

L'Oreal USA, Inc. v Quality King Distrib., Inc.

2005 NY Slip Op 30611(U)

November 30, 2005

Supreme Court, New York County

Docket Number: 110249/04

Judge: Herman Cahn

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 49

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L'OREAL USA, INC., L'OREAL USA PRODUCTS,
INC., L'OREAL USA S/D, INC., and L'OREAL USA
CREATIVE, INC.,

Plaintiffs,

-against-

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QUALITY KING DISTRIBUTORS, INC., PRO'S
CHOICE BEAUTY CARE INC., GSN TRUCKING
CORP., MICHAEL KATZ, and MARCY BLICK,

Defendants.

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HERMAN CAHN, J.:

Plaintiffs L'Oreal USA, Inc., L'Oreal USA Products, Inc., L'Oreal USA S/D, Inc., and L'Oreal USA Creative, Inc. (collectively, L'Oreal) commenced this action for specific performance, breach of contract, and a preliminary injunction.

L'Oreal moves to enjoin the defendants from selling and distributing ARTec brand products. Defendants oppose the motion for injunctive relief and, in three separate cross motions, seek dismissal of the complaint.

Defendants Quality King Distributors, Inc., Michael Katz and GSN Trucking Corp. collectively cross-move pursuant to CPLR 3211 (a) (1), (3), and (7). Defendant Pro's Choice Beauty Care, Inc. cross-moves pursuant to CPLR 3211(a) (1), (3), and (7), and defendant Marcy Blick moves pursuant to CPLR 3211 (a) (1), (2), (4), (7), and (10).

Each party, with the possible exception of GSN, is involved in some aspect of the professional hair care products industry. The products, which are referred to in the industry as "liquids," include shampoos, conditioners, hair coloring agents, and a variety of fixatives.

Pursuant to an August 2002 Acquisition Asset Purchase Agreement (Acquisition Agreement), plaintiff L'Oreal USA, Inc. acquired ARTEc Systems Group, Inc. (ARTEc), a manufacturer and marketer of high quality professional hair coloring and related products, which are protected by registered trademarks and copyrights, and which are produced and sold for use in beauty salons nationwide. Among the acquired assets were ARTEc's intellectual property, licenses, agreements, contracts, claims and causes of action. In its capacity as successor-in-interest to ARTEc, L'Oreal seeks to enforce the terms of a July 19, 1996 settlement agreement (Settlement Agreement) which settled claims for counterfeit, trademark and copyright violations which had been pending in federal court between ARTEc and three out of five of the currently named defendants (ARTEc Systems Group, Inc. v Quality King Distributors, Inc., Michael Katz, Marcy Blick, M.J. Blick & Assoc. et al., No. 96 Civ. 2345 [HB]).

Defendant Quality King is a family-owned business founded in 1961, by Bernard and Ruth Nussdorf (husband and wife), as a distributor of health and beauty aides. One aspect, or division, of the business distributed professional hair care products to retail stores nationwide. It was this division that was targeted and affected by the Settlement Agreement. Paragraph 2 of the Settlement Agreement states that:

[t]he Settling Defendants [Quality King, M. Katz, and M. Blick] hereby agree that neither they, nor their employees (including any business entity which they may control), parents, divisions, affiliates, subsidiaries including any business entity controlled by Bernard Nussdorf, Ruth Nussdorf, Glenn Nussdorf, Steven Nussdorf or Lillian Nussdorf Broder shall purchase, sell, barter or distribute any product manufactured, licensed or distributed by ARTEc. Defendant Quality King Distributors, Inc. may, however, continue to sell the genuine ARTEc products currently held in its inventory until 12:00 midnight December 31, 1996

L'Oreal claims that it has spent, and continues to spend, millions of dollars on an

annual basis developing and promoting its professional hair care products, including the products acquired from ARTec, and training licensed cosmetologists in the proper use of these products. L'Oreal explains that its sells its professional line of "liquids" through a network of authorized distributors, and that each authorized distributor contractually agrees to sell these "liquids" only to professionally licensed beauty salons and licensed cosmetologists. The beauty salons and licensed cosmetologists may resell the "liquids" only to their own clients. The limited sale of "liquids" to, and through, professionals is commonly referred to, in the industry, as the "salon-only policy," and it forms the basis of plaintiffs' professional hair care product line distribution system. L'Oreal alleges that its business model and its reputation for high quality products is undermined, and that its business with current customers is diminished, when ARTec products find their way to retailers who do not employ licensed professional cosmetologists, such as chain and independent drugstores and supermarkets.

