

STATE OF NEW YORK  
SUPREME COURT  
COMMERCIAL DIVISION

COUNTY OF ALBANY

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UNIVERSAL EXPRESS, INC.,

Plaintiff,

**DECISION AND ORDER**

-against-

CDS MERGER SUB, INC., CORPORATE DEVELOPMENT  
SERVICES, INC., SUBCONTRACTING CONCEPTS, INC. (SCI)  
a New York Corporation, SUBCONTRACTING CONCEPTS, INC. (SCI-CN)  
a Connecticut Corporation, SCI TWO-WHEEL, INC. (SCI-GA) a Georgia  
Corporation, COACH INDUSTRIES GROUPS, INC.,  
ROBERT LEFEBVRE, CARMEN B. LEFEBVRE, MARK LEFEBVRE,  
SCOTT LEFEBVRE, EDMUND LEFEBVRE, PAUL GAPP, and  
ROBERT J. SLACK,

Defendants.

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Index No. 6723-05  
(RJI No. 01-06-084645)

(Judge Richard M. Platkin, Presiding)

APPEARANCES:

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Hon. Richard M. Platkin, A.J.S.C.

Plaintiff moves for partial summary judgment dismissing defendants' second, third and fourth affirmative defenses and all four of defendants' counter-claims. Defendants cross move to compel plaintiff to respond to certain discovery requests.

On November 28, 2003, plaintiff entered into a stock purchase agreement with defendants SCI, SCI-CN, SCI-GA, Carmen Lefebvre, Mark Lefebvre, Scott Lefebvre, Edmund Lefebvre, Paul Gapp and Robert J. Stack, whereby plaintiff purchased certain shares of SCI, SCI-CN and SCI-GA stock for approximately \$8 million (hereinafter "SPA-1"). Thereafter, on April 14, 2004, plaintiff entered into a second agreement (hereinafter "SPA-2") with the same entities and individuals whereby plaintiff sold back to the same entities and individuals the stock it had purchased in the first stock purchase agreement. Under SPA-2, plaintiff retained a right of first refusal to repurchase the stock. In pertinent part, that right of first refusal provides:

If any Buyer (a "Selling Buyer") shall desire to enter into a written agreement (a "Sales Agreement") to sell any shares of stock in any Company (the "Subject Shares") to a third person, other than a Company, any other Buyer or any affiliate or associate of any Buyer (as defined in the Securities Act of 1933 or the Securities and Exchange Act of 1934, as amended), effective at any time within twelve months following the Closing Date, the Selling Buyer shall send written notice (the "Notice") to the Seller setting forth the total monetary consideration and the fair market value of any and all non monetary consideration (including any consideration payable in the future or payable as employment/consulting payments) to be received and/or that is receivable by or on behalf of the Selling Buyer (collectively the "Purchase Consideration" [sic]) under the terms of the Sales Agreement. At any time within ten days after receipt of the Notice (in accordance with the terms hereof), the Seller may purchase the Subject Shares by providing to the Selling Buyer immediately available funds in an amount equal to the Purchase Consideration. If the Seller shall fail to provide the Purchase Consideration within such ten day period in connection with any proposed sale of any Subject Shares, the right of first refusal set forth in this subsection shall terminate and be of no further force and effect . . . .

(Garvey Aff. Ex. D, ¶ 8.11).

Further, under SPA-2, “[e]ach Company agree[d] that for a period of thirty six months following the Closing Date, it [would] consider all contractual proposals offered by the [plaintiff] for business alliances and/or arrangements between that Company and the [plaintiff]’s] division as identified on Exhibit ‘E’, attached hereto and incorporated by reference herein, that are acceptable to that Company” (*id.* ¶ 8.12).

On September 9, 2004, defendant SCI, on behalf of its affiliates, associates and collective shareholders of the same, tendered the final remittance due under SPA-2. Representatives of SCI and plaintiff signed a mutual consent and release, acknowledging that the remittance of the funds constituted “an acceleration of the remittance timeline” established in the SPA-2 and that, upon receipt of the funds, SCI “satisfied in full all obligations of SCI to [plaintiff]” (Garvey Aff. Ex. E, ¶ 3). The mutual consent and release also provided:

SCI shall have no further or future obligation to [plaintiff] and [plaintiff] does hereby release SCI from and waive for all time any claim and/or right [plaintiff] may have against SCI, including without limitation any entitlement [plaintiff] may have to receive any sums from or any obligations of SCI to [plaintiff] under the 2004 Agreement [SPA-2], except for section 8.11 and 8.12.

