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Certifying Professionals May Be Subject to Lawsuits

BY ADAM LEITMAN BAILEY AND JOHN DESIDERIO

In its recent Assured Guaranty[1] and Kerusa[2] decisions, the New York Court of Appeals has made it clear that preemption is no longer an issue in private securities and real estate syndication cases where plaintiffs allege common law causes of action that overlap possible violations that only the attorney general may prosecute under New York State's "blue sky" law, the Martin Act,[3] which regulates the public sale of securities and real estate investment offerings.[4] However, questions of Martin Act preemption are still raised in cases involving architect and engineer certifications that the attorney general's regulations require to be included in offering plans filed by developers of condominium and cooperative apartments in newly built or renovated buildings.[5] The theme of this article is that Martin Act preemption should no longer bar suit against architects or engineers who falsely or negligently certify offering plans.

Adam Leitman Bailey

John M. Desiderio

Offering Plans

Under the attorney general's Martin Act regulations, each offering plan must include an inspection report describing the construction and/or renovation of the property prepared by an independent architect or engineer and a certification by that professional stating, among other things: (a) that the professional inspected the existing portions of the property and examined the building plans and specifications included in the offering plan "so that prospective purchasers may rely on the report," (b) that the "certification is made for the benefit of all persons to whom this offer is made," (c) that the report "affords potential investors, purchasers and participants an adequate basis upon which to found their judgment concerning the description and/or physical condition of the property…as will exist upon completion of renovation and/or construction," and (d) that the report "does not (i) omit any material facts, (ii) contain any untrue statements of a material fact, or (iii) contain any fraud, deception, concealment or suppression."

New York courts are often called upon to grapple with the question of whether certifying professionals may be subject to suit for either breach of contract or fraud and/or negligent misrepresentation if the building is not constructed as represented in accordance with their report and certification.[6]

The Court of Appeals, in *Assured Guaranty*, said that its earlier holdings in *CPC International*[7] and *Kerusa* stand for the proposition that "a private litigant may not pursue a common-law cause of action where the claim is predicated solely on a violation of the Martin Act or its implementing regulations and would not exist but for the statute." In so holding, the court affirmed the First Department decision in *Assured Guaranty* which had noted that *Kerusa* held that a private right of action is prohibited only "when the fraud is predicated solely on alleged material omissions from the offering plan amendments mandated by the Martin Act."

Several decisions at the Appellate Division and Supreme Court level, issued both before and after *Kerusa*, hold that architect or engineer certifications in sponsor offering plans are made "pursuant to the Attorney General's implementing regulations and, as such, may not be the basis of private causes of action against them."[8] However, these decisions have not offered any reasoned basis for their holdings other than rote reference to *Kerusa* and prior cases which held that the attorney general has sole responsibility for enforcement of the Martin Act.[9]

Martin Act Violations

One could argue that an architect's or engineer's false or negligent certification of an offering plan cannot be the basis for a private cause of action because, in the words of *Kerusa*, the cause of action "would not exist but for the statute." However, neither that reasoning, nor rote reference to the attorney general's exclusive right to enforce the Martin Act provides a sound basis upon which to bar suit against an architect or engineer who has falsely or negligently certified an of-

fering plan.

The question that should be asked is: What are the Martin Act violations that are within the exclusive province of the attorney general to enforce?

As provided in the Martin Act, an offering plan must contain certain information and representations specified in the act and required by the attorney general's implementing regulations,[10] but "shall not omit any material fact or contain any untrue statement of a material fact."[11] Accordingly, it is a violation of the Martin Act for an offering plan either (a) to fail to disclose material information required by the attorney general's regulations or (b) to make untrue representations regarding any material fact "as will afford potential investors, purchasers and participants an adequate basis upon which to found their judgment."