Defendant Pro's Choice was organized in January 2000, under the direction of Quality King's executive vice-president and Settlement Agreement signatory, M. Katz, as a New Jersey distributor of professional hair care products. By a written Bill of Sale and Assignment of Assets, executed on February 22, 2001, Quality King transferred, or "spun-off," its entire hair care products division to Pro's Choice, which is owned by Ruth Nussdorf (who was named in the Settlement Agreement), and is run by both Ruth Nussdorf and M. Blick¹ (who was a signatory to the Settlement Agreement). According

¹ It is unclear from the submissions whether it is Ruth Nussdorf or M. Blick who holds the position of president, but it is clear that each of them holds two of the four executive positions: president, vice-president, secretary and/or treasurer.

to defendants, Ruth Nussdorf relinquished her interest in Quality King in exchange for her ownership interest in Pro's Choice. Defendants also assert, and plaintiffs do not dispute, that at the time of the spin-off, neither Quality King, nor Pro's Choice, was selling, distributing, or was, in any way, involved with ARTEc products, but that, at the direction of M. Blick, in or about November and December 2002, Pro's Choice began to buy and sell (distribute) ARTEc products to its customers, which include chain drugstores, independent drug stores and supermarkets. Plaintiff views this as a violation of both its salon-only policy and the specific terms of the Settlement Agreement.

Plaintiffs also charge Quality King with distributing (including through the internet) ARTEc brand products, and by creating Pro's Choice, and the defendant trucking company, GSN, as a means of transporting and distributing ARTEc brand products, in contravention of the Settlement Agreement. Calling defendants' operation a "sham" and a "shell game," L'Oreal details how Quality King, under the direction of M. Katz, transferred all of the assets of its hair care division (which operated under the name QK Hair Care Division) in February 2001, to Pro's Choice, without requiring Pro's Choice to comply with the Settlement Agreement's ban against conducting any business involving the ARTEc line of products. Quality King, while not meaningfully denying these charges, counters that its own sales of ARTEc products was inadvertent and de minimis, and, along with the other defendants, seeks a ruling that L'Oreal does not have standing to enforce the Settlement Agreement.

Pro's Choice acknowledges that it distributes ARTEc brand products, and claims that because it was not a party to the Settlement Agreement it is bound by its terms. Pro's

Choice advances this argument despite the fact that M. Blick signed the Settlement Agreement and that Ruth Nussdorf was identified, by name, in the agreement as one of four individuals banned from controlling any business which trades in ARTec brand products.

Plaintiff further asserts that the distribution process is completed by GSN's trucks, which transport ARTec brand products on behalf of Quality King and Pro's Choice. GSN is owned by Glenn Nussdorf, Stephen Nussdorf, and Arlene Nussdorf, and is controlled by both Glenn Nussdorf and M. Katz, who were either named, or were signatories to, the Settlement Agreement. Plaintiff contends that Pro's Choice and GSN are, if not actual divisions of Quality King, affiliated with Quality King, and, therefore, are bound by the Settlement Agreement.

The gravamen of the complaint is that defendants function as "diverters," meaning distributors who knowingly, and willingly, disregard the salon-only policy, by actively distributing ARTec brand "liquids" to unauthorized retail locations (URLs), in breach of the Settlement Agreement. L'Oreal, therefore, seeks to halt defendants' distribution of the ARTec line. The complaint, which articulates claims for specific performance of the Settlement Agreement and for breach of contract, also demands a preliminary injunction for the specific performance of the Settlement Agreement pending resolution of this matter.

Plaintiffs' theory is that the corporate defendants are parts of one family-owned business, which carefully created and crafted corporate entities (GSN and Pro's Choice) which appear to be "separate" and "independent" in order to evade restrictions and

prohibitions, including the Settlement Agreement, which have been imposed on this family business as a result of legal actions taken against it in the federal and state court systems. Only on paper do these defendants exist independently. In practice, they function as one. In support of this allegation, L'Oreal offers proof that GSN has the same principal place of business as Quality King, and that, through assorted written agreements and fee arrangements, Quality King provides Pro's Choice with computer and data processing services, warehouse space and personnel, the right to use Quality King's software and intellectual property related to the professional hair care business, inventory management, purchasing services, vendor lists, sales order entry, accounts payable, accounts receivable and credit/collection services (see Declaration of M. Katz, June 15, 2004, made pursuant to discovery in a separate federal matter [Matrix Essentials, Inc. v Quality King Distributors, Inc., Bernard Nussdorf, Glenn Nussdorf and Stephen Nussdorf, No. 90 CV 1070 [LDW] and submitted as evidence in this action).

