

STATE OF NEW YORK  
SUPREME COURT COUNTY OF LIVINGSTON

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DAVID SIMPSON, RICHARD MANGAN and  
POLLY DITCH,

Plaintiff,

DECISION AND ORDER

v.

Index #2005/0687

ITHACA GUN COMPANY LLC, IGC  
RECOVERY LLC, ITHACA OUTDOORS LLC,  
ANTHONY EISENHUT, ROBERT DEAN, and  
ANDREW SCIARABBA,

Defendant.

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Plaintiffs, David Simpson, Richard Mangan, and Polly Ditch, move to amend the complaint pursuant to CPLR §3025 and for summary judgment pursuant to CPLR §3212. Plaintiffs seek summary judgment is sought on the first, second third, fourth, and fifth causes of action of the complaint, as well as the eighth cause of action in the proposed amended complaint. Defendants, IGC Recovery LLC, Ithaca Outdoors LLC, Anthony Eisenhut, Robert Dean, and Andrew Sciarabba, cross move seeking partial summary judgment dismissing plaintiffs' complaint in its entirety.

Plaintiffs commenced this action to recover monies alleged to be due them from Ithaca Gun Company, LLC ("Ithaca Gun") for unpaid bonuses (Simpson and Mangan), unpaid salary (Simpson), a loan (Simpson), and unreimbursed expenses (Simpson and Ditch). Defendants concede Ithaca Gun Company, LLC's liability for the

all of the above except the unreimbursed expenses of Simpson and Ditch. The motion and cross motion primarily test the claimed liability of IGC for these liabilities of Ithaca Gun under the de facto merger doctrine.

Ithaca Gun was formed in May 1996 to operate a gunsmithing business with assets acquired from BSB Bank & Trust Company, following BSB's foreclosure of its security interests which had belonged to Ithaca Acquisition Corporation. At the time the assets were acquired, Ithaca Gun assumed the debt due to BSB and Ithaca Gun's members personally guaranteed the assumed debt. Between 1996 and 2001, Ithaca Gun was extended additional credit by BSB.

In August 2002, BSB brought an action in New York Supreme Court, Broome County, against Ithaca Gun, seeking the balance due on notes. The action also sought judgment against Ithaca Gun's members pursuant to the guaranties. Ultimately, IGC Recovery LLC ("IGC Recovery") was formed in December 2002 to acquire Ithaca Gun's \$1,185,000.00 debt owed to BSB. IGC Recovery's members also contributed capital, and IGC Recovery purchased the secured debt due to BSB from Ithaca Gun, as well as BSB's security interests in the collateral securing the debt. Ithaca Gun then executed two promissory notes dated December 31, 2002 in the amounts of \$308,000 and \$805,000 in favor of IGC Recovery, as well as a security agreement whereby Ithaca Gun granted IGC

Recovery a security interest in its assets to secure the debt reflected in the notes. Ithaca Gun did not make any payments to IGC Recovery under the notes and was in default as defined in the Security Agreement from February 1, 2003.

Shortly before the BSB action was commenced, in June 2002 Simpson was hired by Ithaca Gun as president at a salary of \$50,000 per year plus a bonus based on performance. In February 2003 Simpson hired Mangan to develop a barrel replacement line for Ithaca Gun's business. In the summer of 2003 Simpson was aware that Ithaca gun could not meet its payroll. Simpson then, not pursuant to any directive, transferred funds from his personal account to cover the payroll. Ditch was hired in early 2005 by Simpson to help with the development of Ithaca Gun's website and to market soft goods. Ditch expended her own money on behalf of Ithaca Gun, and alleges that Simpson authorized her to do so.