While, arguably, prior to *Assured Guaranty*, an architect's or engineer's false certification was subject only to a Martin Act enforcement action by the attorney general, it is no longer so after *Assured Guaranty*. A false certification is an affirmative misrepresentation that should now be subject to either a common law fraud or negligent misrepresentation cause of action brought by a private party who relied upon the certification as a basis for deciding to purchase a condominium or cooperative apartment. As noted above, *Kerusa* held that a private right of action is prohibited only "when the fraud is predicated solely on alleged material omissions from the offering plan amendments mandated by the Martin Act."

A false or negligent certification included in an offering plan is neither an omission nor a disclosure. Therefore, an offering plan that includes the required architect's or engineer's certification (whether true or false) is facially compliant with the Martin Act regulations and does not provide a basis for an attorney general enforcement action based "solely" on an alleged material omission. Only if an offering plan completely omitted an architect's or engineer's certification would the failure to include it constitute a Martin Act violation exclusively within the province of the attorney general to prosecute.[12]

Causes of Action

Permitting a common law fraud, negligent misrepresentation, or contract action to proceed against an architect or engineer who falsely or negligently certifies an offering plan does not in any way violate the policy objectives of the Martin Act—"combating fraud and deception in securities transactions."[13] Indeed, doing so is entirely compatible with Martin Act policy objectives.

Moreover, it is well recognized that individual party principals, who also, on behalf of a sponsor or developer entity, are required to certify (a) that an offering plan "does not (i) omit any material facts, (ii) contain any untrue statements of a material fact, or (iii) contain any fraud, deception, concealment or suppression," and (b) that the plan "affords potential investors, purchasers and participants an adequate basis upon which to found their judgment," may be held liable to plaintiffs for breach of contract where the certifications contained in the offering plan are incorporated by reference into the purchase agreement,[14]—even though such claims also "would not exist but for the statute."

Although fraud causes of action against sponsor principals who certify offering plans are routinely dismissed where the fraud claim is deemed duplicative of the plaintiff's breach of contract claim,[15] there is no substantive reason to hold certifying architects or engineers immune from suit entirely where their certifications are virtually identical with those made by individual party principals and the claims against them are also based on fraud or negligent misrepresentation, or breach of contract.

This is especially so in view of the required language incorporated into the purchase agreement that "this [architect's or engineer's] certification is made for the benefit of all persons to whom this offer is made."[16] This clearly establishes a third-party beneficiary contractual relationship between the architect or engineer and the purchaser for whose benefit the certification is given. Accordingly, whenever this certification is present, there is no basis on which to preclude a purchaser's claim for either fraud or negligent misrepresentation, or for breach of contract.

Unlike the circumstances in *Sykes v. RFD Third Avenue I Associates*,[17] where the defendant engineer did not certify the construction information contained in the plan and the purchaser's cause of action for negligent misrepresentation was dismissed,[18] the certification language contained in an offering plan expressly provides a "contractually expressed intent to benefit third parties."[19] In all such cases, purchasers should be entitled to rely upon the architect's or the engineer's competent performance of his or her professional obligations and be able to hold the architect or engineer accountable where the certification was falsely or negligently made and damage has been suffered.

Privity

The ruling in *Sykes* reaffirmed only what the Court of Appeals said was the longstanding "law in New York that a plaintiff in an action for negligent misrepresentation must show either privity of contract between the plaintiff and the defendant or a relationship 'so close as to approach that of privity.'" *Sykes* followed the Court of Appeals's prior holding in *Credit Alliance v. Arthur Anderson & Co.*,[20] which held that the services of the defendant (1) must be "used for a particular purpose or purposes," (2) "in furtherance of which a known party or parties was intended to rely," and (3) be done with some conduct linking [the defendant] to that "party or parties."

Sykes held that "[t]he words 'known party or parties' in the *Credit Alliance* test mean what they say" and the plaintiff in *Sykes* failed that prong of the test.