(*id.*).

On October 21, 2004, Corporate Development Services, Inc., and its subsidiaries, including SCI, SCI-CN and SCI-GA, merged with CDS Merger Sub, Inc, a wholly owned subsidiary of Coach Industries Group, Inc. (hereinafter “Coach”).

Meanwhile, according to plaintiff, on October 26, 2004, it received a letter via overnight mail from SCI that was dated October 14, 2004. The letter advised plaintiff that “each of the Buyers [under the SPA-2] has transferred his/her ownership interest in the Company [SCI] to an

affiliate or associate of one or more of the Buyers” (First Amended Complaint, Ex. G).

Apparently, these defendants transferred their stock to Corporate Development Services, Inc.

On November 14, 2005, plaintiff commenced the instant action, alleging, in part, that defendants intended to circumvent Section 8.11 of SPA-2 by transferring the shares acquired from plaintiff to CDS Merger Sub, Inc. in this manner (Complaint ¶ 41). Plaintiff acknowledges that defendants had the right under SPA-2 to transfer the stock to their affiliates or associates; however, plaintiff alleges the transfer that occurred was done to evade the right of first refusal. In other words, plaintiff contends the transfer was not legitimate but was part of a larger scheme to effect the merger of Coach with Corporate Development Services, Inc. prior to notifying plaintiff of the same. Plaintiff alleges that, had it been given notice of the transfer of the stock, it would have taken action to ensure its right of first refusal was not impaired. Further, plaintiff alleges it suffered damages as a result of not being able to exercise its right of first refusal, as the subject stock has become more valuable as a result of the merger of Corporate Development Services, Inc. with Coach.

Specifically, plaintiff’s original complaint alleged the following five causes of action: (1) breach of SPA-2; (2) fraudulent concealment; (3) breach of the implied duty of good faith and fair dealing; (4) tortious interference with contractual relations; and (5) tortious interference with prospective economic advantage.

On defendants’ pre-answer motion pursuant to CPLR § 3211, this Court (McCarthy, J.), by Decision and Order dated May 30, 2006, dismissed plaintiff’s causes of action for fraudulent concealment, tortious interference with contract, and tortious interference with prospective

economic advantage. However, the Court denied defendants' motion with respect to the claims for breach of contract and breach of the implied covenant of good faith and fair dealing.

On October 2, 2006, plaintiff served an amended complaint asserting three causes of action: (1) breach of SPA-2; (2) breach of the implied duty of good faith and fair dealing; and (3) tortious interference with contractual relations.

In their answer, defendants assert four affirmative defenses and four counter-claims. For affirmative defenses, defendants contend: (1) defendants' actions did not constitute a breach of the right of first refusal; (2) plaintiff was not damaged by any such alleged breach; (3) the equitable remedy of unclean hands is not available in this action at law; and (4) plaintiff has not adequately re-pleaded its claim of tortious interference. As for counter-claims, the first three relate to plaintiff's asserted breaches of SPA-1, while the fourth counter-claim alleges that plaintiff fraudulently induced defendants to enter into SPA-1.

Plaintiff now moves pursuant to CPLR § 3212 for summary judgment seeking dismissal of defendants' affirmative defenses and counter-claims. As a result of the stay of discovery associated with defendants' prior motion and the making of the instant motion, the parties have had only a limited opportunity to engage in discovery. However, plaintiff moves for summary judgment based primarily on legal grounds.

It is well established that summary judgment is a drastic remedy and should only be granted if there are no material issues of disputed fact (*Sillman v. Twentieth Century Fox Film Corp.*, 3 NY2d 395 [1957]). In evaluating a motion for summary judgment, a court should decide whether material issues of disputed fact preclude the grant of judgment as a matter of law (*S. J. Capelin Assoc. v. Globe Mfg. Corp.*, 34 NY2d 338 [1974]). The party moving for summary judgment has the initial burden of coming forward with admissible evidence to support the

motion, so as to warrant the Court directing judgment in movant's favor; the burden then shifts to the opposing party to demonstrate, by admissible evidence, the existence of any factual issue requiring a trial of the action (*see Zuckerman v. City of New York*, 49 NY2d 557 [1980]).

