. (Tr. 1380.)

The maintenance of that account is not a factor to be considered in reaching a determination of "doing business". Section 1301(b)(3) of the Business Corporation Law specifically excludes consideration of the maintenance of bank accounts in New York in determining whether a foreign corporation is doing business under Section 1312. Posadas de Mexico, S.A. v. Dukes, 757 F. Supp. 297, 302 (S.D.N.Y. 1991); Intermar Overseas, Inc. v. Argocean S.A., 117 AD2d 492, 496, 503 NYS2d 736, 739 (1st Dept. 1986). However, this would not preclude the court from considering the Bank account along with other factors in reaching its determination. See Grove Valve & Regulator Co., Inc. v. Iranian Oil Services Ltd., D.C.N.Y 1980, 87 FRD 93 (fact that foreign corporation maintained checking account in New York City, did not, without more, amount to doing business under BCL Section 1301).

Defendants argue that Winchester, Factored and Riverside were engaging in business in New York on more than an "isolated or accidental" basis. They purposefully set out to establish a presence in the New York mortgage market. The court finds that there is insufficient evidence to support such a conclusion.

From the day Ryan met Chalavoutis on an airplane to the day the last promissory note was signed and the final funds wired to First Secured none of the parties activities supports such a conclusion. Though there was an elaborate plan to avoid taxes for the beneficiaries of the trust, which has previously been set forth by the court tracing the money, not from Highlands but in actuality from Factored via the Republic Bank to First Secured, none of these machinations in the opinion of the court constituted "doing business" in New York

The actual transfer of the funds were incidental to Factoreds interstate commerce business and not part of intra state commerce as required by BCL 1312 for "doing business" purposes.(For the purposes of this discussion it must be remembered that much more activity is needed for "doing business" under the Section 1312 of the BCL than is needed for long arm jurisdiction under the CPLR (see 5 White, New York Corporations, ¶ 1312.01). "Because of the possibility of an unconstitutional infringement of interstate commerce, a higher level of intrastate activity must be shown to trigger §1312." Storwal International, Inc. v. Thom Rock Realty Company, L.P., 784 F. Supp. 1141 (SD NY, 1992).

Defendants argue that the Plaintiffs dealings with Morgan Stephens and the Defendant clearly evidence a general attempt on the part of the Plaintiffs to transact business in this state. See Franklin Enterprises Corp., 34 Misc.2d 594, 595, 226 NYS 2d at 529 (Sup. Ct. 1962). As stated by Judge Gullota in Franklin Enterprises, whether a plaintiff's actions fall within the statute depends on whether the plaintiff's actions constitute "a part of a general attempt to transact business in violation of the statute".

The only real contacts between the plaintiffs and New York would be the aforementioned due diligence visits by Ryan, Hester, Massey or any other Riverside employee.

Plaintiff contends that the Due Diligence activities of Riverside in its role of investment advisor are not attributable to the Factored Receivables Trust.

Where a foreign corporation not qualified to do business in New York has an agent or subsidiary which is so qualified, the activities of the agent will not be attributed to the principal for purposes of determining whether the principal is "doing business" in New York pursuant to BCL § 1312. The primary reason is that § BCL 1312, like GAL § 18 and their predecessors, are revenue-raising statutes, serving the interest of the state that foreign capital should be actively employed within its borders. Dumbarton Flax Spinning Co v. Greenwich & Johnsonville Ry. Co., 83 NYS 1054, 1056, 87 AD 21 (3d Dept. 1903) .

It is undisputed that Riverside acted as investment manager to the Trust. In that capacity, it performed due diligence on the properties proposed by First Secured for investment by the Trust prior to arranging for any advances being made. Ryan testified that he and other representatives of Riverside traveled to New York from time to time to inspect properties offered for investment. (Tr. 305-306). During the eight-month period following execution of the Loan Agreement, when funds were being advanced to First Secured for the purchase of distressed mortgages, Riverside was not qualified and was not required to be qualified to do business in New York. Again, it is unrebutted that Riverside was a Florida corporation, located in Florida and did not maintain employees in New York. Moreover, Riverside acted as investment advisor to a series of trusts which were not shown to be doing any business in New York. Riverside's activities themselves were far from permanent, continuous or regular in New York.

