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publication in the New York Reports.

No. 131
DDJ Management, LLC, et al.,
 Appellants,
 v.
Rhone Group L.L.C., et al.,
 Respondents,
Larry A. Pavey, et al.,
 Defendants.

 Arnold M. Weiner, for appellants.
 Herbert M. Wachtell, for respondents Rhone Group L.L.C.
et al.
 Christopher M. Mason, for respondents Quilvest S.A. et
al.
 Juan C. Basombrio, for respondent Duncan.
 Loan Syndications and Trading Association; Commercial
Finance Association; The Clearing House, amici curiae.

SMITH, J.:

 We hold that plaintiffs in this action for fraud have
alleged facts from which a jury could find that they were
justified in relying on the representations defendants made to
them.

I

Plaintiffs are four companies that loaned a total of \$40 million dollars in March of 2005 to American Remanufacturers Holdings, Inc. and affiliated companies (ARI). ARI was a remanufacturer of automobile parts; it purchased used parts, broke them down into their components, and used the components to make new parts. ARI's stock was owned 45 percent by entities affiliated with Rhone Group L.L.C., and 55 percent by entities affiliated with Quilvest S.A.

After ARI failed to repay the loan, plaintiffs brought a number of claims against Rhone, Quilvest, companies and individuals associated with them, members of ARI management, and ARI's outside accountants. Only the first claim is in issue here. It asserts in essence that Rhone and Quilvest, their corporate affiliates and individuals acting on their behalf (hereafter defendants) defrauded plaintiffs into making the loans.

Plaintiffs allege, among other things, that defendants presented them with ARI financial statements that were false and misleading. More specifically, they allege that the financial statements were designed to inflate the number with which plaintiffs were most concerned -- ARI's earnings before interest, taxes, depreciation and amortization (EBITDA). The allegations on this subject are lengthy, and include some striking details. An e-mail sent to one of the defendants by an ARI executive about

two months before the loan closing says: "I understand the financial reason to manipulate earnings." Another e-mail, sent some three weeks later by the same officer to the same recipient says: "I realize we needed to make EBITDA for banks but we should understand . . . what our true EBITDA is."

We need not describe defendants' alleged misconduct fully; we may assume, for purposes of this appeal, that the complaint adequately alleges that defendants made material misrepresentations. The question for us is whether, if the complaint's allegations are true, a jury could find that plaintiffs justifiably relied on those misrepresentations. Defendants argue that plaintiffs failed to make a reasonable inquiry into the truth of what defendants said, and we will describe in more detail the alleged facts that are relevant to that argument.

The complaint alleges that plaintiffs were first solicited to loan money to ARI in July 2004, and that over the next several months they received a number of written presentations by ARI's investment banker, containing financial and other information that later proved to be false or misleading. At the time of the solicitation -- and indeed until the day the loan closed -- ARI's outside auditors had not completed their audit for the year ending December 31, 2003, and it was part of the original proposal that the loans would be "conditioned upon, and made after, the borrower had provided the

lenders" with audited financial statements for 2003. It was later agreed that unaudited financial statements for 2004 would also be provided.

During the months before those financial statements were completed, plaintiffs had several conversations with ARI representatives in which they were given reassuring information, and made two calls to participants in the industry to get information about ARI's management, which was also reassuring. In December 2004 and January 2005, plaintiffs were sent drafts of the audit report for 2003, and on March 2, 2005 they were sent the unaudited financial statements for 2004. The final version of the 2003 audit report was provided on March 22, 2005, and the loan closed on the same day.

ARI's unaudited 2004 statements, plaintiffs allege, grossly inflated EBITDA, in significant part through a manipulation of ARI's inventory reserves. Plaintiffs say that they could not have detected this, but, as defendants point out, the 2004 statements contained some features that might have aroused concern in a skeptical reader who examined them carefully. They showed a significant increase in the value of ARI's inventory over the previous year; a modest amount of cash on hand, equal to the amount of ARI's bank overdraft; and a remarkable increase in the company's apparent profitability in the last month of the year. Though December 2004 revenues were below the year's monthly average, gross profit was higher than

average, and gross margin was shown as 17.9 percent for the month, compared to 13.5 percent for the year as a whole.