Finally, plaintiffs seek a preliminary injunction to halt defendants' unauthorized sale and distribution of ARTec products on the basis that these actions are causing plaintiff irreparable injury. L'Oreal submits a series of sworn affidavits, including that of R.G. Shakour, an authorized distributor of L'Oreal products (including the ARTec line), in support of its motion for a preliminary injunction. The affidavits confirm that defendants' actions are damaging L'Oreal's reputation and good will, and are causing it to lose both customers and income. They also state that almost all of its distributors over the last two years have complained to L'Oreal that ARTec products are available in URLs due to diversion, and that this has resulted in the decision by several of L'Oreal's

authorized distributors to discontinue carrying the ARTEc line, and an increasing number of salons that are no longer willing to carry and sell the ARTEc brand products. As additional proof, L'Oreal submits documents indicating that ARTEc brand products are available for purchase through a website registered to Quality King, and further investigations by L'Oreal confirms that Quality King supplied these products to URLs in 2003 and 2004, and continues to do so.

Finally, plaintiffs offer, as evidence that Quality King, M. Katz and M. Blick consented to this type of equitable relief to enforce the terms of the Settlement Agreement, the second half of paragraph 2 of the Settlement Agreement, which states in relevant part:

Prohibition Against Selling Any ARTEc Products . . . The Settling Defendants [which include Quality King, M. Katz and M. Blick].specifically agree that ARTEc shall be entitled to injunctive relief and/or specific performance to enforce this paragraph as well as damages. In an action to enforce this paragraph, the prevailing party shall be entitled to recover actual attorney's and investigators' fees.

Defendants Quality King, Katz, GSN, Pro's Choice, and Blick oppose the motion for a preliminary injunction, and cross-move for a dismissal of the complaint on the grounds of documentary evidence, lack of jurisdiction, lack of standing to sue, another action pending between the same parties for the same cause of action, failure to state a claim, and failure to join a necessary party (CPLR 3211 [a] [1], [2], [3], [4], [7], and [10]).

Defendants fail to present arguments with respect to their claims pursuant to CPLR 3211 (a) (2) (4) and (10). Accordingly, these grounds are deemed abandoned.

Defendants question L'Oreal's standing as a plaintiff in this action because: (1) the

Settlement Agreement applies only to products manufactured, licensed or distributed *by* ARTEc; (2) plaintiffs are not successors-in-interest to ARTEc, and therefore, cannot stand in ARTEc's shoes to enforce its terms; (3) Pro Choice did not assume, and is not restricted by the obligations and/or prohibitions against Quality King which are contained in the Settlement Agreement; and (4) four separate entities cannot be "successors" to a single business². These arguments ignore the plain and unambiguous language of both the Settlement Agreement and the Acquisition Agreement, and sidestep the requirement that, for the purpose of a CPLR 3211 motion, the court must accept the facts as alleged in the complaint as true, and accord the plaintiff the benefit of every possible inference (Leon v Martinez, 84 NY2d 83, 87 [1994]).

Defendants theorize that L'Oreal cannot be a successor-in-interest to ARTEc because, after the August 2002 closing, ARTEc continued to exist under the new name "Michael Leland Ltd.," and therefore, if any entity has standing to enforce the Settlement Agreement, it would be Michael Leland Ltd. Defendants attempt to bolster their theory by pointing out that the agreement bars the settling defendants only from engaging in commerce involving "any product manufactured, licensed or distributed *by* ARTEc" (emphasis supplied by defendants), which cannot be L'Oreal, since ARTEc continued to exist after the closing. Defendants also claim that products which contain labels reading: "manufactured exclusively *for* ARTEc," (emphasis supplied by defendants), are, likewise, not covered by the agreement because the words "by" and "for" are not interchangeable, and the ban prohibits defendants from trading only in products manufactured *by* ARTEc.

²Defendant's additional arguments regarding labels, return addresses and the like, are extraneous and without merit.

Defendant's semantic distinctions are unpersuasive. "Words considered in isolation may have many and diverse meanings" (Zodiac Enter., Inc. v American Broadcasting Cos. Inc., 81 AD2d 337, 339, affd 56 NY2d 738 [1982]). It is well settled that:

[a] court 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.

(William C. Atwater & Co., Inc. v Panama R.R. Co., 246 NY 519, 524 [1927]).