### **Affirmative Defenses**

For the reasons set forth below, the Court concludes that defendants' second, third and fourth affirmative defenses each must be dismissed.<sup>1</sup>

#### **1. Second Affirmative Defense (Damages)**

As a second affirmative defense, defendants allege as follows: "Even if Plaintiff had a right of first refusal with regard to Defendants' transfer of shares to CDS, Plaintiff did not have the financial means to exercise the right of first refusal at that time and therefore did not suffer *any damages*" (emphasis added). Plaintiff seeks dismissal of this defense, contending that it is barred by the doctrine of law of the case.

On the prior motion, defendants argued that plaintiff's complaint failed to allege a causal link between the alleged breach of SPA-2 and the claimed monetary damages. More specifically, defendants argued that, even assuming plaintiff should have been given notice allowing it the opportunity to exercise the right of first refusal, plaintiff failed to allege that it would have exercised that right and had the financial ability to repurchase the subject stock. The Court rejected this argument, holding that: "[P]laintiff is not seeking specific performance, which

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<sup>1</sup> In view of this conclusion, it is unnecessary to address plaintiff's arguments that these affirmative defenses should be dismissed collectively on the ground that they are not matters that are "likely to surprise the plaintiff" or "raise fact issues not appearing on the face of a prior pleading" (CPLR § 3018). However, the Court notes that the list of affirmative defenses set forth in CPLR § 3018 is not exclusive, and plaintiff does not identify any prejudice arising to it from defendants' abundance of caution in affirmatively pleading these defenses.

would require such a demonstration . . . . Rather, plaintiff seeks monetary damages for the loss of [its] property interest – a property interest that would have included a right to negotiate a waiver of its right of first refusal.” As a result, the Court declined to dismiss plaintiff’s cause of action for breach of contract, though it recognized that defendants “may eventually be correct in asserting that plaintiff will not be able to prove the amount of damages claimed in the complaint.”

Defendants respond by arguing that this Court’s prior ruling did not determine any issue regarding damages other than to observe that a decision with regard to such matters at the pleading stage was premature. Accordingly, defendants argue that the doctrine of law of the case is not applicable, and the issue of damages is one reserved for trial.

Defendants’ second affirmative defense cannot stand in its current form. This Court previously determined that the lack of any allegation in plaintiff’s complaint that it was ready, willing and able to exercise the right of first refusal was not fatal to plaintiff’s breach of contract claim. This determination, which is protected from relitigation by the doctrine of law of the case (*see People v. Evans*, 94 NY2d 499, 502-03 [2000]), leaves plaintiff free to offer proof that it suffered an injury resulting in a measure of damages that does not depend on it having had the financial capacity to exercise the right of first refusal (*see Cipriano v. Glen Cove Lodge #1458, B.P.O.E.*, 1 NY3d 53 [2003]). Thus, in asserting that plaintiff “did not suffer *any* damages” as a result of plaintiff’s alleged lack of financial capacity, defendants go too far. However, should plaintiff seek to prove a measure of damages that depends on it having successfully exercised the right of first refusal, defendants are, of course, free to offer proof that plaintiff was unable to so perform. Based on the foregoing, defendants’ second affirmative defense is stricken.

## **2. Third Affirmative Defense (Unclean Hands)**

Plaintiff seeks dismissal of defendants' third affirmative defense, which asserts that plaintiff's claim is barred by the equitable doctrine of unclean hands. Plaintiff argues that it is only seeking money damages in this action, and the equitable defense of unclean hands is not available in an action at law.

Defendants respond by asserting that plaintiff's complaint does in fact seek specific performance. Specifically, defendants point to the WHEREFORE clause of plaintiff's first amended complaint, which states that "Plaintiff respectfully seeks declaratory relief and specific performance of the agreement and any all [sic] other relief that this Court shall deem just and proper." However, the remainder of the complaint is devoid of references to specific performance, and the original complaint, which contained an identical WHEREFORE clause, was held on the prior motion to be limited to monetary damages. Under the doctrine of law of the case, the Court declines to revisit this determination. Further, at oral argument on this motion, plaintiff's counsel stipulated that plaintiff is not seeking specific performance of the right of first refusal. Accordingly, defendants' third affirmative defense is stricken.