Ithaca Gun's financial problems also extended to an inability to pay its Federal Firearms and Ammunition Excise tax. As a result, in 2004 the government attached Ithaca Gun's bank accounts. Ithaca Gun attempted to work out a payment plan for the firearms taxes with the US Treasury Department. When it was apparent that the firearm tax issue would not be resolved, IGC Recovery declared Ithaca Gun in default on its obligations under the 2002 notes and security agreement. The U.S. Government's

2004 attachment triggered terms in the security agreement, and IGC Recovery alleges that it is pursuant to those terms it took possession of and collected Ithaca Gun's accounts receivables and deposited its collateral in a bank account maintained by its subsidiary, Ithaca Outdoors LLC. On May 2, 2005, IGC Recovery accepted surrender of Ithaca Gun's assets pursuant to the Agreement Regarding Acceptance of Collateral in Satisfaction of Obligation.

The parties' versions of the facts differ in some respects with respect to whether Ithaca Gun and/or IGC Recovery (through Ithaca Outdoors) continued operations after May 2, 2005. Defendants allege that they did not continue business after that date, instead engaging merely in orderly liquidation of the assets. As part of the liquidation, defendants state that IGC Recovery entered into an Intercreditor Agreement with Cayuga County dated August 8, 2005 whereby it surrendered part of the collateral in satisfaction of a superior security interest held by Cayuga County. The remaining asserts, defendants assert, were sold to Craig Marshall under the terms of an Asset Purchase Agreement dated December 6, 2005.

Plaintiffs offer a different version of what transpired after May 2, 2005. According to plaintiffs, at that time defendants Eisenhut made a speech to Ithaca Gun employees notifying them that a new company named Ithaca Outdoors LLC would

continue Ithaca Gun's business, and that if employees wanted to remain employed, it would be by that different business. Simpson further alleges that Eisenhut informed him that Andrew Gibson and James Moher were interested in purchasing the company and would arrive on May 9, 2005, to operate the company for a period of time until they actually purchased it. Simpson alleges that this in fact happened from May 9, 2005, through the end of June, 2005. Simpson states that he continued in his employment from May 2, 2005 through May 11, 2005 and that IGC Recovery continued conducting business the same as it had before during that time: orders were accepted, firearms were manufactured, and products were shipped. By June 23, 2005, however, Simpson states Messrs. Gibson and Moher had decided not to purchase the business. It was at that point, according to plaintiffs, that IGC Recovery elected to cease business operations and began to sell assets.

The complaint states seven causes of action: the first three allege breaches of contract by Ithaca Gun, the fourth alleges a theory of quantum meruit, the fifth alleges unjust enrichment, the sixth alleges fraudulent conveyance, and the seventh alleges fraud. Defendants' answer interposes two counterclaims: one against Simpson alleging breach of fiduciary duty, and one against Simpson and Ditch alleging conversion of inventory and/or equipment. Neither side addresses the counterclaims. Discovery

between the parties has been completed. On February 15, 2006 Ithaca Gun sought relief under Chapter 7 of the United States Bankruptcy Code to provide its creditors an opportunity to review an orderly review of its transactions. A Chapter 7 Trustee was appointed who determined there was no cause to bring an adversary proceeding to avoid preferential or fraudulent transfers. The petition was granted on May 11, 2006, and the debts of Ithaca Gun were discharged.

Motion to Amend

CPLR §3025(b) states: "A party may amend his pleading, or supplement it by setting forth additional or subsequent transactions or occurrences, at any time by leave of court or by stipulation of all parties. Leave shall be freely given upon such terms as may be just including the granting of costs and continuances." A leave to amend should consequently be granted absent "surprise or prejudice." Comsewoque Union Free School Dist. v. Allied-Trent Roofing Sys., Inc., 15 A.D.3d 523 (2<sup>nd</sup> Dept. 2005). Siegel has noted:

Almost everything parties seek to add to their pleadings is designed to prejudice the other side. That's what litigation is all about. So, the showing of prejudice that will defeat the amendment must be traced right back to the omission from the original pleading of whatever it is that the amended pleading wants to add- some special right lost in the interim, some change of position or some significant trouble or expense that could have been avoided had the original pleading contained what the amended one now

wants to add.

