

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: KORNREICH
Justice

PART 54

SCHNEIDER, PETER

INDEX NO. 602855/09
MOTION DATE 10/12/10
MOTION SEQ. NO. 001
MOTION CAL. NO. _____

- v -

WORD WORLD LLC

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

E-Filed
PAPERS NUMBERED

1-13

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM.
DECISION AND ORDER.**

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 12/17/10

JUSTICE SHIRLEY WERNER KORNREICH
[Signature]
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

SUBMIT ORDER/JUDG.

SETTLE ORDER /JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

-----X
PETER SCHNEIDER,

Plaintiff,

Index No. 602855/2009

-against-

DECISION & ORDER

WORD WORLD LLC,

Defendant.

-----X
SHIRLEY WERNER KORNREICH, J.:

In this action for breach of three contracts, defendant Word World LLC moves to dismiss the amended complaint for failure to state a cause of action and based upon documentary evidence. CPLR 3211(a)(1) and (7). In addition, defendant alleges that plaintiff's claims are barred by the statute of limitations, CPLR 213. Defendant argues that it was not a party to the first two contracts and not bound to them under the theory of de facto merger. Defendant further contends that it did not breach the contracts pursuant to their terms. For the reasons that follow, the motion is denied.

Background

As this is a motion to dismiss, the court accepts as true the factual allegations in the amended complaint and affidavit submitted by plaintiff, affording them the benefit of every favorable inference. *Rovello v Orofino Realty Co.*, 40 NY2d 633, 634 (1976); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Wise Metals Group, LLC*, 19 AD3d 273, 275 (1st Dept 2005). In addition, for purposes of the motion, defendant asks the court to accept as true plaintiff's assertion that he was terminated as manager of defendant without just cause. The following

recitation of facts is drawn from the amended complaint and plaintiff's affidavit. Defendant submitted its verified answer, documentary evidence and legal argument in support of its motion.¹

Just after September 11, 2001, plaintiff Peter Schneider first met Don Moody and Gary Friedman, the CEO and Chairman of the Board of Playgroundz Productions Inc. (PPI), respectively. At the time of their first meeting, plaintiff was a creative product development expert with over twenty-five years experience in creative development, merchandising of licensed products, toy and gift product development and management. PPI had a video product featuring a process called "Read Speak" that taught reading through simultaneously hearing and seeing words emanating from the mouths of speaking characters, a method of achieving literacy through whole word learning. PPI wanted to market the product through television infomercials and needed additional products to sell to make the investment in television infomercials more profitable. PPI's videos were called "Word Wizards." At the first meeting, Moody and Friedman asked plaintiff to come back with "dynamic ideas" to contribute to the Word Wizards project in return for compensation.

Instead, using his background in creating toy figures, dolls and plush toys, plaintiff came up with an educational entertainment product involving uniquely constructed letter-shaped characters called "Word Things" that would live in a world called "Word World." Word World was targeted for pre-school children, while Word Wizards was appropriate for early elementary school children. However, initially Friedman and Moody insisted that Word Things should be

¹Defendant's answer to the amended complaint was filed after oral argument of the motion, but before the final date of submission.

developed for Word Wizards video.

In October 2001, plaintiff entered into an “Interim Independent Contractor Agreement” with PPI (Initial Contract), with a term ending February 28, 2001. The Initial Contract provided that: 1) plaintiff would work full time for PPI to develop a line of products and a marketing program for Word Wizard; and 2) plaintiff assigned to PPI all rights to intellectual property and products he developed in connection with his work for PPI. In return, PPI would pay plaintiff \$11,650 per month. The Initial Contract acknowledged that plaintiff had been paid for two months (Oct. 15- Nov. 15 and Nov. 15- Dec. 15, 2001). Moody signed the Initial Contract as CEO of PPI. Plaintiff was given the title Executive Vice President Product Development and Marketing and told that he would be a substantial part of key management.

On April 10, 2002, plaintiff entered into a “Renewal of Interim Independent Contractor’s Agreement” with PPI (Renewal Contract). The Renewal Contract continued the parties’ relationship for the period March 15, 2002 through February 28, 2003. The Renewal Contract provided that plaintiff would devote a majority of his professional time to product development and sales for PPI. In subparagraph 2(a) of the Renewal Contract, PPI acknowledged that it owed plaintiff \$50,775.00 under the Initial Contract and an extension thereof and PPI agreed to use its best efforts to pay plaintiff that sum by September 15, 2002. Pursuant to Subparagraph 2(a), failure to pay plaintiff that amount by that date was a breach of the terms of the Renewal Contract. In addition, PPI agreed to pay plaintiff \$16,667.00 per month, payable bi-weekly, during the term of the Renewal Contract (Renewal Agreement Compensation).

