

ASP HD L.L.C. v DRL Acquisition Inc.

2005 NY Slip Op 30445(U)

September 30, 2005

Supreme Court, New York County

Docket Number: 602788/04

Judge: Richard B. Lowe

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

PRESENT: HON. RICHARD B. LOWE, III

PART 86

0602788/2004

ASP HD L.L.C.
VS
DRL ACQUISITION INC.

INDEX NO. _____
MOTION DATE 2/23/05
MOTION SEQ. NO. _____
MOTION CAL. NO. _____

SEQ 2

SUMMARY JUDGMENT

The 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 _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

FILED

OCT 13 2005

NEW YORK
COUNTY CLERK'S OFFICE

MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM DECISION

Dated: 9/30/05

HON. RICHARD B. LOWE, III

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

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

SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 56

-----X
 ASP HD L.L.C.,

Plaintiff,

-against-

Index No.: 602788/04

DRL ACQUISITION INC.,
 DR. LEONARD'S HEALTHCARE CORP.,
 CORTEC GROUP FUND III, LLP and
 SUNTRUST BANKS, INC., as escrow agent,

Defendants.

-----X

RICHARD LOWE, J.:

Plaintiff ASP HD L.L.C. moves, pursuant to CPLR 3212, for summary judgment on all of its claims together with attorneys' fees, costs and disbursements. Defendant Cortec Group Fund III, LLP (Cortec III) cross-moves, pursuant to CPLR 3211(a)(7) and 3212, for dismissal of the complaint and/or for summary judgment in its favor.

This is an action for money damages and declaratory relief in connection with the defendants' alleged failure to release \$7.5 million in escrow funds following plaintiff's sale of a retail catalogue business to defendants. Based on the unambiguous language of the parties' written agreements and the uncontroverted facts, plaintiff's motion for summary judgment is denied, and upon searching the record in accordance with CPLR 3212(b), summary judgment is awarded to defendants dismissing the action in its entirety. Cortec III's cross motion to dismiss the action on the basis that it was not a party to the transaction is also granted.

FACTS

Prior to 2002, plaintiff held a controlling interest in DRL Holdings, Inc. DRL Holdings

had a wholly-owned subsidiary, Dr. Leonard's Healthcare Corp. (Dr. Leonard's), which sold goods through two catalogues, known as "Dr. Leonard's" and "Carol Wright Gifts." In May 2002, plaintiff sold 100% of the stock of DRL Holdings to a newly-created corporation called DRL Acquisition, Inc. At the time, DRL Acquisition was an indirect subsidiary of Cortec III. Following the sale, DRL Acquisition and DRL Holdings were merged into Dr. Leonard's, which is now an indirect subsidiary of Cortec III, and Dr. Leonard's continues to operate the two merchandise catalogues.

Plaintiff-seller agreed in the Stock Purchase Agreement that it would indemnify and hold DRL Acquisition harmless from breaches of representations and warranties made in connection with the sale, including, for example, a breach of plaintiff's representation that the catalog businesses had complied with all applicable laws. As is very common, the parties set up an escrow account with SunTrust Banks, Inc.¹ under a separate Escrow Agreement dated May 24, 2002 to hold back \$7.5 million of the purchase price as security for these indemnities. One of those potential claims was for a possible tax liability because of deductions claimed at plaintiff's request for certain payments made to Stephen L. Brotman, the former chief executive officer of the catalogue businesses.

By letter dated November 11, 2002, Dr. Leonard's notified plaintiff that, pursuant to Section 8.03 of the Stock Purchase Agreement, a nation-wide class action lawsuit had been filed on October 9, 2002 in the Supreme Court of the State of New York, Queens County entitled Richman v Carol Wright Promotions, Inc., Index No. 26824/02 (the Richman action). The

¹By Stipulation dated January 11, 2005, SunTrust Banks has been dismissed as a defendant in this action, without prejudice, providing it adheres to any final order of this court with respect to the disposition of the escrow fund.

Richman action challenged a “rush service & free replacement fee” of \$1.50 imposed on all orders by both merchandise catalogues as being a deceptive act or practice directed at consumers that violates Section 349 of the General Business Law. The November 11th letter demanded that plaintiff notify Dr. Leonard’s within thirty days whether plaintiff would assume the defense of this claim for which indemnity “may” be sought.

