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

PRESENT: HELEN E. FREEDMAN PART 39

Index Number : 604319/2004

BUECHNER, JACK

INDEX NO. _____

VS

AVERY, ALLAN R.

MOTION DATE _____

Sequence Number : 002

MOTION SEQ. NO. _____

DISM ACTION/INCONVENIENT FORUM

MOTION CAL. NO. _____

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion Sequences 002 and 003 are consol. dated and ~~is~~ DECIDED

IN ACCORDANCE WITH ACCOMPANYING [illegible]

FILED
APR 11 2006
COUNTY CLERK'S OFFICE
NEW YORK

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

Dated: April 6, 2006

HELEN E. FREEDMAN J.S.C.

Check one: ☐ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

- -X

JACK BUECHNER, CARMCO INVESTMENTS, LLC ANTHONY CONFORTI, WILLIAM DeSETA, KATHERYN SEELIE-FIELDS, FRANK JACOBANIS, MERYL JOSEPH, HUGH KELLOGG, FRANCOIS MACLELLAN, SCOTT NICKERSON, WILLIAM PANZER, ANTHONY PASSANNANTE, MARK PASSANNANTE, JOHN RHODES, GARY PARVIN, JOSEPH BALCER, ED CASTILLO, CATHERINE GARBER and THOMAS GENOVA, as BANKRUPTCY TRUSTEE for THE ESTATE OF THE ADBRITE CORPORATION,

Index No. 604319/04

Plaintiffs,

-against-

ALLAN R. AVERY, NORMAN ROTHSTEIN, ELLEN WILLEN, MICHAEL McNULTY, LYNN MARTIN, AB MEDIA CORPORATION and FUEL CELL COMPONENTS & INTEGRATORS, INC.,

Defendants.

- -X

HELEN E. FREEDMAN, J.:

Motion sequence numbers 002 and 003 are consolidated for disposition.

In this action by the bankruptcy estate of the AdBrite Corporation and various shareholders, plaintiffs allege a conspiracy between the company's former officers and others to misappropriate corporate intellectual property for their own benefit. All defendants now move to dismiss upon documentary evidence, for failure to state a claim, and under the applicable statute of limitations (CPLR 3211[a][1][5] and [7]). Defendant

Allan R. Avery additional moves to dismiss for lack of personal jurisdiction (CPLR 3211[a][8]. For the following reasons, the motion is granted in its entirety.

The Complaint

The following facts are taken from the complaint, together with various orders, pleadings and other documents from the bankruptcy proceedings and related federal court motion practice. The AdBrite Corporation is a Delaware company authorized to do business in New York. It was formed to develop and manufacture a new advertising medium consisting of illuminated waste receptacles. A U.S. patent was granted for the receptacles in 1999. AdBrite thereafter entered into contracts or negotiations with municipalities and companies to lease advertising space on the receptacles. At the time, however, AdBrite had yet to obtain funds to mass produce its product.

In 1999 or early 2000, defendant Avery became a shareholder of AdBrite. He assisted in financing the company by investing personal funds and guaranteeing loans from Merrill Lynch and Ridgefield Bank. He became a director of AdBrite in July 2000 and its President in January 2002.

After becoming President, Avery appointed various colleagues to management positions at AdBrite. He installed defendant Ellen Willen ("Willen") as the company's Chief Financial Officer. He also retained defendant Michael McNulty ("McNulty"), an alleged

founding partner of an investment advisory firm, Arbis Capital LLC ("Arbis"), to help obtain financing for AdBrite.

In early 2002, Avery engaged in discussions with defendant Norman Rothstein ("Rothstein") about obtaining unsecured loans for AdBrite. According to the complaint, the two ultimately agreed to jointly participate in the acquisition of the company's intellectual property. Avery allegedly desired to transfer the assets of AdBrite to a new entity controlled by him which would be free of AdBrite's debt, except for the bank loans he had guaranteed.

In April 2002, Avery and Rothstein formed AB Media Corporation ("AB Media") for the purpose of acquiring AdBrite's intellectual property. Avery and Rothstein were AB Media's principal shareholders, and Avery became President of the new concern. McNulty and Willen were appointed senior officers of AB Media. To secure their cooperation, Avery allegedly promised (or possibly tendered) 700,000 shares of AB Media stock to McNulty and 225,000 shares to Willen. Avery, Willen and McNulty became the sole members of AB Media's board of directors. Plaintiffs allege that Avery and Willen thereafter breached written confidentiality and disclosure agreements with AdBrite by sharing proprietary information about AdBrite and its receptacle units with AB Media and Rothstein.

