

Alarmex Holdings L.L.C. v Pianin

2006 NY Slip Op 30248(U)

September 27, 2006

Supreme Court, New York County

Docket Number:

Judge: Helen E. Freedman

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SCANNED ON 10/22/06
* 1
SUPREME COURT OF THE STATE OF NEW YORK – NEW YORK COUNTY

Index Number : 602075/2005
ALARMEX HOLDINGS LLC
vs.
PIANIN, SCOTT
SEQUENCE NUMBER : 004
AMEND SUPPLEMENT PLEADINGS

PART 39

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____
MOTION CAL. NO. _____

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 _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion *is decided in accordance w accompanying memo of law*

FILED

OCT 02 2006

COUNTY CLERK'S OFFICE
NEW YORK

MPA

Dated: 9/27/06

[Signature]
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):

to Alarmex, made fraudulent conveyances to a trust that he controlled in order to shield his secret profits from Alarmex, and violated the RICO and RICO conspiracy statutes. In a separate action, Pianin sues Alarmex and its directors alleging that they breached the operating agreement provisions related to his termination and the corporate buy-out of his interest in Alarmex. Alarmex seeks leave to amend its complaint and re-plead certain claims, arguing it has discovered new information during disclosure that correct the deficiencies this court identified in the April 10, 2006 decision.

Alarmex's Allegations:

Alarmex designs, manufactures, and sells sportswear and other clothing. Its operations commenced on October 31, 2000 when William Spier acquired, on behalf of Alarmex, certain assets of Periscope Sportswear ("Periscope"), a clothing company that employed Pianin. Earlier that year in April 2000, Periscope's president Glenn Sands was terminated for accepting kickbacks from Periscope's suppliers and embezzling funds from the company. Upon Sand's termination, Pianin was appointed Periscope's President. William Spier invited Pianin to join Alarmex as a minority member when he acquired Periscope's assets.

Alarmex alleges that William Spier invited Pianin to join Alarmex as a minority member because he did not believe that Pianin participated in Glenn Sands' kickback scheme when Pianin worked at Periscope. In September 2004, P.H. Lim, a principal at Alarmex's Korea-based knit sourcing agent, Phil's Sourcing Company ("Phil's Sourcing"), allegedly informed Alarmex that he had been paying Pianin cash kickbacks totaling more than \$70,000 each year, and that this arrangement began when Pianin worked at Periscope. Pianin allegedly placed Alarmex's garment orders with Phil's Sourcing, which placed the orders with its network of manufacturers. Alarmex alleges that Pianin arranged to have it place orders with the manufacturers that Phil's Sourcing used

for particular jobs, and that these manufacturers overcharged Alarmex by five to fifteen cents per item. The manufacturers allegedly passed all or part of the overcharge to Phil's Sourcing, which then paid a portion to Pianin in exchange for securing Phil's Sourcing right to exclusively serve as Alarmex's Korea based knit sourcing agent. Alarmex alleges that Phil's Sourcing paid Pianin amounts between \$10,000 and \$30,000 at a time, and Pianin deposited the money in amounts between \$1000 and \$9000 in various bank accounts. Alarmex alleges that Pianin accepted a total of over \$1 million in kickbacks, derived from the manufacturers' overcharges, and that Alarmex overpaid Phil's Sourcing and its suppliers by over \$6 million. Alarmex seeks \$18,300,000 for its breach of contract and breach of fiduciary duty claims, \$11,000,000 in disgorgement of Pianin's compensation, \$20,000,000 in punitive damages, and \$18,300,000 trebled plus attorneys' fees for the RICO claims.

Contentions:

Alarmex's proposed amended complaint adds two allegations in connection with its fraudulent inducement claim. It alleges that before signing the Operating Agreement, "the Company specifically inquired of Pianin whether he had known of or participated in the kickbacks and other wrongdoing committed by Sands at Periscope," and Pianin denied any such knowledge or participation. Alarmex also alleges before execution of the Operating Agreement, Pianin stated that he had received a four million dollar order from Sam's Club and could generate substantial business from this contact in the future. Alarmex alleges that Pianin fraudulently failed to disclose that his ability to generate business from Sam's Club was "entirely predicated upon the existence of an illicit sexual relationship with the Sam's Club buyer who placed orders with Pianin."

With respect to the RICO and RICO conspiracy claims, Alarmex alleges that Pianin and

Phil's Sourcing allegedly operated as an "association in fact" RICO "enterprise." Alarmex contends that the allegations related to Pianin's kickback scheme form the basis of the "predicate criminal acts" of its RICO cause of action, including commercial bribe receiving, mail and wire fraud, money laundering, and violations of the National Travel Act and National Stolen Properties Act, and that the fact that these acts occurred for at least four years constitute a "pattern of racketeering activity" that caused a cognizable injury to Alarmex's business and property.

