2005 WL 1865369
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United States District Court,
S.D. Ohio, Eastern Division.

DISCOVER BANK, Plaintiff,
v.
NEW VISION FINANCIAL, LLC, Defendant.

No. 2:03-CV-686.
|
Aug. 1, 2005.

Attorneys and Law Firms

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OPINION AND ORDER

FROST, J.

***1** This matter comes before the Court for consideration of a motion for partial summary judgment (Doc. # 49) filed by Plaintiff, Discover Bank, and a motion for partial summary judgment (Doc. # 52) filed by Defendant, New Vision Financial, LLC. Discover Bank also moves the Court for leave to amend its complaint and to reopen discovery. (Doc. # 49.) For the reasons that follow, the Court GRANTS IN PART Discover Bank's motion for partial summary judgment (Doc. # 49), DENIES New Vision's motion for partial summary judgment (Doc. # 52), and GRANTS Discover Bank's requests for leave to amend its complaint and to reopen discovery (Doc. # 49).

I. Background

New Vision Financial, LLC ("New Vision") is a Georgia corporation that purchases delinquent credit card accounts for subsequent collection. Discover Bank is a Delaware corporation with offices in Hilliard, Ohio that routinely sells delinquent accounts. Following discussions between Discover Bank and a company known as Enhanced Asset Management, which was acting on behalf of New Vision, the parties to this litigation entered into an agreement in January 2001 in which New Vision would purchase delinquent credit card accounts from Discover Bank at a rate of 9.28% of the balance of the accounts. The agreement was for one year with an automatic renewal unless either party terminated the agreement via written notice sixty days prior to renewal.

The relationship between the parties deteriorated within three months. According to New Vision, Discover Bank's placement manager had represented to New Vision during negotiations that Discover Bank would sell the credit card accounts without engaging in adverse selection, a procedure in which Discover Bank would hand off carefully selected, less-than-desirable accounts to New Vision. New Vision contends, however, that Discover Bank was not only engaging in adverse selection, but that the company admitted it in a May 14, 2001 communication to Enhanced Asset Management. As a result of improper selection procedures, New Vision contends, Discover Bank was intentionally selling high-balance accounts instead of random accounts; it is apparently more difficult to collect on high-balance accounts.

As an outgrowth of discussions between the parties, New Vision and Discover Bank executed amendments to their initial agreement three times, once on October 1, 2001, once on February 8, 2002, and once on July 10, 2002. These amendments altered several specific terms of the account purchase agreement, but left unchanged and in full effect all agreement provisions not specifically altered via amendment.

New Vision's collection problems allegedly continued. The company asserts, for example, that Discover Bank had begun to sell New Vision an unusual number of accounts in which the debtor had obtained legal representation, which complicates collection procedures and, depending upon the collection procedures employed, can lead to violations of the Fair Debt Collection Practices Act. New Vision also contends that the accounts

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it received contained a disproportionate number of Texas and Florida accounts, which are more difficult to collect due to state law.

***2** New Vision did not purchase any accounts in February, March, April, and May 2002. New Vision then purchased accounts for June through October 2002, did not make any purchases for November 2002, and then again purchased some accounts-but $10.2 million less than required-in December 2002. After New Vision declined to purchase any accounts for the first three months of 2003, Discover Bank terminated the parties' agreement as of April 1, 2003.

Discover Bank subsequently filed this action on July 30, 2003. Following an unsuccessful attempt at dismissing or transferring the action, New Vision filed an answer in which it asserted the following five counterclaims: fraud/intentional misrepresentation, fraud in the inducement, fraud and deceit, negligent misrepresentation, and unjust enrichment. Discover Bank responded by filing a motion to dismiss New Vision's affirmative defenses and the foregoing counterclaims; Discover Bank also sought judgment on the pleadings on the issue of liability. In a July 30, 2004 Opinion and Order, the Court dismissed New Vision's fraud and misrepresentation-related counterclaims and corresponding defenses, as well as the counterclaim for unjust enrichment. The Court also denied the motion for judgment on the pleadings.

Following the completion of discovery, both sides have now filed motions for summary judgment. (Docs.# 49, 52.) Discover Bank has also moved to amend its complaint to assert additional claims against new parties, with a consequent request to reopen discovery. The parties have completed briefing the issues involved, and the motions are now ripe for disposition. Although there has been a request for oral argument, the Court has determined that such argument would be neither helpful nor essential to the fair resolution of the case given the issues involved. Accordingly, the Court shall proceed to decide the motions based upon the memoranda and evidence filed. *See* S.D. Ohio Civ. R. 7.1.

II. Motions to Amend Complaint and Reopen Discovery

Discover Bank moves under Federal Rule of Civil Procedure 15(a) to amend its complaint to assert alter ego, fraudulent transfer, and successor liability claims against New Vision shareholders Fred and Shelly Howard, Titan Recovery, and Titan Management. Rule 15(a) provides that "a party may amend the party's pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires." As New Vision correctly point out in its memorandum in opposition, the policy favoring liberal amendment embodied in the Rule is not absolute. Rather, "leave to amend is properly denied where there is 'undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of the amendment, etc." ' *PR Diamonds, Inc. v. Chandler,* 364 F.3d 671, 698 (6th Cir.2004) (quoting *Foman v. Davis,* 371 U.S. 178, 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962)).

***3** New Vision asserts that Federal Rule of Civil Procedure 16(b) also affects Discover Bank's request to amend its pleading. Rule 16(b) provides for the entry of an order setting forth the case schedule, which "shall not be modified except upon a showing of good cause and by leave of the district judge." The Sixth Circuit has explained that both Rule 16(b) and 15(a) govern a motion to amend the complaint filed after the issuance of a scheduling order. *Russell v. GTE Gov't Sys. Corp.,* No. 04-3437, 2005 WL 1579718, at *6 (6th Cir. July 6, 2005) (citing *Dyer v. Casey,* No. 94-5780, 1995 WL 712765, at *3 (6th Cir. Dec.4, 1995) (per curiam). Therefore, "once a scheduling order's deadline passes, a party must first show good cause under Rule 16(b) for the failure to seek leave to amend prior to the expiration of the deadline before a court will consider whether the amendment is proper under Rule 15(a)." *Hill v. Banks,* 85 Fed. Appx. 432, 433 (6th Cir.2003).

Relying on Rule 16(b)'s good cause provision, New Vision argues that Discover Bank lacks good cause to permit the Court to undertake a Rule 15(a) analysis. New Vision points to the July 30, 2004 e-mail regarding Titan Recovery Group that Discover Bank received and the fact that the agreed-upon proposed September 2004 deadline for amending the pleadings had passed to argue that Discover Bank has unreasonably delayed in seeking amendment. Discover Bank responds in part by asserting that because the September 2004 deadline never became the order of the Court, only Rule 15(a) governs.

Review of the docket indicates that on May 12, 2004, the parties submitted a joint Rule 26(f) report in which they recommended a September 1, 2004 cut-off date for amendment of the pleadings. (Doc. # 33, at 2.) It does not appear either that the Magistrate Judge ever adopted this date via journalized order or that subsequently filed

scheduling orders incorporated the date. (Docs.# 39, 40.) On August 27, 2004, however, the Magistrate Judge entered a scheduling order in this case that set various discovery deadlines and a dispositive motion filing deadline of March 1, 2005. (Doc. # 39.) The Court then issued an additional scheduling order on September 9, 2004 that established additional deadlines, as well as repeating the summary judgment deadline. (Doc. # 40.) Given the foregoing, Discover Bank's March 1, 2005 request to amend its complaint comes six months after the proposed deadline for such amendment and well after the passage of numerous other deadlines. The request for additional discovery is similarly well after the various discovery deadlines.

Complicating the issue is that Discover Bank did pursue discovery about the Titan enterprise that, following resistance, culminated in a January 2005 discovery order by the Magistrate Judge permitting additional narrow discovery. Although this discovery ultimately appeared to be of limited help to Discover Bank, the discovery apparently confirmed its suspicions sufficiently so that the company could assert claims against the three parties it seeks to add in good faith. The period of delay between the date this discovery was obtained, January 25, 2005, and the March 1, 2005 request to amend is fairly inconsequential. Thus, even assuming that Rule 16(b) does apply here, the Court finds that Discover Bank has demonstrated good cause for moving to amend and to reopen discovery after the expiration of the scheduling order dates.

***4** The Court shall therefore proceed under Rule 15(a). There is no apparent undue delay, bad faith or dilatory motive on the part of Discover Bank here. There are also no repeated failures to cure deficiencies by amendments previously allowed. The two central issues are therefore whether the amendment would cause undue prejudice to the opposing party and whether amendment would be futile.

Any prejudice to New Vision or the parties to be added is necessitated in part by their own conduct. Moreover, the Court shall adjust the trial schedule so as to obviate any prejudice, thereby affording the parties due time to fully prepare and litigate this case. The Court further finds that the effect of altering the trial schedule imposes a slight burden on the Court's trial calendar that the Court can and will absorb. The Court also finds that Discover Bank has presented a compelling argument as to why the proposed amendments would not be futile. Although the Howards, Titan Recovery, and Titan Management may ultimately prevail on the claims against them, there is a sufficient basis at this juncture as set forth in the analysis and argument presented by Discover Bank to permit those claims to proceed. The Court thus concludes that the interests of justice support amendment and additional discovery and GRANTS Discover Bank's request to amend its pleading and to reopen discovery. (Doc. # 49.)

III. Summary Judgment Motions

A. Standard Involved

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). The Court must therefore grant a motion for summary judgment here if Gregg, the nonmoving party who has the burden of proof at trial, fails to make a showing sufficient to establish the existence of an element that is essential to his case. *See Muncie Power Prods., Inc. v. United Techs. Auto., Inc.,* 328 F.3d 870, 873 (6th Cir.2003) (citing *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986)).

In viewing the evidence, the Court must draw all reasonable inferences in favor of Gregg, who must set forth specific facts showing that there is a genuine issue of material fact for trial. *Id.* (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)); *Hamad v. Woodcrest Condo. Ass'n,* 328 F.3d 224, 234 (6th Cir.2003). A genuine issue of material fact exists "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Muncie,* 328 F.3d at 873 (quoting *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)). Consequently, the central issue is " 'whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." ' *Hamad,* 328 F.3d at 234-35 (quoting *Anderson,* 477 U.S. at 251-52.)

B. Analysis

***5** Discover Bank moves for summary judgment only on

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the issue of liability for breach of contract after the July 2002 amendment. The company asserts that under Delaware law,[1] New Vision breached the amended contract by failing to purchase accounts for November 2002 through March 2003 (recognizing the partial exception of an insufficient purchase in December 2002) and for a purported renewal period from March 2003 until March 2004. New Vision in turn opposes Discover Bank's motion and itself moves for partial summary judgment on Discover Bank's seeking mitigation damages and lost profits[2] on the grounds that (1) Discover Bank has failed to demonstrate that it incurred any damages, (2) Discover Bank failed to act reasonably in mitigating any damages, (3) Discover Bank is equitably estopped from claiming damages because it acquiesced to New Vision's purchasing pattern, and (4) the parties' contractual obligation was illusory because their agreement lacked mutuality of obligation. Because each party has incorporated its arguments for and against summary judgment in their briefing, the Court shall discuss their motions together while keeping in mind the parties' respective burdens and the different view of the evidence a moving and non-moving party enjoy.

To prevail on its claim, Discover Bank must prove that a contractual obligation existed, that New Vision breached that obligation, and that Discover Bank suffered resulting damages. *VLIW Tech., LLC v. Hewlett-Packard Co.,* 840 A.2d 606, 612 (Del.2003); *H-M Wexford LLC v. Encorp., Inc.,* 832 A.2d 129, 140 (Del.Ch.2003). The Court shall address each element in turn.

It is undisputed that New Vision failed to purchase the requisite accounts since November 2002; New Vision admitted as much in its Answer. (Doc. # 19, at 4 ¶ 16.) What is disputed is whether a valid contractual obligation existed and, if so, what constitutes the length of that agreement.

New Vision argues that no valid contract existed post-July 2002 because that month's amendment granted Discover Bank unfettered discretion to sell or not to sell accounts to New Vision on a monthly basis. New Vision also notes that the agreement enabled Discover Bank to terminate the parties' relationship without cause and at any time, simply by sending a timely written notice 90 days prior to termination. Discover Bank has responded by asserting that the pre-amendment agreement originally contained mutual obligations and that consideration existed for the July 2002 amendment because Discover Bank relinquished its right to pursue damages related to New Vision's prior breaches and because it agreed to accept a lower price for future accounts.

In regard to Discover Bank's discretion to sell or not to sell accounts, the Court concludes that a valid contract existed based on Discover Bank's reading of *Williams Natural Gas Company v. Amoco Production Company,* No. 11040, 1991 WL 58387 (Del.Ch. Apr.16, 1991). That case correctly rejected a similar mutuality of obligation argument by looking at whether mutual obligations existed when the contract was initially formed, as opposed to the parties' modified obligations years later. *Id.* at *12. Such a rationale controls here.

***6** In regard to Discover Bank's ability to terminate, the Court agrees that New Vision has failed to meet its burden of directing this Court to applicable Delaware case law supporting its termination argument, that no such case law was uncovered, and that Discover bank is correct in pointing to case law from other jurisdictions that rejected this novel theory. The Court credits that case law's rejection of New Vision's theory here.

Turning to the length of the contractual obligation between Discover Bank and New Vision, the Court recognizes Discover Bank's reliance on the applicable July 10, 2002 amendment to the parties' agreement. This amendment provided:

> Seller agrees to sell and Buyer agrees to buy all of Seller's right, title, and interest in and to the Accounts, which Seller identifies during each month through March 2003, subject to the terms and conditions set forth in this Agreement. This Agreement shall automatically renew for a one (1) year period, through March 2004, unless terminated by either party upon sixty (60) days written notice to the other party prior to March 31, 2003.

(Doc. # 53, Ex. 5, at 1.) New Vision's president, Fred Howard, testified at his deposition that he could not recall his company serving a timely written notice terminating the contract sixty days prior to March 31, 2003. (Howard Tr. at 186-87.) Discover Bank in fact did not terminate the contract until March 10, 2003-well after the January 30, 2003 date for precluding automatic renewal-with the termination to be effective as of April 1, 2003. Thus, Discover Bank reasons, the contract automatically renewed until its March 2004 expiration. Delaware law

supports such a conclusion. *See, e.g., Lane v. Neudeck,* No. C.A. 00A-04-003, 2000 WL 33114372, at *5 (Del.Super.Ct. Nov.29, 2000) (holding that, despite ongoing negotiations between the parties, a lease automatically renewed in the absence of a statutorily mandated notice of termination).

Disagreeing with this conclusion, New Vision presents essentially three arguments. First, New Vision asserts that by terminating the contract as of April 1, 2003, Discover Bank extinguished its ability to recover for the subsequent period because the parties were no longer in a contractual relationship. New Vision cites to the terms of the contract itself and to two cases to support its argument.

The contract indeed permits Discover Bank to terminate the agreement early upon New Vision's breach, but this does not as New Vision suggests terminate Discover Bank's ability to seek relief for the entirety of the contract term. Discover Bank's citation to *Farnsworth on Contracts* is well taken and highlights the well-settled proposition that an injured party can terminate a contract and seek damages for the balance of the breaching party's performance under the entirety of the contract. The contract terms here simply reinforce this approach, and to conclude otherwise would be to reward New Vision for its breach by enabling them to evade their obligations.

***7** Nor does New Vision's citation to Delaware case law aid its argument. New Vision relies upon *Tanner v. Exxon Corporation,* No. 79C-JA-5, 1981 WL 191389 (Del.Super.Crt. July 23, 1991), but that case is distinguishable. *Tanner* states that "Delaware law does not allow future profits as damages for a period beyond the termination date of the contract sued on since termination automatically extinguishes the relationship between the parties." *Id.* at *3. But the damages at issue in *Tanner* were for a period *beyond the period of the lease involved*-it terminated by expiration of its duration, not by early termination-whereas the disputed portion of the damages in the case *sub judice* target the period of the agreement's life had New Vision not breached and enabled Discover Bank's termination. *Id.* at *1 (explaining that contract was a lease running "for a period of 25 years ending August 26, 1978," the date the contract terminated).

The second case upon which New Vision relies proves similarly unhelpful to their cause. In *J.E. Rhoads & Sons, Incorporated v. Ammeraal, Incorporated,* 1988 WL 32012 (Del.Super.Crt. Mar. 30, 1988), the Delaware Superior Court addressed a situation in which a party breached a contract by sending the other party a notice of termination after a pre-end -ofyear ninety-day period for termination had passed. The contract had therefore automatically renewed for another year, and the court held that the plaintiff's "future profits" damages were limited to the contract period had it not been terminated improperly, i.e., the next year (in addition to possible incidental and consequential damages that might extend beyond that year). *Id.* at *8-10. That set of facts is inapposite to the facts of the instant case where Discover Banks seeks damages for the period of the contract.

Second, New Vision also argues that it served written notice of termination in a November 20, 2002 letter, thereby terminating the contract as of March 2003. This letter provided in relevant part:

> At this time New Vision Financial, LLC will not be able to make a purchase from Discover Bank in the month of November 2002, due to extenuating circumstances. This purchase may, ay Discover Banks['] discretion, be added to the end of New Vision Financial, LLC forward flow contract, which is scheduled to terminate March of 2003.

(Doc. # 53, Ex. 6, Nov. 20, 2002 Howard Letter.) Undercutting New Vision's interpretation of this letter is that New Vision's president-who signed the letter-did not characterize the letter as a notice of termination. (Howard Tr. at 183, 187.) Also arguably undercutting the favorable interpretation New Vision now suggests is a March 10, 2003 letter from New Vision to Discover Bank in which New Vision suggests that it "may be able to make a purchase in the month of April 2003," which would have been beyond the agreement period if New Vision had indeed terminated the contract. (Doc. # 53, Ex. 6, Mar. 10, 2003 Howard Letter.)

***8** Third, New Vision contends that during a telephone conversation, the parties entered into a valid oral agreement that canceled the renewal term. The parties' negotiations alone cannot automatically serve to vitiate the automatic renewal term under Delaware law, as evinced in the aforementioned *Lane v. Neudeck.* Despite New Vision's attempt at distinguishing *Lane,* this Court regards the distinction between the cause of the automatic renewal ultimately immaterial; whether by contractual provision or statutory mandate, the simple fact that negotiations occurred could not serve to defeat renewal in

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Lane and will not serve to defeat renewal of the agreement here.

This does not mean that renewal necessarily occurred here, however. To support its claim that an oral agreement to disregard the automatic renewal provision had occurred, New Vision points to a February 28, 2003 e-mail from New Vision to Discover Bank that stated that “in our recent telephone conversation, it is the position of both parties that there will be no automatic extension of the existing contract.” (Doc. # 55, Ex. 16, Feb 28, 2003 E-mail; Doc. # 63, Ex. 4, Feb 28, 2003 E-mail.) There is certainly evidence contradicting this suggestion of an oral agreement, and Discover Bank denies any such agreement. (Moore Tr. at 82-3, 89-90.)

Discover Bank also directs this Court to the parties' written agreement, which provides that “[n]o change or modification of, or waiver under, this Agreement shall be valid unless it is in writing and signed by duly authorized representatives of Seller and Buyer” (Doc. # 53, Ex. A, Agreement § 13.9, at 16). No such written agreement signed by both sides has been produced or suggested to exist, and New Vision's curious suggestion that the February 28, 2003 e-mail served as proper *timely* written notice of termination is as wholly unfounded as the e-mail “notice” was untimely (coming just over 30 days before renewal as opposed to the 60 days contemplated by the agreement). (Doc. # 70, at 3.)

Additionally, Delaware law provides:

> Any amendment to a contract, whether written or oral, relies on the presence of mutual assent and consideration.... Delaware courts define consideration as a benefit to a promisor or a detriment to a promisee pursuant to the promisor's request. Past consideration, as opposed to true consideration, however, cannot form the basis for a binding contract. A party cannot rely on a pre-existing duty as his legal detriment in an attempt to formulate a contract.

Continental Ins. Co. v. Rutledge & Co., Inc., 750 A.2d 1219, 1232, *reargument denied,* 2000 WL 268297 (Del.Ch.2000). Although disfavored, a specific and direct oral agreement to ignore an aspect of the written contract can nonetheless be enforceable. If the parties indeed agreed to such an arrangement (despite Fred Howard's curious failure of recollection) wherein the contract would terminate, Discover Bank would not enforce its right to renewal or pursue legal remedies, and New Vision would pay Discover Bank a negotiated sum, then there would be no ability to now recover for the renewal term here. Necessarily crediting the evidence, there is thus a factual dispute over the purported oral agreement-a genuine issue of material fact-that ultimately precludes summary judgment here on the issue of liability for the post-automatic renewal term.

***9** Having found that no reasonable juror could reach any conclusion but that a valid pre-automatic renewal contractual obligation existed and that New Vision breached that contractual obligation, the Court next turns to the issue of damages. As noted, New Vision contends that Discover Bank cannot prove this third element of its breach of contract claim.

New Vision argues that because Discover Bank has failed to produce evidence as to what its in-house recovery department did with all its past-due accounts for the time period of the original contract term, “[i]t is entirely possible that Discover Bank actually received more revenue during the months in question that it would have had if it sold the accounts to New Vision.” (Doc. # 66, at 8.) In other words, New Vision is alleging that despite producing evidence of accounts sold to companies like New Vision, Discover Bank is hiding the ball in regard to any accounts it retained ownership of and either referred to traditional collection agencies or attempted to collect itself.

Discover Bank in turn has produced evidence suggesting that it has incurred over $1.0 million in damages. (Docs. # 53, 56, Ex. 14 (under seal)). The company directs this Court to Delaware case law that supports the general proposition that a party need only prove its damages to a reasonable degree of certainty to prevail in a case. This Court agrees. The Court does not agree that such case law invariably means that a party is entitled to summary judgment, but New Vision has failed to produce any evidence that Discover Bank's figure is incorrect. Rather, New Vision relies upon speculation to proclaim that Discover Bank cannot prove damages. New Vision's suggestion of a “[l]ikelihood that Discover Bank has actually suffered no damage at all” is an insufficient basis to create a genuine issue of material fact. (Doc. # 66, at 8.)

New Vision also asserts that because Discover Bank has

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failed to act reasonably in mitigating its damages, "it is barred from recovery as a matter of law against New Vision." (Doc. # 66, at 10.) The Court agrees that as a general principle, a plaintiff in a breach of contract action must act to mitigate its damages. The Court also agrees that the issue of mitigation remains a trial issue. Assuming *arguendo* that there is a duty to mitigate, Discover Bank may ultimately recover nothing if indeed it incurred no actual damages or failed mitigate.

There are also no facts suggesting an apparent waiver of damages on the part of Discover Bank, as evinced in the Robert Deter e-mail to New Vision, which continued to seek funds for the renewal term. (Doc. # 63, Ex. 3, Feb. 26, 2003 E-mail.) Equitable estoppel cannot apply here in regard to the post-July 2002 amendment period because there are simply no facts supporting the contention that Discover Bank had acquiesced to New Vision's breach during this period. New Vision's argument to the contrary ignores both that prior breaches resulted in renegotiated deals that benefitted *both* parties and that the parties undertook efforts to resolve the post-July 2002 breaches without litigation and through negotiation *without dismissing the breaching conduct.* The fact that Discover Bank had previously tried to salvage the business relationship and had repeatedly renegotiated the parties' arrangement did not mean that New Vision could reasonably breach its obligation on a monthly basis without fear of recourse.[3] Nor is there any evidence supporting that the contention that New Vision reasonably relied on Discover Bank's unrelated dealings with third parties in making its decision to ignore its contractual obligations.

***10** In summary, then, the Court holds that Discover Bank is entitled to summary judgment on the limited issue of whether New Vision is liable for breach of the pre-renewal period contract. Whether Discover Bank can prove that it incurred damages in light of a potential duty to mitigate remains open. Additionally, whether the parties' agreement automatically renewed remains a trial issue. Accordingly, summary judgment for either party on the issues of breach and damages for the purported renewal period is inappropriate. New Vision has apparently otherwise abandoned its boilerplate affirmative defenses that it did not address in its briefing.

IV. Conclusion

For the foregoing reasons, the Court GRANTS IN PART Discover Bank's motion for partial summary judgment (Doc. # 49), DENIES New Vision's motion for partial summary judgment (Doc. # 52), and GRANTS Discover Bank's requests for leave to amend its complaint and to reopen discovery (Doc. # 49). Given this decision, the Court DENIES WITHOUT PREJUDICE the now premature motions *in limine* (Docs. # 71, 72, 73) and VACATES the September 19, 2005 trial date. Counsel should be prepared to discuss proposed deadlines for adjusting the case schedule at the August 3, 2005 final pretrial conference, which is now converted into an in-chambers status conference.

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2005 WL 1865369

Footnotes

1 Unlike in the earlier motion to dismiss proceeding involving alleged fraud and issues of equity, Ohio law does not apply to the issues *sub judice.* (Doc. # 24, at 15 n. 5; Doc. # 31, at 5.) As the parties agree, Delaware law applies here pursuant to the parties' contract. *See Muglia v. Kaumagraph Corp.,* 64 F.3d 663, 1995 WL 492933, at *3 (6th Cir.1995) (unpublished table decision) (explaining that under choice of law analysis, law of place of injury applied to tort claims and claims arising in equity, while contract's terms dictated that Delaware law applied to claims involving contract interpretation).

2 Discover Banks asserts that it is seeking contractual "cover" damages pursuant to Section 3.5 of the parties' agreement. (Doc. # 68, at 6.)

3 The agreement in fact states that "[n]either parties' waiver of the other party's breach of any term, covenant or condition contained in this Agreement shall be deemed to be a waiver of any subsequent breach of the same or any other term, covenant or condition in this Agreement." (Doc. # 53, Ex. A, Agreement § 13.6, at 16.)

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Declined to Follow by In re American Paper Mills of Vermont, Inc., Bankr.D.Vt., August 3, 2004

254 B.R. 523
United States Bankruptcy Court,
S.D. New York.

In re CLINTON STREET FOOD CORP., Trenco Food Corp., Grandco Food Corp., Penco Food Corp. and Penco Supermarkets, Inc., Debtors.
Ian Gazes, Chapter 7 Trustee of Penco Food Corp., Plaintiff,
v.
Phillip DelPrete, The Maui Pineapple Co., Inc., Rudy Fuertes, Harry Laufer, Robert Zorn, and Sanford Goldberg, Defendants.

Bankruptcy Nos. 93–B–43200 (SMB1) to 93–B–43204 (SMB1).
|
Adversary No. 98–9294A.
|
March 28, 2000.

Synopsis
Following sale of debtor's assets, Chapter 7 trustee brought adversary proceeding against purchaser, its representative, three potential bidders, and another individual, alleging that the auction had been rigged. Potential bidder, joined in part by other defendants, moved to dismiss. Purchaser and its representative moved for summary judgment. The Bankruptcy Court, Stuart M. Bernstein, Chief Judge, held that: (1) bankruptcy court order approving the sale had res judicata effect on trustee's claims for fraud and fraudulent concealment; (2) even if trustee's ignorance of the claims tolled the one-year limitations period, trustee's claims for fraud and fraudulent concealment were still time-barred; (3) amended complaint stated a legally cognizable claim for "fraud on the court"; (4) both trustee and potential bidder offered reasonable interpretations of scope of general release executed in unrelated adversary proceeding and, thus, whether release barred relief sought by trustee could not be decided on motion to dismiss; and (5) whether a second general release executed in an unrelated adversary proceeding barred trustee's claims against purchaser and its representative could not be determined on motion for summary judgment.

Motions granted in part and denied in part.