However, neither *Sykes*, nor any of the precedent upon which *Sykes* rests, involved an express third-party beneficiary relationship between the plaintiff and the defendant, such as that created by the express words of an architect's or engineer's offering plan certification. Therefore, the "known party or parties" test applies only in cases lacking actual privity between the plaintiff and the defendant, or lacking a relationship "so close as to approach that of privity," Whether or not the plaintiff is known or unknown to the certifying architect or engineer when the offering plan certification is made is irrelevant.

The certification is being made for a particular purpose and, by certifying the offering plan "for the benefit of all persons to whom this offer is made," the architect or engineer has shown that there is a clear intention to "link" the certification to the ultimate purchaser.

Accordingly, after *Assured Guaranty,* there no longer should be any reason, based solely on Martin Act preemption grounds, for a court to dismiss a claim against an architect or engineer, who is alleged to have either falsely or negligently certified a developer's offering plan, whether the claim is based on fraud, negligent misrepresentation, or breach of contract.

Adam Leitman Bailey *is the founding partner of Adam Leitman Bailey, P.C.* **John M. Desiderio** *is a partner at the firm.*

Endnotes:

1. *Assured Guaranty (UK) v. J.P. Morgan Investment Management*, 18 N.Y.3d 341 (2011).
2. *Kerusa v. W10Z/515 Real Estate Partnership*, 12 N.Y.3d 236 (2009).
3. NY General Business Law (GBL), Article 23-A, §§352 et seq.
4. See Bailey and Desiderio, "The Martin Act 'Shield' and Private Fraud Actions," *NYLJ*, Feb. 8, 2012.
5. See 13 NYCRR §20.4(c).
6. See, e.g., *Board of Managers of Woodpoint Plaza Condominium v. Woodpoint Plaza*, 24 Misc.3d 1233(A), 901 NYS2d 897 (Table) (Sup. Ct., Kings Co., 2009); *Kikorov v. 355 Realty Associates*, 31 Misc.3d 1212(A), 927 NYS2d 816 (Sup. Ct., Kings Co., 2011).
7. *CPC International v. McKesson*, 70 NY2d 268 (1987).
8. See *Hamlet on Olde Oyster Bay Home Owners Association v. Holiday Organization*, 65 AD3d 1284 (2d Dept. 2009) (Hamlet II); see also *Board of Managers of 374 Manhattan Avenue Condominium v. Harlem Infil*, 2010 WL 2572583 (Sup. Ct., N.Y. Co., 2010); *Mandracchia v. 901 Stewart Partners*, 2009 WL 5078846 (Sup. Ct., Nassau Co., 2009).
9. See, e.g., *Hamlet II*; but see *Bhandari v. Ismael Leyva Architects*, 84 AD3d 607, 923 NYS2d 484 (1st Dept. 2011) (reversing dismissal of condominium purchasers' action against architect for alleged affirmative misrepresentation in the offering plan of a material fact about the floor dimensions of certain units).
10. GBL §352-e (1)(a).
11. GBL §352-e (1)(b).
12. Any offering plan that lacked either an engineer's or architect's certification would no doubt fail to be "accepted for filing" by the attorney general.
13. 18 NY3d at 353.
14. See, e.g., *Hamlet II*.
15. See, e.g., *Tiffany at Westbury Condominium by Its Board of Managers v. Marelli Development*, 40 AD3d 1073, 840 NYS2d 74 (2d Dept. 2007).
16. 13 NYCRR 20.4(c)
17. 15 NY3d 370 (2010); see also *Kerusa v. W10Z/515 Real Estate Partnership*, 50 AD3d 503, 858 NYS2d 109 (1st Dept. 2008).
18. Adam Leitman Bailey, P.C., represented the plaintiffs in the *Sykes* case in the Supreme Court, the Appellate Division, and before the Court of Appeals.
19. See *Bridge Street Homeowners Association v. Brick Condominium Developers,* 18 Misc.3d 1128(A), 856 NYS2d 496 (Table)(Sup. Ct., Kings, 2008). Adam Leitman Bailey, P.C., represented the plaintiffs in this matter on the issues discussed in this article.
20. 65 NY2d 536 (1985).