Pianin opposes amending Alarmex's pleadings, contending that Alarmex does not add new allegations that cure the already dismissed claims. He argues that the fraudulent inducement claim is duplicative of the breach of contract claim and no actual pecuniary loss is alleged. Pianin argues the RICO claim is a restatement of garden variety fraud and breach of fiduciary duty claims and that Alarmex fails to satisfy the RICO elements of enterprise, at least two predicate acts, pattern of racketeering activity, and a RICO injury. Pianin argues that Alarmex has not suffered a cognizable RICO injury caused by the predicate acts because Alarmex argues that it would have spent less money and earned higher profits absent the racketeering activity. However, it received all of the goods for which it paid and whether or not it would have received more profits absent the alleged scheme is too speculative to constitute a RICO injury. Because the RICO claim fails, Pianin argues Alarmex does not state a cause of action for a RICO conspiracy. Pianin cross moves for sanctions against Alarmex, arguing that the motion is frivolous because Alarmex merely restates and reargues the already dismissed claims rather than correct any identified deficiencies.

Standard for Amending Pleadings:

Although leave to amend should be liberally granted (CPLR 3025(b)), the merits of the proposed pleadings must state viable causes of action. *See DiPasquale v. Security Mut. Life Ins. Co.*

of *New York*, 13 A.D.3d 100 (1st Dept. 2004). The proposed amendments do not correct the deficiencies identified in the April 10, 2006 order, and thus leave to amend is denied.

Fraudulent Inducement:

To make out a fraud claim, plaintiff must allege “a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury.” *Lama Holding Co. v. Smith Barney, Inc.*, 88 N.Y.2d 413, 421 (1996). A fraud claim concerning a contract must also allege “misrepresentations of present facts (rather than merely of future intent) that were collateral to the contract and which induced the allegedly defrauded party to enter into the contract,” and allegations that a party entered into a contract intending not to perform do not state a viable cause of action. *Orix Credit Alliance, Inc. v. The R.E. Hable Co.*, 256 A.D.2d 114 at 115 (1st Dept. 1998). The “damages recoverable for being fraudulently induced to enter into a contract which otherwise would not have been made is ‘indemnity for [the] loss suffered through that inducement’” *Deerfield Communications Corporation, v. Chesebrough-Ponds, Inc., et al.*, 68 N.Y.2d 954 at 956 (1986) citing *Sager v Friedman*, 270 N.Y. 472 at 481 (1936). The damages are limited to compensation for the actual loss sustained, and may not include potential profit, which is inherently speculative. See *Lama Holding Co. v. Smith Barney, Inc.*, 88 N.Y.2d 413 (1996).

Alarmex alleges that had it known about Pianin’s alleged participation in a kickback scheme and personal relationship with the Sam’s Club buyer, it would not have executed the Operating Agreement with Pianin and presumably would have found another individual to serve as its president and minority member, reduced expenses and earned higher profits. The failure to disclose Pianin’s

relationship with the Sam's Club buyer is not a "material omission," and any damages caused by this misrepresentation are too speculative to constitute a basis for a fraudulent inducement claim. The complaint alleges that Alarmex obtained substantial business from Sam's Club precisely because of Pianin's nondisclosed personal relationship.

As stated in the April 10, 2006 decision, the fraudulent inducement claim related to Pianin's alleged involvement with the kickback scheme duplicates the allegations supporting its breach of contract claim, and seeks the same amount in damages. *See Orix Credit Alliance, Inc. v. The R.E. Hable Co.*, 256 A.D.2d 114 (1st Dept. 1998). Alarmex does not explain why its only new allegation that "someone from the company" asked Pianin about his participation in the Periscope kickback scheme was only recently discovered, and does not specify who asked the question. This new allegation does not revive its already dismissed fraud claim because Alarmex fails to allege a cognizable injury caused by the fraud. Despite alleged misrepresentations, lost earnings including the loss of an alternative bargain overlooked in favor of the fraudulent one, is inherently speculative and does not satisfy the "out of pocket" injury rule. *See Geary v. Hunton & Williams*, 257 A.D.2d 482 (1st Dep't 1999). To the extent that Pianin caused Alarmex to pay expenses because of his disloyalty or breach of the Operating Agreement, Alarmex can recover that amount in its remaining causes of action. *See Sheth v. N.Y. Life Ins. Co.*, 308 A.D.2d 387, 388 (1st Dept. 2003)(holding that alleged loss of income and commissions are damages recoverable, if at all, for a breach of contract action, and not "for the fraud by which such contracts are said to have been induced").

RICO:

Alarmex bases its RICO claim on 18 U.S.C. § 1962(c), which provides:

It shall be unlawful for any person employed by or associated with any enterprise

engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

18 U.S.C. § 1962(d) states that "it shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section." "Any person injured in his business or property by reason of a violation of section 1962" may bring a RICO action and recover treble damages and the court costs including a reasonable attorney's fee. 18 U.S.C. § 1964(c).