West Headnotes (26)

[1] **Judgment**

Finality of Determination

Bankruptcy court order approving a sale of assets is a "final order" for res judicata purposes.

6 Cases that cite this headnote

[2] **Judgment**

Finality of Determination

Rule, that bankruptcy court's sale order is a "final order" for res judicata purposes, promotes the important public policy favoring the finality of orders transferring ownership of bankruptcy estate assets.

8 Cases that cite this headnote

[3] **Bankruptcy**

Confirmation

Because a proceeding for confirmation of judicial sale of debtor's assets is in rem, it is final as to the entire world, including those who were not parties to the sale. Bankr.Code, 11 U.S.C.A. § 363.

2 Cases that cite this headnote

[4] **Bankruptcy**

Manner and Terms
Bankruptcy

Collateral attack

Section of the Bankruptcy Code allowing trustee

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to either avoid a collusive sale of estate assets or recover damages, including punitive damages, from any entity who enters into a collusive agreement, is a statutory exception to the rule of finality of bankruptcy sale orders. Bankr.Code, 11 U.S.C.A. § 363(n).

Cases that cite this headnote

[5] **Courts**
Other particular matters, rulings relating to

Prior bankruptcy court ruling, that any equitable or legal claims asserted by Chapter 7 trustee under section of the Bankruptcy Code governing avoidance of asset sales, relating to alleged bid-rigging at auction of estate's assets, were barred by one-year limitations period, was the law of the case and would not be revisited in subsequent proceeding. Bankr.Code, 11 U.S.C.A. § 363(n); Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

3 Cases that cite this headnote

[6] **Judgment**
Matters which might have been litigated

Prior bankruptcy court order approving sale of estate assets had res judicata effect on Chapter 7 trustee's claims for fraud and fraudulent concealment arising from alleged bid-rigging at auction, even if trustee was ignorant of claims at time of sale; although, in ruling that claim asserted by trustee under section of the Bankruptcy Code governing avoidance of asset sales was barred by one-year limitations period, court had not expressly ruled on trustee's fraud and fraudulent concealment claims, these common law claims were indistinguishable from the statutory claim that had been dismissed, in that all claims depended on bid-rigging scheme and issuance of sale order, and sought damages based on improper procurement of sale order, and trustee could have raised claims to defeat purchaser's bid and acquisition of assets, but failed to do so. Bankr.Code, 11 U.S.C.A. § 363(n); Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

7 Cases that cite this headnote

[7] **Bankruptcy**
Judgment or Order

One-year limitations period set forth in rule governing relief from judgment or order on the basis of fraud is an absolute, outside limit, and courts lack power to grant motions filed beyond that time. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

2 Cases that cite this headnote

[8] **Bankruptcy**
Limitations and time to sue; computation

Chapter 7 trustee's fraud and fraudulent concealment claims against entities involved in alleged bid-rigging at auction sale were still time-barred, even if his ignorance of those claims tolled the one-year limitations period under the rule governing relief from judgment or order on the basis of fraud, where trustee retained law firm as special counsel to prosecute claims and then waited more than a year to commence adversary proceeding. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

4 Cases that cite this headnote

[9] **Bankruptcy**
Judgment or Order

"Fraud on the court" encompasses conduct which represents an attempt to defile the court itself, or a fraud perpetrated by officers of the

court so that the judicial machinery cannot perform its impartial task of judging cases. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

2 Cases that cite this headnote

[10] **Bankruptcy**
Judgment or Order

Fraud on the court involves conduct that seriously affects the integrity of the normal process of adjudication. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

3 Cases that cite this headnote

[11] **Bankruptcy**
Judgment or Order

Independent action seeking relief from a judgment on the basis of fraud on the court is available only to prevent a grave miscarriage of justice. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

1 Cases that cite this headnote

[12] **Bankruptcy**
Judgment or Order

Fraud on the court is not necessarily limited to situations where the court or an officer of the court subverts the judicial process through fraudulent conduct; the actions of a litigant may qualify as well, although it is not clear whether an officer of the court must also be involved. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

Cases that cite this headnote

[13] **Bankruptcy**
Order of court and proceedings therefor in general

Chapter 7 trustee stated claim for fraud on the court, as required to set aside bankruptcy court order approving sale of estate assets, by alleging that purchaser, potential bidders, and another lied when bankruptcy court inquired about any bidding agreements, that defendants' lie contributed to acceptance of purchaser's bid and approval of sale order, that trustee lacked opportunity to discover the fraud in light of the summary nature of the sale proceeding and the relatively short time frame between filing of sale application and auction, and that defendants benefitted, in that purchaser, through the deceitful conduct of its agent, bought $2 million worth of property for $320,000.00, and potential bidders were paid off. Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 60(b)(3), 28 U.S.C.A.

2 Cases that cite this headnote

[14] **Release**
General release

Usual rules governing the interpretation of contracts under New York law also apply to general releases.

Cases that cite this headnote

[15] **Bankruptcy**
Debtor's Contracts and Leases

Where defendants in adversary proceeding brought by Chapter 7 trustee asserted that a release barred trustee's claims, scope and effect of release were controlled by state law.

Cases that cite this headnote

[16] **Release**
Nature and requisites in general

New York law governed construction and effectiveness of release where all of the events in question took place in New York.

Cases that cite this headnote

[17] **Evidence**
Grounds for admission of extrinsic evidence
Release
General rules of construction

Under New York law, courts must look to language of release, the words used by the parties, to determine their intent, resorting to extrinsic evidence only when court concludes as a matter of law that it is ambiguous.

1 Cases that cite this headnote

[18] **Evidence**
Releases
Release
General rules of construction

Under New York law, interpretation of a release and the limitations on parol evidence are often subject to special rules in light of the nature of releases.

Cases that cite this headnote

[19] **Release**
General release

Under New York law, meaning and coverage of a general release hinges on the controversy being settled and the purpose for which the release is actually given.

Cases that cite this headnote

[20] **Release**
General release

Under New York law, scope of a general release depends on the intention of the parties and should not be interpreted to cover claims the parties did not intend to cover.

Cases that cite this headnote

[21] **Release**
General release

Under New York law, even the most broadly drawn general release cannot necessarily be taken at face value.

1 Cases that cite this headnote

[22] **Bankruptcy**
Proceedings

Where defendant, relying on a general release executed in an unrelated proceeding, moved to dismiss Chapter 7 trustee's adversary complaint against him for failure to state a claim, relevant inquiry was whether each party had advanced a reasonable interpretation of the scope of the release, rendering it ambiguous under ordinary principles of contract interpretation. Fed.Rules Bankr.Proc.Rule 7012(b), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

Cases that cite this headnote

[23] **Bankruptcy**

Proceedings

Where defendant, relying on a general release executed in an unrelated proceeding, moved to dismiss Chapter 7 trustee's adversary complaint against him for failure to state a claim, burden was on defendant to establish that release was intended to discharge the claims in the present action. Fed.Rules Bankr.Proc.Rule 7012(b), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

Cases that cite this headnote

[24] **Bankruptcy**
Debtor's Contracts and Leases
Bankruptcy
Proceedings

Both Chapter 7 trustee and potential bidder offered reasonable interpretations of scope of general release executed in prior, unrelated adversary proceeding, so as to render it ambiguous under New York law, thus precluding bankruptcy court from determining, on motion to dismiss, whether release barred trustee's claims of bid-rigging at auction sale of estate assets; although language of release was quite broad and indicated intention to enter into global release of all claims, not just claims asserted in prior lawsuit, nothing in record of prior lawsuit focused on specific issues in the present litigation, pending claims were unknown to trustee at time of prior lawsuit, it did not appear that parties bargained over auction claims or that estate received any additional consideration for releasing such potentially valuable claims, and potential bidder was not a named releasee. Fed.Rules Bankr.Proc.Rule 7012(b), 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

2 Cases that cite this headnote

[25] **Bankruptcy**
Proceedings

Where defendants in adversary proceeding brought by Chapter 7 trustee moved for summary judgment in reliance on general release executed in prior, unrelated adversary proceeding, defendants had initial burden of showing that release was unambiguous and that it extended to claims asserted in the present litigation; if they did so, burden would shift to trustee to show material issue of fact regarding release's scope. Fed.Rules Bankr.Proc.Rule 7056, 11 U.S.C.A.; Fed.Rules Civ.Proc.Rule 56, 28 U.S.C.A.

Cases that cite this headnote

[26] **Bankruptcy**
Judgment or Order

Genuine issues of material fact existed as to whether general release executed in prior, unrelated adversary proceeding extended to claims asserted against asset purchaser and its representative in present proceeding, precluding summary judgment in Chapter 7 trustee's action based on allegedly rigged bankruptcy auction.

Cases that cite this headnote

Attorneys and Law Firms

***526** Jaffe & Asher, LLP (**Mark H. Moore**, of Counsel), New York City, for Defendant Robert Zorn.

Paul, Weiss, Rifkind, Wharton & Garrison (Jeffrey D. Saferstein, of Counsel), New York City, for Chapter 7 Trustee.

***527** Gerson, Wood & Blakeman, LLP (Ralph Wood, of Counsel), New York City, for Defendants Philip DelPrete and The Maui Pineapple Co., Inc.

Sanford Goldberg, New York City, Pro Se.

Gersten, Savage & Kaplowitz, LLP (Steven R. Popofsky, of Counsel), New York City, for Defendant Rudy Fuertes.

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MEMORANDUM DECISION GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS TO DISMISS AMENDED COMPLAINT

STUART M. BERNSTEIN, Chief Judge.

This adversary proceeding involves claims arising from an allegedly rigged bankruptcy auction. Ian Gazes, the chapter 7 trustee of the above-captioned debtors, seeks to recover damages on behalf of the estate of Penco Food Corporation ("Penco"), contending that the named defendants' secretly colluded to control the sale price of Penco's assets. His claims include fraud, "fraud on the court" and fraudulent concealment.

One of the defendants, Robert Zorn, has moved to dismiss the trustee's amended complaint. Defendants Sanford Goldberg, Rudy Fuertes, Harry Laufer, Philip DelPrete and The Maui Pineapple Co., Inc. ("Maui") have joined in Zorn's motion, and DelPrete and Maui have also moved for summary judgment. For the reasons discussed below, the motions are granted in part and denied in part.

BACKGROUND

A. The Amended Complaint

As this is a motion to dismiss, we must begin with the allegations in the amended complaint which, standing alone, are straightforward. On or about June 17, 1993, Penco and certain affiliated companies filed separate voluntary petitions for protection under chapter 11 of the Bankruptcy Code. (Amended Complaint, dated Nov. 11, 1999, at ¶ 5.) Judge James L. Garrity, Jr. converted the cases to chapter 7 on October 15, 1993, and the plaintiff was appointed the chapter 7 trustee. (*Id.*)

In or about December of 1993, the trustee entered into a written agreement to sell certain of Penco's assets to the defendant Rudy Fuertes for $300,000.00, subject to higher and better offers. (*Id.,* ¶ 9.) At a January 7, 1994 hearing (the "Sale Hearing"), the trustee sought approval of that sale. (*Id.,* ¶ 11.) Unbeknownst to the trustee, Del Prete, a representative of Maui, had agreed to pay the defendants Fuertes, Laufer and Zorn $50,000.00, $50,000.00 and $70,000.00, respectively, not to bid. (*Id.,* ¶ 13.) The defendant Goldberg participated in these discussions, and was aware of the conspiracy. (*Id.*) The individual defendants failed to disclose the scheme to the trustee, (*id.,* ¶ 14), and also failed to disclose it to the bankruptcy court even though Judge Garrity expressly asked the defendants and their counsel at the Sale Hearing "whether they were aware of the existence of any agreement to control the sale price."[1] (*Id.,* ¶ 15.)

As a result of these undisclosed agreements, Maui bid $320,000.00, no one else bid, and Maui's bid was accepted. (*Id.,* ¶ 17.) In fact, the assets were worth at least $2 million. (*Id.,* ¶ 18.) By order dated March 24, 1994 (the "Sale Order"), Judge Garrity approved the sale to Maui for $320,000.00, (*id.,* ¶ 17), and the Sale Order is final.

B. The Releases

Several of the parties contend that they have been released from the claims asserted by the trustee. The origin and scope of releases entails consideration of two adversary proceedings otherwise unrelated to the trustee's instant action.

***528** On or about June 22, 1993 (prior to conversion of these cases to chapter 7), the debtors commenced an adversary proceeding against DiGiorgio Corporation, three of its divisions—White Rose Food, White Rose Dairy and White Rose Frozen Food—and W.R. Service Corp. The debtors challenged the validity, priority and extent of their liens on the debtors' assets, and sought $2 million in compensatory and punitive damages as well as subordination of their claims. By stipulation dated May 5, 1995 (the "5/95 Stip."), the trustee and the defendants settled their litigation. As part of that settlement, the trustee gave the defendants the following release:

> The Trustee hereby releases and forever discharges the Defendants of and from any and all actions or causes of action, suits, debts, grievances, claims, complaints, contracts, controversies, agreements, promises, damages, cross-claims, claims for

> contribution or indemnity, claims for attorneys' fees, judgments, and demands whatsoever, in law or in equity, which against the Defendants the Trustee ever had, now has or shall have, including, but not limited to, any claims under the Bankruptcy Code or any other statute under State Law, or violation of any other local, state or federal law, regulation or ordinance having any bearing whatsoever on Trustee's relationship or obligations to the Defendant which Trustee ever had, now has or shall have. The Parties understand all matters pending between the Trustee and Defendants, and this Stipulation and General Release fully executed on behalf of the Parties, *the Trustee will have complete satisfaction of any and all claims, whether known, suspected, or unknown, that they may have had against Defendants from the beginning of the world ad infinitum. The Trustee hereby waives any and all remedies and relief not explicitly provided for herein.*

(5/95 Stip., ¶ 5)(emphasis added.) "Defendants" are defined in the 5/95 Stip. to include both the named defendants as well as "their predecessors, successors, their current and former assigns, affiliates and their current and former partners, officers, directors, shareholders, employees and agents ..., in their official, representative and individual capacities." (*Id.,* ¶ 2.) Zorn was (and still is) the Senior Vice President and Chief Financial Officer of White Rose, and hence, appears to be a beneficiary of the release. Judge Garrity "so ordered" the 5/95 Stip. on July 12, 1995, and that order was never appealed, vacated or modified.

In October of 1993, R. Best Produce, Inc. ("R. Best") commenced an adversary proceeding against the debtors to recover amounts allegedly due under the Perishable Agricultural Commodities Act. The trustee settled that litigation in accordance with the terms of a May 1994 stipulation (the "5/94 Stip.") that, among other things, released R. Best, together with its "current and former officers, directors, shareholders, employees and agents ... in their official, representative and individual capacities" from:

> any and all obligations, claims and demands of any kind whatsoever, at law or in equity, known or unknown, discovered or undiscovered [except as set forth therein].

(5/94 Stip., ¶¶ 4, 9.) By the time of the 5/94 Stip., defendant DelPrete had left Maui and was employed by R. Best. Thus, he appears to be a beneficiary of the release. Judge Garrity "so ordered" the 5/94 Stip. on June 30, 1994, and that order was never appealed, vacated or modified.

C. This Adversary Proceeding

The resolution of the pending motions also requires consideration of the procedural history of this adversary proceeding. On or about April 17, 1997, the trustee retained Paul, Weiss as his special counsel to bring this adversary proceeding, but it was not commenced until October 5, 1998, or more than one year later. The original complaint contained four causes of action—fraud, "fraud on the court," violation ***529** of § 363(n) of the Bankruptcy Code[2] and fraudulent concealment. It alleged the same wrongdoing as the current amended complaint with some language differences. Each of the defendants either answered the complaint or moved to dismiss it. On January 20, 1999, Judge Garrity conducted a status conference at which the parties agreed that the trustee would disseminate a proposed amended complaint to the defendants in an effort to obtain their consent to the filing of that document. Absent their unanimous consent, the trustee was free to move for leave to amend the complaint, which he ultimately did on February 3, 1999.

The proposed amended complaint contained the same four claims for relief, but added and/or modified certain factual allegations. In a May 17, 1999 decision and a July 9, 1999 order, Judge Garrity granted the trustee leave to amend the complaint, except for claims under § 363(n) of the Bankruptcy Code which were time-barred under Fed.R.Civ.P. 60(b)(3):[3]

> Section 363(n) supplements the general powers of a court to avoid a sale by giving the trustee the right to do

so if the sale price is the product of bid rigging. *See Robertson v. Isomedix, Inc. (In re International Nutronics, Inc.),* 28 F.3d 965, 969 (9th Cir.1994) (citing 2 *Collier on Bankruptcy* ¶ 363.14 (15th ed. rev.1998)). Nonetheless, § 363(n) is subject to the rules governing the finality of judgments. Thus, because the Trustee is seeking to avoid the Sale Order by reason of defendants' alleged fraud, we characterize this § 363(n) claim as a motion under Rule 60(b)(3), and apply its one year statute of limitations. *See id.;* 3 *Collier on Bankruptcy* § 363.12 (15th ed. rev'd 1998); 9A Am.Jur.2d Bankr.§ 1636 (1991). The Trustee commenced this action more than one year after the entry of the order approving the Asset Sale. Thus, the Trustee is time-barred pursuant to Rule 60(b)(3) from asserting a claim under § 363(n), and we will not permit him to amend the complaint to assert that claim. *See Gazes v. Del Prete et al. (In re Clinton Street Food Corp.),* Nos. 93 B 43200 through 43204(JLG), Adv. Proc. No. 98–9294A (Bankr.S.D.N.Y. May 17, 1999) (unpublished memorandum decision) (the "5/17 Decision") at 21–22.

The trustee moved for reconsideration. Judge Garrity granted reconsideration in ***530** part, but adhered to his original decision. Further, he concluded that the trustee's money damage claims under § 363(n) were also time-barred. *See Gazes v. Del Prete et al. (In re Clinton Street Food Corp.),* Nos. 93 B 43200 through 43204(JLG), Adv. Proc. No. 98–9294A (Bankr.S.D.N.Y. Sept. 14, 1999) (unpublished memorandum decision), at 13–14. Neither decision addressed the remaining claims, and the trustee filed the present amended complaint omitting the time-barred § 363(n) claim, but including the other three.

Defendant Robert Zorn now moves to dismiss part or all of the amended complaint on four grounds. First, the fraud and fraudulent concealment claims are barred by *res judicata.* Second, the trustee has failed to plead the fraud claims with particularity. Third, the "fraud on the court" claim is legally insufficient. Fourth, the release is a complete defense. Defendants Goldberg, Fuertes and Laufer, who did not receive releases, join in the other parts of Zorn's motion. Defendants DelPrete and Maui also join in these parts of Zorn's motion, and separately move for summary judgment based upon the second release discussed above.

DISCUSSION

The rules that guide a court's consideration of a motion to dismiss under Fed.R.Civ.P. 12(b)(6) are well-settled. The court must assume the facts alleged in the complaint to be true, *Harsco Corp. v. Segui,* 91 F.3d 337, 341 (2d Cir.1996), and draw all reasonable inferences in the plaintiff's favor. *Scheuer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974). In addition to the complaint, the court may consider the contents of any documents attached to the complaint or incorporated by reference, matters as to which it can take judicial notice, and documents in the non-moving party's possession or which it knew of or relied on in connection with its claim. *Brass v. American Film Technologies, Inc.,* 987 F.2d 142, 150 (2d Cir.1993). The court may only dismiss the complaint if it appears beyond doubt that the plaintiff would not be entitled to any type of relief, even if he proved the factual allegations in his complaint. *Conley v. Gibson,* 355 U.S. 41, 45–46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957); *Harsco Corp. v. Segui,* 91 F.3d at 341; *Cohen v. Koenig,* 25 F.3d 1168, 1171–72 (2d Cir.1994).

A. Res Judicata

Zorn's 12(b)(6) motion is premised principally upon the *res judicata* effect of Judge Garrity's order approving the sale. Zorn contends that the trustee's claims for fraud and fraudulent concealment (Counts 1 and 3) are barred by *res judicata* because the order approving the sale is a final judgment, the only vehicle for challenging the order is § 363(n), and Judge Garrity has already held that the trustee's § 363(n) claims are time barred.

The trustee disagrees, arguing that neither the parties nor the issues relating to the Sale Hearing are identical to those raised in his amended complaint. In addition, he maintains that the claims asserted in the amended complaint cannot be precluded because (1) through the defendants' trickery, he was prevented from asserting them at the time of the sale, (2) in the case of all of the defendants except Maui, he is not attacking the purchaser at the sale, and (3) his causes of action relate not to the particular facts and circumstances of the sale itself, but rather, to the defendants' secret collusion.

[1] [2] [3] A bankruptcy court order approving a sale of assets is a final order for *res judicata* purposes. *See Balaber–Strauss v. Markowitz (In re Frankel),* 191 B.R. 564, 570 (Bankr.S.D.N.Y.1995); *accord Starns v. H.E. Avent,* 96 B.R. 620, 627 (M.D.La.1989), *aff'd sub nom. Hendrick v. Avent,* 891 F.2d 583 (5th Cir.), *cert. denied,* 498 U.S. 819, 111 S.Ct. 64, 112 L.Ed.2d 39 (1990); *Third Nat'l Bank v. Fischer (In re Fischer),* 184 B.R. 293, 301

(Bankr.M.D.Tenn.1995). This rule promotes the important public policy favoring ***531** the finality of orders transferring ownership of bankruptcy estate assets. *See Kabro Assocs. v. Colony Hill Assocs. (In re Colony Hill Assocs.),* 111 F.3d 269, 272 (2d Cir.1997); *Gekas v. Pipin (In re Met–L–Wood Corp.),* 861 F.2d 1012, 1017 (7th Cir.1988), *cert. denied,* 490 U.S. 1006, 109 S.Ct. 1642, 104 L.Ed.2d 157 (1989); *see also* 11 U.S.C. § 363(m) (providing that the reversal or modification on appeal of an order approving sale does not affect the validity of the sale to an entity that purchased in good faith unless the order was stayed pending appeal). Further, because a § 363 proceeding is *in rem,* it is final as to the entire world, including those who were not parties to the sale. *In re Met–L–Wood Corp.,* 861 F.2d at 1017.

[4] [5] [6] [7] Section 363(n) is a statutory exception to the rule of finality of bankruptcy sale orders. *See Robertson v. Isomedix, Inc. (In re International Nutronics, Inc.),* 28 F.3d 965, 968 (9th Cir.), *cert. denied,* 513 U.S. 1016, 115 S.Ct. 577, 130 L.Ed.2d 493 (1994); *Gumport v. China Int'l Trust and Investment Corp. (In re Intermagnetics America, Inc.),* 926 F.2d 912, 917 (9th Cir.1991). It allows the trustee either to avoid a collusive sale or recover damages (including punitive damages) from any entity who enters into a collusive agreement. *See* 11 U.S.C. § 363(n). The statute does not state how long after the sale a claim may be asserted. Judge Garrity answered that question, however, when he ruled that any equitable or legal claims relating to the bid rigging under § 363(n) were barred by the one-year period of limitations established under Fed.R.Civ.P. 60(b)(3). That ruling is law of the case, and will not be revisited.

The motions to dismiss ask me to extend this conclusion to the fraud and fraudulent concealment claims. Judge Garrity did not rule on these claims, and moreover, he granted leave to assert them. This implies a ruling that they are not time-barred. I am reluctant, however, to adopt this view. The parties and the court focused exclusively on the § 363(n) claim. Further, Judge Garrity's decisions do not expressly address the relationship between the § 363(n) claims and the other claims asserted in the complaint and proposed amended complaint, and more particularly, the period of limitations governing these claims. Moreover, having now considered the fraudulent concealment and fraud claims (Counts 1 and 3), I conclude that they too are barred by *res judicata,* and are subject to the same one year period of limitations.

The common law claims that the defendants now seek to dismiss are indistinguishable from § 363(n) claim that Judge Garrity already dismissed as time-barred. Although they may enjoy distinct elements, *see Lone Star Industries, Inc. v. Compania Naviera Perez Companc, S.A.C.F.I.M.F.A. (In re New York Trap Rock Corp.),* 42 F.3d 747, 751–55 (2d Cir.1994)(separately analyzing § 363(n) and fraudulent concealment claims) they are not distinct for *res judicata* purposes; all of the claims depend on the bid rigging scheme and the issuance of the Sale Order, and seek damages based upon the improper procurement of the Sale Order. More important, the trustee could have raised these claims to defeat Maui's bid and acquisition of the Penco assets. *See In re Int'l. Nutronics, Inc.,* 28 F.3d at 970–71 (*res judicata* effect of sale order bars antitrust claims that infringe the same rights as the collusive bidding, and could have been asserted at the sale hearing); *In re Met–L–Wood Corp.,* 861 F.2d at 1016 (*res judicata* effect of sale order bars related RICO claim). If a party could transform a § 363(n) damage claim into a common law claim and avoid the one year period of limitations, § 363(n) would become meaningless.[4] *See id.* at 1017 (the trustee's damage claim is a "thinly disguised collateral attack on the judgment confirming the sale," and "may be done only by the route ***532** provided for collateral attacks on judgments").

The trustee nevertheless seeks to escape the preclusive effect of *res judicata,* arguing that his common law claims did not exist, or were unknown, at the time of the sale. These contentions are either wrong or disingenuous, or both. All of the wrongful conduct alleged in the amended complaint occurred prior to the entry of the Sale Order which itself is an essential element of every claim. Thus, the trustee's claims arose no later than the entry of the Sale Order. Further, the trustee has not pointed to any authority suggesting that ignorance of the claims tolls the period of limitations under Fed.R.Civ.P. 60(b)(3).[5] To the contrary, the one year period is an absolute, outside limit, and a court lacks the power to grant motions filed beyond that time. 12 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 60.65 [2][a], at 60–200 (3d ed.1999).

[8] Even if ignorance tolls the one year period, the trustee's claims are still time-barred. The trustee retained Paul, Weiss, his special counsel, to prosecute these claims, and then waited more than a year to commence this adversary proceeding. He obviously knew he had a claim when he hired Paul, Weiss. If the sale had occurred on that date, the trustee's claims would be time-barred. Since the claims arose long before then, *a fortiori,* they are time-barred.[6]

B. Fraud on the Court

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[9] [10] [11] The trustee's second claim asserts "fraud on the court." "Fraud on the court" encompasses conduct which represents an attempt to defile the court itself, or a fraud perpetrated by officers of the court so that the judicial machinery cannot perform its impartial task of judging cases. *Hadges v. Yonkers Racing Corp.,* 48 F.3d 1320, 1325 (2d Cir.1995); *Transaero, Inc. v. La Fuerza Area Boliviana,* 24 F.3d 457, 460 (2d Cir.1994), *cert. denied,* 520 U.S. 1240, 117 S.Ct. 1843, 137 L.Ed.2d 1047 (1997); *Gleason v. Jandrucko,* 860 F.2d 556, 558 (2d Cir.1988); *Kupferman v. Consolidated Research & Mfg. Corp.,* 459 F.2d 1072, 1078 (2d Cir.1972). It involves conduct that "seriously affects the integrity of the normal process of adjudication," *Gleason,* 860 F.2d at 559, and an independent action seeking relief from a judgment on that basis is available " 'only to prevent a grave miscarriage of justice.' " *Lehman Brothers, Inc. v. Maselli,* No. 93 Civ. 4478, 1998 WL 531831, *6 (S.D.N.Y. Aug. 24, 1998) (quoting *United States v. Beggerly,* 524 U.S. 38, 47, 118 S.Ct. 1862, 141 L.Ed.2d 32 (1998)).