David D. Siegel, N.Y. Practice, §237. The decision whether to grant such a motion lies in the court's discretion. See C-Kitchens Assoc., Inc. v. Travelers Ins. Companies, 15 A.D.3d 905 (4<sup>th</sup> Dept. 2005), *citing* Edenwald Contr. Co. v. City of New York, 60 N.Y.2d 957, 959 (1983). A proposed amendment may be denied where it is apparent that the proposed amendment patently lacks merit. See Water Club Homeowners Assoc., Inc. v. Town Bd. of the Town of Hempsted, 16 A.D.3d 678 (2d Dept. 2005); McFarland v. Michel, 2 A.D.3d 1297, 1300 (4<sup>th</sup> Dept. 2003). "[A] court will not ordinarily consider the merits of the proposed new matter unless it is so obviously lacking in merit as to have no chance of success whatever...." N.Y. Practice, §237.

Plaintiffs seek leave to amend their complaint to add a cause of action for breach of fiduciary duty owed by the managing members of Ithaca Gun to plaintiffs. The original complaint contains a cause of action against the three managing members of Ithaca Gun for fraud, and contains many operative facts relied upon by Plaintiffs in the motion to amend. Moreover, the only additional facts alleged in the proposed amendment relate to Ithaca Gun's declaration of bankruptcy and Plaintiffs' allegation that various debts of Ithaca Gun were assumed by IGC Recovery. As there can be no surprise suffered by the defendants who had full knowledge of the bankruptcy and the proposed amendment does

not patently lack merit, Plaintiffs' motion to amend to add the eighth cause of action for breach of fiduciary duty is granted.

However, to the extent Plaintiffs' seek summary judgment on this new cause of action, upon which issue obviously has not been joined pursuant to CPLR §3212, the motion for summary judgment is premature. See N.Y. CPLR §3212(a) ("Any party may move for summary judgment in any action, after issue has been joined...."). Plaintiffs' motion for summary judgment on the eighth cause of action is denied.

#### Motion for Summary Judgment

It is well settled that "the proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact." Alvarez v. Prospect Hosp., 68 N.Y.2d 320, 324 (1986) (citations omitted). See also Potter v. Zimmer, 309 A.D.2d 1276 (4<sup>th</sup> Dept. 2003) (citations omitted). "Once this showing has been made, the burden shifts to the nonmoving party to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact that require a trial for resolution." Giuffrida v. Citibank Corp., 100 N.Y.2d 72, 81 (2003), *citing* Alvarez, 68 N.Y.2d at 324. "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the responsive papers." Wingrad v. New York Univ. Med. Ctr., 64 N.Y.2d 851, 853 (1985)

(citation omitted). See also Hull v. City of North Tonawanda, 6 A.D.3d 1142, 1142-43 (4th Dept. 2004). When deciding a summary judgment motion, the evidence must be viewed in the light most favorable to the nonmoving party. See Russo v. YMCA of Greater Buffalo, 12 A.D.3d 1089 (4<sup>th</sup> Dept. 2004). The court's duty is to determine whether an issue of fact exists, not to resolve it. See Barr v. County of Albany, 50 N.Y.2d 247 (1980); Daliendo v Johnson, 147 A.D.2d 312,317 (2<sup>nd</sup> Dept. 1989) (citations omitted). Although plaintiffs' notice of motion indicates that it seeks summary judgment without qualification, the reply affirmation of Andrew Ryan, Esq. indicates that summary judgment is sought only on the first, second, third, fourth, fifth, and proposed eighth causes of action. As stated, previously, the court denies without prejudice the motion as to the eighth cause of action, as issue as to that claim has not been joined.

Plaintiffs allege that they are entitled to summary judgment on the first five causes of action against IGC Recovery and Ithaca Outdoors, as those entities are successors in interest to Ithaca Gun.<sup>1</sup> "It is the general rule that a corporation which acquires the assets of another is not liable for the torts of its predecessors." Schumacher v. Richards Shear Co., Inc., 59 N.Y.2d

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<sup>1</sup>Plaintiff's first five causes of action are pled against Ithaca Gun. The allegations of successor liability relied on by plaintiffs in the instant motion are set forth in the "Background" section of the complaint. Each of the first five causes of action repeats and realleges the previous allegations.