## **3. Fourth Affirmative Defense (Tortious Interference)**

As a fourth affirmative defense, defendants contend that plaintiff has failed to state a cause of action with regard to its claim of tortious interference with contract. Plaintiff argues that its amended complaint overcomes the defect identified by the Court in its prior ruling and, therefore, defendants' fourth affirmative defense must be dismissed.

On the prior motion, the Court held that plaintiff's claim of tortious interference with contract failed to allege that the contract would not have been breached "but for" the defendants' conduct. The Court explained that "the complaint lacks any allegations regarding the activities

of [defendant Coach] and fails to allege that ‘but for’ the actions of Coach, the contract would not have been breached.” Plaintiff’s amended complaint reframes the allegations of tortious interference with contract around the conduct of defendant Coach and specifically alleges but-for causation. Nonetheless, defendants argue that plaintiff’s “conclusory and vague” allegations on this cause of action are deficient.

The elements of a cause of action for tortious interference with contract were set forth in this Court’s prior Decision and Order:

A claim for tortious interference with contract requires a valid contract between the plaintiff and a third party, defendant’s knowledge of the contract, and an intentional procurement of the third party’s breach of the contract without justification, actual breach and resultant damages” (*Williams Oil Co. v Randy Luce E-Z Mart One, LLC*, 302 AD2d 736, 738 [3d Dept 2003]; see *Bradbury v Cope-Schwarz*, 20 AD3d 657, 659 [3d Dept 2005]). “Specifically, a plaintiff must allege that the contract would not have been breached “but for” the defendant’s conduct” (*Burrows v Combs*, 25 AD3d 370 [1st Dept 2006]; see *68 Burns New Holding v Burns Street Owners Corp.*, 18 AD3d 857, 858 [2d Det [*sic*] 2005]).

“Statements in a pleading shall be sufficiently particular to give the court and parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved and the material elements of each cause of action or defense” (CPLR § 3013).

Plaintiff’s amended complaint alleges each of the material elements of a cause of action for tortious interference with contract. Further, the Court finds that the amended complaint – as amplified by the motion practice and prior rulings of this Court – is adequate to put defendants on notice of the transactions upon which plaintiff intends to rely. Accordingly, defendants’ fourth affirmative defense must be dismissed.

## Counter-Claims

### **1. Counterclaims Nos. 1, 2 and 3 (Breach of SPA-1)**

Plaintiff argues that defendants' first three counter-claims, which are based on alleged breaches of SPA-1, are foreclosed by the parties' subsequent SPA-2 agreement.<sup>2</sup> Plaintiff also contends that the mutual consent and release, executed in September 2004, terminated both the SPA-1 and SPA-2 agreements and any obligations or liabilities arising thereunder, leaving only plaintiff's right of first refusal and the possibility of a strategic business alliance in the future. Defendants disagree with plaintiff's interpretation of SPA-2 and the mutual consent and release, and, in the alternative, argue that parol evidence should be received to interpret these agreements.

The principles of New York law governing the interpretation of a contract are well settled (*see generally Kass v. Kass*, 91 NY2d 554 [1998]). Whether an agreement is ambiguous is a question of law to be determined by the Court (*see Van Wagner Adv. Corp. v S & M Enters.*, 67 NY2d 186, 191 [1986]). Ambiguity must be determined by looking within the four corners of the document, rather than through consideration of extrinsic sources (*see W.W.W. Assoc. v Giancontieri*, 77 NY2d 157, 162-163 [1990]). Where the document makes clear the parties' over-all intention, courts examining isolated provisions "should then choose that construction which will carry out the plain purpose and object of the [agreement]" (*Williams Press v State of New York*, 37 NY2d 434, 440 [1975], quoting *Empire Props. Corp. v Manufacturers Trust Co.*, 288 NY 242, 249 [1942]).

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<sup>2</sup> In response to plaintiff's motion for summary judgment, defendants have withdrawn their first counterclaim, which alleged a breach of section 1.3.2.2 of SPA-1.