[12] "Fraud on the court" is not necessarily limited to situations where the court or an officer of the court subverts the judicial process through fraudulent conduct. The actions of a litigant may qualify as well, although it is not clear whether an officer of the court must also be involved. *See Hazel–Atlas Glass Co. v. Hartford–Empire Co.,* 322 U.S. 238, 245, 64 S.Ct. 997, 88 L.Ed. 1250 (1944) (where applicant for patent procured publication in trade journal of article prepared by applicant's attorney but signed by an ostensibly disinterested expert lauding applicant's alleged invention and then used article to procure both a patent from a patent office and a judgment by Circuit Court of Appeals upholding such patent, fraud was conclusively established); *Aoude v. Mobil Oil Corp.,* 892 F.2d 1115, 1118 (1st Cir.1989) (service station operator's conduct in fabricating ***533** purchase agreement and in allowing his counsel to annex bogus agreement to complaint seeking to force franchisor to accept his operation of station constituted "fraud on the court" warranting dismissal of action); *Cleveland Demolition Co. v. Azcon Scrap Corp.,* 827 F.2d 984, 986 (4th Cir.1987) (fraud on court may exist where witness and attorney conspire to present perjured testimony); *Rozier v. Ford Motor Co.,* 573 F.2d 1332, 1338 (5th Cir.1978) (same, where party, with counsel's collusion, fabricates evidence); *Tri–Cran, Inc. v. Fallon (In re Tri–Cran, Inc.),* 98 B.R. 609, 617 (Bankr.D.Mass.1989) ("a cause of action for fraud on the court can be maintained against one who is not an officer of the court and in whose favor judgment was granted if that person colluded with an officer of the court to perpetrate fraud on the court and thereby obtained the favorable judgment"); *see also Intermagnetics,* 926 F.2d at 916 ("fraud upon the court includes both attempts to subvert the integrity of the court and fraud by an officer of the court").

Leber–Krebs, Inc. v. Capitol Records, 779 F.2d 895 (2d Cir.1985), is instructive. There, the plaintiff sued a third party, and obtained an *ex parte* order of attachment. It served the order on the defendant, and moved to confirm it four days later. The defendant submitted a garnishee's statement attesting that it did not hold any property of the third party and was not indebted to him; as a result of the statement, the court denied the motion to confirm the order of attachment. *Id.* at 896–97. The garnishee's statement, however, was false. The defendant owed a substantial contract debt to the third party which it subsequently paid over to the latter before the plaintiff could obtain a second order of attachment. *Id.* at 897.

The plaintiff then commenced an action against the defendant alleging, *inter alia,* that the filing of the false garnishee's statement constituted a "fraud on the court." In ruling on the adequacy of the claim, the Court of Appeals alluded to counsel's participation in the filing of the false statement, *see id.* at 898, but counsel's role does not appear to be part of the holding. Instead, the court upheld the sufficiency of the claim based on (1) the defendant's misrepresentation to the court, (2) the denial of the motion to confirm based on the misrepresentation, (3) the lack of an opportunity to discover the misrepresentation and either bring it to the court's attention or bring a timely turnover proceeding against the garnishee, and (4) the benefit the defendant derived by inducing the erroneous decision. *Id.* at 899–900.

[13] The trustee's "fraud on the court" claim satisfies these requirements. According to the amended complaint, the defendants lied when the bankruptcy court inquired about any bidding agreements, the lie contributed to the acceptance of Maui's bid and the approval of the Sale Order, the trustee lacked the opportunity to discover the fraud in light of the summary nature of the sale proceeding and the relatively short time frame (only three weeks between the filing of the sale application and the auction), and the defendants benefitted. Maui, through the deceitful conduct of its agent DelPrete, bought $2 million worth of property for $320,000.00, and Fuertes, Laufer and Zorn were paid off. It is not altogether clear what Goldberg got out of the collusive scheme, but the amended complaint alleges that he knew about the collusive scheme and that the defendants (which includes Goldberg) covered it up and lied to the court. If true, Goldberg would be a co-conspirator or aider and abettor of the fraud, and presumably, liable on that basis. Accordingly, the amended complaint states a legally cognizable claim for "fraud on the court."[7]

*534 C. Effect of the Releases

[14] [15] [16] [17] [18] [19] [20] [21] Zorn, DelPrete and Maui also request dismissal based on the general releases described above. The usual rules governing the interpretation of contracts under New York law[8] also apply to general releases. *Mangini v. McClurg,* 24 N.Y.2d 556, 301 N.Y.S.2d 508, 249 N.E.2d 386, 389 (1969). "The courts must look to the language of the release—the words used by the parties—to determine their intent, resorting to extrinsic evidence only when the court concludes as a matter of law that the contract is ambiguous." *Wells v. Shearson Lehman/American Express, Inc.,* 72 N.Y.2d 11, 530 N.Y.S.2d 517, 526 N.E.2d 8, 12 (1988); *accord K & S Co. v. Sexton Investment Co., L.P.,* No. 96 Civ. 8741(JGK), 1999 WL 92284, *6 (S.D.N.Y. Feb. 18, 1999). Nevertheless, the interpretation of a release and the limitations on parole evidence are often subject to special rules in light of the nature of releases. *See Mangini v. McClurg,* 301 N.Y.S.2d 508, 249 N.E.2d at 389–90. Thus, the meaning and coverage of a general release hinges on the controversy being settled and the purpose for which the release is actually given. In the end, the scope of the release depends on the intention of the parties, and should not be interpreted to cover claims the parties did not intend to cover. *See Cahill v. Regan,* 5 N.Y.2d 292, 184 N.Y.S.2d 348, 157 N.E.2d 505, 510 (1959)(Fuld, J.); *Long Island Pipe Fabrication & Supply Corp. v. S & S Fire Suppression Sys., Inc.,* 226 A.D.2d 1136, 641 N.Y.S.2d 477, 478 (N.Y.App.Div.1996); *Enock v. National Westminster Bankcorp,* 226 A.D.2d 235, 641 N.Y.S.2d 27, 28 (N.Y.App.Div.1996); *Lefrak SBN Assocs. v. Kennedy Galleries, Inc.,* 203 A.D.2d 256, 609 N.Y.S.2d 651, 652 (N.Y.App.Div.1994). Even the most broadly drawn general release cannot necessarily be taken at face value. *See Bushkin, Gaims, Gaines, Jonas & Stream v. Garber,* 677 F.Supp. 774, 776 (S.D.N.Y.1988) (general release will not bar relief for injury unknown at time of release if settlement agreement was not fairly and knowingly made).

1. The Zorn Release

[22] Zorn has moved to dismiss pursuant to Rule 12(b)(6), relying on the general release contained in the 5/95 Stip. Given the procedural posture, the relevant inquiry is whether each party has advanced a reasonable interpretation of the scope of the release, rendering it ambiguous under ordinary principles of contract interpretation. *See Nowak v. Ironworkers Local 6 Pension Fund,* 81 F.3d 1182, 1192 (2d Cir.1996); *Sayers v. Rochester Tel. Corp. Supplemental Management Pension Plan,* 7 F.3d 1091, 1095 (2d Cir.1993); *Seiden Assocs., Inc. v. ANC Holdings, Inc.,* 959 F.2d 425, 428 (2d Cir.1992); *Walk–In Med. Ctrs., Inc. v. Breuer Capital Corp.,* 818 F.2d 260, 263 (2d Cir.1987).

[23] [24] Concededly, the language of the release, quoted above, is quite broad, and looks like it should embrace the trustee's claims against Zorn. Further, the final WHEREAS clause in the stipulation indicates the intention to enter into a global release of all claims, not just the claims asserted in the pending lawsuit. If the principals (*i.e.,* the trustee and DiGiorgio/White Rose) intended a global release, it would be reasonable to also release groups like officers, employees and agents who, if sued by the trustee, might assert indemnity claims against their principal.

Nevertheless, other factors weigh against upholding Zorn's interpretation of the release, at least as a matter of law. The general release was given in the context of the settlement of a specific and entirely unrelated action, and the burden ***535** is on Zorn to establish that it was intended to discharge the claims in this action. *See Structural Processing Corp. v. Farboil Co.,* 234 A.D.2d 284, 650 N.Y.S.2d 769, 770 (1996). Nothing in the stipulation or the record of the earlier lawsuit focuses on the specific issues in this litigation, and hence, there is nothing for Zorn to point to on this motion. This is not surprising. The pending claims were unknown to the trustee, and hence, not the subject of a dispute at the time, making it less likely that they are covered by the release. *Enock v. National Westminster Bankcorp,* 641 N.Y.S.2d at 28 (general release did not bar undisputed claim); *Simon v. Simon,* 84 N.Y.S.2d 307, 274 A.D. 447, 449 (1948)(same). In addition, it does not appear that the parties bargained over the auction claims, or that the estate received any additional consideration for releasing such potentially valuable claims. *See Tarantola v. Williams,* 48 A.D.2d 552, 371 N.Y.S.2d 136, 140 (1975); 19A N.Y. JUR. 2D, *Compromise, Accord & Release* § 85, at 174 (1999).

Finally, Zorn is not a named releasee. Instead, he is a member of a group (DiGiorgio/White Rose's "employees and agents ... in their official, representative and individual capacities") that was released by the trustee's law firm, the trustee and his "agents and employees." While Zorn does not have to be named specifically, *see Wells v. Shearson Lehman/ American Express, Inc.,* 530 N.Y.S.2d 517, 526 N.E.2d at 12, a court should be wary

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of reading a general release to encompass wholly unrelated claims involving unnamed persons that may not have been within the contemplation of the principals that negotiated it. Indeed, the release in this case is so broad that it cannot possibly mean what the language appears to convey. Under Zorn's reading, the release would discharge a personal injury claim arising from an automobile accident caused when an individual, who also happens to be an employee of White Rose, drove a car that struck the trustee's secretary.[9] Similarly, it would discharge a food poisoning claim. Despite the broad language, no one would seriously argue that the release encompassed such claims.

The ability to hypothesize excluded claims nevertheless falling within the literal terms of the release buttresses the conclusion that the release is ambiguous. Both parties have offered reasonable interpretations regarding the scope of the release, and these interpretations cannot be resolved on a motion to dismiss. Accordingly, Zorn's motion to dismiss based upon the release is denied.

2. The DelPrete Release

[25] DelPrete and Maui have moved for summary judgment in reliance on the release contained in the 5/94 Stip. Thus, DelPrete and Maui have the initial burden of demonstrating that the release is unambiguous, and extends to the claims asserted in this litigation. If they meet this burden, the burden then shifts to the trustee to show a material issue of fact regarding its scope.

[26] Here, the release suffers from the same ambiguities as the DiGiorgio/White Rose release.[10] In addition, the stipulation of settlement focuses entirely on the dispute at issue, and there is no recitation pointing to a global resolution. Further, DelPrete's connection to the R. Best release is more attenuated. The allegations against DelPrete concern acts committed while in the employ of Maui, and R. Best would not have any business reason to seek a release for those acts.

DelPrete's submissions on this motion do not resolve these ambiguities, and in ***536** fact, support the trustee's argument that the parties did not intend to release the estate's claims against DelPrete. DelPrete's mother, Mary DelPrete, is the president and majority stockholder in R. Best. (*Declaration of Mary DelPrete in Support of Philip DelPrete's Motion for Summary Judgment,* dated Jan. 6, 2000, at ¶ 1.) If the parties had intended to discharge the trustee's claims, it would have been simple enough for her to say so in the supporting declaration submitted on the current summary judgment motion. Instead, she stated that she was not aware of any claims between the estate and the releasees, and didn't ask for the broad release ultimately included in the 5/94 Stip. (*Id.* at ¶ 5.) In short, the auction claims were unknown, and their discharge was not contemplated by the parties.

Under the circumstances, I conclude at this stage that the releases do not bar the claims against Zorn, DelPrete and Maui. Thus, I do not have to decide whether fraud vitiates the releases, as the trustee argues. I note, however, that the trustee's fraud claim seems unsupportable. Assuming that Zorn and DelPrete were under a continuing duty to disclose their fraudulent conduct, the trustee did not negotiate the releases with either of them. They are members of groups that received the benefit of releases negotiated by others. In this regard, the trustee does not suggest that the parties with whom he did negotiate were guilty of any concealment or wrongdoing. Under the circumstances, it appears unlikely that he will be able to prevail on this theory.

RECAPITULATION

Counts 1 and 3 of the Amended Complaint are dismissed as to all defendants. The motions to dismiss or for summary judgment are denied in all other respects.

Settle order on notice.

All Citations

254 B.R. 523, 45 Collier Bankr.Cas.2d 163

Footnotes

1 Apparently, the parties never ordered a transcript of the Sale Hearing.

2 Section 363(n) states that:

The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential

> bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

11 U.S.C. § 363(n).

3 With certain irrelevant exceptions, Fed. R. Bankr.P. 9024 makes Fed.R.Civ.P. 60 applicable herein. Rule 60(b) states in relevant part as follows:

> On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgment, order, or proceeding for the following reasons: ... (3) fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party; ... or (6) any other reason justifying relief from the operation of the judgment. The motion shall be made within a reasonable time, and for reasons (1), (2), and (3) not more than one year after the judgment, order, or proceeding was entered or taken. A motion under this subdivision (b) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C., § 1655, or to set aside a judgment for fraud upon the court....

Fed.R.Civ.P. 60(b).

4 *New York Trap Rock* did not concern, as the trustee implies, the period of limitations governing a fraudulent concealment claim arising in connection with a collusive sale.

5 The trustee's papers cite *International Nutronics* and *Met–L–Wood,* but neither supports this argument. The former stands for the proposition that a sale order can bar a non-core antitrust claim that could have been asserted at the sale hearing. 28 F.3d at 969–70. In the latter case, the court ruled that the sale order was good against the entire world, 861 F.2d at 1017, and after the time to appeal runs, the sale order is final, "even against nonparties to the sale proceeding." *Id.* at 1018.

6 In light of this conclusion, I need not consider Zorn's argument that the trustee failed to plead fraud with particularity.

7 To the extent that counsel's participation is an element of the claim, the amended complaint alleges that the defendants and/or their counsel concealed the existence of their illicit scheme from Judge Garrity. (Amended Complaint, ¶¶ 15, 26.)

8 The scope and effect of the release are controlled by state law. *Barrett v. United States,* 622 F.Supp. 574, 582 n. 5 (S.D.N.Y.1985) (citing *Rushford v. United States,* 204 F.2d 831, 832 (2d Cir.1953)), *aff'd,* 798 F.2d 565 (2d Cir.1986). Since all of the events in question took place in New York, New York law governs the construction and effectiveness of the release. *See id.*

9 I do not suggest that the trustee would be empowered to give such a release, but only that Zorn's interpretation of the broad language of the release would support what is so obviously an unintended result.

10 Nothing in the language of the release or the circumstances surrounding its execution indicates an intent to release Maui.

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865 F.Supp. 194
United States District Court,
S.D. New York.

The CHASE MANHATTAN BANK, N.A., Plaintiff,
v.
REMINGTON PRODUCTS, INC. and Victor K. Kiam II, Defendants.

No. 92 Civ. 7983(MEL).
|
Oct. 19, 1994.

Synopsis
Bank brought suit against corporation and its principal claiming to be owed fees under engagement agreement and principal's accompanying guarantee. Principal and corporation asserted counterclaims. On bank's motion for summary judgment, the District Court, Lasker, J., held that: (1) engagement agreement was unambiguous in not mandating that bank seek investors in corporation before turning to option of sale of corporation's stock or assets, and (2) bank's alleged violation of antitying provisions of Bank Holding Company Act (BHCA) would not be defense to bank's claim against corporation and principal for fees due under engagement agreement.

Motions granted.

West Headnotes (8)

[1] **Contracts**
Services in general

Engagement agreement, under which bank was required to assist corporation in various options and recommend courses of action, was unambiguous in not mandating that bank seek investor in corporation before turning to option of sale of corporation's stock or assets; agreement did not mandate that bank do bidding of principal of corporation as long as bank could opine in good faith that its actions were fair from a financial standpoint.

Cases that cite this headnote

[2] **Contracts**
Services in general

Provision in contract requiring bank to assist corporation in its financial trouble and recommend courses of action did not condition bank's receipt of fee on its bringing about a transaction or consummation of any particular type of transaction; sole prerequisite to payment listed in subsection of contract was consummation of transaction or signing of agreement that resulted in a transaction, not a consummated transaction.

4 Cases that cite this headnote

[3] **Contracts**
Weight and sufficiency

Evidence established that bank provided services called for in engagement agreement with corporation and that all conditions precedent to payment had occurred, and thus, bank was entitled to its fee pursuant to agreement; bank submitted extensive evidence of advice and representations provided corporation by bank directed toward consummation of transaction of type contemplated in agreement.

2 Cases that cite this headnote

[4] **Contracts**
Defenses

Even if bank violated antitying provisions of Bank Holding Company Act (BHCA) by allegedly conditioning personal loan to corporation's principal on corporation obtaining services of bank's mergers and acquisitions department, BHCA would not be defense to bank's claim against corporation and principal

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for fees due under engagement agreement, as only private remedy available under BHCA is three times the amount of damages sustained. Bank Holding Company Act Amendments of 1970, § 106(b), 12 U.S.C.A. § 1972.

Cases that cite this headnote

[5] **Action**
Nature of Action

New York law does not recognize cause of action for negligent performance of contract.

6 Cases that cite this headnote

[6] **Fraud**
Fiduciary or confidential relations

Corporation and its principal failed to establish that bank, which entered into engagement agreement with corporation and principal to help it obtain some form of refinancing, violated any fiduciary duty owed to corporation; principal's preferences as to form and timing of transaction were irrelevant as legal matter, as bank's role was to find, and if necessary require corporation to accept, transaction that would satisfy loan, and there was no indication that bank pursued any other agenda.

1 Cases that cite this headnote

[7] **Fraud**
Fiduciary or confidential relations

"Fiduciary duty" exists when one person is under duty to act for or to give advice for benefit of another upon matters within scope of relation.

1 Cases that cite this headnote

[8] **Fraud**
Fiduciary or confidential relations

Scope of fiduciary duty can be limited by contract.

1 Cases that cite this headnote

Attorneys and Law Firms

***195** Hertzog, Calamari & Gleason, New York City (Peter E. Calamari, **Mark H. Moore**, Gerald D. Silver, of counsel), for plaintiff.

Pollack & Greene, New York City (Alan M. Pollack, Scott A. Sommer, Mitchell G. Mandell, of counsel), for defendants.

Opinion

LASKER, District Judge.

Chase Manhattan Bank, N.A. moves for an order under Fed.R.Civ.P. 56(c) granting summary judgment (1) on its claim that Remington Products, Inc. and Victor K. Kiam, II owe Chase fees under an engagement agreement between Chase and Remington and Kiam's accompanying guarantee of payment and (2) on each of the defendants' four counterclaims. The motion is granted.

I

Remington, headquartered in Bridgeport, Connecticut, is a manufacturer and seller of electric shaving devices and other personal grooming products. This litigation has its origin in Kiam's simultaneous ownership of 100 percent of the voting stock of Remington and a controlling interest in the New England Patriots National Football League franchise. Kiam formed Remington when he acquired the assets of the Sperry–Rand Corporation's Remington Shaver division in a leveraged buyout in 1979. He purchased his interest in the Patriots in 1988 with the

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proceeds of a loan (the "Patriots Loan") from IBJ Schroder Bank & Trust Company ("IBJ Schroder"). Kiam pledged his Remington stock as collateral for the Patriots Loan.

Kiam's simultaneous ownership of Remington and a majority stake in the Patriots soon became financially untenable. Remington had pledged all of its assets to secure a $65 million loan (the "RPI Loan") from a consortium of banks and other lending institutions (the "RPI Lenders"). By the Spring of 1991, the RPI Loan was in default and Remington was having difficulty obtaining seasonal financing—that is, working capital to enable Remington to manufacture inventory sufficient to meet consumer demands during the holiday shopping season. At the same time, Kiam had problems servicing the Patriots Loan and was under pressure from IBJ Schroder. Kiam's attempts to refinance the Patriots Loan were unsuccessful, at least in part because his most significant asset—his Remington stock—was already employed as collateral for the Patriots Loan. Kiam also faced the threat of litigation over loans received from other personal creditors.

During this period, Kiam apparently came to the conclusion that some form of refinancing, merger or sale involving either Remington or the Patriots would be necessary both to meet the debt service on the Patriots Loan and to obtain badly needed working capital for Remington. His initial step in this regard appears to have been toward the investment bank Bear Stearns & Co., Inc.. In April 1991, Kiam sought Bear Stearns' advice as to how Remington's standing with the RPI Creditors might be improved and how Remington might obtain seasonal financing. While Kiam pursued these discussions with Bear Stearns, he sought from various lending institutions a personal loan to be secured by his Manhattan cooperative apartment. The attempt to obtain a mortgage loan was unsuccessful, as were Bear Stearns' early attempts to obtain new financing for Remington.

In May 1991, in search of a mortgage loan, Kiam contacted Gerald Daniello of Chase's Stamford, Connecticut office. During the course of their negotiations, Kiam and Chase also discussed the possibility of Chase's mergers and acquisitions department representing and advising Remington in a sale, merger or refinancing. The parties disagree on the extent, if any, to which Kiam's receipt of a mortgage loan was conditioned on Chase's being retained as Remington's financial advisor. Kiam contends that his desire was to retain Bear Stearns as Remington's financial adviser; Chase, he maintains, used ***196** his need for a personal loan to force his hand in favor of selecting Chase. Chase denies any attempt to condition Kiam's Loan on its being hired by Remington and insists that Remington sought its advice as to a strategy to repay the RPI Lenders. In any event, on May 21, 1991, Kiam received a $3 million personal loan from Chase's private banking division. While Chase's internal credit approval memorandum did note the fact that Remington had retained Chase's mergers and acquisitions department, the only evidence either party has produced on the factual issue of whether Chase conditioned (or "tied") Kiam's receipt of a mortgage loan on Chase's retention as Remington's financial advisor is conflicting affidavit and deposition testimony.

Its reasons for doing so aside, on May 23, 1991 Remington signed an "engagement letter" with Chase (the "May 23 Letter") naming Chase as its financial advisor in connection with a range of potential transactions, including investments in, or a sale of, Remington. At the same time, Kiam executed a letter of guarantee in favor of Chase, pursuant to which Kiam guaranteed payment of Chase's fee.

On June 26, 1991, in response to mounting pressure to repay, respectively, the RPI Loan and the Patriots Loan, Remington and Kiam jointly entered into an "RPI Sale and Intercreditor Agreement" (the "Intercreditor Agreement") among themselves, the RPI Lenders and IBJ Schroder. The Intercreditor Agreement contained three key provisions. First, Remington and Kiam were obligated to use their "best efforts to effect or cause to be effected (and not hinder the consummation of)" an "Acceptable Transaction" (essentially defined as a transaction generating proceeds sufficient to satisfy the RPI Loan) by May 31, 1992, with an automatic extension to June 30, 1992. Second, the Agreement recognized that Chase had been retained as Remington's financial advisor and obligated Remington to cause Chase to keep the RPI Lenders and Schroder informed as to the progress of their efforts toward closing an Acceptable Transaction. Third, the Agreement required Kiam to grant Chase an irrevocable proxy under which Chase was authorized to vote Kiam's Remington shares in favor of—and consummate—an Acceptable Transaction in the event Kiam refused to do so, provided that Chase could in good faith issue an opinion that the terms of the transaction were fair from a financial standpoint to both Remington and Kiam. Under this provision Remington also gave Chase certain requisite powers of attorney.

On June 26, Remington and Chase also signed an amendment to the May 23 Letter ("the Amendment Letter" and, collectively with the May 23 Letter, the "Engagement Agreement"). The effect of the Amendment

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Letter was to coalesce the terms of the Engagement Agreement with those of the Intercreditor Agreement. Section 1 of the Engagement Agreement—entitled "Services to be Rendered"—obligated Chase to provide the following "financial advisory services":

(a) Chase will develop and maintain a continuing familiarity with the financial situation and plans of the Company [i.e., Remington] with a view to fulfilling its role as financial advisor;

(b) Chase will evaluate and recommend financial and strategic alternatives with respect to a Transaction[1];

(c) Chase will assist the Company in preparing an information memorandum for distribution to potential buyers, describing ***197** the Company based upon information supplied to Chase by the Company;

(d) Chase will identify and contact potential purchasers, approved in advance by the Company, in respect of a proposed Transaction, advise the Company concerning the strategy and tactics of negotiations with such potential purchasers, and assist in such negotiations;

(e) Chase will advise the company with respect to the timing, structure, and pricing of a Transaction;

(f) Within a reasonable time after a request by the Company, Chase will render (i) a written opinion ... as to the fairness ..., from a financial point of view, of the consideration to be received by the Company, or its common stockholders, as the case may be, in connection with a Transaction and (ii) an appraisal ... of the fair market value ... of the non-cash portion, if any, of the consideration to be ... received in such Transaction....; and

(g) Chase will provide such additional financial advisory services as from time to time may be mutually agreed upon by the Company and Chase.

Section 7 of the Engagement Agreement—entitled "Additional Services to be Rendered"—listed a number of further services to be provided by Chase, each of which was contemplated by the Intercreditor Agreement. These included (i) possession of the irrevocable proxy and power of attorney to vote Kiam's Remington shares in favor of a Transaction over Kiam's objection, (ii) production of monthly progress reports, (iii) production of a preliminary report on transactions that appeared promising (iv) production of a fairness opinion and appraisal on Chase's own initiative in the event Remington failed to request the fairness opinion called for in section 1 and (v) use of the irrevocable proxy and power of attorney to vote Kiam's shares in favor of a proposed Transaction if a preliminary report indicated that it was capable of generating proceeds sufficient to satisfy the RPI Loan. In recognition of the fact that Chase's role in providing these services raised ethical concerns because of Chase's role in providing the services enumerated in section 1, section 7 of the Engagement Agreement also provided in part as follows:

> The Company [e.g., Remington] acknowledges that [the] duties and responsibilities [set forth in section 7] may represent a potential conflict of interest for Chase in light of the other services Chase has agreed to provide the Company in Section 1 hereof. The Company hereby agrees that the performance by Chase of the additional services specified in this Section 7 shall not constitute a conflict of interest for purposes of Chase's other services hereunder and expressly waives its right to assert any such conflict against Chase.

The Engagement Agreement was to expire on May 23, 1991. However, under section 3, Remington was obligated to pay Chase a fee if, "during the term of th[e] agreement [or] at anytime within twelve months thereafter," a Transaction was consummated, or an agreement was signed that resulted in a "Transaction being consummated." Thus, the Engagement Agreement provided that if a Transaction (or an agreement leading to a Transaction) was in place by the end of a one year "tail period" (that is, by May 23, 1993), Chase would receive a fee under the same terms and in the same manner as during the term of the Agreement. Remington could cancel the Engagement Agreement at any time with fifteen days written notice. However, if it did so, Chase would nonetheless be paid as if the Agreement remained in force for the full term.

Though the parties dispute the effectiveness of and motives behind Chase's efforts on Remington's behalf, the record demonstrates that Chase engaged in substantial activity on Remington's behalf throughout late 1991 and early 1992. The evidence establishes that Chase (1) arrived at a preliminary timetable for the initial stages of the transaction process by the end of May 1991

(Plaintiff's Exhibit 17), (2) made requests for company information (Plaintiff's Exhibits 18–19), (3) assisted in the preparation of the information memorandum contemplated by section 1(c) of the Engagement Agreement (Plaintiff's Exhibit 28), (4) provided Remington with lists of potential investors (Plaintiff's Exhibits 20–24 and 29), (5) arranged on-site visits to Remington's ***198** plant for potential investors (Plaintiff's Exhibit 30) and (6) kept Kiam informed as to Chase's progress (Plaintiff's Exhibits 25–26). Chase's report of January 7, 1992 indicates that by that time it had made initial contact with 141 investors, four of whom would make proposals to purchase Remington by the end of the month. Two of those four bids—the so-called "Warburg" and "Kohlberg" proposals—would have provided Kiam with several million dollars more than the amount necessary to pay off the RPI Lenders.