239, 244 (1983). Exceptions to the general rule arise in the following circumstances where a corporation will be held liable for a predecessor's debts:

(1) it expressly or impliedly assumed the predecessor's tort liability; (2) there was a consolidation or merger of seller and purchaser; (3) the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction is entered into fraudulently to escape such obligations.

Id. at 245. See also, Kasem v. BNC Storage, LLC, 30 A.D.3d 469 (2d Dept. 2006); AT&S Transportation, LLC v. Odyssey Logistics & Tech. Corp., 22 A.D.3d 750 (2d Dept. 2005); Sweatland v. Park Corp., 181 A.D.2d 243 (4<sup>th</sup> Dept. 1992). It has been held that this doctrine applies equally in a breach of contract action. See Kretzmer v. Firesafe Prod. Corp., 24 A.D.3d 158 (1<sup>st</sup> Dept. 2005), *citing* Fitzgerald v. Fahnestock & Co., 286 A.D.2d 573 (1<sup>st</sup> Dept. 2001). Here, plaintiffs rely upon the doctrine of *de facto* merger to argue that IGC Recovery's receipt of Ithaca Gun's assets under Security Agreement obtained from BSB constituted a "consolidation or merger of seller and purchaser" under New York law. The *de facto* merger doctrine will be applied where "the acquiring corporation has not purchased another corporation merely for the purpose of holding it as a subsidiary, but rather has effectively merged with the acquired corporation." Fitzgerald v. Fahnestock & Co., Inc., 286 A.D.2d 573, 574 (1<sup>st</sup> Dept. 2001). The following have been noted as "hallmarks" of a

*de facto* merger:

[C]ontinuity of ownership; cessation of ordinary business and dissolution of the acquired corporation as soon as possible; assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and, continuity of management, personnel, physical location, assets and general business operation.

Id., citing Sweatland, 181 A.D.2d at 245-46. A party need not demonstrate all of these elements in order for a court to determine that there has been a *de facto* merger. Id. at 574-75. "However, in non-tort actions, 'continuity of ownership is the essence of a merger.'" Washington Mut. Bank, F.A. v. SIB Mortgage Corp., 21 A.D.3d 953, 954 (2d Dept. 2005), quoting Cargo Partner AG v. Albatrans, Inc., 352 F.3d 41, 46 (2<sup>nd</sup> Cir. 2003).

Continuity of ownership exists if "the shareholders of the predecessor corporation become direct or indirect shareholders of the successor corporation. . . ." Continuity of ownership has been deemed "'the essence of a merger'" that is "a necessary element of an *de facto* merger finding, although not sufficient to warrant such a finding by itself." New York City Asbestos Litigation, 15 A.D.3d 254,256 (1<sup>st</sup> Dept. 2005), citing Cargo Partner AG, 352 F.3d at 46-47. Here, Ithaca Gun and IGC Recovery were owned by the same seven individuals. Ithaca Outdoors is a limited liability company owned by IGC. As such, plaintiffs have demonstrated continuity of ownership. Plaintiffs have also

demonstrated cessation of ordinary business and dissolution of the predecessor as soon as practically and legally possible. Although Ithaca Gun continued to exist on paper after May 2, 2005, it did not remain in existence "in a meaningful way." Id. By the time Ithaca Gun's bankruptcy petition was filed, it had ceased operation and its assets had been seized pursuant to the Security Agreement IGC Recovery had received from BSB.

With respect to the assumption of Ithaca Gun liabilities necessary for the uninterrupted continuation of business, plaintiffs establish that IGC paid Ithaca Gun liabilities to Cayuga County and Binghamton Savings Bank, the latter of which the LLC members personally guaranteed. that had be paid due to the possession of superior security interests. IGC also paid Sciarabba Walker & Co. Ithaca Gun debts. It is uncontroverted that Ithaca Gun and IGC Recovery were both managed by the same individuals, that many of the same employees continued to report to work, and that the physical locations and assets of Ithaca Gun were the same as those used by IGC Recovery.