**a. SPA-2**

Plaintiff contends that the SP1-A agreement was explicitly superseded by SPA-2. In making this argument, plaintiff relies primarily on section 8.4 of SPA-2, which states:

ENTIRE AGREEMENT. This Agreement embodies the entire agreement and understanding of the parties with respect to the transactions contemplated hereby and supersedes all prior written or oral commitments, arrangements or understandings between the parties with respect thereto . . . . There are no restrictions, agreements, promises, warranties, covenants or undertakings with respect to the transactions contemplated hereby other than those expressly set forth herein. The representations, warranties, covenants and agreements obtained herein shall survive the Closing of the transactions contemplated hereby.

“[T]he purpose of a general merger provision . . . , typically containing the language . . . that it "represents the entire understanding between the parties," is to require full application of the parol evidence rule in order to bar the introduction of extrinsic evidence to vary or contradict the terms of the writing (*see Matter of Primex Intl. Corp. v. Wal-Mart Stores*, 89 NY2d 594 [1997]; S. Kaye, *The Parol Evidence Rule Generally*, in 3 *Commercial Litigation in New York State Courts* § 36.3, at 390, n 82 [Haig, et al., eds 1995]).

Plaintiff argues that the broad merger clause in SPA-2 forecloses any consideration of SPA-1 and extinguishes any liability or obligations arising thereunder. In particular, plaintiff points to the language stating that SPA-2 “embodies the entire agreement and understanding of the parties with respect to the transactions contemplated hereby and supersedes all prior written or oral commitments, arrangements or understandings between the parties with respect thereto.” It is plaintiff’s position that the “transactions contemplated” by SPA-2 was the complete unwinding of SPA-1, subject only to plaintiff’s right of first refusal and the defendants’ agreement to “consider” future proposals for business arrangements advanced by plaintiff.

In their moving papers, defendants contend that SPA-2 was limited to the repurchase of stock and did not address plaintiff's obligations under SPA-1 to finance a captive insurer for the benefit of defendants' businesses (section 5.4) and to provide all capital financing necessary for such businesses (section 5.8). In making this argument, defendants point to section 5.7 of SPA-2, which contains an express provision terminating the parties' mutual obligations pursuant to section 1.3.2 of SPA-1. Based on this specific language deeming a particular portion of SPA-1 void *ab initio* and the lack of any corresponding language with respect to sections 5.4 and 5.8, defendants contend that these obligations were not affected by SPA-2. Defendants also note that the agreement does not contain any language releasing plaintiff from claims arising out of SPA-1.

While defendants' argument based on section 5.7 is not without force, its flaw is that it gives controlling weight to one isolated provision of SPA-2 while ignoring the circumstances under which the agreement was executed. Courts "should examine the entire contract and consider the relation of the parties and the circumstances under which it was executed. Particular words should be considered, not as if isolated from the context, but in the light of the obligation as a whole and the intention of the parties as manifested thereby. Form should not prevail over substance and a sensible meaning of words should be sought" (*Atwater & Co. v Panama R. R. Co.*, 246 NY 519, 524 [1927]).

Here, in November 2003, plaintiff agreed to a purchase \$8 million of stock in the defendant corporations. In connection with this equity purchase, plaintiff also agreed to finance defendants' business needs as well as establish or acquire a captive insurer for their benefit – two substantial and financially intensive commitments. A little more than four months later, the parties entered into SPA-2, an agreement that provided for an express unwinding of the stock

purchase that would leave plaintiff with no financial stake in the defendant corporations. Unlike SPA-1, which imposed specific business commitments on plaintiff in connection with its purchase of stock, SPA-2 left the parties with the most tenuous of relationships: if plaintiff chose to propose new business arrangements or alliances with defendants, defendants committed only to “consider” these proposals (and only if such proposals were received in the 36 months following execution of SPA-2). Moreover, the Court must take notice of the fact that SPA-2 was entered into in the shadow of an escalating Securities & Exchange Commission (“SEC”) investigation of plaintiff that created substantial legal and business peril to its corporate business partners (*see U.S. Securities & Exchange Commission v. Universal Express, Inc.*, 04 Civ. 2322 (Opinion & Order dated February 21, 2007, at 4-5)).