Dissatisfied with this choice of bids as well as Chase's efforts on their behalf generally, Remington and Kiam began, sometime during January or February of 1992, to solicit investors independently of Chase. According to Kiam, it had been his preference from the time the Engagement Agreement was signed that any transaction that Remington entered into be a financing arrangement (i.e., an equity or debt offering, a joint venture or the formation of a partnership) rather than an outright sale of the company or its assets. Kiam was particularly interested in maintaining control of Remington.

In July 1992, Kiam entered into a transaction (the "Perlmutter Transaction") with Isaac Perlmutter that constituted a Transaction within the meaning of the Engagement Agreement with Chase. While it is unclear from the record whether it was expected—or Kiam believed—at the time the Perlmutter Transaction was consummated that Kiam would remain in charge of Remington, Kiam preferred Isaac Perlmutter's proposal to any proposal received by Chase.

The record is unclear as to when precisely Chase demanded, and Remington refused to pay, its fee. Chase has submitted correspondence and memoranda which indicate strongly that as late as July 1992 Remington did not dispute that Chase was owed compensation for its services. Whatever negotiations occurred on this topic ended on October 29, 1992, however, when Chase filed this suit, alleging that Remington's failure to pay it a fee constituted a breach of the Engagement Agreement and that Kiam was liable as guarantor. Remington's and Kiam's answer denies the substance of Chase's complaint and asserts counterclaims to the effect that (1) Chase's failure to perform its obligations under the Engagement Agreement constituted a breach of contract, (2) Chase "tied" Kiam's receipt of a mortgage loan to Chase's selection as Remington's investment banker in violation of the Bank Holding Company Act ("BHCA"), 12 U.S.C. §§ 1971–78, (3) Chase negligently managed the process of attracting investors, thereby forcing Remington to pursue the Perlmutter Transaction, which they describe as disadvantageous, and incur costs they otherwise would have avoided and (4) Chase breached its fiduciary duty to Remington by pursuing its own interests and the interests of the RPI Lenders at the expense of Remington. As noted above, Chase moves for summary judgment on its claim and on each of these counterclaims.

II

[1] The dispositive issue is whether Chase has fulfilled its obligations under the Engagement Agreement. Although the defendants contend that there is a genuine dispute as to the intent of the parties in drafting the Agreement, neither party argues that the terms of the Agreement are ambiguous. Chase claims that under the Engagement Agreement it performed the required services and is entitled to be paid. Remington and Kiam disagree, arguing that summary judgement is inappropriate, not only because the intent of the parties is a material fact in dispute, but because Chase failed to perform the services it was obligated to perform under the Agreement, in particular because Chase failed to adopt Kiam's preference for attracting an investor in, rather than a purchaser of, Remington. I conclude that Chase is correct.

There is little doubt as to the services Chase was obligated to provide under the Engagement Agreement. While section 1 required Chase to "assist" Remington, "identify" options, "recommend" courses of action, and "advise" Remington as to its various options regarding Transactions, that is all it required Chase to do. Whatever the defendants' intention was, the Engagement Agreement does not, and cannot reasonably be construed to, mandate Chase to seek an investor ***199** in Remington before turning to the option of a sale of Remington stock or assets. Chase was under no obligation to do Kiam's bidding as long as it could opine in good faith that its actions were fair from a financial standpoint.

[2] Nor does section 3 condition Chase's receipt of a fee on its bringing about a Transaction or on the consummation of any particular type of Transaction. The sole prerequisite to payment listed in section 3 is the consummation of a Transaction (or the signing of an

agreement that results in a Transaction). As both Kiam and his attorney, Arthur Emil, recognized on deposition, *see* Plaintiff's Reply Exhibit 3 at 451–52; Plaintiff's Reply Exhibit 4 at 453–54, section 3 does not even condition Chase's entitlement to a fee on its being involved in a consummated transaction.[2]

[3] The record clearly establishes that Chase did in fact provide the services called for in the Engagement Agreement and that all conditions precedent to Chase's being entitled to payment have occurred. As described above, Chase has submitted extensive evidence of advice and representation provided Remington by Chase directed toward the consummation of a transaction the form of which was clearly contemplated in the Engagement Agreement. Nothing in the Engagement Agreement prohibited Chase from pursuing particular types of Transactions to the exclusion of others.

Accordingly, Chase's motion for summary judgment on its claim that the defendants are in breach of the Engagement Agreement is granted. Moreover, since the guarantee is unambiguous and the sole condition precedent to its becoming operative—that is, the liability of Remington—has occurred, Chase's motion for summary judgment on its claim against Kiam is also granted.

III

It follows from the foregoing discussion of Chase's claims that Chase's motion for summary judgment dismissing the defendants' counterclaim for breach of contract must be granted. As discussed above, there is no genuine issue whether Chase performed adequately under the Engagement Agreement and the defendants have failed to call into question Chase's substantial evidence of performance.

IV

[4] The defendants allege that Chase made Kiam's receipt of a mortgage loan contingent on Chase's being chosen as Remington's financial advisor in violation of the anti-tying provisions of the BHCA. 12 U.S.C. § 1972 reads in pertinent part as follows:

> (1) A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement—
>
> (A) that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service ...

12 U.S.C. § 1975 creates a private right of action and an award of treble damages to "[a]ny person who is injured in his business or property by reason of anything forbidden in section 1972...." The defendants allege that, before extending Kiam a personal loan, Chase imposed the "condition or requirement" that Remington obtain the services of the Chase mergers and acquisitions department.

While the issue of whether tying actually took place remains, Remington and Kiam fail to point to any injury or measure of damages upon which to recover under the statute. Indeed, in light of the fact that Remington consummated a Transaction and Kiam received a mortgage loan on market terms, it is difficult to envision precisely what form of injury Remington or Kiam could possibly allege. To the extent that the defendants assert Chase's alleged tying activity as a ***200** defense to Chase's claim, the law is against them. Section 1975 clearly states that the only private remedy available under the BHCA is "three times the amount of damages sustained" by the plaintiff. The statute does not absolve successful § 1975 plaintiffs from the obligation to fulfill contracts that result from a tying arrangement. *See Exchange National Bank of Chicago v. Daniels,* 768 F.2d 140, 144 (7th Cir.1985) (even if tying pressure is applied in connection with a loan application, "an obligation to pay back a loan is not an injury"). Accordingly, Chase's motion for summary judgment dismissing the defendants' BHCA counterclaim is granted.

V

[5] The defendants allege that Chase engaged in various forms of negligent behavior during the period of the parties' contractual relationship, among them "fail[ure] to explore other avenues of alternative financing," "failure to have a sales agreement drafted and sent to all prospective investors," "artificially accelerating the bidding process" and "failing to consummate a 'suitable' transaction." The merit of these allegations aside, Chase correctly notes and

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the defendants do not contest, with certain exceptions not relevant here, that New York does not recognize a cause of action for negligent performance of a contract. *See Clark–Fitzpatrick, Inc. v. Long Island Railroad Company,* 70 N.Y.2d 382, 521 N.Y.S.2d 653, 656–57, 516 N.E.2d 190, 192–94 (Ct.App.1987) (breach of contract is not a tort unless the breach violates a legal duty that is independent of the contract). Chase's motion for summary judgment dismissing the Defendant's negligence counterclaim is therefore granted.

VI

[6] [7] [8] The defendants' final counterclaim is that Chase's conduct constituted a breach of fiduciary duty. A fiduciary duty exists " 'when one person is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation.' " *Flickinger v. Harold Brown & Co., Inc.,* 947 F.2d 595, 599 (2nd Cir.1991). However, the scope of the duty can be limited by contract. *See Riviera Congress Associates v. Yassky,* 18 N.Y.2d 540, 277 N.Y.S.2d 386, 392–93, 223 N.E.2d 876, 879–80 (Ct.App.1966) (limited partners may contract away the right to bring an action against the general partner for self-dealing). The defendants allege that Chase's fiduciary duty was violated when Chase "pursued its own self interest and that of the RPI Lenders rather than that of Remington, intentionally mischaracterized an expression of interest as an exploding preemptive bid ... and brazenly advised potential investors that it could sell Remington without Kiam's consent."

The defendants have submitted no evidence supporting the claim that Chase violated the fiduciary duty it owed Remington. The defendants' argument proceeds on the assumption that Chase signed an agreement, in Remington's expert's words, to "advise and assist Remington in facilitating and effectuating *a transaction of Remington's choosing* ..." (emphasis in original). Hurley Affidavit at 6, Affidavits in Opposition to Plaintiff's Motion for Summary Judgment. This is not correct. Kiam's preferences as to the form and timing of a Transaction were irrelevant as a legal matter. Chase's role was to find—and, if necessary, require Remington to accept—a transaction that would satisfy the RPI Loan. The record contains no evidence to suggest that Chase pursued any agenda other than the one contemplated by the parties to the Engagement and Intercreditor Agreements. Chase's motion for summary judgment dismissing this counterclaim is therefore granted.

* * * * * *

Chase's motion for summary judgment on its claim that Remington is in breach of the Engagement Agreement and Kiam is in breach of the May 23, 1991 guarantee is granted. Chase's motion for summary judgment dismissing the defendants' counterclaims is also granted.

Submit judgment on notice.

All Citations

865 F.Supp. 194

Footnotes

1 "Transaction" was defined as follows in section 1 of the Engagement Agreement:

> For purposes of this agreement, a "Transaction" shall mean, whether in one or a series of transactions, (i) any merger, consolidation, reorganization, recapitalization, leveraged buy-out, restructuring or other business combination or transaction involving the Company [i.e., Remington], (ii) the disposition by the Company or any of its shareholders, directly or indirectly, through public or private sales or otherwise of all or any portion of the assets, securities, properties, or businesses of the Company, (iii) the formation of a joint venture, partnership, or special purpose vehicle for the purpose of combining all or any portion of the assets, securities, properties, or businesses of the Company, or (iv) any management, consulting, supply, service, distribution, licensing agreement, or similar arrangement involving the Company or any of its shareholders and a potential purchaser.

2 The Defendants' attempt to minimize the significance of the plain meaning of section 3 by arguing that, in drafting section 3, the parties could not possibly have intended that Chase be paid regardless of whether it spent little or no effort on Remington's behalf. It may be that this argument would come into play if Chase simply ignored its responsibilities entirely. As the record indicates, however, such was not the case.

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775 F.Supp. 660
United States District Court,
S.D. New York.

DREXEL BURNHAM LAMBERT GROUP, INC.,
Plaintiff,
v.
MICROGENESYS, INC., Defendant.

No. 91 Civ. 2060 (SWK).
|
Oct. 15, 1991.

Synopsis
Payee of subordinated convertible bridge note sued maker under Securities Exchange Act, Securities Act, and state law. On motion to dismiss, the District Court, Kram, J., held that: (1) claim under Securities Act sounded in fraud so that requirements of rule with respect to pleading fraud with particularity had to be satisfied, and (2) claims under both Acts pleaded facts sufficient to give rise to strong inference of fraudulent intent on part of maker of note, to effect that maker did not intend to pay the note at the time it was made.

Motion denied.

West Headnotes (13)

[1] **Securities Regulation**
Manipulative, Deceptive or Fraudulent Conduct
Securities Regulation
Scienter

To state claim under section of Securities Exchange Act relating to use of manipulative or deceptive device in connection with purchase or sale of security, or Rule 10b–5, plaintiff must allege: material misstatements or omissions; indicating intent to deceive or defraud (scienter); in connection with the sale or purchase of any security; upon which plaintiffs detrimentally relied. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Cases that cite this headnote

[2] **Securities Regulation**
Misrepresentation

Making specific promise to perform particular act in the future while secretly intending not to perform that act may violate Securities Exchange Act when promise is part of the consideration for the transfer of securities. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

1 Cases that cite this headnote

[3] **Federal Civil Procedure**
Fraud, mistake and condition of mind

Though rule with respect to pleading fraud provides that intent may be averred generally, plaintiff may not rely on conclusory assertions that defendant acted with fraudulent intent, but must plead factual basis which gives rise to "strong inference" of fraudulent intent. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

1 Cases that cite this headnote

[4] **Federal Civil Procedure**
Fraud, mistake and condition of mind

To satisfy dictates of rule with respect to pleading fraud, plaintiff may not simply allege nonperformance of a promise; in order to properly convert a contract claim into a tort claim for fraud, the allegedly defrauded party must allege specific facts from which reasonable trier of fact could directly or indirectly infer that promisor intended not to honor his obligations at the time the promise was made. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

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3 Cases that cite this headnote

[5] **Federal Civil Procedure**
Fraud, mistake and condition of mind

Plaintiff pleading fraud under Securities Exchange Act must allege facts from which scienter can be inferred, but great specificity is not required. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Cases that cite this headnote

[6] **Federal Civil Procedure**
Fraud, mistake and condition of mind

Requirements of rule with respect to pleading fraud are relaxed when facts are peculiarly within opposing party's knowledge, and allegations may be based on information and belief so long as specific facts are alleged to support a strong inference of fraud. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

Cases that cite this headnote

[7] **Federal Civil Procedure**
Fraud, mistake and condition of mind

Payee of senior subordinated convertible bridge note pleaded facts sufficient to give rise to strong inference of fraudulent intent on the part of maker, so as to satisfy requirements of rule as to pleading fraud, as to claims under Securities Exchange Act and Securities Act, though payee did not explicitly state that maker did not intend to repay note at time note was signed, where payee alleged that, after it sent demand letter, maker's attorney informed payee that maker did not owe payee any money because maker viewed note as payment to it for expenses incurred before the note was made. Securities Act of 1933, §§ 12, 12(2), 15 U.S.C.A. §§ 77*l*, 77*l* (2); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

3 Cases that cite this headnote

[8] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

To satisfy scienter requirement with respect to claim under the securities laws that maker of senior subordinated convertible bridge note executed note without present intent to pay, it was not necessary to allege that maker's attorney whose statements supported such claim was involved in negotiations leading to making of the note or had previously represented the maker in his dealings with payee, or to allege that the attorney had knowledge of the maker's intention at the time of the execution of the note, where it was alleged that attorney was involved in a discussion with payee regarding repayment of the note and spoke on the maker's behalf. Securities Act of 1933, §§ 12, 12(2), 15 U.S.C.A. §§ 77*l*, 77*l* (2); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

Cases that cite this headnote

[9] **Federal Civil Procedure**
Insufficiency in general

Complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim that would entitle him to relief, and thus doubt as to plaintiff's ability to prove his case is not reason for dismissal of pleadings for failure to state a claim on which relief can be granted. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

Cases that cite this headnote

[10] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Liability under section of Securities Act with respect to sale of security by communication which includes untrue statement of material fact or omission of material fact may result from negligent conduct, misstatements or omissions, so that showing of scienter is not required. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77*l* (2).

1 Cases that cite this headnote

[11] **Federal Civil Procedure**
Fraud, mistake and condition of mind

To extent that plaintiffs need not allege fraud or scienter in actions brought under Securities Act, rule with respect to pleading fraud with particularity is inapplicable, but if a claim under the Act is based on fraud, the claim must comply with the pleading requirements of the rule. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77*l* (2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

1 Cases that cite this headnote

[12] **Federal Civil Procedure**
Fraud, mistake and condition of mind

Claim under Securities Act sounded in fraud, as opposed to negligent or unintentional conduct, and thus complaint had to satisfy requirements of rule with respect to pleading fraud, where the alleged omission of material fact was that maker of senior subordinated convertible bridge note failed to disclose its intention not to repay the note. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77*l* (2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

2 Cases that cite this headnote

[13] **Federal Courts**
Jurisdiction of Entire Controversy; Pendent and Supplemental Jurisdiction

Pendent jurisdiction exists whenever there is a claim arising under the Constitution, laws or treaties of the United States and relationship between that claim and state claim permits conclusion that entire action before the court comprises but one constitutional "case," but the state and federal claims must derive from a common nucleus of operative fact. U.S.C.A. Const. Art. 3, § 2.

Cases that cite this headnote

Attorneys and Law Firms

***662** Tenzer, Greenblatt, Fallon & Kaplan by **Mark H. Moore**, New York City, for plaintiff Drexel Burnham Lambert Group, Inc.

Cummings & Lockwood by William H. Narwold, William H. Bright, Hartford, Conn., for defendant MicroGeneSys, Inc.

MEMORANDUM OPINION AND ORDER

KRAM, District Judge.

In this action involving a claim on a subordinated convertible bridge note, defendants have moved, pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure, for an order dismissing plaintiff's first, second and third claims based on § 10(b) of the Securities Exchange Act of 1934 and § 12(2) of the Securities Act of 1933. In addition, defendants have moved to dismiss plaintiff's fourth, fifth and sixth claims on the ground that there is no independent basis for federal jurisdiction over

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these common law claims.

BACKGROUND[1]

In 1989, the plaintiff, Drexel Burnham Lambert Group, Inc. ("Drexel"), an underwriter, loaned $1,000,000 to the defendant, MicroGeneSys, Inc. ("MicroGeneSys"), a biotechnology company. This money was provided after Drexel failed to accomplish an initial public offering (the "IPO") of MicroGeneSys' shares. To evidence the obligation, MicroGeneSys executed a Senior Subordinated Convertible Bridge Note (the "Note"), in the amount of $1,000,000, payable to Drexel. Drexel and MicroGeneSys simultaneously entered into a Senior Subordinated Convertible Bridge Note and Warrant Purchase Agreement, dated February 27, 1989 (the "Agreement"). The Agreement and Note were later amended to provide that principal and interest would become due and payable on January 1, 1990, unless all unpaid interest which had accrued through that date was paid.

As of January 2, 1990, MicroGeneSys had not paid any of the accrued interest due, and the Note became payable under the terms of the Agreement. By letter dated December 11, 1990, from Drexel Associate Counsel Carla Volpe Porter, Esq. ("Porter") to MicroGeneSys, Drexel demanded payment of the Note. After sending the demand letter to MicroGeneSys, Porter discussed the matter with the defendant's attorneys, Cummings & Lockwood. Speaking on behalf of MicroGeneSys, William Narwold, Esq. ("Narwold") of Cummings and Lockwood informed Porter that MicroGeneSys did not owe Drexel any money because defendant viewed the Note as payment for expenses it incurred during the unsuccessful IPO. Complaint, at ¶ 23.

In its Complaint, Drexel asserts federal securities claims and state law contract claims. Drexel contends that at the time MicroGeneSys executed and delivered the Note it had no intention of repaying it. Drexel further alleges that MicroGeneSys ***663** never informed Drexel of its intention not to repay the Note prior to executing and delivering the Note.

Subject matter jurisdiction is based on Section 22 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77v, Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78aa, and principles of pendent jurisdiction.

MicroGeneSys now moves to dismiss Drexel's Complaint. MicroGeneSys contends that Drexel's first and second claims, based on § 10(b) of the Exchange Act, and its third claim, based on § 12(2) of the Securities Act, should be dismissed for failure to state a claim upon which relief may be granted, and failure to plead securities fraud with the requisite particularity. In addition, MicroGeneSys contends that Drexel's three common law claims should be dismissed as there is no independent basis for jurisdiction once the federal question claims are dismissed. Drexel opposes the motion.

DISCUSSION

I. Claims under § 10(b) and Rule 10b–5

MicroGeneSys has moved to dismiss Drexel's first and second claims (based on § 10(b)[2] of the Exchange Act [15 U.S.C. § 78j(b)] and Securities Exchange Commission Rule 10b–5[3] [C.F.R. § 240.10b–5]), for failure to state a claim. In considering a motion to dismiss pursuant to Rule 12(b)(6), a complaint must be read generously and every inference drawn in favor of the plaintiff. *Pross v. Katz,* 784 F.2d 455, 457 (2d Cir.1986); *Metzner v. D.H. Blair & Co.,* 663 F.Supp. 716, 719 (S.D.N.Y.1987). A complaint should be dismissed only if it "appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief." *Frasier v. General Elec. Co.,* 930 F.2d at 1007 (quoting *Conley v. Gibson,* 355 U.S. 41, 45–46, 78 S.Ct. 99, 101–02, 2 L.Ed.2d 80 (1957)).

[1] To state a claim under § 10(b) and Rule 10b–5, the plaintiff must allege the following: (1) material misstatements or omissions (2) indicating an intent to deceive or defraud (scienter) (3) in connection with the sale or purchase of any security (4) upon which plaintiffs detrimentally relied. *Luce v. Edelstein,* 802 F.2d 49, 55 (2d Cir.1986) (citing *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976)).

The Complaint alleges that MicroGeneSys never intended to repay the Note delivered and executed on or about February 27, 1989. Since Drexel contends that the provisions of the Agreement, Note and Amendment were representations by MicroGeneSys that it intended to repay the Note, and MicroGeneSys never communicated to

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Drexel any intention not to repay the Note prior to the time the Note was made, Complaint, at ¶¶ 24–26, Drexel asserts that the representations were fraudulent, specifically, that:

> These representations were materially false and misleading, in that defendant intentionally concealed and failed to disclose ***664** the material fact of its intention not to repay the Note.

Complaint, at ¶ 27. Drexel also contends that such intentional failure to inform it of MicroGeneSys' intent not to repay the Note constituted an omission of a material fact in connection with the purchase or sale of a security. Complaint, at ¶ 32.

[2] It is well settled that "making a specific promise to perform a particular act in the future while secretly intending not to perform that act may violate Section 10(b) when the promise is part of the consideration for the transfer of securities." *Luce v. Edelstein,* 802 F.2d at 55 (citing *Pross v. Katz,* 784 F.2d 455, 457 (2d Cir.1986)). This proposition, however, is not contested in this action. What is in dispute is whether Drexel has properly alleged its § 10(b) claims, specifically, intent to defraud, with sufficient particularity.

[3] Rule 9(b) of the Federal Rules of Civil Procedure requires that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Though Rule 9 provides that intent may be averred generally, the Second Circuit has held that a plaintiff may not rely on conclusory assertions that the defendant acted with a fraudulent intent. Instead, a plaintiff is "required to plead the factual basis which gives rise to a 'strong inference' of fraudulent intent." *Wexner v. First Manhattan Co.,* 902 F.2d 169, 172 (2d Cir.1990) (citing *Beck v. Manufacturers Hanover Trust Co.,* 820 F.2d 46, 50 (2d Cir.1987), *cert. denied,* 484 U.S. 1005, 108 S.Ct. 698, 98 L.Ed.2d 650 (1988)).

[4] In *O'Brien v. National Property Analysts Partners,* 936 F.2d 674, 676 (2d Cir.1991), the Second Circuit espoused a test for determining whether a plaintiff has pleaded facts sufficient to give rise to a "strong inference" of fraudulent intent. The court stated that:

> Essentially while Rule 9(b) permits fraudulent intent to be demonstrated by inference, this "must not be mistaken for license to base claims of fraud on speculation and conclusory allegations." *Wexner,* 902 F.2d at 172. An ample factual basis must be supplied to support the charges.

Further, to satisfy the dictates of Rule 9(b) a plaintiff may not simply allege nonperformance of a promise. Courts are reluctant to infer fraud where the only allegation of fraud is that the defendant never intended to live up to its promise. *See e.g., Value Time Inc. v. Windsor Toys, Inc.,* 700 F.Supp. 6 (S.D.N.Y.1988). In addition, the Second Circuit has stated that "nonperformance of a promise alone does not support an inference that it was fraudulent when uttered." *Zola v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* CCH Fed.Secur.L.Rep. ¶ 93, 159 at 95, 721–722, 1987 WL 7742 (S.D.N.Y.1987). Thus, "the mere allegation that defendants did not intend to honor the contract at issue does not alone create a basis for alleging fraud." *Zucker v. Katz,* 708 F.Supp. 525, 529 (S.D.N.Y.1989) (citing *Murray v. Xerox Corp.,* 811 F.2d 118, 122 (2d Cir.1987)). In order to properly convert a contract claim into a tort claim for fraud, the allegedly defrauded party must allege specific facts from which a reasonable trier of fact could directly or indirectly infer that the promisor intended not to honor his obligations at the time the promise was made. *See Luce,* 802 F.2d at 55; *National Westminster Bank v. Ross,* 130 B.R. 656, 664 (S.D.N.Y.1991); *Songbird Jet Ltd. v. Amax Inc.,* 581 F.Supp. 912, 925 (S.D.N.Y.1984), *aff'd,* 812 F.2d 713 (2d Cir.1987).

[5] [6] The Second Circuit has recognized, however, that "great specificity is not required with respect to scienter." *Zucker v. Katz,* 708 F.Supp. at 529 (citing *Connecticut Nat. Bank v. Fluor Corp.,* 808 F.2d 957, 962 (2d Cir.1987)). A plaintiff must allege facts from which scienter can be inferred, but great specificity is not required as it would be unrealistic to expect a plaintiff to plead a defendant's actual state of mind. *Zucker v. Katz,* 708 F.Supp. at 529 (citing *Connecticut Nat. Bank v. Fluor Corp.,* 808 F.2d at 962). Further, when the facts are peculiarly within the opposing party's knowledge the ***665** requirements of Rule 9(b) are relaxed, *See Nicholas v. Poughkeepsie Savings Bank/FSB,* [1990–91 Transfer Binder] CCH Fed.Secur.L.Rep. ¶ 95,606 at 97,836, 97,839, 1990 WL 145154 (S.D.N.Y.1990) (citing *Segal v. Gordon,* 467 F.2d 602 (2d Cir.1972) and *Di Vittorio v. Equidyne Extractive Industries, Inc.,* 822 F.2d 1242, 1247 (2d Cir.1987)), and allegations may be based on information and belief so long as specific facts are alleged to support a "strong inference" of fraud. *Wexner,* 902 F.2d at 172.

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[7] In this case, Drexel has pleaded facts sufficient to give rise to a "strong inference" of fraudulent intent on the part of MicroGeneSys, and thus the requirements of Rule 9(b) have been satisfied. Drexel has not based its claims of fraud on conclusory allegations, and has not merely alleged nonperformance of a contract. The Complaint alleges that MicroGeneSys refused to make any payments due under the Note, *see* Complaint, at ¶ 19, and that:

> ¶ 22. After Porter sent plaintiff's demand letter to defendant, she discussed plaintiff's claim with the defendant's attorneys, Cummings & Lockwood, a law firm located in Stamford, Connecticut.
>
> ¶ 23. William Narwold, Esq. ("Narwold") of Cummings & Lockwood, on behalf of defendant, informed Porter that defendant did not owe plaintiff any money, because defendant viewed the Note as payment to defendant for expenses it incurred during the failed IPO.
>
> ¶ 24. Thus, at the time that defendant executed and delivered the Note, it had the then present intention not to repay it.

Although this statement by Narwold was made two years after the execution of the Note, and Narwold did not explicitly state that MicroGeneSys did not intend to repay the Note at the time the Note was signed, the statement creates a "strong inference" of fraudulent intent at the time the Note was executed. *Wexner,* 902 F.2d at 172. MicroGeneSys' contention that "at best, this statement, if made, only suggests that MicroGeneSys now, some two years later, views the Note as a set-off for a claim it has against plaintiff," Defendant's Reply Memorandum to Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss, at 7–8, is not persuasive.

In 1988, Drexel attempted to assemble a syndicate of underwriters and generate investor interest in order to accomplish an IPO of MicroGeneSys' shares. Complaint, at ¶ 6. Drexel, however, failed to complete the IPO for MicroGeneSys. Complaint, at ¶ 7. According to Drexel's Complaint, shortly after this unsuccessful IPO, in early 1989, MicroGeneSys' chief executive officer, Frank Volvovitch ("Volvovitch"), requested that Drexel lend MicroGeneSys funds in order to meet its short-term cash needs. Drexel agreed to do so and, in February of 1989, the parties entered into the Note and Agreement, and Drexel delivered one million dollars to MicroGeneSys.