The complaint does not allege that plaintiffs asked questions about these or other aspects of the financial statements, or that they asked to look at ARI's underlying records. Plaintiffs did, however, insist that ARI represent and warrant, in substance, that the financial statements were accurate. Specifically, ARI represented and warranted in the loan agreement (as summarized in the complaint) that the 2004 financial statements "present fairly in all material respects the financial position of ARI as at December 31, 2004 and the results of ARI's operations and cash flows for the period then ended"; that the statements were prepared in accordance with generally accepted accounting principles; that "between December 31, 2003 and March 22, 2005 [the closing date], no event has occurred, which alone or together with other events, could reasonably be expected to have a Material Adverse Effect" on ARI's business, assets, operations or prospects or its ability to repay the loans; and that "no information contained in the loan agreement, the other loan documents or the financial statements being furnished to the Plaintiffs contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained therein not misleading in light of the circumstances under which they were made." All of these representations and warranties, plaintiffs say, later proved to

be false.

The loan agreement, as defendants emphasize, also provided for a high interest rate: ARI agreed to pay plaintiffs the lower of 10 percent above the LIBOR rate or 9 percent above an index rate derived from the "base rate" charged by United States banks to corporate borrowers.

As we mentioned above, plaintiffs' claim for fraud against defendants was one of several in the complaint. On motions pursuant to CPLR 3211, Supreme Court dismissed all the others, but allowed this claim to stand. The Appellate Division modified Supreme Court's decision and dismissed the claim, emphasizing that "plaintiffs never looked at ARI's books and records" and concluding that, having failed to do so, they "cannot now properly allege reasonable reliance on the purported misrepresentations" (DDJ Mgt., LLC v Rhone Group L.L.C., 60 AD3d 421, 424 [1st Dept 2009]). We granted leave to appeal, and now reverse.

II

The rule defendants rely on was stated more than a century ago in Schumaker v Mather (133 NY 590, 596 [1892]):

"[I]f the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations."

See also Danann Realty Corp. v Harris (5 NY2d 317, 322 [1959]).

This rule has been frequently applied in recent years where the plaintiff is a sophisticated business person or entity that claims to have been taken in. In some cases, the rule serves to rid the courts of cases in which the claim of reliance is likely to be hypocritical. Thus in Global Mins. & Metals Corp. v Holme (35 AD3d 93 [1st Dept 2006]), the plaintiff had fired an officer whom it found to be untrustworthy, and given him a general release. Later, it claimed to have trusted, without verifying, the officer's assurances as to the innocent nature of a particular transaction. The Appellate Division held such trust to be unjustified. In other cases, the rule rejects the claims of plaintiffs who have been so lax in protecting themselves that they cannot fairly ask for the law's protection. In Lampert v Mahoney, Cohen & Co. (218 AD2d 580, 582 [1st Dept 1995]), the Appellate Division dismissed the claim of a plaintiff who said "that he loaned some \$3 million to a corporate entity and its principal without ever investigating the financial condition of the business beyond obtaining some vague verbal assurances from its accountant." In cases like Global Minerals and Lampert, the plaintiff "may truly be said to have willingly assumed the business risk that the facts may not be as represented" (Rodas v Manitaras, 159 AD2d 341, 343 [1st Dept 1990]).

Where, however, a plaintiff has taken reasonable steps to protect itself against deception, it should not be denied

recovery merely because hindsight suggests that it might have been possible to detect the fraud when it occurred. In particular, where a plaintiff has gone to the trouble to insist on a written representation that certain facts are true, it will often be justified in accepting that representation rather than making its own inquiry. Indeed, there are many cases in which the plaintiff's failure to obtain a specific, written representation is given as a reason for finding reliance to be unjustified (see e.g. Curran, Cooney, Penney v Young & Koomans, 183 AD2d 742, 743-744 [2d Dept 1992]; Rodas v Manitaras, 159 AD2d at 343; Emergent Capital Investment Management, LLC v Stonepath Group, Inc., 343 F3d 189, 196 [2d Cir 2003] [applying New York law]). It is harder to find cases holding that a plaintiff who did obtain such a representation could not justifiably rely on it; one such case is Ponzini v Gatz (155 AD2d 590 [2d Dept 1989]), in which the plaintiff's attorney actually knew that the warranty in question was false. In National Conversion Corp. v Cedar Bldg. Corp. (23 NY2d 621 [1969]) -- a case admittedly much different in its facts from this one -- we held that it was reasonable for the plaintiff to rely on a written representation as a substitute for making an investigation of the facts represented.

"The question of what constitutes reasonable reliance is always nettlesome because it is so fact-intensive" (Schlaifer Nance & Co. v Estate of Warhol, 119 F3d 91, 98 [2d Cir 1997]).