Subparagraph 2(b) of the Renewal Contract, entitled “New Compensation,” further provided as follows:

If the Company [PPI], during any pay period, is unable to make full payment of the Renewal Agreement Compensation then due Schneider ... , then: (i) the Company shall pay Schneider not less than it pays any other executive, board member or other independent contractor/consultant, such as Schneider herein, during such pay period; and (ii) all unpaid sums then remaining shall accrue interest at a rate of 8 ½% per year. Company will make best efforts to pay such Renewal Agreement Compensation to Schneider in accordance with the payment schedule set forth herein and in return Schneider agrees not to allege any breach of the terms of this provision until on or after September 15, 2002. Company's failure to make full or current payment of the Renewal Agreement Compensation the [sic] due and owing by September 15, 2002 shall constitute, in addition to a breach of the terms hereof, a failure to discharge the Company's obligations within the meaning of subsection (c) below. Until such time as the Company has brought current its obligations to Schneider under this subparagraph (b) and at any time thereafter in which Company is in arrears to Schneider pursuant to this subparagraph, Schneider shall be entitled to receive a "Sales Override" of not less than ten percent (10%) on all "Net Revenue", as defined herein, received by the Company as a result of product sales for which Schneider is primarily responsible less (i) 25% of such total revenues which shall be directed to the pay down of certain deferred debt of the Company ... ("Company Deferred Debt"); (ii) 10% of such total revenues to ReadSpeak as a royalty for the exploitation of their licensed technology; and (iii) any percentage and/or cash commissions approved by Schneider relative to such product sales. Upon satisfaction of the Company Deferred Debt, it is understood and agreed that such deduction will be eliminated from the calculation of Net Revenues set forth in the foregoing sentences of this paragraph. Such Sales Override commissions shall be due and payable to Schneider within ten (10) days of receipt of such monies by Company.... Such Sales Override monies shall count towards the satisfaction of the then outstanding obligations due Schneider under this subparagraph 2(b).

Subparagraph 2(c) provided that Schneider was to receive 5% of PPI's common stock. In the Renewal Contract, as in the Initial Contract, plaintiff assigned to PPI all rights to intellectual property and products he developed in connection with his work for PPI. Moody and Friedman executed the renewal contract for PPI, as CEO and Chairman of the Board of Directors, respectively. Noah Shube also signed it as a member of PPI's Board.

While Word Things characters were being developed, the Word Wizards video project was experiencing roadblocks. After discussions with PPI's management, Moody, Friedman,

plaintiff and others decided to dedicate all their manpower, time and resources to the development of Word World and to form a new company for that purpose.

On October 1, 2002, PPI entered into a Foundational Agreement with defendant, pursuant to which PPI transferred all of its rights, title and interest in Word World to defendant. In return, defendant agreed to assign 14,000 of its membership units to PPI, representing 70% of defendant's equity issued and outstanding immediately after execution of defendant's Operating Agreement by the initial members. The Foundational Agreement was executed by Friedman on behalf of PPI and by Moody as Manager and CEO of defendant. PPI was dissolved by the New York State Secretary of State on June 30, 2004.

Also on October 1, 2002, the Word World LLC Operating Agreement was executed (Operating Agreement). The Operating Agreement provides that defendant was formed by plaintiff and Moody to develop and exploit Word World. The Operating Agreement provides that there "*shall*" be two initial managers and that the number of managers may be changed in the sole discretion of the "Managers." Significantly, "Managers" is plural. The Operating Agreement states that Moody and plaintiff shall be the managers and that managers "*shall*" have five-year terms. The Operating Agreement provides that the salaries of Moody and plaintiff would be \$200,000 per annum for the year running from October 1, 2002 to October 2, 2003. However, the Operating Agreement says that the salaries "*shall* be deferred, without interest, until the company [defendant] has the ability to pay (as determined by the Managers)." [emphasis supplied] Upon the completion of a term, resignation or in the event that a manager could or would not perform his/her duties, the remaining managers could appoint a replacement manager. Plaintiff fully performed all of his duties.

With respect to meetings, the Operating Agreement provides that at least 50% of the members or managers holding more than 50% of the membership interests may call a meeting on at least ten-days prior, written notice to each member or manager. A quorum is defined as not less than 50% of the managers and a majority of all membership interests. Once a quorum is present, an affirmative vote of members holding at least a majority of membership interests is required to approve any action. Members may vote only in the event that the vote is expressly authorized by law, expressly authorized by the Operating Agreement and/or there is a deadlock between the managers at a meeting or otherwise. Moody is empowered by the Operating Agreement to vote, in his sole and absolute authority, his membership units and on behalf of any and all of the PPI Investors. The Operating Agreement defines the PPI Investors to mean PPI and the persons listed on Exhibit A. Exhibit A has not been submitted to the court.