By letter dated December 2, 2002, plaintiff notified Dr. Leonard’s that it would be assuming the defense of the Richmond action, but advised that it had not yet determined whether the claim, in whole or in part, was subject to indemnification under the Stock Purchase Agreement or whether any of the allegations in the Richmond complaint implicate any of the seller’s warranties or representations under the Stock Purchase Agreement. Dr. Leonard’s rejected this letter as “defective” in a letter dated December 20, 2002 for two reasons. First, Dr. Leonard’s took the position that it had the right to approve counsel chosen by plaintiff to defend the claim. Second, Dr. Leonard’s took the position that plaintiff “cannot legitimately seek to assume a defense of a claim unless it agrees that the claim as alleged would be indemnifiable.”

By letter dated December 30, 2002, and without admitting that Dr. Leonard’s approval of counsel was a pre-condition to plaintiff assuming the defense of the Richmond action, plaintiff submitted the name of an attorney they were “inclined to retain.” This offer was apparently rejected, and the firm of Nixon Peabody LLP was retained by Dr. Leonard’s to defend the Richman action.

By letter dated May 28, 2003, Dr. Leonard’s notified the escrow agent, SunTrust Banks, that it had a pending claim against the escrow fund as a result of the filing of the Richman action. The letter further states that since the maximum potential damages from this claim could not be determined at that time, the escrow agent was instructed to retain in escrow the entire amount of

the fund, except for interest earned during the "Initial Escrow Period." By letter dated May 30, 2003, counsel for Dr. Leonard's again instructed SunTrust Banks not to release any of the escrowed funds, except interest earned during the Initial Escrow Period. In this letter, defense counsel claimed that the time period by which Dr. Leonard's was required to give notice of a claim against the escrow fund was May 31, 2003, and thus claimed that both plaintiff and SunTrusts Bank had been given timely notice of the claim by these letters.

On or about November 30, 2004, the court in the Richmond action issued an order granting preliminary approval to a settlement between Dr. Leonard's and the plaintiffs in the Richmond action. The class was defined as all customers who ever paid Dr. Leonard's a fee for rush service and free replacement for orders lost or damaged. Class members would receive a voucher for a discount of 10%, up to a maximum of \$3.00, for the purchase of catalogue goods, or could convert the voucher into \$1.00 in cash. The attorneys' fee award to class counsel was capped at \$300,000.

Counsel for Dr. Leonard's claims that, in view of the settlement, plaintiff's counsel was then informed that Dr. Leonard's would be willing to release \$4.5 million from the escrow fund. This offer was allegedly rejected by plaintiff, who demanded the immediate release of the entire \$7.5 million. Despite this rejection, on January 13, 2005, Dr. Leonard's wrote to SunTrust Banks and directed it to release all but \$3 million from the escrow fund to plaintiff. Plaintiff responded with a letter dated February 13, 2005, in which it advised SunTrust Banks that it would happily accept money from the escrow fund "without prejudice" to its claims in this action, and counsel for the plaintiff advised the court at oral argument of the motions on April 12, 2005 that this money has, in fact, been turned over to plaintiff.

In the meantime, plaintiff commenced this action on August 25, 2004. The first cause of action alleges that defendants breached the Stock Purchase Agreement by preventing plaintiff from assuming the defense of the Richmond action. The second cause of action alleges that the defendants breached the Escrow Agreement. In the fourth cause of action,² plaintiff seeks an order directing SunTrust Banks to pay over the entire escrow fund to plaintiff forthwith. The fifth cause of action seeks a declaratory judgment, pursuant to CPLR 3001, declaring that plaintiff is not liable to indemnify any of the defendants for the attorney's fees, costs or any damages arising from the Richmond action.