An authoritative line of cases analyzing the extent to which an agent's in-state activities will be attributed to the principle holds that the activities of a qualified agent make it *less*, not more likely, that the principal will be found to be doing business as a result of the agent's activities. In Mayatextil, S.A. v. Liztex U.S.A., Inc., 1993 WL 51094 (S.D.NY Feb. 24, 1993), the plaintiff, a Guatemalan textile manufacturer, sued its former U.S. sales agent for fraud. The defendant, which was authorized to do business in New York, raised BCL § 1312 as a defense, claiming that it had made frequent business trips to New York on plaintiff's behalf and had generated a substantial volume of business thus there principal was doing business in New York without being authorized to do so. The court rejected both arguments, pointing out that sending sales agents into New York does not constitute doing business under § 1312. With regard to the agency relationship, the court held that "Liztex's actions as Mayatextil's sales agent not only fails to demonstrate that Mayatextil was doing business in New York, as defendants argue, but further indicates that by using a New York corporation, Mayatextil should not also be subject to the registration requirements of § 1312." Id. Defendants were equally unsuccessful with their alternative argument that Liztex's business activity in New York should be attributed to plaintiff based on piercing the corporate veil. The court said there was no authority for attributing the agent's activity to the principal in this circumstance. and declined to apply the argument to § 1312. Id. *8. Though not on "all fours" with our case Mayatextil and Storwall both provide valuable guidance in this area.

Riverside's activities in performing due diligence were acts in furtherance of its businesses as investment advisor. In essence, they are no different than those of the sales agent in Mayatextil and do not support the conclusion that Factored was doing business in New York. Riverside did become qualified to do business in New York during the pendency of this litigation (Jan. 18, 2001). To the extent that it at one time acted in a representative capacity in maintaining this suit on behalf of Factored, it satisfied the gatekeeper requirements of the BCL § 1312. (Ex. 167)

Riverside was terminated as investment manager for Factored in May 2001 and replaced by Structured Asset Services ("SAS"). SAS, in turn, filed its application on January 27, 2003 (Exh. 176). Pursuant to BCL § 1305, these applications were effective upon filing and continue until surrendered, suspended or annulled.

It is argued that since Riverside and SAS have acted as agents for Factored in New York and are or were themselves qualified to do business in New York, Factored need not qualify. E.g., Mayatextil, supra. and Storwal, supra. This may hold true for Riverside but it is irrelevant whether SAS was or was not registered in that SAS is not a party to this action (It is the court's understanding that there had been an application made to amend the caption to remove Riverside and add Structured Asset Services but it was denied by O'Connell, J. and is the law of the case).

General Associations Law § 18, in many respects a parallel statute to Art. 13 of the Business Corporation Law, bars any association "doing business in New York" from maintaining an action in New York until it has filed a certificate designating the secretary of state as its agent for the service of process. The term "association" is defined in GAL § 2(4) as joint stock association or a "business trust." Section 2(2) defines a business trust as "any association operating a business under a written instrument or declaration of trust, the beneficial interest under which is divided into shares represented by certificates." Accordingly, before any trust is required to file a certificate of designation as a predicate for maintaining a lawsuit in the Courts of New York, three conditions must be satisfied; to wit: (1) the trust must be a business association operating under a written trust instrument; (2) its beneficial interests must be evidenced by share certificates; and (3) it must be doing business in New York. Factored neither issued stock certificate nor, it argues, does it do business in NY.

Although Factored contends it had not previously "done business" in New York, and argues it is not "doing business" in New York, in order to obviate the defense presented by First Secured, Factored filed a certificate of designation with the New York Secretary of State under GAL § 18. (Ex. 183), on March 11, 2003. It is well established that a violation of BCL § 1312 may be cured at any time before judgment. Caspian Investments, Ltd. v. Vicom Holdings, Ltd., 770 F. Supp. 880 (S.D.NY 1991). Presumably, the same rule applies to GAL § 18, since like the BCL, it refers to "maintaining" as opposed to "commencing" an action.

Does Plaintiffs' Investment Plan, which included Avoiding Taxes for the Investors, Provide A Basis to Determine that Plaintiffs Fall Within the Purview of BCL Section 1312 and Section 18 of the General Associations Law, that they were "Doing Business" in New York?

Defendants have continuously argued that Plaintiffs were "doing business" in New York. They also argue that Winchester and Factored's activities in New York were in furtherance of a deliberate tax avoidance plan which is further evidence to find that Winchester's and Factored's activities in New York bring them within the proscriptions of BCL Section 1312 and General Associations Law Section 18.

