

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

PRESENT: BERNARD J. FRIED
Justice

FBEM

PART 60

WACHOVIA SECURITIES
PLAINTIFF

INDEX NO. #104326-2006

MOTION DATE _____

- v -

JOSEPH, RICHARD A

MOTION SEQ. NO. #001

MOTION CAL. NO. _____

DEFENDANT

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

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

| PAPERS NUMBERED |
|-----------------|
| _____ |
| _____ |
| _____ |

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

This motion is decided in accordance with the accompanying memorandum decision.

SO ORDERED

FILED
FEB 07 2007
NEW YORK
COUNTY CLERK'S OFFICE

Dated: 2/7/07

Bernard J. Fried
J.S.C. **BERNARD J. FRIED**
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 60

-----X
WACHOVIA SECURITIES, LLC,

Plaintiff,

-against-

Index No.
104326/06

FBEM

RICHARD A. JOSEPH (individually, as Trustee to the R.J. Alan Co. Inc. Profit Sharing Plan Dtd., and as Responsible Individual to Pepper Caylie Kundtz Joseph Coverdell IRA), DELAWARE CHARTER GUARANTEE & TRUST COMPANY d/b/a TRUSTAR RETIREMENT SERVICES (as Trustee to Franklin Scott Koonce IRA, Dean A. Joseph Coverdell IRA, Dennis L. Joseph Coverdell IRA, and Pepper Caylie Kundtz Joseph Coverdell IRA), DOUG JOSEPH (as Responsible Individual for Dean A. Joseph Coverdell IRA and Dennis L. Joseph Coverdell IRA), HUDSON SECURITIES, INC., and KOONCE SECURITIES, INC.,

Defendants.

FILED
FEB 07 2007
NEW YORK
COUNTY CLERK'S OFFICE

APPEARANCES

For Plaintiff:

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R. Scott Garley
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Motion sequence numbers 001 and 002 are consolidated herein for disposition. This action arises as a result of a transaction in which plaintiff, Wachovia Securities, LLC (Wachovia), bought pink sheet¹ securities for its account, after which those securities underwent a 1000-to-1 reverse stock split. In attempting to close its open position by selling its shares, Wachovia mistakenly short sold the new securities, which had a new symbol, and a starkly different value. Wachovia now seeks to rescind that transaction.

According to the complaint, on March 1, 2004, a Wachovia employee in California purchased 450 shares of Siebels Bruce Group (Siebels) (symbol SBIG) for settlement on March 4, 2004. Wachovia then moved the 450 shares of SBIG from the purchase account to Wachovia's error account, where 450 shares could be sold to close the position.

On or about March 2, 2004, apparently without the knowledge of Wachovia, Siebels engaged in a 1000-to-1 reverse split of its stock; the new stock bore the symbol SBBGV (which would later become SBBG). On March 3, 2004, Wachovia attempted to close its position in SBIG, but its computer system rejected the sell order. That same day, Wachovia

¹

Pink sheets are a static paper quotation medium printed twice daily and distributed to broker/dealers.

reissued the sell order using a new symbol, SBBGV, which according to the complaint, it mistakenly took to be the same security as SBIG. In effect, then, the transaction (the SBBGV Short Sale) resulted in a short position of SBBGV in Wachovia's error account.

In the SBBGV Short Sale, 450 shares of SBBGV were sold to Hudson Securities, Inc. (Hudson) at \$10 per share at 11:44 AM on March 3, 2004. Subsequently, Hudson sold the 450 shares of SBBGV at the same price to defendant Koonce Securities, Inc. (Koonce). Koonce apparently purchased the securities on behalf of some of the remaining defendants (specifically, Richard A. Joseph [150 shares], R.J. Alan Co. Inc. Profit Sharing Plan Dtd. [150 shares], Pepper Caylie Kundtz Joseph Coverdell IRA [50 shares], Franklin Scott Koonce IRA [90 shares], Dean A. Joseph Coverdell IRA [5 shares], Dennis L. Joseph Coverdell IRA [5 shares]). Koonce and the remaining defendants named will be referred to as the "Investors," and this series of transactions, starting with the SBBGV Short Sale, and culminating in the purchase of the shares by the Investors, will be referred to as the "Sales Series."

According to the complaint, the Investors and/or their agents understood at the time of Sales Series that there was confusion in the marketplace concerning Siebels' stock, and they recognized the potential for Wachovia's mistake. Investors then allegedly set the trap of posting a very low buy offer – by one account a mere 38 minutes after the reverse stock split – for SBBGV (the Trap) in order to take advantage of unsuspecting market participants. Wachovia claims to have fallen into the Trap.