DISCUSSION

The Escrow Fund

A contract is to be interpreted so as to give effect to the intention of the parties expressed in the unequivocal language employed. Breed v Ins. Co. of North America, 46 NY2d 351, 355 (1978). Contracts must be enforced in accordance with the plain meaning of their terms (Evans v Famous Music Corp., 1 NY3d 452, 458 [2004]; Greenfield v Philles Records, Inc., 98 NY2d 562, 569 [2002]), and courts should avoid interpretations that would leave a contractual clause meaningless (Two Guys from Harrison-N.Y., Inc. v S.F.R. Realty Assoc., 63 NY2d 396, 403 [1984]; 150 Broadway N.Y. Assoc., L.P. v Bodner, 14 AD3d 1, 6 [1st Dept 2004]). Where the intent of the parties can be determined from the face of the instrument, interpretation is a matter of law and the case is ripe for summary judgment. W.W.W. Assoc., Inc. v Giancontieri, 77 NY2d 157, 162 (1990).

²The third cause of action against SunTrust Banks for breach of the Escrow Agreement has been discontinued.

Under New York law, instruments executed at the same time, by the same parties, for the same purpose and in the course of the same transaction will be read and interpreted together.

Nau v Vulcan Rail & Constr. Co., 286 NY 188, 197 (1941). Thus, the Stock Purchase Agreement and Escrow Agreement must be construed together since they were executed by both plaintiff-seller and Dr. Leonard's, at substantially the same time, were related to the same transaction, and effectuated a common purpose. Accord S.A. Cameuse v M.J. Stavola Indus., Inc., 823 F Supp 125, 131 (SD NY 1993).

The plain terms of both the Stock Purchase Agreement and the Escrow Agreement provides for a one-year period following the closing of the transaction, during which the purchaser may advise the seller of any claim requiring indemnification under the Stock Purchase Agreement. If such a claim is timely made, in that event, the escrow agent is to hold back an amount sufficient to cover the claim and release the remainder of the escrow funds, if any, on May 24, 2003, with the exception of \$3 million to cover tax obligations. The \$3 million is to be held until the statute of limitations for federal income tax has expired. The plaintiff's tortured reading of the language of Section 8.06 of the Stock Purchase Agreement as requiring the release of the entire \$7.5 million in the event an indemnification claim is not timely made by May 21, 2003 ignores the plain language of other sections of both agreements providing for the continued escrow of \$3 million to cover certain tax claims after the one-year period following the closing, and is rejected.

Equally unavailing is Dr. Leonard's claim that it had until the end of May 2003 to give notice of a claim to the plaintiff-seller and the escrow agent. The Escrow Agreement is dated May 24, 2002. It clearly and unambiguously provides in Section 2.02(c) that the "Initial Escrow

Period” is defined as the “twelve month period following the date hereof,” that is from May 25, 2002 to May 24, 2003. Section 4.02(a) defines the phrase “Expiration Date” as the “date of the expiration of the Initial Escrow Period” (again, May 24, 2003) and provides that notice of a claim be made to both the seller and the escrow agent “at least three days prior to the Expiration Date,” that is May 21, 2003. If the parties had intended for the Expiration Date to be “the end of the twelfth month following the date of the Escrow Agreement,” as Dr. Leonard’s contends, that is how the Escrow Agreement should read. But it does not.

Nor does the choice of slightly different words in the Stock Purchase Agreement create an ambiguity on this issue. Section 8.06(b) of that agreement defines the one-year period as “the expiration of 12 months from the Closing Date (the “Original Expiration Date”),” but then drops the word “Original” when it provides that notice of a claim must be made “at least three days prior to the Expiration Date ...,” a term that is not explicitly defined in that document. The only reasonable interpretation of this language, which must be construed together with the clear-cut language of Section 4.02(a) of the Escrow Agreement, is that the phrases “Original Expiration Date” and “Expiration Date” mean the same thing – twelve months from the closing date, and defendants themselves admit that the transaction closed on May 24, 2002 (Neal Kayes Aff., ¶ 8).

Accordingly, based on the undisputed facts and documentary evidence before the court, Dr. Leonard’s was required to give notice of a claim against the escrow fund no later than May 21, 2003 to both plaintiff and the escrow agent. Plaintiff argues that since SunTrust Banks was not given notice of the Richmond claim until May 28, 2003, and the Escrow Agreement provides in Section 4.14 that “time is of the essence,” plaintiff was entitled to receive all but \$3 million of the escrow fund on May 24, 2003.