It is the timing of these events that supports a "strong inference" that MicroGeneSys intended to defraud Drexel when the transaction was made. According to the Complaint, Attorney Narwold explicitly stated that MicroGeneSys viewed the Note as payment to defendant for expenses it incurred during the failed IPO. Complaint, at ¶ 23. Since the IPO failed in 1988, it is logical to assume that these expenses were incurred in the same year, before the Note was executed in 1989. Thus, MicroGeneSys knew about the unsuccessful IPO and the expenses incurred when it entered into the Note and Agreement with Drexel. While this does not conclusively establish that MicroGeneSys intended to defraud Drexel at the time it executed the Note, it makes plausible Drexel's allegation that MicroGeneSys executed and delivered the Note with the present intention not to repay it. *See Luce v. Edelstein,* 802 F.2d at 56 (plausible allegations that defendants made specific promises to induce a securities transaction while secretly intending not to carry them out or knowing they could not be carried out, and that they were not carried out, are sufficient to state a claim for relief under Section 10(b)); *see also Zucker v. Katz,* 708 F.Supp. at 530 (plaintiff's allegation that defendant never intended to perform may satisfy the scienter pleading requirements as long as the ***666** allegation is plausible under the circumstances). In addition, the Complaint alleges no event occurring between the execution of the Note and Attorney Narwold's statement that would indicate that MicroGeneSys' decision not to repay was reached two years after the failed IPO.

[8] Moreover, to satisfy the scienter requirement it is not necessary for Drexel to allege that Attorney Narwold was involved in the negotiations of the Note in 1989, or that he represented MicroGeneSys in its prior dealings with Drexel. Nor is it necessary to allege that Narwold had knowledge of MicroGeneSys' intention at the time of execution of the Note. Drexel's Complaint alleges that Narwold was involved in a discussion with plaintiff's counsel regarding repayment of the Note, and spoke on the defendant's behalf during that discussion. Thus, it is permissible to infer that MicroGeneSys had informed Narwold, defendant's outside litigation counsel, of the relevant details surrounding the transaction that took place in February of 1989.

[9] MicroGeneSys suggests that Drexel's Complaint cannot create a "strong inference" of fraud because the only factual basis for its fraud claims is Narwold's statement, which was made during settlement discussions and may not be admissible at trial. It is well settled, however, that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief. *Conley v. Gibson,* 355 U.S. 41, 47–48, 78 S.Ct. 99, 102–103, 2 L.Ed.2d 80 (1957). "Accordingly, doubt as to a party's ability to

prove his case, no matter how unlikely it seems he will be able to prove it, is no reason for dismissing his pleadings for failure to state a claim upon which relief can be granted." *Raine v. Lorimar Productions, Inc.,* 71 B.R. 450 (S.D.N.Y.1987) (citing *Walker Distributing Co. v. Lucky Lager Brewing Co.,* 323 F.2d 1, 4 (9th Cir.1963); *Carnivale Bag Co. Inc. v. Slide Mfg. Corp.,* 395 F.Supp. 287, 291 (S.D.N.Y.1975)).

II. Claim under § 12(2)[4]

MicroGeneSys has also moved to dismiss Drexel's third claim (based on § 12(2) of the Securities Act [15 U.S.C. § 77*l* (2)]), for failure to state a claim, and failure to allege fraud with particularity.

[10] [11] The Second Circuit has determined that actions brought under Section 12(2) of the Securities Act "do not require a showing by the plaintiff of any kind of scienter on the part of defendant." *Wigand v. Flo–Tek, Inc.,* 609 F.2d 1028, 1034 (2d Cir.1979) (citing *Franklin Savings Bank of New York v. Levy,* 551 F.2d 521, 526, 527 (2d Cir.1977). Section 12(2) liability may result from negligent conduct, misstatements or omissions. *Billet v. Storage Technology Corp.,* 72 F.R.D. 583, 585 (S.D.N.Y.1976). To the extent that plaintiffs need not allege fraud or scienter in actions brought under Section 12 of the Securities Act, Rule 9(b) is inapplicable. *Id.*

If a Section 12(2) claim is based on fraud, however, that claim must comply with the pleading requirements of Rule 9(b). *Moran v. Kidder Peabody & Co.,* 609 F.Supp. 661, 666 (S.D.N.Y.1985), *aff'd,* ***667** 788 F.2d 3 (2d Cir.1986); *see also In re Chaus Securities Litigation,* [1990 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 95,646 at 98,003, 1990 WL 188921 (S.D.N.Y. Nov. 20, 1990).

[12] Here, Drexel's third claim, which alleges a violation of Section 12(2) of the Securities Act, sounds in fraud; the Complaint must therefore satisfy the pleading requirements of Rule 9(b). The basis for the Court's conclusion is two-fold. First, the alleged material omission by
MicroGeneSys is the same that Drexel generally refers to earlier in the Complaint, specifically, in Drexel's first and second § 10(b) claims. *See Moran v. Kidder Peabody & Co.,* 609 F.Supp. at 666 (it may be assumed that a claim under § 12 sounds in fraud if the alleged misstatements are those generally referred to earlier in the complaint). In both its § 10(b) and § 12(2) claims, Drexel alleges the omission of the same material fact, namely, that MicroGeneSys failed to disclose its intention not to repay the Note.

Second, Drexel can only be alleging fraud, as opposed to negligent or unintentional conduct, when it identifies the material omission as follows:

> In connection with the sale of such security, defendant never notified plaintiff of its then present intent not to repay the Note.

Complaint, at ¶ 37. By defining the material omission as MicroGeneSys' failure to disclose its intent not to repay the Note, Drexel is claiming that MicroGeneSys' "intent to defraud was a material fact that should have been disclosed to Drexel." Defendant's Reply Memorandum to Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss, at 14. Since it is unreasonable to suggest that MicroGeneSys negligently or unintentionally failed to disclose its intent to defraud or not repay the Note, Drexel's claim sounds in fraud and Drexel must satisfy the pleading requirements of Rule 9(b). Thus, Drexel must allege facts that create at least a "strong inference" that MicroGeneSys knew of the existence of a misrepresentation or material omission in a prospectus or oral communication in connection with the sale of a security. *See Devaney v. Chester,* 813 F.2d 566 (2d Cir.1987) (court dismissed claim based on § 12(2) of the Securities Act for failure to plead the events which gave rise to an inference of knowledge).

In this case, Drexel adequately alleges scienter. As in the § 10(b) claims discussed above, Attorney Narwold's statement creates a "strong inference" that MicroGeneSys knew it was defrauding Drexel.

III. State Law Claims

[13] Since Drexel's federal law claims have not been dismissed pursuant to Rule 12(b)(6) or Rule 9(b), this Court will retain pendent jurisdiction over Drexel's state law claims. Pendent jurisdiction exists whenever there is a claim "arising under [the] Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their authority," U.S. Const. art. III, § 2, and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional "case." *United Mine Workers of America v. Gibbs,* 383 U.S. 715, 725, 86 S.Ct. 1130, 1138, 16 L.Ed.2d 218 (1966). Before a federal

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court exercises pendent jurisdiction, however, it must determine that the state and federal claims derive from a common nucleus of operative fact. *Id.* If a court finds that a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial proceeding, the federal court has the power to hear all the claims. *Id.*

In this case, Drexel's state claims arise out of the Agreement and Note that serve as the basis for its federal claims. Thus, this court has the power to exercise pendent jurisdiction over the state claims.

CONCLUSION

For the reasons set forth above, MicroGeneSys' motion, pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure, for an order dismissing Drexel's § 10(b), § 12(2) and common law claims for failure to state a claim and failure to plead fraud with particularity is denied. Defendant shall file its answer ***668** within the time provided for under Rule 12(a)(1).

SO ORDERED.

All Citations

775 F.Supp. 660, Fed. Sec. L. Rep. P 96,418

Footnotes

1 For purposes of this motion, the facts alleged in the Complaint will be accepted as true. *See Frasier v. General Elec. Co.,* 930 F.2d 1004, 1007 (2d Cir.1991) (citing *Cooper v. Pate,* 378 U.S. 546, 84 S.Ct. 1733, 12 L.Ed.2d 1030 (1964)).

2 In relevant part, § 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange—
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3 Rule 10b–5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstance under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operated or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

4 Section 12(2) of the Securities Act provides:

> Any person who—
> (2) offers or sells a security (whether or not exempted by the provisions of section 3 [15 USCS § 77c], other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

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151 B.R. 49
United States District Court,
S.D. New York.

In re The DREXEL BURNHAM LAMBERT GROUP, INC., et al., Debtors.
SUPER BOWL CORPORATION LIMITED, Appellant,
v.
DREXEL BURNHAM LAMBERT INCORPORATED, Appellee.

Nos. 92 Civ. 7183 (MP), 92 Civ. 7184 (MP).
|
March 3, 1993.

Synopsis
Chapter 11 debtor-securities brokerage firm objected to customer's proof of claim. The Bankruptcy Court, Francis G. Conrad, J., sustained objection and dismissed claims, but declined to award costs to debtor. Customer appealed and debtor cross-appealed. The District Court, Milton Pollack, Senior District Judge, held that: (1) customer failed to establish federal securities fraud violations; (2) customer failed to establish common-law fraud claim; (3) customer failed to establish claim for breach of fiduciary duty; (4) customer failed to establish negligent misrepresentation claim; and (5) debtor, which prevailed on all issues, was entitled to costs under Bankruptcy Rule.

Affirmed in part and reversed in part.

West Headnotes (12)

[1] **Securities Regulation**
Causation; Existence of Injury

Brokerage account investor bringing federal securities fraud claim cannot complain about fraud that did not cause it any harm.

Cases that cite this headnote

[2] **Securities Regulation**
Connection with Purchase or Sale

Elements of securities fraud claim under Rule 10b–5 are similar in substance to those of claim for common-law fraud, but Rule additionally requires fraudulent activity to be conducted in connection with purchase or sale of any security. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

1 Cases that cite this headnote

[3] **Securities Regulation**
Connection with Purchase or Sale

Any general misrepresentation by securities brokerage firm's customer representative that account, if opened, would be serviced diligently could not support securities fraud claim under Rule 10b–5 when alleged misrepresentation could not be connected to any particular subsequent transactions. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

1 Cases that cite this headnote

[4] **Securities Regulation**
Connection with Purchase or Sale

Brokerage firm's failure to execute purchase or sale order is not "in connection" with purchase or sale of securities, and, thus, is not actionable securities fraud under Rule 10b–5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Cases that cite this headnote

[5] **Securities Regulation**
Connection with Purchase or Sale

Insufficient connection existed between alleged

misstatements by brokerage firm's customer representative and any transactions by customer and, therefore, firm could not be held liable for federal securities fraud violation, even though customer claimed that alleged misrepresentations induced him later on into making numerous security purchases, where any misrepresentations or omissions did not pertain to securities themselves. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Cases that cite this headnote

[6] **Securities Regulation**
Causation; Existence of Injury

Even if alleged misrepresentations and omission by brokerage firm's customer representative influenced customer's decision to purchase options, such purchases could at most be "but-for" cause of losses sustained in stock market crash and, therefore, could not support securities fraud claim under Rule 10b–5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Cases that cite this headnote

[7] **Fraud**
Weight and Sufficiency

Under New York law, each element of common-law fraud must be established by clear and convincing evidence.

Cases that cite this headnote

[8] **Brokers**
Pleading

Under New York law, customer's common-law fraud claim against brokerage firm, alleging that customer representative failed to execute order to sell-out customer's account and failed to disclose that account would be turned over to trading assistant while customer representative was on vacation, failed to raise triable issue of fact with respect to causation, scienter, and materiality.

Cases that cite this headnote

[9] **Brokers**
Pleading

Under New York law, customer failed to state claim against brokerage firm for breach of fiduciary duty by customer representative, where customer's principal himself negated any purpose to deceive on part of representative.

Cases that cite this headnote

[10] **Fraud**
Statements Recklessly Made; Negligent Misrepresentation

Under New York law, elements of negligent misrepresentation are: carelessness in imparting words; others are expected to rely upon words; others acted or failed to act due to words; others were damaged; and author expressed words directly, with knowledge that they would be acted upon, to one whom author is bound to by some relation or duty of care.

6 Cases that cite this headnote

[11] **Brokers**
Fraud of Broker or His Agent

Under New York law, customer failed to establish that brokerage firm's customer representative's alleged failure to inform customer of his vacation and representative's alleged breach of promises of constant, personal attention constituted negligent

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misrepresentation.

Cases that cite this headnote

[12] **Bankruptcy**
Prevailing Party

Chapter 11 debtor-securities firm was entitled to be awarded costs of suit to be taxed by clerk against customer to extent permitted by Bankruptcy Rule, where debtor prevailed on all issues with respect to its objections to customer's claims, and no equitable reason appeared for taxing estate for expense of trial. Fed.Rules Bankr.Proc.Rule 7054(b), 11 U.S.C.A.

1 Cases that cite this headnote

Attorneys and Law Firms

***51** Hornsby, Sacher, Zelman & Stanton, P.A. (Barton S. Sacher, P.A., of counsel; Nancy Van Sant, with him, on the brief), Miami, FL, for appellant Super Bowl Corp.

Tenser, Greenblatt, Fallon & Kaplan (Joel D. Leifer, of counsel; **Mark H. Moore**, Daniel Hume, David L. Wagner and William H. Devany, with him on the brief), New York City, for appellee and cross-appellant, Drexel Burnham Lambert Inc.

MILTON POLLACK, Senior District Judge:

Preliminary

I.

This case arises out of the euphoria created in the securities markets in 1987 which was followed by an unprecedented market crash on October 19, 1987 when the Dow Jones Industrial Averages plunged more than 500 points. The Super Bowl securities account with Drexel held in addition to equity stocks a vast number of uncovered short puts (options) which registered huge losses in the market crisis. By the claims filed in the bankruptcy proceedings, Super Bowl sought to shift these losses to the broker's bankrupt estate.

Super Bowl is a family corporation based in Mexico City, Mexico. The Super Bowl account was operated by its President, Mr. Abraham Silberstein. Drexel's customers' representative on the account was Martin Askowitz; his assistant was Marilyn Berry. It will serve a better understanding of the trial if an outline of the significant factual findings by the trier of the facts precedes a more complete statement of the record based on those findings. At the inception of the trial, counsel for Super Bowl gave the following outline of his case:

By Mr. Sacher:

(a) "our case is a negligence action for a failure to execute a sell order on the 7th of October";

(b) "the period of time roughly from the spring to the 19th of October, sets forth a relationship between Mr. Silberstein on behalf of Super Bowl and Mr. Askowitz of trust, confidence and reliance on his personal expertise";

(c) "[Askowitz] did not tell his clients he was leaving [on vacation] until a few days before he left for the trip so as not to upset them ... those facts ... gives us the four corners of a fraud claim under New York law, a securities fraud claim under 10(b)(5), as well as ... a breach of fiduciary duty under New York law, in addition to the core negligence claim."

II.

The preliminary consideration of the issues to be tried

Shortly before inception of the trial, Drexel moved for an order granting Drexel partial summary judgment with

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respect to the federal securities claims, common law fraud claim, breach of fiduciary claim and negligent misrepresentation claim, asserted by Super Bowl. The motion was based on the Super Bowl Proof of Claim, Super Bowl's opposition and response to Drexel's objection to the proof of claim, excerpts from transcripts of the pretrial depositions of Abraham Silberstein and of Martin Askowitz, and the transcripts of an arbitration proceeding between Super Bowl against members of Drexel, copies of statements of Marilyn Berry and Martin Askowitz, statements of the Super Bowl account for September, October and November 1987 and stipulations dated January 21, 1992 and June 12, 1992.

The Rule 13(h) statement pursuant to the Local Bankruptcy Rules set forth Drexel's ***52** version of the events in the Super Bowl relationship and account with Drexel.

Super Bowl submitted its opposition to Drexel's 13(h) statement indicating what it believed raised a genuine issue to be tried. It also supplemented the documentary data to be considered by the Court.

In briefs submitted on the motion for partial summary judgment, Drexel argues, *inter alia:*

> 1) No violation of section 10(b) was involved
>
> a) alleged misrepresentations and omissions were not made "in connection with" the purchase or sale of a security
>
> b) the scienter requirement was not satisfied
>
> c) the alleged misrepresentations and omission are not material
>
> d) loss causation was not and could not be established
>
> e) no reliance was placed by Super Bowl on any misstatements or omissions.

Additionally, Drexel argued that no deceitful intent was involved so no breach of fiduciary duty could be asserted and that the common law claims of fraud and misrepresentation could not be sustained as there was no causation.

In opposition, Super Bowl asserted as genuine triable issues of material fact that "While Super Bowl's 'failure to execute' (viz., orders to sell out Super Bowl's account on October 7, 1987, not part of the partial summary judgment motion) are an essential part of Super Bowl's case, Drexel largely ignores an additional cause of action set forth in Super Bowl's Proof of Claim stating that 'Askowitz was taking a long-planned approximate one-month vacation to Israel in the relatively near future and would be unavailable to closely supervise, monitor and service the positions in the Super Bowl account.' " That alleged essential part of its case (which the motion for partial summary judgment addresses) was elaborated in its brief as:

> 1. "failure to disclose that the account would be turned over to a mere trading assistant while Askowitz was in Israel, based upon which Super Bowl relied in making numerous securities purchases, particularly in September 1987 are actionable under Section 10(b) of the Exchange Act;
>
> 2. "The deposition testimony of Mr. Silberstein that he personally believed Marty Askowitz was only 'negligent' does not foreclose a finding of scienter or intent on the part of Askowitz ... Askowitz's vacation had been planned as early as June 24, 1987 and paid for by September 14, 1987, ..."

The Bankruptcy Judge carefully analyzed the supposed triable issues cast up by Super Bowl and made the following findings of fact, ruling that only alleged negligence and breach of contract contentions of Super Bowl remained to be tried, albeit that the other supposed issues mentioned above were nevertheless reiterated and ventilated by Super Bowl on the trial itself and merged into the ultimate findings of fact and conclusions of law.

> "The Court: Counsel, in reference to the motion for partial summary judgment, I'm going to grant the motion for any number of reasons which I will state on the record, and what will remain is simply a negligence claim. It is very clear from the facts of this case, and I've gone through the exhibits which were presented and the deposition testimony, et cetera, and I think the parties have also stated this on a number of occasions, what has really happened here is what happened in the space of maybe a couple of days or a couple of hours between Super Bowl and the account representative, but partial summary judgment is appropriate with the pleadings, depositions, answers to interrogatories, admissions, together with the affidavits to show that there is not genuine issue of fact, material fact and that the moving party is entitled to judgment as a matter of law. And as counsel for Drexel has indicated, that they bear the initial burden of demonstrating the absence of a genuine issue of material fact, it discharges this burden by demonstrating to the Court that there is an absence of ***53** evidence to support the claims, whether Super Bowl has the burden of proof.

* * * * * *

"There are many, many claims by Super Bowl, but if you just take the proof of claim that was submitted, that alone on its face really shows that this is a negligence and a breach of contract. And I think that Super Bowl, taking all of the evidence as a whole, and I'm talking about the material evidence, I think really fails to establish a violation under Section 10(b) of the Exchange Act, or Rule 10(b)(5). I don't think the misrepresentations or admissions were made in connection with the sale of the security, purchase or sale. At most it was puffery. I think your client was sophisticated and knew that.

* * * * * *

"Second of all, there's no satisfaction of a scienter requirement there, and I think those words came out of your own client's mouth, at least the principal of the client, in the depositions. And any misrepresentations or omissions are certainly not material. Moreover, there's a failure even to establish any loss causation in reference to these types of claims.

* * * * * *

"Moreover, I don't think again, and I think this comes from your client's own deposition testimony, that there really was no deceitful intent here. This is clearly a negligence and breach of contract case, and on the basis of that I think it follows a fortiori that the common law claims of fraud and negligent misrepresentation must be dismissed.

* * * * * *

"So the only thing that is really here before us is the breach of contract and the negligence on behalf of Drexel. So the motion for partial summary judgment is granted.

* * * * * *

"... the remaining issues to be resolved by the court pertain to negligence and breach of contract ..."

III.

The findings on the remaining matters

By the Court:

"The crux of this case really is a case of credibility"

* * * * * *

"I think there's no doubt that Mr. Silberstein wanted personal service, I think ... that he received this service ... I think every stockbroker in the world promises and swears that they will provide the best service ever, and many professions do that. But I don't think that rises to the level of a contract, but I think it rises more to market puffery.

* * * * * *

"[B]ased upon Mr. Silberstein's testimony ... I think it's clear that he was many, many times the driving force behind this account. I think that it's true that he did rely upon Mr. Askowitz ... he learned a lot from Mr. Askowitz ... he grew to have his own level of sophistication ... he recognized his own sophistication and that he did control many of the trades. I think there's a very big difference between listening to someone's advice and then coming to your own conclusion, and I think many times that was what was done here, he used Mr. Askowitz for this, and I think that he was well aware of what was going on in the market.

* * * * * *

"It's clear that Drexel Burnham kept him informed about his account

* * * * * *

"Then we come to the event of Mr. Askowitz's vacation. I think it is very, very clear that Mr. Silberstein is an optimist. He has a very positive view of things, in the stock market they call that a bullish mentality, that the market will rise, and based upon a review of his positions which this court has done very, very carefully, it's clear that he was poised in the stock market for a rise in the stock market during the period of time in question. This, however, is a risky position and he used his judgment to hedge by ***54** using the three-prong strategy that Mr. Askowitz referred to. And here the testimony as to that strategy in reference to buying short and long to cover your positions.

* * * * * *

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> "I think the testimony is very consistent that he didn't want Mr. Askowitz to go on vacation ... I think that in terms of executing trades I find that Ms. Berry was perfectly capable of executing trades.
>
> I think that the stock positions were sold [on October 7, 1987], I think the parties testified that that was their plan, that she [Ms. Berry] then started selling the short positions and the other positions in an alphabetical order. I think it was the long positions in an alphabetical order.

* * * * * *

> So I think it's clear that she started to execute the program that the parties had agreed to in the telephone conversation which occurred on October 7th....

* * * * * *

> It's also clear that Ms. Berry stopped the program and I think that it stopped sometime probably just before noon ... it defies common sense, and I think that's the key here, that Ms. Berry would just stop a program when in most respects, ... that she would just stop, it defies common sense ... and I think at that point in time he [Silberstein] took control of his account ... I think Mr. Silberstein said ... I'm going to take control of my own account and ... Ms. Berry believed that ... [there] was a countermand of an order, and I think that's a fair understanding and I think she behaved that way. We then have testimony for several days and evidence which indicates that Mr. Silberstein claims that he told her to sell out my account, but in point of fact, he was doing roll downs in order to protect himself from what he perceived was going to be a large margin call which he could not bear.

* * * * * *

> I find that Drexel was not negligent, and if they were, any negligence whatsoever was certainly eliminated by Mr. Silberstein taking over the management of his own account.

* * * * * *

> I think it's clear he was sophisticated and I think he was making his own trades and on that basis there was no breach of contract and no negligence.

* * * * * *

> Now in reference to the supervisory practices ... there is really no evidence as to churning ... I don't find that there was any supervisory negligence on behalf of the officers at Drexel"....

IV.

The circumstances supporting the findings

In greater detail, and based on the foregoing essential findings the record on appeal presents the following background.

Super Bowl had been doing business with Drexel from 1983. In the summer of 1987, Silberstein decided to transfer Super Bowl's brokerage account with Charles Schwab to Drexel and to place it under the supervision of Martin Askowitz, a customer's representative and an acknowledged expert in put and call options trading. Askowitz promised constant personal attention, monitoring and necessary supervision of the account. Askowitz had been informally advising Silberstein on his trading of options conducted by Silberstein through Charles Schwab & Co., another securities broker. The Super Bowl account was received and was always maintained at Drexel as a non-discretionary account, Silberstein always maintaining control and direction of its securities transactions.

From inception, Silberstein and Askowitz talked stocks and options at least four to eight times a day on the telephone, virtually every business day and into the evenings and weekends from their homes and elsewhere.

Silberstein frequently followed recommendations from Askowitz but the trading ***55** instructions and orders to the brokers for the account were always his.

In September, 1987, undoubtedly spurred by a palpably bullish view of the future course of the market, Silberstein materially increased the number and size of the option transactions and positions in the account. Super Bowl had sold a large quantity of uncovered short put option contracts, in effect gambling on the continuance of the upward surge of the securities markets and impliedly wagering that the short put options which had nearby maturities would not be called before they expired.

On or about October 2, 1987, the day before the Jewish

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holiday of Yom Kippur, Askowitz, an Orthodox Jew, told Silberstein, a Secular Jew, that he and his family were about to vacation during the brief holiday period in Israel. This was a planned vacation for Askowitz. Silberstein sought to dissuade Askowitz from taking this vacation but the latter promised to keep in telephone contact with his office and would continue to supervise his able assistant, Ms. Marilyn Berry, during his absence, and assured Silberstein that other supervision and assistance was also available from the office manager and others in the office if called upon. On prior occasions when Askowitz was physically away from the office, Silberstein would place an order for the Super Bowl account with Ms. Berry, a registered representative. The latter would provide Silberstein with quotations but gave no advice on strategy; she did not suggest the purchase or sale of securities, options or combinations thereof.

Silberstein was an extremely sophisticated investor on his own with a net worth of $150 million approximately. He had been an active participant in the commodities and securities markets for decades, having purchased and sold common stocks, dealt in certificates of deposit, bonds, stocks and index options, foreign currency and futures. He had maintained brokerage accounts with the cream of Wall Street: Prudential Bache, Shearson Lehman, Merrill Lynch, Paine Webber, Charles Schwab, Morgan Stanley, Kidder, Peabody, and Drexel.

Silberstein owned and operated export-import, mining construction and manufacturing businesses and is a major shareholder and member of Banamex, the largest commercial bank in Mexico and member of the board of directors of Bancomer, the second largest commercial bank in Mexico. He is a man described to be highly opinionated and confident of his judgments, which swept all advice before him.

Silberstein always maintained non-discretionary trading accounts. He did not commit market decisions on his behalf to others. He alone made his trading decisions. He sought advice—but the judgments and decisions on trading were solely his. He both understood and was not afraid of investment risks.

On the morning of October 7, 1987, at about 10 a.m. (New York time) after a down market on the previous day, Berry, at Silberstein's request, arranged a conference call with Askowitz in Israel, herself in New York and Silberstein in Mexico City. During a lengthy conversation, on Askowitz's recommendation, Silberstein decided to liquidate, at the market price, all of the short option positions (puts that he had sold) together with his other puts and calls long in the account, as well as his stocks other than stock in Gerber Foods, Eli Lilly and Fannie Mae. The orders were to be entered as "at the market" orders. Askowitz recommended and Silberstein accepted his recommendation that the sequence of liquidation should be 1) to sell stocks first; 2) to close out short puts next in alphabetical order and 3) then to close out the remainder of the options; and Silberstein agreed and issued the instruction to proceed accordingly and Berry was so informed.

The market had been off on October 6th by approximately 90 points on the Dow Jones Industrial Averages. But by late morning of October 7th, the market gave signs of stabilizing, and indeed actually closed slightly up in price for the day.