Based on the foregoing, the Court determines that primary and dominant purpose of SPA-2 was, at a minimum, for the parties to unwind the initial stock purchase agreement and ancillary business relationship between plaintiff and defendants, subject only to a right of first refusal (section 8.11) and an agreement to explore future business alliances (section 8.12). These were the “transactions contemplated” by SPA-2. As a result, SPA-2, through operation of its broad merger clause, “supersedes all prior written . . . commitments . . . between the parties with respect thereto.” Defendants’ proposed interpretation – that plaintiff would no longer hold an equity interest in defendant corporations, but would nonetheless remain obliged to finance their capital and insurance needs – is not a reasonable interpretation under the objective circumstances surrounding the SPA-2 agreement.

At oral argument, defendants’ counsel recognized that it would be unreasonable to conclude that the funding obligations of sections 5.4 and 5.8 of SPA-1 survived after the

execution of SPA-2. However, defendants do seek to recover for breaches of sections 5.4 and 5.8 of SPA-1 that accrued prior to the execution of SPA-2, arguing that nothing in SPA-2 extinguished accrued causes of actions or released plaintiff from liability therefrom.

Whether SPA-2 effected a discharge of liabilities or obligations accrued under the prior agreement depends on the intention of the parties, deduced from the documents and the circumstances of their execution (*Mallad Constr. Corp. v. County Fed. Sav. & Loan Assn.*, 32 NY2d 285, 292 [1973]). Ordinarily, where an agreement alleged to have been breached has been rescinded by a subsequent agreement, the claim is determined by reference to subsequent rescission agreement, “and in general no such claim can be made unless expressly or impliedly reserved upon the rescission” (*id.* at 293).

The Court concludes that SPA-2 is ambiguous as to whether defendants retain the right to sue for breaches of sections 5.4 and 5.8 of SPA-1 that occurred prior to the execution of SPA-2. The language of SPA-2 expressly deeming certain obligations created by SPA-1 to be void *ab initio* and the absence of similar language with respect to sections 5.4 and 5.8 leaves open the possibility that SPA-2 implicitly reserved such a right. This issue is one upon which the parties should have the opportunity to submit extrinsic evidence, following an opportunity for discovery.

#### **b. Mutual Consent & Release**

Plaintiff also contends that the mutual consent and release forecloses defendants’ claims for breaches of SPA-1. Approximately five months after entering into SPA-2, plaintiff and defendant SCI entered into a “Mutual Consent and Release” whereby defendant SCI, on behalf of its affiliates, associates and collective shareholders, acknowledged remittance of the funds due to plaintiff under “an acceleration of the remittance timeline” established in SPA-2 and that, upon

receipt of such funds, SCI “satisfied in full all obligations of SCI to [plaintiff]” (Garvey Aff. Ex. E, ¶ 3). This agreement also provided that “SCI shall have no further or future obligation to [plaintiff] and [plaintiff] does hereby release SCI from and waive for all time any claim and/or right [plaintiff] may have against SCI, including without limitation any entitlement [plaintiff] may have to receive any sums from or any obligations of SCI to [plaintiff] under the 2004 Agreement [SPA-2], except for section 8.11 [right of first refusal] and 8.12 [consideration of future business arrangements]" (*id.*).

Defendants respond by noting that although the document is denominated a “mutual consent and release”, its operative language is entirely one-sided. The mutual consent and release, by its terms, provides that plaintiff releases defendant SCI, but does not have SCI providing an express release to plaintiff. Moreover, defendants note that the release is signed only by one corporate defendant, none of the other corporate defendants and none of the individual defendants.

Plaintiff, in turn, re-emphasizes that the release was, by its terms, “mutual” and it was further directed at the parties’ objective of a “complete unwinding of the transactions contemplated by the 2003 agreement.” With respect to the issue of which defendants are bound by the release, plaintiff argues that the release states that it was executed on behalf of SCI affiliates and associates and its/their shareholders, and plaintiff reasonably relied upon this representation. Plaintiff also argues that defendants ratified the agreement through conduct.