However, as Dr. Leonard's points out, plaintiff's breach of contract claim relating to amounts other than the \$3 million tax escrow fund are moot, because the funds were disbursed from the escrow fund sometime earlier this year, together with accrued interest. Although plaintiff might have been entitled to that money on May 24, 2003, not two years later, it has now recovered the amount to which it is entitled together with interest at the rate it bargained for in the Escrow Agreement. Plaintiff's claim for damages beyond the bargained for return on income it has already received, based on the speculative belief that it could have invested the money in some more profitable way, ignores settled law in this state on the ability of a court to compensate a plaintiff for the loss of the use of money in a breach of contract action, particularly where the defendant was equally deprived of the use of the money.³ See Spodek v Park Prop. Dev. Assoc., 96 NY2d 577, 581-82 (2001). Nor has plaintiff provided any basis for an award of attorney's fees in its favor.

Accordingly, plaintiff's motion for summary judgment on the second and fourth causes of action is denied. Searching the record pursuant to CPLR 3212(b), defendants are awarded summary judgment dismissing these claims, since any claim to the tax escrow fund has not been shown to have accrued.

Indemnification for the Richman Claim

The first and fifth causes of action seek damages for breach of the Stock Purchase Agreement and a declaratory judgment that plaintiff is not liable to indemnify any of the

³The cases cited in plaintiff's reply brief in support of its claim for damages on the \$4.5 million portion of the escrow fund set forth the standard for an award of damages for fraud, as opposed to breach of contract, which is a different standard. See, e.g., Lam v American Express Co., 265 F Supp 2d 225, 233 (SD NY 2003).

defendants for the attorney's fees, costs or any damages arising from the Richmond action on the basis that defendants prevented plaintiff from assuming the defense of that action, and thereby waived the right to seek indemnification.

In Section 8.01(a) of the Stock Purchase Agreement, plaintiff-seller agreed to "indemnify and hold harmless" the purchaser from "any and all liabilities," including reasonable attorneys' fees, incurred resulting from any breach of a representation or warranty on the part of the seller. Section 8.03(a) of the Stock Purchase Agreement, entitled "Procedures with Respect to Third-Party Claims," provides that in the case of "any claim by a third party against a party entitled to indemnification under this Agreement," the indemnified party (the purchaser, in this instance) must give prompt notice of the claim to the indemnifying party (the seller). This section provides further that the purchaser "shall permit" the seller, at the seller's expense, to assume the defense of the claim, provided that counsel chosen by the seller to defend the claim "shall be reasonably satisfactory" to the purchaser and the purchaser "may participate in, but not direct, such defense" at the seller's expense. Section 8.03(b) further provides that the seller shall have thirty days after receipt of the notice to assume the defense of the claim, and that if a defense is offered and rejected, the seller shall not be liable to the purchaser under Section 8.01 for any fees of other counsel or any other expenses incurred by the purchaser in connection with the defense of the claim.

An insurer's duty to defend is separate and distinct from the duty to indemnify, and the duty to pay is determined by the actual basis of the indemnified party's liability to the third party. Servidone Constr. Corp. v Sec. Ins. Co., 64 NY2d 419, 424 (1985); Zurich-Am. Ins. Cos. v Atlantic Mut. Ins. Cos., 139 AD2d 379, 381 (1st Dept 1988), affd 74 NY2d 621 (1989). Thus,

where a conflict of interest arises between an insurer and its insured because the insurer offers to defend a suit against the insured only under a reservation of rights, New York courts have consistently held that the interests of the insured and insurer are best accommodated by permitting the insured to choose his own counsel and by requiring the insurer to pay the reasonable fees of that counsel. Hartford Acc. and Indem. Co. v Vil. of Hempstead, 48 NY2d 218, 228-29 (1979); Prashker v United States Guar. Co., 1 NY2d 584, 593 (1956); 69th Street and 2nd Ave. Garage Assoc., L.P. v Tjcor Title Guar. Co., 207 AD2d 225, 227 (1st Dept), lv denied 87 NY2d 802 (1995); see also Ottaviano v Genex Coop., Inc., 3 Misc 2d 1024 (Sup Ct, Erie County 2004), affd 15 AD3d 924 (4th Dept 2005).