In early April 2004, Wachovia learned of the mistake and immediately attempted to correct the short position in its error account by buying 450 shares of SBBGV (by this time,

SBBG). However, there was little or no market for the stock, only 8,000 shares of SBBG existed, and, allegedly, almost all of them were held by insiders of the company. Wachovia was advised that the few shares of SBBG that were actually being offered for sale were being sold for \$1,500 to \$3,000 per share. Thus, Wachovia's mistake, which was intended to close a position valued at no more than \$4,500, became a short sale position exposing Wachovia to between \$675,000 and \$1,350,000 in financial obligation to the Investors.

The complaint, filed more than two years later, on March 29, 2006, seeks to rescind the SBBGV Short Sale and, accordingly, the Sales Series, on the legal bases of unconscionability (first cause of action), unilateral mistake (second cause of action), or unjust enrichment/constructive trust (third cause of action). Hudson and the Investors move to dismiss the complaint, pursuant to CPLR 3211(a)(7) for failure to state a cause of action.

The test to be applied on a motion to dismiss is whether, upon examination of the four corners of the pleading, the factual allegations contained in Wachovia's pleading indicate the existence of any cause of action cognizable at law. Guggenheimer v Ginzburg, 43 NY2d 268, 275 (1977); but see CPLR 3013 (complaint is required to contain statements of sufficient particularity to give the court and the parties notice of the transactions and occurrences intended to be proved, along with the material elements of each cause of action).

Wachovia argues that to allow the Sales Series to stand upon its own terms would be unconscionable. A valid claim of unconscionability generally requires a demonstration of an absence of meaningful choice on the part of one of the parties together with contract terms that are unreasonably favorable to the other party. Gillman v Chase Manhattan Bank, N.A., 73 NY2d 1, 10 (1988); Chrysler Credit Corp. v Kosal, 132 AD2d 686 (2nd Dept 1987).

Wachovia has failed to allege any absence of meaningful choice on their part in participating in the SBBGV Short Sale, or any oppression and unfair surprise. See e.g. Uniform Commercial Code §2-302. Also, in commercial transactions among sophisticated business entities, under terms that are standard in the trade, there is a presumption that unconscionability is legally inapplicable. Chrysler Credit Corp., 132 AD2d at 686; 22 NY Jur 2d Contracts §§153, 156; 93 NY Jur 2d Sales §47. Wachovia has failed to overcome that presumption.

In any event, the doctrine of unconscionability has both substantive and procedural aspects; a determination of unconscionability requires a showing that the transaction was both procedurally and substantively unconscionable when made. Gillman, 73 NY2d at 10; Rosiny v Schmidt, 185 AD2d 727 (1st Dept 1992); see also State v Avco Fin. Serv. of New York Inc., 50 NY2d 383, 390-391 (1980). The substantive aspect considers whether the terms of the transaction are unreasonably favorable to one party; the procedural aspect considers the transaction formation process.

Here, neither the substantive or procedural aspects of the unconscionability doctrine are inferable from the complaint. Substantively, Wachovia's only direct connection with the defendants is through Hudson, which resold the SBBGV shares at the same price. Thus, the transaction is favorable to neither Wachovia nor Hudson. Procedurally, the complaint fails to allege that any defendant other than Hudson had any connection whatsoever to Wachovia's election to engage in the SBBGV Short Sale.

The complaint establishes that Wachovia was not induced to enter the transaction due to the Trap, but, rather, placed the shares of SBIG in its error account in order to sell them.

See Complaint, ¶¶12, 13, 14, 23. Wachovia, although having means by which to ascertain the value of SBBGV, then acted on that intention, with self-confessed limited knowledge, and made a mistake in execution. See Ittleson v Lombardi, 193 AD2d 374, 376 (1st Dept 1993) (a party with means ‘by the exercise of ordinary intelligence’ to discern the true nature of a transaction, must make use of those means in order to recover for being induced to enter a transaction by misrepresentations); Gans v Wormser, 73 App Div 623 (1st Dept 1902) (opportunity to ascertain the exact situation obviates cause of action for rescission based upon unilateral mistake); Restatement 2d Contracts §154 (“[a] party bears the risk of a mistake when ... he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient”).

Hence, even accepting the allegations of the complaint as true (that the Investors set the Trap), Wachovia has failed to establish any right to recovery on the basis of unconscionability. The first cause of action is dismissed as against Hudson and the Investors.