As to the continuity of general business operation, defendants deny that they continued the business, and instead attest that, post May 2, 2005, IGC Recovery began the lawful liquidation of the collateral and did not continue the operation of Ithaca Gun. Evidence presented by plaintiffs, however, paints a different picture, and this evidence is largely uncontradicted

on this record. Plaintiffs attest that business continued as usual after May 2, 2005 until the end of June 2005 when Messrs. Gibson and Moher decided not to purchase the business. See Affidavit of Katrinka Ryan dated November 29, 2006; Affidavit of David Simpson dated November 29, 2006, at ¶13, 16. It is true that Mr. Simpson's alleged observation of "business as usual" at the site extended only to May 16, 2005. The affidavit of Ms. Ryan states that normal business ended as of the end of June 2005, but stops short of specifically stating that new orders were being taken, but rather states that the employees "continued with the usual business of manufacturing, selling, and repairing firearms." K. Ryan Affidavit, ¶5. Defendants had admitted this much in their papers, but stated that, while IGC Recovery endeavored post May 2, 2005 to finish up outstanding work and orders received prior to May 2, 2005, no new work was accepted. The fact that the company was continued in operation until the decision of the putative buyers not to purchase the business in late June is, on this record, beyond serious question.

Therefore, plaintiffs establish as a matter of law the occurrence of a de facto merger, and defendants fail to raise an issue of fact warranting a trial. Although as defendants contend, the Second Circuit has held that each of the four factors identified above must be established, New York case law as to the contrary, and, in any event, enough undisputed evidence

on the continuity issue has been adduced by plaintiff to establish, together with the forceful showing in their favor on the other 3 factors, that the de facto merger doctrine must be applied. Summary judgment against IGC LLC and IGC Recovery, for the liabilities of IGC LLC conceded by defendants, is granted, but is denied insofar as the motion concerns the remaining defendants. The cross-motion for summary judgment on these discrete claims, brought on behalf of all defendants, is granted except with respect to IGC Recovery and Ithaca Outdoors, as to those two defendants the cross-motion addressed to these claims is denied. That leaves for trial the liability of Ithaca Outdoors on these claims.<sup>2</sup>

That leaves for consideration the balance of plaintiff's motion, and the cross-motion of the co-defendants for summary judgment. Simpson's motion for summary judgment on his claim for unreimbursed expenses in the amount of \$10,246.64 was not challenged by defendants during depositions, Eisenhut deposition, at 177 ("I don't have reason to dispute it"), and therefore is granted as against IGC LLC and IGC Recovery, but is otherwise denied as against the remaining defendants. That part of the

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<sup>2</sup> The parties' papers are in agreement that Ithaca Outdoors LLC is wholly owned by IGC Recovery, but they do not address why Ithaca Outdoors should be held responsible the liabilities of IGC Recovery. Ithaca Outdoors has no operating agreement, nor have any managing members been appointed. It has no employees and was not considered an operating company, according to Sciarabba.

cross-motion addressed to Simpson's reimbursement claim is granted except as it concerns IGC Recovery and Ithaca Outdoors, and as to those two defendants is denied. That leaves the liability of Ithaca Outdoors for this discreet claim for trial.

Ms. Ditch's motion for summary judgment on her claim for unreimbursed expenses is supported only by her affidavit claiming \$10,536.65 due for purchases of "soft goods" and promotional items with the Ithaca Gun logo affixed. No supporting documentation is provided, however, and her deposition testimony was wholly inconclusive on the issue of the amount that was due. Accordingly, her motion is denied. Insofar as the cross-motion is addressed to this discrete claim, it is granted in favor of all defendants except IGC LLC and IGC Recovery, and as to the latter defendants is denied (those two defendants having failed to show initially that nothing was due Ditch).

Plaintiffs' motion for summary judgment on the Sixth and Seventh Causes of Action is denied and the cross-motion of all defendants to dismiss these causes of action is granted.

SO ORDERED.

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KENNETH R. FISHER  
JUSTICE SUPREME COURT

DATED: December 8, 2006  
Rochester, New York