Here, plaintiff was entirely within its rights to assume the defense of the Richmond action with a reservation of rights. Dr. Leonard's was also within its rights, under Section 8.03 of the Stock Purchase Agreement, to object to plaintiff's December 2nd letter on the ground that it had the right to pass judgment on the law firm plaintiff would be hiring to defend the Richmond action, and no law firm had been named in the letter. In addition, due to the conflict of interest created by plaintiff's reservation of rights, Dr. Leonard's was entitled, under established law, to choose its own counsel and require plaintiff to pay the reasonable fees of that counsel.

Accordingly, there was no breach of the Stock Purchase Agreement on Dr. Leonard's part, and plaintiff's motion for summary judgment on the first and fifth causes of action is denied, and those claims are dismissed pursuant to CPLR 3212(b).

Dismissal Against Cortec III

Notwithstanding the dismissal of plaintiff's claims on the merits, this action should be dismissed as against Cortec III. The undisputed facts show that the buyer was DRL Acquisition,

then an indirect subsidiary of Cortec III. Since Cortec III is not a party to either the Stock Purchase Agreement or the Escrow Agreement, it cannot be held liable for any alleged breaches of those agreements. See, e.g., Pevensey Press, Ltd. v Prentice-Hall, Inc., 161 AD2d 500, 500-501 (1st Dept 1990).

Although not pled in its complaint, plaintiff argues that Cortec III is a proper party to this breach of contract action on a veil-piercing or alter ego theory, arguing that its subsidiary, DRL Acquisition, was a dummy corporation that was used by Cortec III solely for the purpose of signing the agreements at issue, and then dissolved after the transaction was completed. This theory fails as a matter of law for several reasons. First, it is an undisputed fact that DRL Acquisition was not dissolved after the sale, but rather was merged into Dr. Leonard's and the latter company has assumed all of the rights, liabilities and obligations of DRL Acquisition. Second, to hold a parent liable for the contractual obligations of a subsidiary, a plaintiff must allege that the parent improperly exercised complete domination and control over the subsidiary and that this domination was used to commit a wrong which resulted in plaintiff's damages. See Morris v New York State Dep't of Taxation & Finance, 82 NY2d 135, 141-42 (1993). Plaintiff does not allege, either in the complaint or in support of its request to replead (see CPLR 3211[e]), that Cortec III or any other defendant committed any wrongful act by structuring the purchase by DRL Acquisition, a company that was subsequently merged into Dr. Leonard's.

Plaintiff's reliance on Horsehead Industries, Inc. v Metallgesellschaft AG (239 AD2d 171 [1st Dept 1997]), is misplaced. In that case, the plaintiff alleged that the parent company of its contracting partner engaged in extensive and direct participation in the negotiations leading up to the contract at issue, not just indirect participation through its subsidiary, such that plaintiff

believed its contractual partner was the parent, not the subsidiary.

Finally, plaintiff contends that because David L. Schnadig, alleged to be an individual partner of the "Cortec partnership," signed the Stock Purchase Agreement and Escrow Agreement, as a matter of basic partnership law, Cortec III is bound by these contracts. However, the documentary evidence submitted shows that Mr. Schnadig signed these agreements as a vice-president of DRL Acquisition, not in any capacity as a partner of Cortec III.

CONCLUSION AND ORDER

For the foregoing reasons, it is hereby

ORDERED that plaintiff ASP HD L.L.C.'s motion for summary judgment is denied, and pursuant to CPLR 3212(b), defendants are awarded summary judgment dismissing the remaining causes of action of the complaint; and it is further

ORDERED that the cross motion of defendant Cortec Group Fund III, LLP for dismissal of the complaint pursuant to CPLR 3211(a)(7) and 3212 is granted; and it is further

ORDERED that the Clerk is directed to enter judgment dismissing the action with costs and disbursements to defendants.

Dated: September 30, 2005

ENTER:

FILED

OCT 13 2005

NEW YORK
COUNTY CLERK'S OFFICE


HON. RICHARD B. LOWE, III
J.S.C.