Shortly after Berry began executing the sale of the stocks and just about the commencement of closing out some short puts at the market, Silberstein phoned Berry ***56** and, according to Berry, he told her that he had changed his mind and was cancelling his instructions with respect to wholesale liquidations at the market; and that he no longer wished the indiscriminate covering of his options at the market but instead, before closing out any more of the short options he desired to consider separately, one by one, the facts pertinent to the security under option as well as the option on which he was obligated relating thereto and that he would on the basis thereof decide "as to which ones to cover and which ones to leave alone" (Berry's testimony). On this countermand the proposed sell-out was immediately stopped—Berry was given no alternative—and the laborious and time-consuming process of considering the investment facts pertinent to each option and its related stock and waiting for his instruction whether to cover or not cover the option went on for most of the day thereafter. The evidence was that Berry and Silberstein would discuss every position from inception to include treating the stocks as the underlying security in conjunction with the options upon them. Then, "he instructed me exactly which ones he wanted to cover, and which ones he wanted to hold", said Berry. Interestingly, the earliest closeout order ticket shows that it was entered and closed out "at the market" price by circling the word "market" printed on the order ticket. The order tickets for transactions after the countermand show no entry thereof for coverage "at the market" but show they were entered as "day" orders; this is evidenced by the circling of that printed rubric on the order ticket and then a price is stated which is circled.

The order tickets to close out options on the next seven trading days, October 9, 12, 13, 14, 15 and 16th, also were similar tickets, bearing notations that each was entered as a day order, a price was stated and then circled,

presumably when reported by the order department. None of these later closeouts was recorded on the order ticket as entered as at the market orders.

Silberstein, in his testimony, denied giving the countermand and denied Berry's testimony that they reviewed each option and denied he gave her the instruction that day and the next six days "which ones to cover and which ones to leave alone," "which ones he wanted to hold." The trier of the facts did not credit those denials.

On October 8th the Dow Jones Industrial Averages were lower again and on October 9th Silberstein told Berry that it was imperative that he speak with Askowitz; that he would be at his Acapulco residence on Sunday, October 11th and wanted a telephone call there from Askowitz. Askowitz phoned Silberstein from Jerusalem on Sunday as requested, and learned from Silberstein that the October 7th orders had not gone forward as market orders.

Askowitz spent about 70 minutes with Silberstein on the telephone from Jerusalem to Acapulco. During the call he asked Silberstein why his positions had not been closed out at the market on October 7th as agreed in the lengthy phone talk on that day. The spurious answer he got was that Berry did not have any expertise in closing out options and that Askowitz had to come back and close out his position. Askowitz replied that he would speak to Berry in the morning and get back to Silberstein. Askowitz did phone Berry on the 12th and learned of the countermand on October 7th and the substitute procedure that Silberstein had ordered to be followed and the selective covering of options. Silberstein and Askowitz did not talk again until he returned to New York on the following Monday, October 19th. In the intervening few days Silberstein continued in control of his transactions and ordered certain "rolldowns" to be made in his account; this constituted buying back options about to expire and selling options on the same stock with the same striking price with a longer expiration date. Those roll-outs simply kept Silberstein in the market, manifesting thereby his chronic bullish frame of mind on the course of the market.

After the Sunday talk with Askowitz, Silberstein continued his dialogue with Berry from Mexico City each hour or so until on Thursday, October 15th when Silberstein went to Las Vegas and they continued to talk about two or three times a day ***57** from Las Vegas when Silberstein would contact her. All this time the market kept gyrating and options in the account were being covered or liquidated on Silberstein's instructions. The ledger of the account reflects these transactions.

Drexel, in accordance with its practice, delivered Super Bowl's daily Trade and Positions Sheets to Silberstein via DHL to Mexico, several times and also to Las Vegas to Caesar's Palace as well as sending him special sheets which reflected all his positions.

V.

The Market Collapse

The deluge on October 19, 1987 brought about substantial margin selling in the Super Bowl account. Silberstein had withdrawn huge amounts of cash from the account in the preceding weeks, $1,875,000 was wired to his bank in Los Angeles by Ms. Berry on October 6th, and $375,000 was wired to him by her on October 9th, 1987.

Upon arriving in New York on Black Monday, October 19th, Askowitz was in frequent contact with Silberstein in order to liquidate his positions to meet impending margin calls created by the crash and the cash withdrawals. After analyzing Berry's documentation for the Super Bowl account during his two weeks physical absence from the office, Askowitz concluded that several new positions had actually been added by Silberstein keeping certain positions alive through Silberstein's rolldowns by which he thereby remained in the market.

VI.

As a postscript to the foregoing, several interesting admissions emerged from Super Bowl's counsel, Mr. Sacher, during the argument of the appeal which may be worth noting as they bear on and corroborate the findings and conclusions reached by the Court below.

The Court inquired of counsel whether it was appellant's position that the physical presence of Askowitz at his office was bargained for as a condition of submitting the bulk of his accounts to Drexel. Counsel's response was

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> “not his physical presence but his presence either on the scene or by telephone from his home or wherever he was, was bargained for, that this person, this expert, would daily supervise this account. That was what was promised, that was what was expected ... It didn’t matter if he was in New York or in Israel ...”

Again by the Court:

> “the point of the matter is that Mr. Askowitz was reasonably available during that period of time, and the supposed lengthy visit of his to Israel during the holidays was not for an indeterminate time and to the preclusion of telephone consultation. Isn’t that correct?

By Mr. Sacher:

“That is correct ...”

By the Court:

> “At any time in the business transactions that were discussed here, did Askowitz have discretionary trading authority?”

Mr. Sacher:

“No.”

By the Court:

> “Was Silberstein in touch with Drexel at any time on October 8? [Same question asked about October 9, 12, 13 and 14]

Mr. Sacher:

[In each case] “Yes, sir.”

VII.

Super Bowl raised fraud related claims. These fall to the ground because the evidence gathered before and submitted at the inception of the trial showed that Silberstein had repeatedly conceded that Drexel had no fraudulent intent and that promised attention to the customer’s account were the customary assurances expected from every sales person that do not support a claim of breach of fiduciary duty or negligent misrepresentation.

[1] Super Bowl was neither a defrauded purchaser of stocks and options or a defrauded seller. Its supposed injury did not stem from any trading that Drexel did. No ***58** tortious conduct of Drexel actually caused harm to Super Bowl. A brokerage account investor bringing a securities fraud claim cannot complain about a fraud that did not cause it any harm.

In short, the Super Bowl claims spelled out as federal securities violations, do not fall within the zone of interests protected by the federal statutes under which Super Bowl seeks relief.

Silberstein flatly conceded that there was no scienter on the part of Askowitz or Drexel and plainly there was no showing that failure to advise Silberstein of Askowitz’s vacation plans was a proximate cause of any damages to Silberstein who was entirely free to submit orders to or withdraw from Drexel at all times.

In his deposition made part of the record Silberstein asserted

> “I really think Askowitz, the only wrongdoing of him was the negligence of going away after taking such a big account and such big positions.”

Askowitz testified that he told Silberstein of his

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availability during his holiday:

> "I said Abraham, I'll do anything you want me to do. I said the people who are in the office will continue to be in the office. I have every intention of being in perpetual contact with the office. It wasn't that I was going to a country that had no telephone communications."

Again, in the record before the Bankruptcy Judge:

> "Q: ... you are not accusing Marty Askowitz of intentionally defrauding you?
>
> "A: No, no, no ...
>
> "Q: Do you think Marty Askowitz ever did anything to intentionally hurt you?
>
> "A: No."

The resolution of the issues depended on an assessment of the credibility of the witnesses. Having considered their testimony and all the documentary data bearing thereon, the probabilities, the circumstances and the motivations, the findings reached were not an abuse of discretion. The record supports the rulings of the trier of the facts.

Bankruptcy Rule of Procedure 8013 provides that:

> On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

The authorities are legion, in a variety of contexts, that the facts of this case do not support a legal claim of federal or common law fraud.

Super Bowl's losses were proximately caused by Silberstein's decision to countermand the sell-out order on October 7, 1987 and to retain certain positions in the account from October 7 and day to day to October 19. As the Second Circuit aptly expressed it in another connection:

> [t]he loss at issue was caused by the Bennett's own unwise investment decisions, not by U.S. Trust's misrepresentations.

* * * * * *

> allegations concerning misrepresentations ... fail to establish the necessary loss causation; there is simply no direct or proximate relationship between the loss and the misrepresentation.[1]

Bennett v. United States Trust Co. of New York, 770 F.2d 308, 314 (2d Cir.1985), *cert. denied,* 474 U.S. 1058, 106 S.Ct. 800, 88 L.Ed.2d 776 (1986).

[2] "In order to prove a claim under section 10(b), or Rule 10b–5, a plaintiff must show ... that the defendant, with scienter, made a misrepresentation of material fact or failed to disclose a material ***59** fact, and that the plaintiff relied on the misrepresentation or omission and suffered a loss as a result of the misrepresentation or omission." *Burke v. Jacoby,* 981 F.2d 1372, 1378 (2d Cir.1992). The elements of a Rule 10b–5 claim are similar in substance to those of a claim for common law fraud, but Rule 10b–5 additionally requires the fraudulent activity to be conducted "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b–5.

Courts in this Circuit have held that "[m]isrepresentations or omissions involved in a securities transaction, but not pertaining to the securities themselves, cannot form the basis of a violation of Section 10(b) or Rule 10b–5." *Manufacturers Hanover Trust Co. v. Smith Barney, Harris Upham & Co.,* 770 F.Supp. 176, 181 (S.D.N.Y.1991) (Connor, J.); *see also Pross v. Katz,* 784 F.2d 455, 459 (2d Cir.1986) (defendant's fraudulent acts must be "integral to the purchase and sale of the securities in question"); *Chemical Bank v. Arthur Andersen & Co.,* 726 F.2d 930, 941–44 (2d Cir.), *cert. denied,* 469 U.S. 884, 105 S.Ct. 253, 83 L.Ed.2d 190 (1984) (incidental involvement of securities as collateral for loan obtained through misrepresentation regarding financial condition of company was insufficient to meet "in connection" requirement); *Moran v. Kidder Peabody & Co.,* 617 F.Supp. 1065, 1068 (S.D.N.Y.1985), *aff'd,* 788 F.2d 3 (2d Cir.1986) ("misstatements [that] are of a general nature

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and not in reference to any particular security" can not support a claim under Rule 10b–5).

[3] [4] [5] In this case, the complaint is that were an account to be opened it would be serviced diligently; that can not be connected to any particular subsequent transactions and such general misrepresentations can not support a Rule 10b–5 claim. *See McCoy v. Goldberg,* 748 F.Supp. 146, 150 (S.D.N.Y.1990) (an experienced broker's general statement in an effort to get business that he would personally handle plaintiff's account did not support federal securities fraud claim, which must pertain "to the value or quality of any specific security"); *Siegel v. Tucker, Anthony & R.L. Day, Inc.,* 658 F.Supp. 550, 553 (S.D.N.Y.1987) (same). Furthermore, the alleged misrepresentation or omission can not be linked to the alleged failure to sell-off Super Bowl's account in October 1987, because a failure to execute a purchase or sale order is not "in connection" with the purchase or sale of securities. *See Moran v. Kidder Peabody & Co.,* 617 F.Supp. 1065, 1067 (S.D.N.Y.1985).[2] We accordingly affirm the Bankruptcy Court's finding that, in spite of Silberstein's claims that the alleged misrepresentations induced him later on into making numerous securities purchases, there is an insufficient connection between the alleged misstatements and any Super Bowl transactions.

[6] Even if Super Bowl's contention were credited that the alleged misrepresentations and omission influenced its decision to purchase certain options, such purchases could at most be a "but-for" cause of the losses sustained in the October 19 stock market crash, and therefore cannot support Super Bowl's claim under Rule 10b–5. *See Bloor v. Carro, Spanbock, Londin, Rodman & Fass,* 754 F.2d 57, 61–62 (2d Cir.1985) (in Rule 10b–5 claim, the "required causal connection may not be supplied by "but for" allegations").

[7] [8] Super Bowl's common law fraud claim suffers from the same infirmities as its Rule 10b–5 claim. Under New York law, "[t]he elements of common law fraud are a material false misrepresentation, an intent to defraud thereby, and reasonable ***60** reliance on the representation, causing damage to the plaintiff." *Katara v. D.E. Jones Commodities, Inc.,* 835 F.2d 966, 970–71 (2d Cir.1987). Each element must be established by clear and convincing evidence. *Id.* Under this standard, Super Bowl's common law fraud claim fails to raise a triable issue of fact with respect to causation, scienter, and materiality. *See Bennett,* 770 F.2d at 316 (affirming dismissal of common law fraud claim on same basis as 10b–5 claim); *Freschi v. Grand Coal Venture,* 767 F.2d 1041, 1050 (2d Cir.1985), *rev'd on other grounds,* 478 U.S. 1015, 106 S.Ct. 3325, 92 L.Ed.2d 731 (1986) (applying Rule 10b–5 findings to adjudication of common law fraud claims); *Weinberger v. Kendrick,* 698 F.2d 61, 78 (2d Cir.1982), *cert. denied,* 464 U.S. 818, 104 S.Ct. 77, 78 L.Ed.2d 89 (1983) (comparing Rule 10b–5 claims to common law fraud claims).

[9] An action for breach of a fiduciary duty also "requires a showing of 'deceitful intent' on the part of the fiduciary" and no evidence supporting a deceit was shown, to the contrary, Silberstein himself negated any purpose to deceive on the part of Askowitz. *See Flickinger v. Harold C. Brown & Co.,* 947 F.2d 595, 599 (2d Cir.1991).

[10] [11] Super Bowl claims that an issue of fact existed whether Askowitz's failure to inform Silberstein of his vacation and his promises of constant, personal attention constituted negligent misrepresentation. Under New York law, the elements of negligent misrepresentation are: (1) carelessness in imparting words, (2) upon which others were expected to rely, (3) upon which they did act or failed to act, (4) to their damage, and (5) the author must express the words directly, with knowledge they will be acted upon, to one whom the author is bound to by some relation or duty of care. *White v. Guarente,* 43 N.Y.2d 356, 362, 401 N.Y.S.2d 474, 478, 372 N.E.2d 315, 319 (1977); *Rotanelli v. Madden,* 172 A.D.2d 815, 569 N.Y.S.2d 187, 188 (2d Dep't 1991), *appeal denied,* 79 N.Y.2d 754, 581 N.Y.S.2d 281, 589 N.E.2d 1263 (1992).

No evidence to support such a contention was adduced directly or by inference. Moreover, Super Bowl's negligent misrepresentation claim suffered from infirmities with respect to the materiality of the alleged misrepresentations, and lack of proximate cause.

VIII.

Costs are due to the prevailing party

[12] Bankruptcy Rule of Procedure 7054(b) provides that:

> The court may allow costs to the prevailing party except when a statute of the United States or these rules otherwise provides.

Drexel prevailed on all issues. No equitable reason appears for taxing the bankrupt estate for the expense of a trial in which it was, as here, put to great expense and costs and prevailed.

Drexel should be awarded its costs of suit to be taxed by the Clerk to the extent permitted by Rule 7054. The denial of costs is reversed.

IX.

The remaining contentions of appellant have each been considered and found lacking in merit.

Judgment should be entered in the Bankruptcy Court consistent with the foregoing.

All Citations

151 B.R. 49, Fed. Sec. L. Rep. P 97,601

Footnotes

1 As stated by the Second Circuit Court of Appeals in *Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb, Inc.,* 967 F.2d 742, 747 (2d Cir.1992), the causation analysis in a Rule 10b–5 claim is analogous to that of a common law tort claim: "The causation analysis encompasses two related, yet distinct elements—reliance and causation—elements that, in effect, correspond respectively with common law notions of "but-for" and proximate causation."

2 Super Bowl relies heavily on *Marbury Management, Inc. v. Kohn,* 629 F.2d 705 (2d Cir.), *cert. denied,* 449 U.S. 1011, 101 S.Ct. 566, 66 L.Ed.2d 469 (1980). In that case, a trainee at a brokerage firm misrepresented his expertise by claiming he was a fully-qualified broker and a portfolio management specialist in order to induce plaintiffs to invest in particular securities. However, as the Court of Appeals pointed out in *Bennett v. United States Trust Co. of New York,* 770 F.2d 308, 314 (2d Cir.1985), the broker's alleged misrepresentations in that case related directly to the value of particular securities in a particular transaction. In contract with *Marbury,* the general misrepresentations and omission alleged by Super Bowl in the present case do not related to the value of any particular securities and do not pertain to a particular purchase or transaction.

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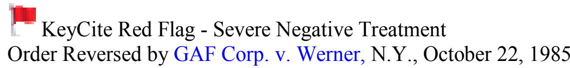
KeyCite Red Flag - Severe Negative Treatment
Order Reversed by GAF Corp. v. Werner, N.Y., October 22, 1985

106 A.D.2d 41
Supreme Court, Appellate Division, First Department, New York.

GAF CORPORATION, Plaintiff-Appellant,
v.
Jesse WERNER, Defendant-Respondent,
and
T. Roland Berner, Peter Bosshard, Augustine R. Marusi, Herman Sokol, Nolan B. Sommer and Robert Spitzer, Defendants. (Action No. 1).
Application of GAF CORPORATION, Petitioner-Appellant,
For an Order Pursuant to Article 75 of the CPLR Staying Arbitration of a Certain Controversy
v.
Jesse WERNER, Respondent-Respondent.
(Proceeding No. 2).
Jesse WERNER, Plaintiff-Respondent,
v.
GAF CORPORATION, Defendant-Appellant,
and
Samuel J. Heyman, Daniel T. Carroll, Robert C. Wilson, Sanford Kaplan, Jacob E. Goldman, William P. Lyons, Scott A. Rogers, Jr., Edward E. Shea, William Spier, Joseph D. Tydings, Robert H. Beber and Richard F. Smith, Defendants. (Action No. 3).

Jan. 22, 1985.

Synopsis

The Supreme Court, New York County, Martin Evans, J., entered order, inter alia, denying corporation's motion to stay arbitration of former chairman of the board's employment agreement dispute, granting chairman's cross motion to compel arbitration, granting corporation's cross motion for consolidation and sua sponte staying trial of actions with respect to certain issues, and corporation appealed. The Supreme Court, Appellate Division, Ross, J., held that interests of justice required that arbitration be stayed and consolidated actions concerning alleged mismanagement, corporate unfairness, waste and self-dealing by chairman and former board members be allowed to proceed to trial.

Order modified and otherwise affirmed.

West Headnotes (2)

[1] **Commerce**
Arbitration

Federal Arbitration Act governed arbitration pursuant to employment agreement between former chairman of the board and corporation which had shareholders living in various parts of United States and business operations carried on in interstate commerce. 9 U.S.C.A. § 1 et seq.

1 Cases that cite this headnote

[2] **Alternative Dispute Resolution**
Stay of Arbitration

Interests of justice required that arbitration between former chairman of the board and publicly held corporation be stayed and that consolidated actions concerning alleged mismanagement, corporate unfairness, waste and self-dealing by chairman and former board members be allowed to proceed to trial where arbitrable issue of employment agreement was but minor part of larger controversy, there was strong danger that arbitrators would be unable to separate arbitrable issue from nonarbitrable issues and individual board members were not parties to arbitration.

Cases that cite this headnote

Attorneys and Law Firms

***41** Norman Solovay, New York City, of counsel (Harvey J. Goldschmid, David R. Foley and Mark H. Moore, New York City, with him on brief; Holtzmann, Wise & Shepard, New York City, attorneys), for plaintiff-appellant.

Arthur Richenthal, New York City, of counsel

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(Richenthal, Abrams & Moss, New York City, attorneys), for respondent.

Before KUPFERMAN, J.P., and ROSS, CARRO and FEIN, JJ.

Opinion

ROSS, Justice.

GAF Corporation (GAF) manufactures and sells chemicals, photographic products, and building materials. It is a Delaware ***42** corporation and its principal place of business is located in New York County. In 1965, GAF became a publicly held company and its common and preferred stock are listed and traded on the New York Stock Exchange. This corporation had approximately 45,000 shareholders in 1983.[1]

Jesse Werner (Werner) has spent his entire career with GAF, commencing in 1938 as a research chemist. Over the next twenty-six years Werner rose through the corporate ranks, and in 1964 he was elected Chairman of the Board of Directors. Thereafter, he held that post until December 1983, when he was terminated by new management, which had won a proxy fight.

In the two years preceding the firing of Werner, five separate shareholder derivative actions had been filed against Werner and the members of the Board of Directors (the old Board) that were serving with him. The common thread that ran through these derivative actions was that Werner and the old Board were allegedly guilty of acts of financial mismanagement, corporate unfairness, waste and self dealing. In particular, those actions charged: (1) that Werner, while Chairman, improperly controlled the old Board by his influence over the salaries, emoluments and other benefits that these persons received from GAF; (2) that allegedly this improper control led the old Board to approve, in 1981, a compensation package for Werner, which has an alleged value of about $5,000,000; (3) that allegedly this old Board improperly approved the excessive expenditure of GAF funds in waging a proxy battle, solely to protect Werner's and their position at GAF, and Werner's compensation package; and, (4) that allegedly both the approval of the Werner compensation package and the funds to finance this proxy fight constituted breaches of fiduciary duty to the shareholders ****14** by Werner and the old Board members.

The subject compensation package consists of two parts. First, there is a written employment agreement between GAF and Werner, dated September 17, 1981, and it provides, in pertinent part: (a) that its term is five years; (b) that his base salary is fixed at $425,000 for the first year and each year thereafter it increases by $25,000; (c) that lifetime dental, medical and hospital benefits are provided to Werner and his wife; and, (d) that he is provided supplemental retirement benefits. Second, during the period 1977–1981, Werner was granted stock options, to purchase 120,000 shares of GAF common stock, pursuant to GAF's 1975 stock option plan.

***43** Following the ouster of Werner and the old Board, the successor Board of Directors (the new Board) appointed a Special Committee, chaired by former United States Senator Joseph Tydings (Tydings), to examine into, *inter alia,* the merits of the charges set forth in the five derivative suits,[2] mentioned *supra,* and make recommendations. Upon the basis of its investigation, this Committee reported to the new Board that these suits contained merit, and recommended that it would be in the best interest of GAF to cause these individual actions to be discontinued, and to prosecute in the corporate name, allegations of financial mismanagement, corporate waste, self dealing and breach of fiduciary duty against Werner and the old Board, which allegations related to the old Board's approval of Werner's compensation package and the financing of the proxy struggle. The new Board adopted this recommendation and commenced action.

The instant complaint in this GAF action (hereinafter referred to as the consolidated action) deals in the first cause of action with the alleged improprieties of Werner's compensation package, including that portion of the package that relates to the employment agreement, and deals in the second cause of action with the alleged improprieties in making available excessive funds to fight the proxy battle. GAF seeks to recover in this action compensatory and punitive damages from Werner and the old Board for their misconduct.

On or about December 13, 1983, before the new Board instituted GAF's instant action, they stopped paying Werner his salary and benefits under the 1981 employment agreement, mentioned *supra.* In response to the new Board ceasing to pay him a salary and benefits, Werner, by registered letter, dated January 18, 1984, notified the new Board of GAF that they were allegedly in breach of the employment agreement, and that he demanded arbitration of this dispute, pursuant to paragraph 12 of that agreement. Paragraph 12 reads, in pertinent part:

> "In the event that *any* disagreement of *any* kind shall arise between the parties hereto as to any matter or thing whatsoever hereunder, such disagreement shall be arbitrated in the City of New York...." [emphasis

added].

***44** In timely fashion, GAF moved to stay arbitration, upon the basis that the dispute about the employment agreement was only a small part of the controversy between the parties, which controversy is fully set forth in the consolidated action, and that the disposition of all of the issues in one Court proceeding outweighs the public policy in favor of arbitration.

Also, prior to GAF commencing its consolidated action, Werner began his own Court action against GAF to recover compensatory and punitive damages, in view of the fact that the new Board of GAF had refused to honor Werner's exercise of the ****15** stock option portion of the compensation package.

Now, after Werner's demand for arbitration and the institution of his action, GAF launched its consolidated Court action. The two actions and the arbitration proceeding were all begun within two months of one another. These three matters are identified in the caption of this lawsuit in the following manner: Action No. 1 is GAF's consolidated Court action, Proceeding No. 2 is GAF's application to stay arbitration, and Action No. 3 is Werner's Court action concerning the stock option.

Werner responded to GAF's petition to stay arbitration by cross-moving to, *inter alia,* compel arbitration. Furthermore, GAF cross-moved to, *inter alia,* consolidate for trial GAF's action with Werner's action.

Special Term, *inter alia,* (1) denied GAF's motion to stay arbitration; (2) granted Werner's cross-motion to compel arbitration; (3) granted GAF's cross-motion to consolidate the two actions; and, (4) *sua sponte* stayed the trial of the consolidated actions, only insofar as the issues that relate to the employment agreement which the arbitration proceeding is to consider. We disagree.

[1] Even though GAF moved to stay arbitration under New York law (CPLR 7503, subdivision (b)), the instant arbitration is governed by the Federal Arbitration Act (9 U.S.C. sections 1 and 2, et seq.) since the employment agreement affects interstate commerce. As mentioned *supra,* GAF is a Delaware corporation with a principal office in New York County, it has thousands of shareholders who live in various parts of the United States, and its business operations are carried on in interstate commerce. The Supreme Court of the United States recently held, unequivocably, that the Federal Arbitration Act preempts State law, when the subject contract affects interstate commerce (*Southland Corp. v. Keating,* 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984)).

***45** Although the United States Congress, by enacting the Federal Arbitration Act, has "declared a national policy favoring arbitration"[3] (*Southland Corp. v. Keating,* cited *supra,* at page 852, 104 S.Ct. at page 858), there are instances when Federal Courts will stay arbitration of one part of a controversy while another part of the controversy, not subject to arbitration, is permitted to proceed first in a judicial forum. Some examples of Federal Courts staying arbitration, while allowing the Court action to move forward, are: (1) in cases involving, *inter alia,* antitrust issues, which on public policy grounds have been held inappropriate for resolution by arbitration,[4] upon the basis that the antitrust issues so permeate the controversy that the arbitrator can "not easily separate the antitrust issues from the other arbitrable issues and [can] not easily decide the arbitrable issues without inquiry into the antitrust issues" (*Applied Digital Tech., Inc. v. Continental Cas. Co.,* 576 F.2d 116, 118 (7th Cir.1978)) [material in brackets added]; (2) in cases involving, *inter alia,* Federal securities law issues, which are non-arbitrable under Federal law,[5] upon the basis "that when it is impractical if not impossible to separate out non-arbitrable federal securities law claims from arbitrable contract claims, a court should deny arbitration" (*Sibley v. Tandy Corp.,* 543 F.2d 540, 543 (5th Cir.1976), *reh. denied* 547 F.2d 286, *cert. denied* 434 U.S. 824, 98 S.Ct. 71, 54 L.Ed.2d 82 (1977)), (3) in a case involving a property damage suit, where there was an arbitrable issue of the insurer's duty to defend, the arbitration of that issue was stayed while an issue of liability, which was not subject to arbitration, was allowed to go to trial, upon the basis that there was "the possibility of conflicting fact-finding" between the arbitrator and the Court on ****16** the key issue of liability (*Petroleum Helicopters v. Boeing-Vertol Co.,* 478 F.Supp. 84, 87 (E.D.La.1979), *aff'd* 606 F.2d 114 (5th Cir.1979)); and, (4) in a case involving, a breach of contract, where the non-arbitrable claims far outnumbered the arbitrable ones, upon the basis that "under all the circumstances, the interests of the parties would best be served by staying the arbitration" (*Bell Canada v. ITT Telecommunications Corp.,* 563 F.Supp. 636, 641 (U.S.D.C.S.D.N.Y.1983)).