No two cases are alike in all relevant ways. However, several federal cases applying New York law bear a noticeable resemblance to this one -- and all of them hold that the plaintiffs' claims of justifiable reliance were legally sufficient (Merrill Lynch & Co. v Allegheny Energy, Inc., 500 F3d 171, 181-182 [2d Cir 2007]; Barron Partners, LP v Lab123, Inc., 2008 WL 2902187, 2008 US Dist LEXIS 56899 [SD NY 2008]; JP Morgan Chase Bank v Winnick, 350 F Supp 2d 393 [SD NY 2004]; Faller Group, Inc. v Jaffe, 564 F Supp 1177 [SD NY 1983]).

JP Morgan is perhaps the case most similar to ours. Plaintiffs there were banks that had extended credit to Global Crossing, Ltd. (GC). After it became insolvent, the banks sued GC's officers, directors and employees for fraud. The district court denied defendants' motion for summary judgment on the fraud claims, rejecting the argument "that the plaintiffs cannot demonstrate reliance on the alleged misrepresentations" (350 F Supp 2d at 404). The court emphasized that plaintiffs had bargained for a provision in their credit agreement with GC to the effect that "each loan request was 'deemed' a 'representation and warranty' by GC that no 'event of default' had occurred" (id. at 396). Examining the facts of several state and federal cases applying New York law, the court concluded that they "do not support the interpretation that a duty to inquire is necessarily triggered as soon as a plaintiff has the slightest 'hints' of any 'possibility' of falsehood" (id. at 408). The court said:

"It is undisputed that the Banks expressly bargained not only for the right to examine GC's books and records, but also for the provision of the Agreement deeming each borrowing request to be a representation that GC remained in compliance with its debt covenants at the time the request was made. Under these circumstances, it cannot be argued that the Banks failed to bargain for adequate safeguards to establish, at least initially, the basis for their reliance on the defendants' representations"

(id. at 409).

Noting the defendants' argument "that GC's . . . financial statements . . . were so transparently false -- or at least, that the assumptions on which they were based were so apparently questionable -- that no reasonable banker would have lent GC a penny without conducting further inquiry into their accuracy" (id.), the court found that the question it presented was for the jury. The court was unable to say as a matter of law that "a reasonable lender of equivalent experience should have inquired further" into GC's financial statements (id. at 411).

We reach a similar conclusion here. It is fair to say that there were hints from which plaintiffs might have been put on their guard in this transaction. Some aspects of the 2004 financial statements -- particularly the sudden improvement in profitability in the last month of the year -- might have seemed too good to be true; the fact that it took an auditor until March of 2005 to complete an examination of the 2003 financial statements was hardly encouraging; and the high interest rate

itself demonstrates that plaintiffs knew the transaction carried considerable risk. But plaintiffs made a significant effort to protect themselves against the possibility of false financial statements: they obtained representations and warranties to the effect that nothing in the financials was materially misleading. We decline to hold as a matter of law that plaintiffs were required to do more -- either to conduct their own audit or to subject the preparers of the financial statements to detailed questioning. If plaintiffs can prove the allegations in the complaint, whether they were justified in relying on the warranties they received is a question to be resolved by the trier of fact.

Defendants emphasize that the warranties were given only by ARI, and suggest that they cannot support a claim against Rhone, Quilvest and others. But this argument blurs the distinction between claims for breach of warranty and claims for fraud. It is true that, as a contractual matter, the only rights plaintiffs acquired under the warranties were against ARI. If plaintiffs prove only that the warranties were false, they cannot recover against Rhone and Quilvest. But if they can prove that Rhone and Quilvest knew the facts represented and warranted were false -- in other words, that Rhone and Quilvest knew the financial statements gave an untrue picture of ARI's financial condition -- the case is different. It can be inferred from the allegations of the complaint that plaintiffs believed Rhone and

Quilvest would not knowingly cause a company they controlled to make false representations in a loan agreement as to the accuracy of financial statements. We cannot say as a matter of law that this was an unjustifiable belief.

Accordingly, the order of the Appellate Division, insofar as appealed from, should be reversed with costs, and the case remitted to the Appellate Division for consideration of questions raised but not determined on the appeal to that court.

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Order, insofar as appealed from, reversed, with costs, and case remitted to the Appellate Division, First Department, for consideration of issues raised but not determined on the appeal to that court. Opinion by Judge Smith. Chief Judge Lippman and Judges Ciparick, Graffeo, Read, Pigott and Jones concur.

Decided June 24, 2010