Given the absence of express language providing plaintiff a release from defendant SCI (or any other defendant), the apparent conflict between the broad caption of agreement and the actual scope of the releases expressly set forth therein and the seemingly ancillary nature of this issue to the parties’ objective of achieving a “complete unwinding” of the business transactions

set forth in SPA-1, the Court is not persuaded at this juncture that the mutual consent and release necessarily forecloses defendants' counter-claims as a matter of law. Again, this is an issue upon which extrinsic evidence should be considered following an opportunity for discovery.

## **2. Counterclaims No. 4 (Breach of SPA-1)**

As a fourth counterclaim, defendants claim that they were induced to enter into SPA-1 through plaintiff's fraudulent misrepresentations. In moving for dismissal, plaintiff contends that defendants copied this counterclaim verbatim from an SEC complaint and failed to adequately plead scienter and deception. Moreover, plaintiff argues that defendants cannot demonstrate injury, since the unwinding of the transaction as a result of SPA-2 restored defendants to the position they would have been in had they not entered into SPA-1. Plaintiff also argues that defendants' failure to engage in sufficient due diligence forecloses a claim of reasonable reliance. Finally, plaintiff argues that neither SPA-2 nor the mutual consent and release reserve to defendants a claim for fraud.

"To make out a prima facie case of fraud, the complaint must contain allegations of a representation of material fact, falsity, scienter, reliance and injury" (*Small v Lorillard Tobacco Co.*, 94 NY2d 43, 57 [1999]). While a mere misrepresentation of an intention to perform under the contract is insufficient to sustain a claim of fraud, a misrepresentation of material fact that serves as an inducement for the contract is sufficient (*WIT Holding Corp. v Klein*, 282 AD2d 527, 528 [2<sup>nd</sup> Dept. 2001]; see *Todd v Grandoe Corp.*, 302 AD2d 789, 791 [3<sup>rd</sup> Dept. 2003]). "Where a cause of action or defense is based upon misrepresentation, fraud, mistake, wilful default, breach of trust, or undue influence, the circumstances constituting the wrong shall be stated in detail" (CPLR § 3016 [b]).

The Court finds that defendants have failed to plead their cause of action for fraudulent inducement in accordance with the requirements of the CPLR. The lack of any allegation of scienter or reliance is fatal to defendants' counterclaim (*see Barclay Arms v. Barclay Arms Assoc.*, 74 NY2d 644, 646-47). Further, although defendants devote 12 pages of their answer to detailing this claim of fraudulent inducement, the pleading fails to provide specific evidentiary facts constituting the facts and circumstances by which defendants were fraudulently induced to enter into SPA-1. Rather, as plaintiff contends, this verbiage appears to have been copied verbatim from a complaint filed by the SEC in a separate action against plaintiff. While defendants may well be correct in asserting that plaintiff's alleged fraud against defendants involved similar misrepresentations regarding plaintiff's financial capacity and its business relationships, defendants nonetheless must plead specific evidentiary facts detailing the elements of the fraud allegedly committed against them. Accordingly, defendants' fourth counterclaim must be stricken.

In recognition of this possibility, defendants have attached a proposed amended answer that repleads the fraudulent inducement claim. Having reviewed the proposed amended pleading, the Court finds that it adequately alleges scienter and reliance. Moreover, it provides specific and detailed allegations concerning the facts and circumstances of the fraud allegedly committed by plaintiff against defendants. Accordingly, the Court finds that the proposed counter-claim would overcome the pleading defects identified above.

The Court must then consider the other objections to the fraud claim raised on this motion by plaintiff, so as to ensure that the proposed amendment would not be futile (*see DeLorenzo v. Bac Agency*, 256 AD2d 906, 908 [3<sup>rd</sup> Dept. 1998]).

First, plaintiff argues that the defendants cannot demonstrate injury – an essential element

of a cause of action for fraud – since SPA-2 restored defendants to the same position had they not entered into the SPA-1 transaction. This argument is without merit. Defendants aver that they have suffered substantial transaction costs, loss of customers, lost opportunities and damage to business representation as a result of their dealings with plaintiff (Lefebvre Aff. ¶ 37). The unwinding of SPA-1 did nothing to make defendants whole for these actual pecuniary losses alleged to arise from plaintiff’s fraudulent misrepresentations (*see Lama Holding Co. v. Smith Barney*, 88 NY2d 413, 422 [1996]).