[2] Applying the legal concepts contained in these Federal cases, cited *supra,* to the facts of the instant case, which involves an action brought by a corporation, whose stock is publicly held by thousands of shareholders, we conclude that the interests of justice require that arbitration be stayed and the consolidated ***46** actions be allowed to proceed to trial. We find the following factors significant in making our determination:

1. that the arbitrable issue of the employment agreement is only a minor part of the larger

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> controversy involving non-arbitrable issues such as corporate waste, breach of fiduciary duties, mismanagement and issuing misleading information in the proxy contest;
>
> 2. that, if the arbitration is permitted to go forward, there is a strong danger that the arbitrators will be unable to separate the arbitrable issue of the employment agreement from the non-arbitrable issues and the result may be inconsistent fact-finding between the arbitrators and the Court on the non-arbitrable issues; and,
>
> 3. that the individual members of the old Board, who are defendants in the GAF consolidated action, are not parties to the arbitration and we are concerned that the arbitrators may make an award that may have collateral effect in the consolidated actions.

Werner argued that the Court can only stay the arbitration if the ground for the stay is specifically set forth in CPLR 7503, otherwise the Court has no power to act. The Courts have consistently held to the contrary. CPLR 2201 has been construed as permitting a stay to "... avoid a multiplicity of suits, or ... prevent litigation of an issue which should more appropriately be litigated in the other action...." (2A Weinstein, Korn & Miller, New York Civil Practice paragraph 2201.03, at page 22–11). Further, the Court has specifically exercised its inherent power to stay an arbitration pending the trial of a related lawsuit (*Matter of the Arbitration Between Sun Rubber Company, and New York Credit Men's Adjustment Bureau, Inc.,* 278 App.Div. 933, 105 N.Y.S.2d 545 (1st Dept.), aff'd 303 N.Y. 961, 106 N.E.2d 54). Further, almost fifty years ago, Justice Cardozo wrote for a majority of the United States Supreme Court, in *Landis v. North American Co.,* 299 U.S. 248, 254–255, 57 S.Ct. 163, 165–166, 81 L.Ed. 153 (1936):

> "... [P]ower to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. How this can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance ..." [material in brackets added].

Our decision in the instant case meets this *Landis* test of maintaining an even balance, without prejudicing either party.

Accordingly, the order, Supreme Court, New York County (Martin Evans, J.), entered May 15, 1984, which, *inter alia,* (1) denied GAF's motion to stay arbitration, (2) granted Werner's cross-motion to compel arbitration, (3) granted GAF's cross-motion to consolidate the two Court actions, and, (4) *sua sponte* ***47** stayed the trial of the consolidated actions insofar as the issues related to the employment agreement which the arbitration proceeding is to consider, should be modified, on the law, the facts and in the exercise of discretion, to the extent of (1) granting the petition to stay arbitration; (2) denying the cross-motion to compel arbitration; (3) vacating the stay of ****17** the trial of those issues pertaining to the employment agreement, and otherwise affirmed, with costs.

Order, Supreme Court, New York County (Martin Evans, J.), entered on May 15, 1984, unanimously modified, on the law, the facts and in the exercise of discretion, to the extent of (1) granting the petition to stay arbitration; (2) denying the cross-motion to compel arbitration; (3) vacating the stay of the trial of those issues pertaining to the employment agreement, and otherwise affirmed. Appellant shall recover of respondent $50 costs and disbursements of this appeal.

All concur.

All Citations

106 A.D.2d 41, 484 N.Y.S.2d 12

Footnotes

1 *GAF Corp. v. Heyman,* 724 F.2d 727, 728 (2nd Cir.1983).

2 The titles of the derivative actions are: *Stotland v. GAF Corporation, Jesse Werner, et al.* (Delaware Chancery Court, New Castle County, Civil Action No. 6876); *Miller v. GAF Corporation, Jesse Werner, et al.* (Delaware Chancery Court, New Castle County, Civil Action No. 6795); *Weinberger v. Jesse Werner, et al.* (Supreme Court, New York County, Index No. 10403/83); *Heyman v. GAF Corporation, Jesse Werner, et al.* (U.S.D.C.S.D.N.Y.) (Civil Action No. 82–7442); and *Heyman v. GAF Corporation, Jesse Werner, et al.* (U.S.D.C.S.D.N.Y.) (Civil Action No. 83–2106).

3 New York State also has announced a policy that favors and encourages arbitration (*Nationwide Gen.Ins.Co. v. Investors Ins.Co.,* 37 N.Y.2d 91, 95, 371 N.Y.S.2d 463, 332 N.E.2d 333 (1975)).

4 *American Safety Equipment Corp. v. J.P. Maguire et al.,* 391 F.2d 821 (2nd Cir.1968).

5 *Wilko v. Swan,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953).

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21 Misc.3d 1133(A)
Unreported Disposition
(The decision of the Court is referenced in a table in the New York Supplement.)
Supreme Court, New York County, New York.

MUNICIPAL HIGH INCOME FUND, INC., Smith Barney Managed Municipals Fund, Inc., Managed Municipals Portfolio, Inc., Managed Municipals Portfolio II, Inc., Smith Barney Income Funds–Smith Barney Municipal High Income Fund, and Smith Barney Muni Funds–National Portfolio, Plaintiffs,
v.
GOLDMAN, SACHS & CO., and R.W. Beck, Inc., Defendants.
Goldman, Sachs & Co., Third–Party Plaintiff,
Western Asset Management Company, a subsidiary of Legg Mason Inc., f/k/a Smith Barney Fund Management LLC, formerly a subsidiary of Citigroup, Inc., f/k/a Greenwich Street Advisors, a division of Smith Barney Mutual Funds Management Inc., Third–Party Defendant.

No. 600012/06.
|
Oct. 30, 2008.

Attorneys and Law Firms

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Warren Hutchison, Esq. (LeClair Ryan PC), for defendant R.W. Beck.

Donald F. Luke, Esq. (Jaffe Asher LLP), Mark H. Moore, Esq. (Jaffe Asher LLP), for defendant Western Asset Mgt.

Opinion

CHARLES E. RAMOS, J.

***1** Defendants Goldman, Sachs & Co. (Goldman) and R.W. Beck Inc. (Beck) move separately, pursuant to CPLR 3212, to dismiss the complaint on statute of limitation grounds. Plaintiffs Municipal High Income Fund, Inc., Smith Barney Managed Municipals Fund, Inc., Managed Municipals Portfolio, Inc., Managed Municipals Portfolio II, Inc., Smith Barney Income Funds–Smith Barney, Municipal High Income Fund, and Smith Barney Muni Funds–National Portfolio (collectively "plaintiffs") oppose the motions and seek a trial.

Summary Judgment

Pursuant to CPLR 3212(b), a court will grant a motion for summary judgment upon a determination that the movant's papers justify holding, as a matter of law, "that there is no defense to the cause of action or that the cause of action or defense has no merit." Further, all of the evidence must be viewed in the light most favorable to the opponent of the motion. *Insurance Co. of N.Y. v. Central Mut. Ins. Co.,* 47 AD3d 469 (1st Dept 2008).

The proponent of a motion for summary judgment must make a prima facie showing of entitlement to judgment as a matter of law by tendering sufficient evidence to eliminate any material issues of fact as to the claim or claims at issue. *Alvarez v. Prospect Hosp .,* 68 N.Y.2d 320, 324 [1986]. Failure to make such a showing requires denial of the motion, regardless of the sufficiency of the opposing papers. *Winegrad v. New York Univ. Med. Ctr.,* 64 N.Y.2d 851, 853 [1985]).

Once the prima facie showing has been made, the party opposing a motion for summary judgment bears the burden of "produc[ing] evidentiary proof in admissible form sufficient to require a trial of material questions of fact" *Amatulli v. Delhi Constr. Corp.,* 77 N.Y.2d 525 (1991).

Background[1]

On May 27, 1998, the Michigan Strategic Fund, a state agency responsible for economic development, sold $80 million in Resource Recovery Limited Obligation Revenue Bonds (the "Bonds") to finance the conversion of the Central Wayne County Sanitation Authority Municipal Solid Waste Incineration Project into a waste-to-energy project (the "Project"). Goldman was the underwriter for the Bonds and prepared a Limited Offering Memorandum (LOM). Beck prepared an

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Independent Engineer's Report for inclusion in the LOM concerning the feasibility of constructing and operating the Project (the "Beck Report").

Plaintiffs, six municipal bond mutual funds, and admittedly sophisticated investors, purchased $50.5 million of the Bonds. The interest and principal on the Bonds were payable solely from revenues that were projected to be generated by the Project. These revenues stemmed from tipping fees charged in exchange for the dumping of waste, the sale of metals recovered from the waste, and the electricity generated by incinerating the waste.

The Beck Report contained, among other things, annual projections of tipping fees for the life of the Bonds, a detailed description of the methodology by which the projections were developed, and the assumptions on which they were based. The Beck Report projected that tipping fees would be $18.50 per ton in 1998, $19.51 in 2000, $20.04 in 2001, $20.58 in 2002, and further escalations thereafter. Plaintiffs understood that tipping fees would represent about 51% of total Project revenues.

***2** From the outset, the Project encountered difficulties with regard to construction and operation, which resulted in the shutdown of at least one boiler for varying periods of time. Separate and apart from these setbacks, the projected tipping fees were never met.

On June 26, 2000, Beck released a report to the plaintiffs projecting "a significant shortfall in the availability of funds to meet the monthly requirements," including interest payable on the Bonds. The reasons for the shortfall, according to Beck, included a "softening of the market for spot market disposal, and a market that had become "increasingly competitive during the last two years ..."

Beginning in May 2001, plaintiffs received reports from the Project specifically listing, among other things, the actual tipping fees on a month-by-month basis. The tipping fees ranged mostly on the low end of a scale ranging from $9.22 to $15.51 in 2001 and 2002, below projections. Due to these shortfalls in revenue, plaintiffs decided to enter into a Forbearance Agreement ceasing all accrual and payment of interest on the Bonds.

On July 13, 2001, the portfolio manager e-mailed plaintiffs stating: "[T]he project has not been able to improve its financial position and has now depleted the debt service reserve fund. At this time we have no reason to believe that the project is likely to show any improvement in the near term." On October 12, 2001, plaintiffs formally designated the Bonds a matter of heightened credit concerns. As of April 30, 2002, the plaintiffs had written down the value of the Bonds by about $20.2 million. By May 2003, plaintiffs valued their total holdings of the Bonds at $12.625 million, representing a $37.875 decline in value.

Plaintiffs first commenced an action against Beck in Michigan, alleging negligent misrepresentation. Applying New York law, the Michigan court dismissed the case as barred by the Martin Act. After the filing of a third amended complaint, plaintiffs alleged that Goldman and Beck defrauded them. The case was dismissed again, this time on *forum non-conveniens* grounds.

On May 5, 2005, nearly seven years after the plaintiffs purchased the Bonds, and after several years has passed since discovery that Beck's projections were inaccurate, the plaintiffs commenced this action alleging claims for fraudulent misrepresentation and non-disclosure against Goldman and Beck.

Discussion

A cause of action for fraud must be commenced within six years of the date of the fraudulent act, or within two years of the date the fraud was, or with reasonable diligence could have been, discovered.[2] CPLR 213(8). An inquiry as to the time a reasonably diligent plaintiff could have discovered the fraud turns upon whether a person of ordinary intelligence possessed knowledge of facts from which the fraud could be reasonably inferred. *Rite Aid Corp. v. Grass,* 48 AD3d 363 (1st Dept 2008).

However, an analysis of a plaintiff's duty to inquire may not be necessary where it can be proven by undisputed evidence that the plaintiff had actual knowledge of the facts giving rise to an action for fraud, and did not initiate the action within the statutory time. See generally, *Avalon LLC v. Coronet Properties Co.,* 306 A.D.2d 62, 63 (1st Dept), appeal denied, 100 N.Y.2d 513 (2003)(case dismissed on statute of limitation grounds where plaintiff had actual knowledge of the fraud prior for two years before commencement of the action).

***3** Having positive knowledge of fraud is not required to commence the running of the two-year statute of limitations. *Watts v. Exxon Corp.,* 188 A.D.2d 74 (3rd Dept 1993). Rather, in order to start the limitations period regarding discovery, a plaintiff need only be aware of enough operative facts so that, with reasonable diligence, it could have discovered the fraud. *Id.* In other words, all

that is necessary are sufficient facts to suggest to a person of ordinary intelligence the probability that he/she "may have been defrauded." *Id.*

Therefore, even if every element of the fraud was not actually known, such as Beck and Goldman's scienter, plaintiffs had every opportunity to initiate a timely action for fraud upon information and belief[3] (along with negligent misrepresentation) when it first became aware, or should have become aware, that material misrepresentations had been made. Failure to do so is fatal a claim for fraudulent misrepresentation, as barred by the statute on limitations. *See Waters of Saratoga Springs, Inc. v. State of New York,* 116 A.D.2d 875 (3rd Dept) affirmed, 68 N.Y.2d 777 (1986).

There is ample evidence cited in the record pointing to plaintiffs' actual knowledge, before May 5, 2003, of Beck's alleged misrepresentation of the tipping fee projections which were published in the Official Statement. A non-exhaustive list is as follows:

1. October 6, 1999: After meeting with the plant operator, plaintiff's research director, Mike Maher and analyst Rocco Gagliardi wrote that "per the Official Statement," "tipping fees are low in the area right now." Maher cautioned: "short term operations and profitability of the facility has to be questioned."

(Exhibit 5, Barrett Affidavit).

2. April 28, 2000: Gagliardi learned from the plant operator that "lower than expected tipping fees" partly caused "a loss of over $3 million in revenues." Senior portfolio manager Joseph Deane testified that this loss was "meaningful" and he was "aware that tipping fee income was less than projected in the Official Statement ." (Exhibit 9, Barrett Affidavit).

3. March 29, 2001: Maher and Gagliardi received the first of regular monthly updates with detailed financial information from the plant operator. Actual tipping fees averaged $9.81 to 10.42 per ton compared to projected $20.04. (Exhibit 19, Barrett Affidavit).

4. May 2001: Deane admitted it was "Maher's responsibility in May of 2001" to "look into why the tipping fees ... were substantially lower" than projections in the Official Statements; Deane was "sure" Maher had done so. (Exhibit 75, Barrett Affidavit).

5. July 2001: Plaintiffs hired outside engineer David Ross to "evaluate and opine [on] the facility," including its operations and tipping fee problems. (Exhibit 76; 30; Barrett Affidavit).

6. July 13, 2001: Portfolio manager David Fare e-mailed Smith Barney Fund Management executives McLendon, Cumming, Deane, Coffey, Maher and in-house counsel Gordon Swartz, stating: "[T]he project has not been able to improve its financial position and has now depleted the debt service reserve fund. At this time we have no reason to believe that the project is likely to show any improvement in the near term." (Exhibit 26, Barrett Affidavit).

***4 7. July 13, 2001:** When asked why Fare e-mailed in-house counsel Swartz, Deane admitted that the Bonds were "uncomfortably below par. In case some legal action at some point in time in the future had to take place we wanted to keep them in the loop." (Exhibit 75, Barrett Affidavit).

8. September 5, 2001: Maher and Gagliardi received regular monthly updates from the plant operator. Actual tipping fees averaged $9.22 per ton in July 2001, compared to projected $20.04. (Exhibit 31, Barrett Affidavit).

9. October 12, 2001: Bonds are placed on internal "credit concerns" watch list due to "severe cash flow problems ... tipping fees much lower than anticipated ... no debt service monies available-need to restructure the debt or sell the plant ..." (Exhibit 33, Barrett Affidavit).

10. May 23, 2002: Smith Barney's research and legal departments "reviewed and approved" a Standstill Agreement which acknowledged "unanticipated shortfalls in projected revenues"; "failure[s] to pay or provide for payment of principal and interest"; and that Plant operator "anticipates ... similar events of default" in the future." (Exhibit 50; 78, Barrett Affidavit).

11. August 13, 2002: Smith advised Maher, Gagliardi and Ross of a Detroit News article reporting that the Central Wayne municipalities had "hired an attorney in case the [Plant operator] files for bankruptcy" because the Project did "not have significant cash flow to meet their payment bonds ... that sent up a red flag." (Exhibit 52, Barrett Affidavit)

12. December 12, 2002: Plant operator discusses with Maher possibly shutting down the Project due to cash flow shortages. (Exhibit 58; 78 Barrett Affidavit)

13. January 3, 2003: Monthly operations report sent to Maher and Gagliardi reported actual tipping fees for year 2002 averaged $11.78 per ton compared to $20.58 projected in the Official Statement. (Exhibit 59; 82 Barrett Affidavit).

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14. May 2, 2003: Plaintiffs valued Bonds at only 25[cents] on the dollar. Plaintiffs' financial statements filed with the SEC showed write down totaling nearly $38 million of the original $50.5 million investment. (Exhibit 7, Barrett Affidavit).

Plaintiffs argue that these known, undisputed facts evidencing the Project's poor performance, which was substantially accredited to the (also known, undisputed) disparity between actual and projected tipping fees, *did not* suggest the probability to the plaintiffs that they may have been defrauded. Rather, plaintiffs point to mechanical failures and operational issues that "overshadowed" and were "intertwined with" the changing market that negatively affected tipping fees. Plaintiffs assert their ignorance of the probability of being defrauded until July 2003, when the Project ultimately failed. This Court is not persuaded.

It is undisputed that tipping fees were a primary source of the Project's revenue stream and substantially affected the value of the Bonds. It is of no consequence that other factors contributed to the Project's failure. The very predicate to the plaintiffs' fraud claim were the misrepresentations in the Official Statement that clearly came to light between 1999 and 2001, more than two years prior to filing suit. Therefore, the complaint is time-barred.

***5** Notwithstanding the above dispositive analysis, it is clear from the numerous instances of red flags that became apparent throughout the Project, that consist mostly of reports of massive Bond value loss, that a duty to investigate a possible fraud was triggered long before May 5, 2003.

In May 2001, Deane admitted in his deposition that it was Maher's responsibility to look into the cause for low tipping fees. This is a clear admission that plaintiffs possessed enough operative facts in 2001 to trigger a duty to inquire, thus commencing the two-year limitations period. It is unclear from the record what, if any, conclusions were made after Maher's supposed inquiry, or if such an inquiry was diligently undertaken. Nonetheless, no lawsuit was initiated at that time. It can only be concluded that plaintiff failed to conduct a diligent inquiry, or otherwise failed to act on the fruits of a diligent investigation. If the former, the complaint is time barred. CPLR 213(8). If the latter, the complaint is time barred. *Cruden v. Bank of New York,* 957 F.2d 961 (2nd Cir1992) (when a plaintiff "shuts his eyes to the facts which call for investigation, knowledge of the fraud will be imputed to him.")

Lastly, the law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions and the business they are acquiring. *Global Mins. & Metals Corp. v. Holme,* 35 AD3d 93 (1st Dept 2006), appeal denied, 8 NY3d 804 (2007). Plaintiffs are indisputably sophisticated investors that failed to adequately or timely investigate the market for waste disposal in Michigan prior to purchasing over $50 million in municipal bonds. If plaintiffs had endeavored to conduct meaningful vetting of the Project at its inception, the record suggests that public information would have exposed the poor state of the market for waste disposal and Beck's inflated and allegedly fraudulent tipping fee report.

On this record, the facts of the fraud claim against defendants, to the extent that they were not already known, could have been discovered with the exercise of due diligence more than two years before the action was commenced. Therefore, the complaint must be dismissed as untimely, and judgment entered in favor of defendants.

All further arguments were considered and found unavailing.

All Citations

21 Misc.3d 1133(A), 875 N.Y.S.2d 821 (Table), 2008 WL 4938280, 2008 N.Y. Slip Op. 52327(U)

Footnotes

1 The facts have been gleaned from the Rule 19A Statements submitted by the parties and the Court's independent analysis of the supporting affidavits and exhibits.

2 It should be noted that "the burden of establishing that the fraud [was not or] could have been discovered before the two-year period prior to the commencement of the action rests on the plaintiff, who seeks the benefit of the exception." *Lefkowitz v. Appelbaum,* 258 A.D.2d 563 (2nd Dept 1999).

3 It should be noted that on this record, such a claim would not have been dismissed on particularity grounds. The purpose of CPLR 3016(b)'s pleading requirement is to inform a defendant with respect to the incidents complained of. *Pludeman v. Northern Leasing Sys., Inc.,* 10 NY3d 486 (2008).

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25 A.D.3d 633
Supreme Court, Appellate Division, Second Department, New York.

Christian P. BENEFIELD, respondent,
v.
HALMAR CORPORATION, defendant third-party plaintiff-respondent-appellant;
Sussex County Erectors, Inc., third-party defendant-appellant-respondent.

Jan. 24, 2006.

Synopsis
Background: Employee of subcontractor on construction project brought suit against general contractor to recover for injuries sustained in fall from ladder. General contractor brought claim against subcontractor for indemnification. The court denied parties' motions for summary judgment. Appeals were taken, and the Supreme Court, Appellate Division, affirmed as modified, 264 A.D.2d 794, 695 N.Y.S.2d 394. On remand, the Supreme Court, Orange County, Slobod, J., granted judgment after jury verdict for employee. General contractor and subcontractor appealed.

Holdings: The Supreme Court, Appellate Division, held that:

[1] award of $30,000,000 for past and future pain and suffering deviated materially from what would have been reasonable compensation;

[2] award of $5,000,000 for future medical expenses and rehabilitation was excessive; and

[3] award of $10,000,000 for future lost earnings was excessive.

Affirmed as modified.

West Headnotes (3)

[1] **Damages**
Excessive damages in general

Jury award of $30,000,000 for past and future pain and suffering of worker who was injured in fall from ladder deviated materially from what would have been reasonable compensation, and thus was excessive, warranting new trial on issue of damages for past and future pain and suffering unless worker filed written stipulation consenting to reduce verdict as to such damages to $3,200,000. McKinney's CPLR 5501(c).

4 Cases that cite this headnote

[2] **Damages**
Future expenses

Jury award of $5,000,000 for future medical expenses and rehabilitation of worker who was injured in fall from ladder deviated materially from what would have been reasonable compensation, and thus was excessive, warranting new trial on issue of damages for future medical expenses and rehabilitation unless worker filed written stipulation consenting to reduce verdict as to such damages to $400,000. McKinney's CPLR 5501(c).

3 Cases that cite this headnote

[3] **Damages**
Impairment of Earning Capacity

Jury award of $10,000,000 for future lost earnings of worker who was injured in fall from ladder deviated materially from what would have been reasonable compensation, and thus was excessive, warranting new trial on issue of damages for future lost earnings unless worker filed written stipulation consenting to reduce verdict as to such damages to $3,200,000, since award did not take into account physical nature of work, likelihood of injury, and cyclical fluctuations in construction industry. McKinney's CPLR 5501(c).

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4 Cases that cite this headnote

Attorneys and Law Firms

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Jaffe & Asher, LLP, New York, N.Y. (Marshall T. Potashner, Gregory E. Galterio, and **Mark** **H**. **Moore** of counsel), for defendant third-party plaintiff-respondent-appellant.

Sacks and Sacks, LLP, New York, N.Y. (Scott N. Singer of counsel), for respondent.

BARRY A. COZIER, J.P., DAVID S. RITTER, ROBERT A. SPOLZINO, and ROBERT J. LUNN, JJ.

Opinion

***634** In an action to recover damages for personal injuries, the third-party defendant, Sussex County Erectors, Inc., appeals from a judgment of the Supreme Court, Orange County (Slobod, J.), entered January 8, 2004, which, upon a jury verdict in favor of the plaintiff and against the defendant third-party plaintiff Halmar Corporation, inter alia, finding that the ****421** plaintiff sustained damages in the principal sums of $15,000,000 for past pain and suffering, $15,000,000 for future pain and suffering, $2,500,000 for future medical expenses, $2,500,000 for future rehabilitation, and $10,000,000 for future lost wages, and upon so much of an order of the same court dated April 11, 2002, as granted that branch of its motion pursuant to CPLR 4404 which was to set aside the verdict on the issue of damages only to the extent of granting a new trial unless the plaintiff stipulated to reduce the verdict as to past pain and suffering to the sum of $2,000,000, as to future pain and suffering to the sum of $5,000,000, as to future medical expenses to the sum of $500,000, as to future rehabilitation expenses to the sum of $500,000, and as to future lost wages to the sum of $4,800,000, and the plaintiff having so stipulated, is in favor of the plaintiff and against the defendant third-party plaintiff Halmar Corporation and is in favor of the defendant third-party plaintiff and against it, and the defendant third-party plaintiff Halmar Corporation cross-appeals, as limited by its brief, from stated portions of the same judgment.

ORDERED that the judgment is modified, on the facts and as an exercise of discretion, by deleting the provisions thereof awarding damages for past pain and suffering, future pain and suffering, future medical expenses, future rehabilitation, and future lost wages, and a new trial is granted on damages for those categories only unless, within 30 days after service upon him of a copy of this decision and order, the plaintiff serves and files in the office of the Clerk of the Supreme Court, Orange County, a written stipulation consenting to further reduce the verdict as to damages for past pain and suffering from the sum of $2,000,000 to the sum of $1,000,000, for future pain and suffering from the sum of $5,000,000 to the sum of $2,250,000, for future medical expenses from the sum of $500,000 to the sum of $200,000, for future rehabilitation expenses from the sum of $500,000 to the sum of $200,000, and for future lost wages from the sum of $4,800,000 to the sum of $3,200,000 and to the entry of an appropriate amended judgment in his favor; in the event that the plaintiff so stipulates, then the judgment, as so reduced and amended, is affirmed, without costs or disbursements; and it is further,

***635** ORDERED that the cross appeal by the defendant third-party plaintiff Halmar Corporation is dismissed as academic, without costs or disbursements.

On October 12, 1992, the plaintiff, then a 23–year–old ironworker, was injured when he fell approximately 25 feet from an extension ladder while performing work as part of a construction project. The defendant third-party plaintiff, Halmar Corporation (hereinafter Halmar), was the general contractor for the project. Halmar contracted with the third-party defendant, Sussex County Erectors, Inc. (hereinafter Sussex), the plaintiff's employer, to furnish and erect structural steel and install bearings as needed for the project. Their contract contained a provision requiring Sussex to indemnify Halmar for losses or casualties incurred in connection with the performance of the contract.

During the liability phase of the trial, the Supreme Court precluded Sussex from offering evidence of Halmar's alleged negligence based on this court's determination in a prior appeal that Halmar had not committed any negligent acts causally connected to the plaintiff's injuries (*see Benefield v. Halmar Corp.,* 264 A.D.2d 794, 695 N.Y.S.2d 394). The jury rendered a verdict in favor of the plaintiff on the issue of liability, and found that the work he was performing when he was ****422** injured was within the scope of the contract. In light of the jury finding and the absence of negligence on the part of Halmar, the indemnification provision of the contract was triggered. The trial court then excluded Halmar from participating in

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the damages phase of the trial, reasoning that any judgment against it would be satisfied by Sussex.

The Supreme Court properly precluded the admission of evidence pertaining to Halmar's alleged negligence in light of this court's previous decision and order (*see Benefield v. Halmar Corp., supra*). Thus, contrary to Sussex' contention, the judgment properly required it to indemnify Halmar.