Article VII of the Operating Agreement provides that any action that could be taken at a meeting of members may be taken without a meeting if the action is evidenced by a written consent executed by at least 50% of the managers and at least 50% of the membership interests. The same Article provides that the members may vote in the event that there is a deadlock as between the managers “with respect to any action, at a meeting...or otherwise.”

The Operating Agreement was executed by Moody and plaintiff as defendant’s managers, by Friedman as PPI’s Chairman, and by Moody, Shube, Friedman and plaintiff, as members, as well as by various other individual members.²

After the Operating Agreement was signed, the location and contact information of

²Although the Operating Agreement states that the membership interest units of the members are set forth in Schedule A, the copy of the Operating Agreement provided to the court by defendant has no such schedule.

defendant was the same as PPI's. The personnel and operations continued without interruption. Defendant gave membership interests to PPI's landlord in lieu of payment of rent.

In press releases, interviews and US patent applications, Moody has claimed to be Word World's sole creator. Plaintiff introduced Moody to the President of FAO Schwarz who launched Word World at retail. Plaintiff introduced Moody to the principal owner of a research and testing company for the Department of Education, which led to major grant funding. Plaintiff negotiated the first licensing deal with Running Press Publishing Company, which provided significant advance royalty income. Plaintiff attracted some of Word World's first investors, who provided operating capital. Plaintiff developed a showroom of Word World toy samples. Plaintiff introduced defendant to Toys R Us, Germtion Enterprises, Warner Bros and others.

In December 2003, Moody asked plaintiff to resign as manager. Plaintiff refused. On December 23, 2003, two proposals purportedly were approved by defendant upon written consent without a meeting (Consent). Proposal one was to change the number of managers to one and to appoint Moody as sole manager. Proposal two was to amend the Operating Agreement to permit any manager to be removed by majority vote. The Consent states that the members voted because there was a deadlock between the managers as to both proposals. On January 2, 2004, the consent was sent to defendant's members by memorandum. Plaintiff was not given an opportunity to present opposing or supporting views as to the proposals. He received no written or oral notice of a change or amendment to the Operating Agreement.

On April 29, 2008, plaintiff and defendant signed a settlement agreement, subject to plaintiff's right to terminate it (Settlement Agreement). The Settlement Agreement is not in the

record, but is referred to in the Amended Complaint, ¶¶ 18-20. The Settlement Agreement provided that the statute of limitations was tolled with respect to the parties' disputes from April 29, 2008 until plaintiff terminated the Settlement Agreement, which he did by letter on April 23, 2009. *Id.* The summons and complaint in this action were filed on September 16, 2009.

Discussion

De Facto Merger

Defendant contends that plaintiff's first two causes of action should be dismissed because defendant was not a party to the Initial Contract and the Renewal Contract. Plaintiff urges that defendant can be held liable on a theory of de facto merger.

A corporation cannot be held liable for liabilities of its predecessor unless: 1) it assumes the 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. *Schumacher v Richards Shear Co., Inc.*, 59 NY2d 239, 244-245 (1983). The rule is known as the de facto merger doctrine and it applies to contractual as well as tort obligations. *Matter of AT&S Transportation, LLC v Odyssey Logistics & Technology Corp.*, 22 AD3d 750, 752 (2d Dept 2005). The hallmarks of a de facto merger are continuity of ownership, cessation of ordinary business and dissolution of the predecessor as soon as possible, assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business and a continuity of management, personnel, physical location, assets and general business operations. *Id.* The factors are analyzed in a flexible manner to determine whether it was the intent of the successor to absorb and continue the business of the predecessor. *Id.* De facto merger does not necessarily require the presence of

each factor. *Matter of NYC Asbestos Litigation v A.W. Chesterton Co.*, 15 AD3d 254, 256 (1st Dept 2005). Legal dissolution of the predecessor is not necessary before a finding of de facto merger will be made so long as the predecessor is shorn of assets and has become in essence a shell. *Matter of AT&S Transportation*, 753.

Here, plaintiff has made a sufficient showing of de facto merger to avoid dismissal on the ground that defendant was not a signatory to the Initial Contract and Renewal Contract. Accepting plaintiff's allegations as true and giving them the benefit of every favorable inference, defendant was created to take over Word World and devote all of PPI's energy's to its development and marketing in PPI's former space, with its former management and employees. PPI was dissolved. Defendant has offered no proof that PPI continued operations upon defendant's incorporation. Thus, plaintiff has sufficiently alleged a continuation of PPI's business by defendant.