The unwritten purpose of §1312 is to protect businesses that operate within this state from unfair competition from other, out of state businesses , that operate within New York, but do not pay New York state taxes. See Von Arx A.G. v. Breitenstein, 52 AD 2d 1049, 384 NYS 2d 895 (4th Dept. 1976), aff'd 41 NY2d 958, 394 NYS 2d 876 (1977) (purpose of § 1312 is to regulate foreign business so that they will not be doing business under more advantageous terms than those allowed corporations of New York state).

Defendants also contend that even if, on its facts, Plaintiffs would appear not to owe any taxes, as per the Dept. of Taxation, the court could, from the evidence presented on trial, conclude that a foreign corporation did still owe back taxes and thus conclude that the plaintiff is precluded from bringing or maintaining this action.

The court disagrees. It does not believe it can draw such a conclusion nor does it find that the evidence supports it. At one point in its Memo of Law, when addressing the acts of Riverside and Winchester on behalf of Factored, the defense calls out to the court "This Court should not be lured into aiding and abetting this tax evasion scheme by focusing solely on each individual leg of the transaction". This court is not "lured" into support for a tax evasion scheme but will leave it up to the State and Federal authorities to determine if there has been an evading of taxes and by whom. It does not appear from the evidence and the Tax Law (658©) and 208 (1) (d)) that Factored would owe either income taxes or franchise taxes. However, this is merely dicta.

No matter what else has been discussed here, one salient fact remains, that 7.6 million dollars went into the hands of the defendants and nothing came back.

Conclusion

Considering all of the above, the evidence produced at trial, both exhibits and testimony, the court finds the plaintiffs stand legitimately before this court and may proceed on these actions. The evidence shows that First Secured failed to pay interest or principal when it became due, that the Donovan Family Trust failed to pay pursuant to its guaranty and is liable for the full amount funded plus applicable interest, that the amount funded and not repaid is $7,618,655.86.

That interest shall be calculated pursuant to the notes and as set forth in Ex 178a. However, for the 10th, 38th, 44th and 18th causes of action interest shall be recalculated pursuant to the earlier ruling of the court due to the blank space in Sec 2.02 of the Notes (Exs. 5, 6, 8, 7 and 11) that corresponded to those causes of action. This will result in an increase in pre-default interest and a decrease in post-default interest.

The accrued interest at 18% on each loan from date of funding to date immediately prior to default is $1,903,318.89. Interest from event of default to date of trial (March 2003) equals $11,949,675.57. The total of interest plus principal of all outstanding loans equals $21,471,650.29.

Judgment shall enter against defendants First Secured Capital as well as the Donovan Family Trust for said total amount of $21,471,650.29.

Pre-judgment interest of 9% compounded annually shall be added to said amount from March 3, 2003 until entry of judgment.

Post-judgment interest shall be 9% per annum compounded annually.

A declaratory judgment shall issue entitling Factored to exercise all rights and remedies pursuant to the Stock Pledge.

The court hereby issues an injunction effective upon service of a copy of this decision upon the defendants enjoining the defendants First Secured Capital Corporation and the Donovan Family Trust, its respective officers, directors, employees, principals, agents and affiliates from either directly or indirectly selling, assigning, transferring, hypothecating, encumbering or otherwise disposing of the distressed loan collateral, any proceeds of sale derived therefrom, or any other assets, whether in the ordinary course of business or otherwise, until such time as the monetary judgment granted to the Factored Receivables Trust is satisfied.

The court hereby pierces the corporate veil and further enjoins First Secured Lien Corp., Secured Lien Corp., Secured Partners Corp. and Secured Property Corp., all corporations controlled by Thomas B. Donovan and used by him for depositing of proceeds from the sale of distressed properties, from disposing of any funds deposited therewith from the sale of the distressed mortgages, which were the subject matter of this action.

The defendants are ordered to disclose within 30 days of the date of this decision the history of each loan heretofore not previously provided to plaintiffs. Said history shall include whether the property is still held by First Secured and, if not, the disposition of said property, including how the proceeds of any sale were distributed (including a copy of any closing statement).

Any funds recovered by Winchester/Factored shall be held in escrow until the rights of Riverside vis-a-vis Winchester and Factored are determined by the court.

The matter of attorney fees and costs shall be determined at a hearing to be held on September 19, 2003, before this court, or a referee if the court so directs.

Settle judgment on notice.

Dated: August 11, 2003

J.S.C.