[1] [2] [3] The damages awarded the plaintiff for past and future pain and suffering are excessive to the extent indicated as they deviate materially from what would be reasonable compensation (*see* CPLR 5501[c]; *Vasquez v. Skyline Constr. & Restoration Corp.,* 8 A.D.3d 473, 779 N.Y.S.2d 113; *Lind v. City of New York,* 270 A.D.2d 315, 705 N.Y.S.2d 59; *Baumgarten v. Slavin,* 255 A.D.2d 538, 680 N.Y.S.2d 658). The damages awarded for future medical expenses and rehabilitation, to the extent they are supported by the record, are similarly excessive to the extent indicated (*see Diaz v. Parsons Props.,* 309 A.D.2d 892, 766 N.Y.S.2d 102; *Placakis v. City of New York,* 289 A.D.2d 551, 736 N.Y.S.2d 379; *Sanvenero v. Cleary,* 225 A.D.2d 755, 640 N.Y.S.2d 174), as ***636** is the award for future lost earnings, as it does not take into account the physical nature of the work, the likelihood of injury, and the cyclical fluctuations in the construction industry (*see Klos v. New York City Tr. Auth.,* 240 A.D.2d 635, 638, 659 N.Y.S.2d 97; *Cole v. Long Is. Light. Co.,* 24 Misc.2d 221, 229, 196 N.Y.S.2d 187).

On its appeal, Halmar seeks a new trial on the issue of damages based on its exclusion from the damages phase of the trial (*see Ross v. Manhattan Chelsea Assocs.,* 194 A.D.2d 332, 334, 598 N.Y.S.2d 502; *Schulman v. Consolidated Edison Co. of N.Y.,* 85 A.D.2d 186, 447 N.Y.S.2d 722; *Phillips v. Chevrolet Tonawanda Div. of General Motors Corp.,* 43 A.D.2d 891, 352 N.Y.S.2d 73), but only if the portion of the judgment requiring Sussex to indemnify Halmar were not upheld. In light of our determination, this issue is academic.

All Citations

25 A.D.3d 633, 808 N.Y.S.2d 419, 2006 N.Y. Slip Op. 00464

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1994 WL 707000
Only the Westlaw citation is currently available.
United States District Court,
S.D. New York.

The CHASE MANHATTAN BANK, N.A., Plaintiff,
v.
REMINGTON PRODUCTS, INC. and Victor K. Kiam II, Defendants.

No. 92 CIV. 7983 (MEL).
|
Dec. 19, 1994.

Attorneys and Law Firms

Hertzog, Calamari & Gleason, (Peter E. Calamari, **Mark H**. **Moore**, Gerald D. Silver, of counsel), New York City, for plaintiff.

Pollack & Greene, (Alan M. Pollack, Scott A. Sommer, Mitchell G. Mandell, of counsel), New York City, for defendants.

OPINION

LASKER, District Judge.

***1** Chase having prevailed on its motion for summary judgment, there remains the question of the extent of Remington and Kiam's liability.

I.

Both sides make valid arguments in their calculation of an appropriate Transaction Fee. As an initial matter, Chase's use of the July 25, 1992 "Remington Partnership Estimated Opening Balance Sheet" to value the Perlmutter Transaction was appropriate. The defendants object that Chase's recent reliance on the July 25 balance sheet is indicative of what they describe as Chase's persistent tendency to change its method of applying section 3 of the Engagement Agreement when doing so enhances the Transaction Value. While this may be true, Chase's current calculation is persuasive. The balance sheet specifies the particulars of Remington's refinancing—including the amount of cash contributions, new debt and the assumption of liabilities—and the defendants have presented no evidence to demonstrate that the balance sheet has not been prepared in accordance with generally accepted accounting principles. Because the right side of a balance sheet represents the source of a corporation's funds, Chase's method of basing its fee calculation on the right side of the July 25 balance sheet is consistent with the definition of Transaction Value contained in section 3 of the Engagement Agreement.

The defendants also object that the balance sheet was not introduced in a timely manner. While it is true that it did not appear as part of Chase's initial submission regarding damages, the defendants' laxity in matters of discovery and disclosure has been a persistent feature of this litigation and Chase's representation that it would have relied on the balance sheet sooner had the defendants been more forthcoming is acceptable. In any event, the critical question is whether the balance sheet's figures are accurate and dependable—and they appear to be—not when they were presented to the court.

Chase concludes from the July 25 balance sheet that the Transaction Value is $104,184,000.[1] Remington and Kiam contend that this figure is subject to four adjustments downward. The first—in the amount of $21,145,000—is the value of Kiam's equity in RPI, all of which Kiam contributed to RPC. The defendants' argue that Chase is not entitled under the Engagement Agreement to the inclusion of the assets which Kiam contributed to the refinancing of Remington. Chase responds that, because Kiam actually transferred his equity in RPI to RPC as part of the Perlmutter Transaction, the affected assets are includible within the definition of Transaction Value contained in section 3 of the Engagement Agreement and therefore should be included in Transaction Value.

Even if the language of section 3 of the Engagement Agreement is arguably susceptible to Chase's reading—a proposition far from clear—the inclusion of Kiam's own assets in the calculation of a fee for Chase's services would be so contrary to the intuitive expectation that a banker does not become entitled to a fee by reason of a client retaining assets that the client already owns, that such a reading would not be tenable unless it was the only reasonable interpretation of section 3. Clearly, it is not. As

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described in section 3, Transaction Value includes "the total proceeds and other consideration paid or contributed ... in connection with a Transaction...." The most reasonable interpretation of this language in the context of this case is that Transaction Value is made up of the value of assets received from third parties, not the value of retained assets. Chase's argument that Kiam's equity was in fact "contributed" to RPC in connection with RPC's formation is an unnatural formalism. It follows that Chase's calculation of the Transaction Value should be reduced by the $21,145,000 which Kiam contributed.[2] Chase's contention at oral argument that this reduction should in turn exclude the $5,280,000 which Perlmutter loaned to Kiam, and Kiam then contributed to RPI, is unpersuasive. If Kiam and Perlmutter had agreed that Kiam need not repay the $5,280,000, the argument that the corresponding equity should be attributed to Perlmutter, not Kiam, for purposes of calculating Chase's fee would have some merit. In such a case, the "loan" would have no economic impact on Kiam's investment in Remington. However, the record contains no evidence of such an agreement. Assuming that the defendants' representation that Kiam has incurred a bona fide obligation to Perlmutter is valid, Kiam has in fact increased his investment in Remington and Chase's argument fails.

***2** The three other downward adjustments that the defendants have proposed for the calculation of Transaction Value are without merit. They seek to reduce the Transaction Value by the amount of cash shown on the July 25 balance sheet because, they argue, this cash could have been used to reduce current liabilities. If the defendants' argument is taken to its logical extreme, the Transaction Value should be reduced by the value of *any* asset that could be sold and the proceeds used to reduce current liabilities.

The defendants also seek to deduct from Chase's proposed Transaction Value liabilities in the amount of $2,731,000 on the ground that they represent, in the defendants words, "liabilities of foreign corporate subsidiaries that were independent from and not assumed by the Kiam/Perlmutter joint venture." If by this description the defendants suggest that the liabilities are obligations for financial reporting purposes only, not bona fide obligations, the record is insufficient to determine whether this is true. RPC is presumed to be responsible for the liabilities reflected on the July 25 balance sheet in the absence of evidence that such treatment is inappropriate.

Finally, the defendants argue that the present value of the employment contract which Kiam received in connection with the Perlmutter Transaction is not includible in the computation of the Transaction Value. There are strong indications in the record that Isaac Perlmutter never had any intention of allowing—and in fact did not allow—Kiam to exercise appreciable authority over RPC's operations. For example, Perlmutter testified on deposition that he had little regard for Remington's top management and had made replacing them a priority. According to the same testimony, Kiam himself was removed from day-to-day control of Remington by June of this year at the latest. In such circumstances, it is reasonable to conclude that Kiam's employment contract constitutes additional consideration paid in exchange for Kiam's equity in the company (with the added attraction from Remington's standpoint of being tax deductible).

In sum, after subtracting from Chase's proposed Transaction Value of $104,184,000 Kiam's retained equity of $21,145,000, the Transaction Value of the Perlmutter Transaction is determined to be $83,039,000. Applying the staggered percentages specified in section 3(c) of the Engagement Agreement,[3] this results in a Transaction Fee of $1,188,475. Crediting the $350,000 that Remington has already paid in accordance with the Engagement Agreement, the defendants remain liable to Chase for a Transaction Fee of $838,475.

Under section 4(a) of the Engagement Agreement, Remington agreed to pay Chase's reasonable expenses in connection with its role as Remington's financial advisor. Chase has adequately described and documented its disbursements and therefore is entitled to the $65,570 it has requested. Under section 4(b) of the Engagement Agreement, Remington was obligated to pay a $20,000 advance on expenses at the time the Agreement was executed. If this advance was paid, it may be subtracted from the amount now due.

II.

***3** The defendants do not dispute that, under section 5 of the Engagement Agreement, they are liable to Chase for reasonable attorney's fees and the parties have made numerous submissions on the issue of what amount is reasonable. Chase has submitted affidavits by Peter Calamari as well as Hertzog, Calamari and Gleason's bills. Chase admits that attorney's fees in this case are unusually high but contends that the defendant's practice of mounting as lengthy and extensive a defense as possible is the cause of the excessive expense. The

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defendants have submitted affidavits by Alan Pollack and Milton Yusim, who specializes in the valuation of legal services. They argue that various methods employed by Hertzog, Calamari and Gleason—including "block" billing, use of .25 hour rather than .10 hour increments and "team staffing"—unreasonably inflated the firm's bills.

Upon careful review of the material submitted, and consideration of the several factors relevant to an inquiry as to the reasonableness of attorney's fees—including the difficulty of the issues presented and the skill required to resolve them; the lawyers' experience, apparent ability and reputation; the time and labor expended; the amount involved and the benefit accruing to the client as a result of the services; and the customary fees charged for similar services—I find that the defendants have failed to introduce any significant evidence that Hertzog, Calamari & Gleason's bills and billing methods are out of line with standard practices in this district in cases of this type. Regardless of whether billing in smaller time increments, leaner staffing and more precise diary entries do or do not reduce legal fees, there is no basis for penalizing Chase for hiring counsel whose billing practices are common in its sector of the profession. The defendants have litigated this case to an extent disproportionate to the amount at issue. That this course of action has proven costly is not Chase's fault. Moreover, Chase's representation that it has promptly paid its counsel's fees throughout the course of this litigation further indicates that those fees were not excessive. As an experienced consumer of legal services, Chase is presumably capable of recognizing overbilling when it sees it. Chase is awarded attorney's fees of $451,767.

III.

Pre-judgment interest at a rate allowed by law is awarded, with respect to both the Transaction Fee and expenses, from August 18, 1992, the date of the Perlmutter Transaction closing memorandum. Post-judgment interest at a rate allowed by law is awarded from the date hereof as to all amounts due.

3

Submit judgment on notice.

All Citations

Not Reported in F.Supp., 1994 WL 707000

Footnotes

1 That is, the aggregate of the liabilities and equity of the newly-formed Remington Products Company ("RPC", as opposed to "RPI", the company Kiam formed in 1979) less $330,000 of RPC intra-company debt.

2 The record is somewhat unclear as to whether $21,145,000 is the correct amount of Kiam's retained equity. Several documents describing the Perlmutter transaction—including the closing memorandum of August 18, 1992—value Kiam's retained equity at $19,720,000. Because the July 25, 1992 balance sheet now relied on by Chase values Kiam's retained equity at the higher figure, however, valuing that equity at $21,145,000 is consistent with adoption of $104,184,000 (the figure Chase sought) as the starting point in determining Transaction Value.

3 That is:

1.25%	x	65,000,000	=	812,500
2.00%	x	15,000,000	=	300,000
2.50%	x	3,039,000	=	75,975
		$1,188,475		

(The record does not contain information sufficient to derive a Threshold Amount for the Perlmutter Transaction but the parties agree that the correct figure is $65,000,000.)

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293 A.D.2d 273
Supreme Court, Appellate Division, First Department, New York.

GENERALE BANK, Plaintiff–Appellant,
v.
BELL SECURITY, INC., Defendant–Respondent.
[And a Third–Party Action].

April 4, 2002.

Synopsis
Creditor which hired security service to guard warehouse where debtor's collateral was stored brought breach of contract action against the service after much of the collateral was removed. The Supreme Court, New York County, Donna Mills and Sheila Abdus-Salaam, JJ., entered summary judgment in favor of security service, and creditor appealed. The Supreme Court, Appellate Division, held that: (1) removal of collateral from warehouse established security service's prima facie liability, and (2) extent of the services that creditor engaged security service to provide and whether such services encompassed the removal of items from warehouse by means of access other than the front door were questions of fact that precluded summary judgment.

Reversed.

West Headnotes (4)

[1] **Detectives and Security Guards**
Authority, duty, and liability of private detectives and security providers

Removal of collateral from warehouse that creditor hired security service to guard after obtaining temporary restraining order preventing debtor from removing its inventory from warehouse established security service's prima facie liability to creditor for breach of contract, even if actions of third parties caused the collateral's removal.

1 Cases that cite this headnote

[2] **Judgment**
Contract cases in general

Extent of the services that creditor engaged security service to provide and whether such services encompassed the removal of items from warehouse by means of access other than the front door were questions of fact that precluded summary judgment in creditor's action against service for breach of contract to guard warehouse and prevent removal of debtor's collateral.

1 Cases that cite this headnote

[3] **Damages**
Reparation by wrongdoer

Amount of creditor's settlement with debtor in action on debt represented set off against creditor's loss in its breach of contract action against security service, which allegedly allowed removal of collateral from warehouse that creditor had hired service to guard.

Cases that cite this headnote

[4] **Guaranty**
Release or loss of other securities
Secured Transactions
Disposition of collateral

Impairment of collateral subjects a creditor or guarantor to greater liability.

Cases that cite this headnote

Attorneys and Law Firms

****199 Mark H. Moore, for Plaintiff-Appellant.

Deborah DelSordo, for Defendant-Respondent.

MAZZARELLI, J.P., ANDRIAS, WALLACH, RUBIN and MARLOW, JJ.

Opinion

***273** Order, Supreme Court, New York County (Donna Mills, J.), entered on or about January 19, 2001, which granted defendant's motion to renew a prior order of the same court (Sheila Abdus Salaam, J.), denying defendant's motion for summary ***274** judgment and, upon renewal, granted defendant's motion and dismissed the complaint, unanimously reversed, on the law, with costs, the motion denied and the complaint reinstated.

Plaintiff Generale Bank is the creditor of third-party defendant Easy Trading, N.V., which owes some $6.6 million secured by a lien on its inventory stored at a Brooklyn warehouse. On July 19, 1994, plaintiff obtained a temporary restraining order preventing Easy Trading or its agents from removing, transferring or otherwise disposing of any inventory subject to the lien.

That same day, counsel for plaintiff sent a letter by facsimile transmission, confirming that "Bell Security will have two security guards watch the warehouse * * * If anyone attempts to remove any inventory from the warehouse, your guards should show them the order of the court" and inform counsel or plaintiff's vice president of the incident. Plaintiff's attorney included a copy of the temporary restraining order in the transmission. The address listed in the order transposed two digits in the Street number of the warehouse. However, both the letter and the cover sheet state the correct address. Moreover, it is clear that defendant actually did guard the warehouse located at 791 Kent Avenue (not 719) because plaintiff was billed some $60,000 for security services provided to that address over a period of five months.

On November 17, 1994, having obtained an order of seizure, plaintiff bank entered into a stipulation with the debtor permitting the bank to sell the collateral and apply the proceeds to the debt. However, ****200** when plaintiff's vice president gained access to the warehouse, he discovered that "more than three quarters of the inventory had been removed." Plaintiff thereafter settled its action against Easy Trading for $2.82 million, of which approximately $450,000 remains unpaid.

Plaintiff commenced this action in February 1996. In October 1999, defendant brought a motion for an order "[p]ursuant to CPLR 3212, granting summary judgment dismissing the summons and complaint." The moving papers contended that plaintiff could not prove that it sustained any damage as the result of defendant's malfeasance because plaintiff could offer only speculation regarding who stole the inventory and how the items—some 44,000 pieces of crystal and china—were removed from the warehouse. This motion was denied by the first order (Sheila Abdus Salaam, J.), entered on or about March 28, 2000. The court found issues of fact as to whether defendant was hired to prevent removal of items from the warehouse or merely to guard the front door, as defendant alleges.

***275** In September 2000, defendant submitted its second motion, denominated a motion to dismiss pursuant to CPLR 3211, which also sought renewal of the former CPLR 3212 motion. On September 18, 2000, the parties appeared before Justice Abdus–Salaam, who was engaged in the trial of another matter and who referred this and all other motions to the Trial Justice. It is apparent that trial began almost immediately because defendant states, "On September 21, 2000, following several days of testimony," the court undertook "to review the motions and determine whether there was a viable cause of action." The court's review culminated in the order appealed from, dismissing the complaint on the ground that "the lack of specificity in the 'letter agreement' and the misstatement of the location of the property in the Temporary Restraining Order annexed to this letter does not create a contract between the plaintiff Generale Bank and the defendant Bell Security." The court concluded, "Without a contractual relationship, or the meeting of the minds, the plaintiff's action fails."

[1] [2] It is abundantly clear that defendant provided security services to plaintiff, that property was removed from the premises secured by defendant and that plaintiff was damaged by the loss of its collateral. Under these facts, having actually undertaken performance, defendant would be prima facie liable to plaintiff for breach of contract even in the absence of a writing. The intervention of third parties is immaterial because such a breach of security is the immediate consequence of the lapse in security with which defendant is charged (*McKinnon v. Bell Security,* 268 A.D.2d 220, 700 N.Y.S.2d 469). The extent of the security services defendant was engaged to provide and whether such services encompassed the removal of items by means of access other than the front door merely present questions of fact for resolution at trial.

[3] [4] That plaintiff settled its action against the debtor is material only insofar as the amount of the settlement represents a set off against the total amount of plaintiff's loss. It is accepted that impairment of collateral subjects a

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creditor or guarantor to greater liability (*see, Executive Bank v. Tighe,* 54 N.Y.2d 330, 337, 445 N.Y.S.2d 425, 429 N.E.2d 1054). In this case, plaintiff has been able to recover less than half of the amount owed by the debtor, and the unavailability of collateral securing the debt represents a significant monetary loss.

All Citations

293 A.D.2d 273, 741 N.Y.S.2d 198, 2002 N.Y. Slip Op. 02724

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2002 WL 31546519
Only the Westlaw citation is currently available.
This case was not selected for publication in the Federal Reporter.
Not for Publication in West's Federal Reporter See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also Third Circuit LAR, App. I, IOP 5.7. (Find CTA3 App. I, IOP 5.7)
United States Court of Appeals, Third Circuit.

TWIN COUNTY GROCERS, INC.; Twinco Services, Inc., Appellants,
v.
FOOD CIRCUS SUPERMARKETS, INC.; Joseph Azzolina, Sr.; Louis Scaduto; Grace Scaduto; Food King Inc; V & V Inc; Ronald Ginsberg; Mayfoods, Inc; Victor Laracca, L.J.V., Inc; William Michas; Francis Markets, Ltd; Neptune City Liquors, Inc; Donald P. Norkus; Gerard K. Norkus; Norkus Enterprises, Inc; Franelen Inc; Helen Paczkowski; Stanley Paczkowski; Harp Marketing Corp; Jack Pytluk; Martin Pytluk; Ruth Pytluk; Sidney Charles Markets, Inc.; Michael Zimmerman; Sidney Zimmerman; Charles H. Zimmerman; E. Dickerson & Son, Inc; C. Ronald Dickerson; Foodtown; Vincent Laracca, Digiorgio Corporation,

No. 02-1116.
|
ARGUED Oct. 29, 2002.
|
Decided Nov. 18, 2002.

On Appeal from the United States District Court for the District of New Jersey. (D.C. Civil No. 99-cv-05135). District Judge: The Honorable Garrett E. Brown, Jr.

Attorneys and Law Firms

Guy V. Amoresano, (Argued), Gibbons, Del Deo, Dolan, Griffinger & Vecchione, Newark, NJ, for Appellants.

Mark H. Moore, (Argued), Gregory E. Galterio, Jaffe & Asher, New York, NY, for Appellee.

Before NYGAARD, GREENBERG, and MICHEL,* Circuit Judges.

OPINION OF THE COURT

NYGAARD, Circuit Judge.

Appellants Twin County Grocers, Inc. and Twinco Services, Inc. appeal from an order of the District Court which granted summary judgment in favor of Appellee DiGiorgio Corp., the sole remaining defendant. Appellants allege as error the issues listed in paragraph I, taken from its brief. Because we conclude that the District Court did not err, we will affirm.

I.

The allegations of error asserted by Appellants are as follows:

1. The District Court erred by holding that the restrictive covenants were unenforceable against DiGiorgio.

2. The District Court erred by not ordering DiGiorgio to disgorge profits.

3. The District Court erred by holding that Twin was not injured by DiGiorgio's actions.

4. The District Court erred by holding that DiGiorgio had no duty to negotiate with Twin in good faith, or, alternatively, that that duty had not been breached.

5. The District Court erred by holding that DiGiorgio was not unjustly enriched.

II.

The facts and procedural history of this case are well known to the parties and the court, and it is not necessary that we restate them here. The court has heard oral argument on the issues presented to us in this appeal. The reasons why we write an opinion of the court are

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threefold: to instruct the District Court, to educate and inform the attorneys and parties, and to explain our decision. None of these reasons are presented here. We use a not-precedential opinion in cases such as this, in which a precedential opinion is rendered unnecessary because the opinion has no institutional or precedential value. *See* United States Court of Appeals for the Third Circuit, Internal Operating Procedure (I.O.P.) 5.3. Under the usual circumstances when we affirm by not-precedential opinion and judgment, we briefly set forth the reasons supporting the court's decision. In this case, however, we have concluded that neither a full memorandum explanation nor a precedential opinion is indicated because of the very extensive and thorough opinion filed by Judge Garrett E. Brown, Jr. of the District Court. Judge Brown's opinion adequately explains and fully supports its order and refutes the Appellants' allegations of error. Hence, we believe it wholly unnecessary to further opine, or offer additional explanations and reasons to those given by the District Court, why we will affirm. It is a sufficient explanation to say that, essentially for the reasons given by the District Court in its opinion dated the 11th day of December, 2001, we will affirm.

III.

In sum, for the foregoing reasons, we will affirm the order of the District Court.

All Citations

Slip Copy, 2002 WL 31546519

Footnotes

* Honorable Paul R. Michel, Circuit Judge for the United States Court of Appeals for the Federal Circuit, sitting by designation.

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67 N.Y.2d 709
Court of Appeals of New York.

ALLEN & COMPANY INCORPORATED, Respondent,
v.
SHEARSON LOEB RHOADES, INC., Appellant.

Feb. 11, 1986.

Synopsis
Client of securities broker-dealer obtained arbitration award for dealer's failure to inform client that foreign corporation in which customer owned stock had made "offering" of shares and options in subsidiary, preventing client from taking advantage of opportunity to purchase securities. The Supreme Court, New York County, McCooe, J., vacated the arbitration award, and client appealed. The Supreme Court, Appellate Division, 111 A.D.2d 122, 489 N.Y.S.2d 500, reversed and reinstated the arbitration award, and dealer appealed. The Court of Appeals held that the dealer's own admissions in arbitration contradicted its assertions, on appeal, that any communication or acceptance of offer would have been illegal under federal securities laws.

Judgment of Appellate Division affirmed.

West Headnotes (1)

[1] **Alternative Dispute Resolution**
Award

Arbitration award to client of securities broker-dealer for its failure to timely notify client of offering of shares and options in newly formed subsidiary of company whose shares broker was holding in client's account was proper in that broker's own admissions in arbitration contradicted its assertions, on appeal, that any communication or acceptance of offer would have been illegal under federal securities laws.

2 Cases that cite this headnote

Attorneys and Law Firms

*****931 **850 *709** Gerald Kerner and Susan E. Amron, New York City, for appellant.

*****932 **851** David J. Freeman, David R. Foley and **Mark H. Moore**, New York City, for respondent.

OPINION OF THE COURT

MEMORANDUM.

The order of the Appellate Division, 111 A.D.2d 122, 489 N.Y.S.2d 500, should be affirmed, with costs.

***710** As of August 15, 1980 plaintiff, Allen & Company, owned approximately 300,000 common shares of Pancontinental Mining Limited, an Australian company. The shares were held on Allen's behalf by defendant, Shearson Loeb Rhoades, Inc., in a foreign depository account in the name of ANZ Nominees, in Australia. By letter dated August 15, 1980, ANZ informed Shearson that Pancontinental was offering its shareholders as of that date shares and options in Pancontinental Petroleum Limited. The offering was not registered with the Securities and Exchange Commission. ANZ's letter bore the stamped legend, "*urgent. this is an important letter which requires your prompt attention,*" and concluded: "Instructions must be in our hands by 4th September, 1980, at the latest. In the absence of your specific instructions reaching this office by that date, we will lapse your entitlements."

Shearson did not, however, forward this letter to Allen. According to Allen, a Shearson broker first mentioned the offer offhandedly and without full particulars in a telephone conversation just before the offer expired, adding that Allen as an American citizen could not subscribe. By the time Allen received more information, consulted an attorney and informed Shearson that it wanted to subscribe, the offer had expired.

Allen sued for damages, but on Shearson's demand the matter was submitted to arbitration. Shearson's defense in

the arbitration centered on two law issues. First, Shearson contended it could not legally have transmitted the letter or its contents to Allen because the offering was unregistered and that, had it done so, it would have violated section 5(c) of the Securities Act of 1933 (15 U.S.C. § 77e[c]), which makes it unlawful for any person directly or indirectly to offer to sell any unregistered security. In the alternative, Shearson claimed that even had Allen timely received the letter, it could not legally have exercised its right to buy unregistered securities in the United States, and thus suffered no harm. The arbitrators awarded Allen damages and Shearson moved, pursuant to CPLR 7511(b) and the Federal Arbitration Act (9 U.S.C. § 10), to set aside the award on the grounds that it was contrary to public policy as set forth in the Federal securities laws and irrational. Shearson's motion was granted by Special Term but the Appellate Division reversed and reinstated the award.

Shearson's position on the present motion, at bottom, rests on the very same two law issues it unsuccessfully tendered to ***711** the arbitrators—that it could not legally have transmitted the offer, and that Allen could not legally have accepted it; therefore, according to Shearson, an award of damages based on such illegal conduct cannot stand. But even assuming that an arbitration award were subject to vacatur on the ground that the arbitrators erroneously decided the questions of law submitted by the parties (*see, Matter of Maye [Bluestein],* 40 N.Y.2d 113, 118, 386 N.Y.S.2d 69, 351 N.E.2d 717), and even assuming that an arbitration award under the Federal Arbitration Act could be vacated on grounds other than those specified by statute (9 U.S.C. §§ 2, 10[a]–[d]), Shearson's own admissions in the arbitration contradict its assertions on this motion that any communication or acceptance of the offer would have been illegal.

Whether or not Shearson's transmittal of the August 15, 1980 letter to its customer would have constituted an offer to sell securities in violation of section 5(c) of the Securities Act of 1933, Shearson's own general counsel, testifying in the arbitration, acknowledged that a broker "can always legally speak to someone about an offering." He testified that Shearson did not *****933 **852** consider an oral communication regarding an offering a violation of section 5(c), and that Shearson had no policy barring its brokers from orally informing customers of such offerings. Indeed, Shearson offered testimony that its agent had in fact orally communicated the substance of Pancontinental's offer shortly after its receipt, which conflicted with Allen's proof that the communication was incomplete and untimely. Similarly, Shearson's own witness and correspondence indicated that Allen could have made arrangements to subscribe to the rights, thus contradicting the contention that Allen suffered no damage because it could not lawfully have accepted the offer.

WACHTLER, C.J., and MEYER, SIMONS, KAYE, ALEXANDER and TITONE, JJ., concur.

HANCOCK, J., taking no part.

Order affirmed, with costs, in a memorandum.

All Citations

67 N.Y.2d 709, 490 N.E.2d 850, 499 N.Y.S.2d 931

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