Plaintiff also contends that defendants’ failure to engage in due diligence forecloses a claim of fraudulent inducement. New York 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 [1<sup>st</sup> Dept. 2006]; *see also Abrahami v. UPC Constr. Co.*, 224 AD2d 231 [1<sup>st</sup> Dept. 1996]; *First Nationwide Bank v 965 Amsterdam*, 212 AD2d 469 [1<sup>st</sup> Dept. 1995]). While plaintiff may ultimately succeed in demonstrating that defendants’ reliance on plaintiff’s representations were not reasonable under the circumstances, the Court has no basis for determining this issue on the limited record before it, particularly in the absence of discovery (*cf. Jered Contr. Corp. v. New York City Tr. Auth.*, 22 NY2d 187 [1968]).

Finally, plaintiffs’ argument that SPA-2 and/or the mutual consent and release foreclose defendants’ counter-claim for fraudulent inducement must be rejected in view of the Court’s prior conclusion that neither SPA-2 nor the mutual consent and release demonstrate a sufficiently clear intention to extinguish, as a matter of law, accrued claims arising out of SPA-1 that were not expressly extinguished in SPA-2. Further, a general merger clause is ineffective to preclude parol evidence of fraud in the inducement (*see Citibank v. Plapinger*, 66 NY2d 90 [1985]).

Based on the foregoing and cognizant of the fact that certain elements of defendants' fraud claim find strong support in the decision of the federal district court in *SEC v. Universal Express, Inc.*, the Court finds that defendants should be permitted to replead their counterclaim of fraudulent inducement in accordance with the proposed amended answer. Accordingly, the Court grants defendants leave to amend.

### **Discovery**

Finally, in light of the foregoing, the Court denies as moot defendants' cross-motion to compel discovery pursuant to CPLR §§ 3124 and 3126 during the pendency of this motion. Similarly, defendants' motion for a stay of litigation pursuant to CPLR § 2201 pending the outcome of the SEC action in the Southern District of New York, which was decided during the pendency of this motion, also is denied as moot. A court conference will be scheduled to establish an appropriate schedule for discovery and any further dispositive motions in this matter.

Accordingly, it is

**ORDERED** that the branch of plaintiff's motion to dismiss the second, third and fourth affirmative defenses is granted; and it is further

**ORDERED** that defendants' second, third and fourth affirmative defenses are dismissed; and it is further

**ORDERED** that the branch of plaintiff's motion to dismiss the second and third counter-claims is denied; and it is further

**ORDERED** that the branch of plaintiff's motion to dismiss the first and fourth counter-claim is granted; and it is further

**ORDERED** that defendants' request for leave to amend its answer to replead its fourth counter-claim, premised on fraudulent inducement, is granted; and it is further

**ORDERED** that defendants' cross-motion to compel discovery and/or stay the litigation is denied as moot.

This shall constitute both the decision and order of the Court. All papers, including this decision and order, are being returned to plaintiff. The signing of this decision and order shall not constitute entry or filing under CPLR 2220. Counsel is not relieved from the applicable provisions of that section relating to filing, entry and notice of entry.

Dated: May 30, 2007  
Albany, New York

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Richard M. Platkin, A.J.S.C.

Papers Considered:

First Amended Complaint, dated September 29, 2006 with attached Exhibits A-G;

Affidavit of Chris G. Gunderson, Esq, sworn to January 8, 2007;

Affirmation of Lawrence A. Garvey, Esq., dated January 8, 2007 with attached Exhibits A-F;

Notice of Motion, filed January 12, 2007;

Affidavit of Robert Lefebvre, sworn to February 6, 2007 with attached Exhibits A-C;

Affidavit of Robert J. Slack, sworn to February 6, 2007;

Affirmation of Paul A. Levine, Esq., dated February 8, 2007 with exhibits A-DD in separate exhibit volume;

Notice of Cross-Motion, dated February 8, 2007;

Affirmation of Paul A. Levine, Esq., dated February 28, 2007 with attached Exhibit A;

Reply Affirmation of Paul A. Levine, Esq., dated March 16, 2007

Second Affirmation of Paul A. Levine, Esq., dated April 5, 2007 with attached Exhibit A;

Affirmation of Lawrence A. Garvey, Esq., in opposition to motion to compel, undated;