Because of the almost inevitable stigmatizing effect on those named as defendants and the severe penalties the RICO statute imposes, "courts should strive to flush out frivolous RICO allegations at an early stage of the litigation." *Allen v. New World Coffee, Inc.*, No. 00 Civ. 2610, 2001 WL 293683, at 3 (S.D.N.Y. Mar. 27, 2001). In addition, RICO actions should be considered in light of "Congress's goal of protecting legitimate businesses from infiltration by organized crime." *Id.*

The April 10, 2006 decision found that Alarmex did not plead § 1962(c) elements with the requisite particularity, failed to allege that Pianin and Phil's Sourcing constituted an "enterprise," and did not allege factors demonstrating a "pattern of activity" besides the length of time the alleged kickback scheme occurred. Specifically, the complaint only alleged one scheme, one victim, and at most two participants. Alarmex has failed to cure these defects, particularly with respect to the enterprise elements, in its proposed amended complaint.

18 U.S.C. § 1961(4) defines "enterprise" as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." An "associated in fact" enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct," the existence of which is proven "by

evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583 (1981). While proof of the enterprise and "pattern of racketeering activity" elements may overlap, "proof of one does not necessarily establish the other." The "enterprise" is an entity separate and apart from the pattern of activity in which it engages. *Id.* When the alleged enterprise is an "association in fact," plaintiff must allege the enterprise contained organization, hierarchy, distinct from the predicate acts and the RICO "person." *First Capital Asset Management, Inc. v. Satinwood, Inc.*, 385 F.3d 159 (2nd Cir. 2004).

To support its claim that Pianin and Phil's Sourcing constituted an enterprise, Alarmex merely restates its allegations regarding Pianin's and Phil's Sourcing's participation in the kickback scheme. However, commission of predicate acts on its own is insufficient to allege an "association in fact." *See First Capital Asset Management, Inc. v. Satinwood, Inc.*, 385 F.3d 159, 174 (2nd Cir. 2004)(finding no enterprise pled where plaintiff failed to allege "a course of fraudulent conduct separate and distinct from the alleged predicate racketeering acts themselves - a requirement in this Circuit"). Alarmex fails to allege any chain of command in the enterprise, or any ascertainable structure distinct from that inherent in the alleged pattern of racketeering activity. *Goldfine v. Sichenzia*, 118 F.Supp.2d 392 at 401 (S.D.N.Y. 2000). Besides the alleged commission of predicate acts, Pianin and Phil's Sourcing acted in the ordinary course of business as agents for Alarmex. *See Manhattan Telecommunications Corp., Inc. v. DialAmerica*, 156 F.Supp.2d 376 (S.D.N.Y. 2001)(finding that defendant corporation, individual corporate members and the corporation's customers lacked distinctness from the RICO "person," and they "were no more united in an enterprise than any vendor and its customers"). Because there is no RICO enterprise alleged, there

can be no violation of 18 U.S.C. 1962(c).

Additionally, the only new factual allegations Alarmex adds to support the predicate crimes relate to mail and wire fraud. However, the new allegations fail to allege the elements of these crimes and satisfy the heightened particularity requirement. The wire fraud claim is based on payments that Alarmex transmitted by wire, rather than communications by Pianin or Phil's Sourcing. To satisfy the heightened pleading standard for mail fraud, the "complaint must adequately specify the statements it claims were false or misleading, give particulars as to the respect in which plaintiffs contend the statements were fraudulent, state when and where the statements were made, and identify those responsible for the statements." *McLaughlin v. Anderson*, 962 F.2d 187 (2nd Cir. 1992). Alarmex adds vague and conclusory allegations related to mailed communications between Phil's Sourcing and Pianin, and Phil's Sourcing and his factories, which fail to satisfy the particularity requirement. The remaining bases for Alarmex's mail fraud claim are invoices that the manufacturers sent to Alarmex for allegedly overpriced goods and commission statements that Phil's Sourcing sent to Alarmex. Although the proposed amended complaint references exhibits listing invoices and commission statements, Alarmex does not attach the exhibits to its motion papers. In any event, the manufacturers, rather than Pianin and Phil's Sourcing, caused the invoices to be sent. Although Alarmex lists goods ordered and the amount of overcharges in connection with its breach of contract claim, it does not link the overcharges with particular mailings, or allege specific fraudulent or misleading content in the invoices or commission statements such as the extent to which particular mailings inflated prices above normal rates. The invoices listed prices for goods that Alarmex actually received and resold for a profit.

The RICO conspiracy claim is based on a violation of the substantive RICO statute, and thus

the RICO conspiracy claim also fails.

It would be unfair to punish Alarmex with sanctions for bringing this motion to amend its complaint in light of both parties' persistence in bringing multiple motions, often related to issues previously considered by the Court, in the course of their litigation. Thus, Pianin's cross motion for sanctions is denied.

Accordingly, it is

ORDERED that Alarmex's motion seeking leave to amend its complaint is denied, and it is further

ORDERED that Pianin's cross motion for sanctions is denied.

DATED: September 25, 2006 ENTER:



Helen E. Freedman, J.S.C.

FILED

OCT 02 2006

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