Statute of Limitations

The court must accept as true plaintiff's claim that defendant agreed to toll the statute of limitations pursuant to the April 29, 2008 Settlement Agreement until plaintiff terminated it by letter on April 23, 2009. In the Renewal Contract, the parties agreed that plaintiff would not sue for breach of the Initial Contract and the Renewal Contract until September 15, 2002 in return for PPI's promise to use its best efforts to pay plaintiff. The statute of limitations on the Initial Contract began to run anew when the Renewal Contract was executed because it acknowledged the debt and contained an unequivocal promise to pay it. General Obligations Law §17-101; *Jeffrey L. Rosenberg & Assoc., LLC v Lajaunie*, 54 AD3d 813 (2d Dept 2008). The Renewal Contract says it will be breached if plaintiff is not paid the Renewal Compensation by September

15, 2002. The Settlement Agreement tolling the statute of limitations allegedly was made in April 2008, less than six years from September 15, 2002. Plaintiff allegedly ended the toll by terminating the Settlement Agreement and filed suit in September 2009. Thus, defendant has not demonstrated that the action is barred by the statute of limitations as a matter of law.

In addition, defendant's statute of limitations argument is posited on the theory that plaintiff has not proved that defendant ever had the ability to pay him. Were that true, the statute of limitations never began to run on plaintiff's compensation claim under the Operating Agreement. In an action for breach of contract, the statute of limitations accrues at the time of the breach. *Ely-Cruikshank Co. v Bank of Montreal*, 81 NY2d 399 (1993). The statute of limitations begins to run when a cause of action accrues. CPLR 203(a). If defendant never had money to pay plaintiff, then defendant did not breach Operating Agreement, which provides that plaintiff's salary would be deferred until defendant had the ability to pay him.

Failure to State a Cause of Action for Breach

A. Breach of Compensation Agreements

Plaintiff has stated a claim for breach with respect to monies allegedly owed under the Initial Contract, the Renewal Contract and the Operating Agreement. With respect to the Initial Contract, the Renewal Contract provides that the failure to pay the monies due under the Initial Contract by September 15, 2002 would be a breach. Pursuant to the Renewal Contract, defendant could owe money to plaintiff even if PPI did not pay other executives, board members, independent contractors or consultants (key people). The Renewal Contract says that PPI must pay plaintiff not less than the key people during any pay period "**and (ii) all unpaid sums then remaining shall accrue interest at a rate of 8 ½% per year**" (emphasis supplied). Thus, plaintiff

was entitled to all unpaid sums owed with interest. The reference to payments to key employees only required plaintiff to be paid no less than them during a pay period. With respect to the Operating Agreement, there is no proof on this record that defendant did not have the ability to pay plaintiff.

B. Removal of Plaintiff as Manager as Breach of the Operating Agreement

Finally, plaintiff has stated a claim that he was removed as manager in violation of the Operating Agreement. The Operating Agreement provides that defendant shall have two managers, who can only be removed by the managers. While it is true that a vote by written consent of 50% of the managers and membership interests could resolve a deadlock between the two managers, there is no proof that the managers were deadlocked over the two proposals in the Consent.

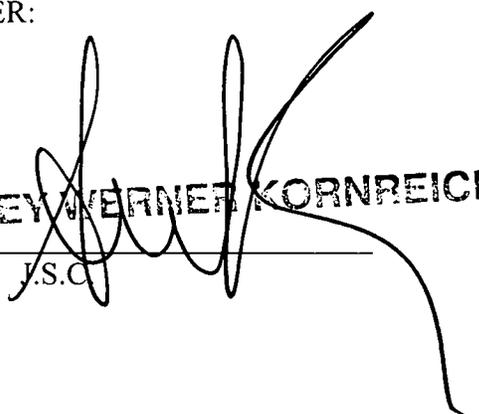
The deadlock concerned whether plaintiff should resign. Plaintiff alleges that Moody asked him to resign and he refused. Proposal one was to change the number of managers to one and to appoint Moody as sole manager. Proposal two was to amend the Operating Agreement to permit any manager to be removed by majority vote, instead of in the sole discretion of the managers. Plaintiff says, and the court must accept as true, that he was never asked to amend the Operating Agreement or given an opportunity to present his view on the proposals. Ergo, there was no deadlock as to the two proposals. Moreover, if there were a deadlock over plaintiff's resignation, which would have permitted a written consent to force his resignation, the Operating Agreement provides that the remaining manager shall appoint another manager. It does not say that the number of managers will be reduced to one or that the remaining manager will be the sole manager.

However, plaintiff is incorrect that he is entitled to notice prior to action by written consent of the requisite number of members on an action they are permitted to take. Limited Liability Company Law §407 permits members of a limited liability company to take an action by vote. Except as provided in the operating agreement, such action may be taken without a meeting and without prior notice upon written consent of the requisite number of votes. LCL §407. Accordingly, it is

ORDERED that the motion by defendant Word World LLC to dismiss the amended complaint of Peter Schneider is denied in all respects.

Dated: December 17, 2010

ENTER:


JUSTICE SHIRLEY WERNER KORNREICH

J.S.C.