Wachovia relies upon Balaban-Gordon Co., Inc. v Brighton Sewer Dist. No. 2 (41 AD2d 246 [4th Dept 1973]) for the assertion that a contract may be rescinded if there was a unilateral mistake that is material, enforcement of the contract would be unconscionable, and the mistake occurred despite the exercise of reasonable care. As noted above, Wachovia has failed to make allegations that establish unconscionability.

While I agree with Wachovia’s argument that a determination of negligence is rare upon a motion to dismiss, I cannot credit Wachovia’s bare allegation that it exercised reasonable care in conducting the SBBGV Short Sale as sufficient to defeat a motion to

dismiss the claim for rescission due to unilateral mistake. See Mark Hampton, Inc. v Bergreen, 173 AD2d 220, 220 (1st Dept 1991) (unsupported facts and bare legal conclusions are not entitled to the presumption of truth and the benefit of every favorable inference).

Price is a fundamental part of any transaction. In fact, there is law that a contract can scarcely be made without an indication of price. See e.g. Ray Proof Corp. v Buffalo Gravel Corp., 5 AD2d 823 (1st Dept 1958); Leonard C. Pratt Co. v Roseman, 259 App Div 534, 537 (1st Dept 1940). Shares of stock each have a unique symbol, and companies may have many different types of shares, with different symbols. For a sophisticated investor to mistakenly sell shares of a security with a different symbol, at a different-than-market price, cannot, under any construction of the facts, be reasonable care.

In addition, I note that Wachovia leaves out the fourth, and key, requirement in Balaban-Gordon Co., namely that “it is possible to place the other party in status quo.” 41 AD2d at 247; accord Broadway – 111th St. Assoc. v Morris, 160 AD2d 182, 184-185 (1st Dept 1990) (rescission based upon unilateral mistake is only feasible only where there is no prejudice, and the parties can be returned to the status quo ante). The requirement that a return to status quo ante be possible “will not be strictly enforced where the party against whom rescission is sought is a wrongdoer who is exploiting its change of position to shield its wrongdoing.” Sokolow, Dunaud, Mercadier & Carreras LLP v Lacher, 299 AD2d 64, 72 (1st Dept 2002). Wachovia does not allege, nor have there been suggested any satisfactory method by which the status quo ante of this two-year old securities transaction may be restored. Nor does the complaint allege that any defendant is exploiting its change of position.

Finally, as Wachovia itself argues, rescission due to unilateral mistake is available where the potential for mistake is known to the other party, and uncorrected. Sheridan Drive-In, Inc. v State, 16 AD2d 400, 405 (4th Dept 1962). Here, there is no indication whatsoever that Hudson or the Investors knew that Wachovia would make such a mistake. Moreover, having no direct connection to Wachovia, it is not clear that the Investors could have corrected Wachovia's mistaken impression at any point before Wachovia ordered the SBBGV Short Sale. As such, the second cause of action for rescission on the basis of unilateral mistake is dismissed as against Hudson and the Investors.

Wachovia offers Broadway – 111th St. Assoc. (160 AD2d at 184-185) to show that the complaint states a cause of action for unjust enrichment. That case pertains to unilateral mistake, and not specifically unjust enrichment. Also, as noted above, that case explicitly requires that there be no prejudice, and that the court is able to restore the status quo ante.

Despite this, Wachovia, relying upon EBC I, Inc. v Goldman Sachs & Co. (7 AD3d 418 [1st Dept 2004], affd as mod 5 NY3d 11 [2005]), argues that all that is required to maintain an action for unjust enrichment is that the “defendant received benefits to which it was not entitled that were effectively conferred by plaintiff in the form of a lower price for its shares.” Id., at 420.

EBC I, Inc. is factually dissimilar to the instant matter. First, in that case, the defendant, who had a fiduciary relationship with plaintiff, set the price at which the plaintiff's shares were sold in order to increase profits. Here, Wachovia had no relationship with the Investors at all (a fortiori they did not have a fiduciary one), and an arm's-length relationship with Hudson. Second, Wachovia itself elected the price in the SBBGV Short

Sale; Wachovia has not alleged that any of the Investors directed information specifically to Wachovia.

In addition, to the extent that Wachovia points to Hudson as having some sort of obligation toward Wachovia, the uncontested evidence is that Hudson purchased and sold the SBBGV shares at the same price; as a matter of law, Hudson was not unjustly enriched. Once those shares were resold by Hudson, Wachovia had no connection whatsoever to the shares or the subsequent purchasers.