An examination of the Acquisition Agreement reveals that L'Oreal USA, Inc. and ARTEc, which had been owned by Leland Hirsch and Carem Michael Mazzei (Hirsch and Mazzei), intended that, for valuable consideration received, L'Oreal USA, Inc. would acquire all rights, title and interest in and to, all of ARTEc's material and operating assets, and assume all of ARTEc's liabilities. The fact that ARTEc's operating assets, including its rights and interest to agreements and claims, were then assigned to L'Oreal USA, Inc.'s subsidiaries, or that a company car, and other non-material and non-operating assets, such as the corporate charter and tax returns, were excluded from the acquisition, does not diminish the plaintiffs' standing to enforce the Settlement Agreement. L'Oreal submits an affidavit from Carl F. Wand, counsel to Michael Leland, Ltd., in support of the preliminary injunction and to confirm L'Oreal's claim that the parties to the Acquisition Agreement intended nothing less than a complete sale of every aspect of the ARTEc professional "liquids" to L'Oreal. To construe the contract language in the manner proposed by defendants would effectively render meaningless the clear terms employed by the parties to effectuate the sale (Helmsley-Spear, Inc. v New York Blood Ctr., Inc., 257 AD2d 64, 69 [1st Dept 1999]).

Defendants' attempts to raise controversy around L'Oreal's standing by offering evidence that ARTec continued to exist after the closing, by submitting copies of past ARTec product labels, are readily dispelled by the affidavits and documentary evidence submitted by plaintiff. The Wand affidavit makes clear that, concomitant with the closing, Hirsch and Mazzei changed the name of the entity formerly known as ARTec to Michael Leland, Ltd., and that Michael Leland, Ltd., does not manufacture, sell, or distribute, professional hair care products, or any other products. It exists for the sole purpose of collecting and distributing payments to Hirsch and Mazzei, under an escrow account set up pursuant to the Asset Agreement, and defendants' submission of old product labels does not constitute dispositive evidence that ARTec survived the sale.

With respect to defendants' motion to dismiss the complaint for failure to state a cause of action, the court's inquiry is limited to ascertaining "whether the facts, as alleged fit within any cognizable legal theory" (Leon, 84 NY2d 87 - 88). An assessment of the complaint reveals that the causes of action for specific performance and breach of contract are facially sufficient. Defendants' blanket denials of plaintiffs' factual allegations do not render the claims deficient. It is alleged that defendants breached, and continue to breach, the Settlement Agreement by engaging in proscribed actions with respect to ARTec brand products, and that, as successors-in-interest to ARTec, L'Oreal is entitled to enforce the Settlement Agreement against the named defendants. The complaint is sufficient to apprise the defendants of the claims against them.

Pro's Choice contends that, because it is an independent entity, it is immune from the Settlement Agreement's restrictions. The defendants uniformly explain that the prime motivating factors for the Pro's Choice spin-off, was the desire of the Quality King shareholders

to disassociate their businesses and to operate them independently. Defendants' secondary explanation, that there was a dispute among family members, is both lacking in proof, and lacking in credibility. The affidavits and declarations fail to support the family-dispute theory, and the multiple, and complicated, ties between the three entities, with respect to their day-to-day operations, raise questions as to whether Quality King, Pro's Choice, and GSN are actually separate and distinct entities (see Radio and Tel. Broadcast Technicians Local Union 1264 v Broadcast Serv. of Mobile, Inc., 380 US 255, 256 [1965]). The documentary evidence submitted by defendants fails to resolve these factual issues as a matter of law, and conclusively dispose of plaintiffs' claims (CPLR 3211 [a] [1]; Held v Kaufman, 91 NY2d 425, 430 - 431 [1998]; Teitler v Max J. Pollack & Sons, 288 AD2d 302 [2nd Dept 2001]).

Defendants' arguments in opposition to a preliminary injunction are not persuasive. Defendants contend that the imposition of a preliminary injunction would cause sizable injury to their respective businesses, and that the imposition of an injunction would disturb the status quo. L'Oreal's submissions demonstrate: (1) a likelihood of ultimate success on the merits; (2) that L'Oreal would suffer immediate irreparable injury (loss of their customers/distributors) if the relief is denied; and (3) a balance of the equities in plaintiff's favor (W.T. Grant Co. v Srogi, 52 NY2d 496, 517 [1981]).

Defendants' remaining arguments have been considered and have been found to be without merit.

Accordingly, it is


ORDERED that the cross motions by defendants are denied; and it is further

ORDERED that the motion by plaintiffs for a preliminary injunction during the pendency of this action is granted.

Settle order on 48 hours notice. The proposed order should contain a provision for an undertaking.

Dated: November 30, 2005

ENTER:



J.S.C.