Wachovia also argues that Mississippi & M.R. Co. v Cromwell (91 US 643 [1875]) is similar to this case. In Mississippi & M.R. Co., the plaintiff was seeking specific performance of a contract involving transfer of capital. The Court, refused to use its equitable powers to enforce specific performance of the unconscionable contract, but, rather, elected to “leave the [defendant] to his remedy at law.” Id., at 645. Here, in contrast, Wachovia brings an action, not for specific performance, but for rescission. Moreover, while in Mississippi & M.R. Co., the plaintiff had a direct relationship with the defendant, here, Wachovia’s only direct relationship is to Hudson, which, it is uncontested, was not unjustly enriched. Mississippi & M.R. Co. does not consider the equitable power to rescind a contract, but, rather endorses the public policy of forbearance to use equitable powers to enforce a contract that may be unconscionable. The third cause of action for unjust enrichment is dismissed as against Hudson and the Investors.

Defendants also argue that the complaint should be dismissed due to laches. See e.g. 18B Carmody-Wait 2d, NY Prac §117:178 (“[r]escission is an equitable remedy subject to the equitable defense of laches). While, it is unnecessary to determine the validity of

defendants' laches argument because the complaint has been dismissed upon other bases, I note that, generally, laches is a matter of defense, and does not directly pertain to the sufficiency of the complaint. Desser v Schatz, 182 AD2d 478, 480 (1st Dept 1992).

Notwithstanding, as to the sufficiency of the complaint, it is beyond cavil that an action for rescission of a sale must be brought promptly after discovery of the fraud. See Palumbo v Norstar Bank Upstate New York, 212 AD2d 377 (1st Dept 1995); Flamm v Noble, 43 NYS2d 922, 923-924 (Sup Ct, NY County), affd 266 App Div 1001 (1st Dept 1943); compare Bank Leumi Trust Co. of New York v D'Evori Intern., Inc., 163 AD2d 26, 30-31 (1st Dept 1990) ("party who would repudiate a contract procured by duress, must act promptly, or he will be deemed to have elected to affirm it") (citations omitted). Here, Wachovia, without any explanation of its delay, seeks to have a transaction rescinded some two years later. See Bruce v Davenport, 1 Abb Dec 233, 5 Abb Pr NS 185 (NY 1867) (three months too long); Devendorf v Beardsley, 23 Barb 656 (Sup Ct, NY County 1857). Especially with transactions such as the sale of securities, parties "cannot be permitted to rescind after the course of events has demonstrated that disaffirmance is the better policy." J.J. Little & Ives Co. v Lamb Pub. Co., 108 Misc 14, 19 (Sup Ct, NY County 1919).

Any doubt on dismissing this complaint as against Hudson and the Investors vanishes when I consider the repercussions of unwinding or rescinding an accepted and adopted sale of securities to a third party based on a two-year-old contract between the first two parties. See e.g. Stein v Severino, 41 Misc 2d 209, 211 (Sup Ct, NY County 1963). Such indiscriminate use of the court's equitable powers would render an innocent market participant unsure that a purchase or sale had actually been completed, or leave that party to

wonder whether, based upon some collateral transaction, such a completed purchase or sale might be rescinded by the later action of a court. Thus, absent extraordinary circumstances, the legislature and the courts have traditionally protected, and upheld the rights of, third-party purchasers. See e.g. Restatement of Restitution §§ 168, 172, 208 (1937).

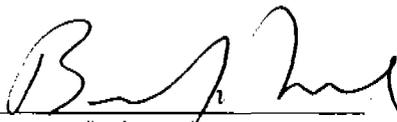
The essence of Wachovia's claims is that the Investors set the Trap, and, apparently, both Wachovia and Hudson fell into it. There is an old equity maxim that is, in a measure, apropos to the instant matter: "where one of two innocent parties must suffer from the acts of a third person, the loss must fall upon him who has enabled the third party to do the injury." 20 NY Jur Equity, §118, at 145; see also National Safe Deposit Sav. & Trust Co. v Hibbs, 229 US 391, 394-398 (1913); Bunge Corp. v Manufacturers Hanover Trust Co., 31 NY2d 223, 228 (1972). The party with control over the SBBGV Short Sale, and the party that patently failed to exercise reasonable care in ordering that transaction was Wachovia.

Accordingly, it is hereby

ORDERED that the motions of defendants Hudson Securities, Inc., Koonce Securities, Inc., Richard A. Joseph, and Doug Joseph to dismiss the complaint is granted, and the complaint is dismissed with costs and disbursements to those defendants as taxed by the Clerk of the Court; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: 2/7/07



J.S.C. **BERNARD J. FRIED**
J.S.C.

FILED
FEB 07 2007
NEW YORK
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