[* 5]

Also in early April 2002, Avery allegedly misrepresented to AdBrite's other officers and directors that he had raised over one million dollars in financing for the company. The complaint asserts that he further misrepresented to those officers and directors, including AdBrite Chairman Caesar Passannante ("Passannante") and director Gary Ferguson ("Ferguson") that his investors were demanding that the financing of the receptacles be accomplished through an entity other than AdBrite. Specifically, Avery advised AdBrite's management that he had formed AB Media and that it was the corporate vehicle in which the investors had agreed to invest. In reliance on these representations, AdBrite engaged in negotiations to merge with AB Media.

AdBrite and AB Media thereafter entered into an Original Letter of Intent ("OLI"), under which plaintiffs and other AdBrite shareholders were to receive either 1 or 1.25 of common stock in AB Media for each share of AdBrite. The OLI provided that the merger would occur on or about July 7, 2002 and prohibited AdBrite from pursuing any other acquisition proposals before that time. According to the complaint, Avery engaged in self-dealing during the negotiations for the OLI by insisting that AB Media would assume AdBrite's obligations for only the two bank loans he had personally guaranteed.

During this same time, Avery proposed that AdBrite enter into a short-term loan (less than 60 days) from Rothstein in the

amount of approximately $560,000. The loan was to be secured by all of AdBrite's intellectual property. To induce AdBrite to take the funds, Avery allegedly misrepresented that he had raised the funds necessary to pay off the loan. The OLI also represented that AB Media could pay it off. Furthermore, Avery and McNulty promised that they could personally satisfy the loan if any problem arose with the investor's funds.

The complaint alleges that as a further inducement to accept the loan, Avery and Rothstein misrepresented that Rothstein would extend the terms of the loan until such time as Avery had actually secured the necessary financing and the merger with AB Media was completed. Plaintiffs also assert that Avery pressured AdBrite's officers and directors to accept the use of the company's intellectual property as collateral for the loan by refusing to seek financing in any other manner and by threatening to terminate the existing loan arrangements with Merrill Lynch and Ridgefield Bank.

AdBrite executed the loan and security documentation for the Rothstein loan on May 14, 2002. In connection with that transaction, plaintiffs allege that at Avery's insistence, AdBrite entered into an onerous manufacturing agreement with Rothstein. Plaintiffs further assert that Avery attempted to divert the proceeds of the Rothstein loan to an unauthorized bank account, returning it only at the insistence of the corporation.

Avery also allegedly set up a website which misrepresented that AB Media's offices were the headquarters and contact site for AdBrite.

In June 2002, AdBrite's officers made repeated inquiries to Avery regarding the repayment of the Rothstein loan. Avery allegedly misrepresented that he would talk to Rothstein about extending the loan or pay it off if necessary, and stated that AB Media would provide financing to AdBrite including monthly payments of $100,000. On June 26, 2002, the OLI was amended to reflect the understanding regarding AB Media's obligationss. However, on August 8, 2002, Avery instructed AdBrite to enter into an interim loan arrangement with AB Media whereby AB would acquire a security interest in AdBrite's intellectual property and gain title to it upon default.

AB Media thereafter failed to make any of the monthly $100,000 payments. As AdBrite was about to default on the Rothstein loan, Avery sought to induce AB Media to renegotiate the merger in a manner that would exclude plaintiffs and the other individual shareholders of AdBrite from any equity participation in AB. Rather than accept this proposal, in October 2002 AdBrite elected to seek protection in bankruptcy. Rothstein subsequently foreclosed under the loan and obtained the intellectual property of AdBrite. Plaintiffs allege that Avery and Rothstein are presently involved in the manufacture of

illuminated receptacle units through defendant Fuel Cell Components & Integrators, Inc., a company controlled by Rothstein.

On March 6, 2003, the bankruptcy court converted AdBrite's case from Chapter 11 to Chapter 7. In a Memorandum Opinion dated May 24, 2003 (see, In Re AdBrite Corp., 290 BR 209 [Bkrtcy SDNY 2003]), the court held that conversion was justified on at least six grounds: "(1) the continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; (2) the inability to effectuate a plan; (3) AdBrite's bad faith in filing the petition; (4) AdBrite's failure to file timely, accurate operating statements; (5) AdBrite's failure to make quarterly fees under 28 U.S.C. § 1930; and (6) AdBrite's books and records are not reliable" (In Re AdBrite Corp., supra at 220). Among other factual conclusions, the court found that AdBrite's Chairman, Caesar Passannante, had "wrongfully used corporation money for his personal expenses" and "made repeated false representations that financing would be forthcoming" (In Re AdBrite Corp., supra at 221).

The bankruptcy court also noted that hearings had been held on a motion by Rothstein to terminate the automatic stay to permit him to foreclose on his liens. However, the court held the motion in abeyance to give the bankruptcy trustee time to evaluate the estate and liquidation, and invited the parties to

brief whether AdBrite's failure to respond to certain document demands and comply with local bankruptcy rules prohibited it from offering evidence of any alleged increase in the value of the patent (In Re AdBrite Corp., supra at 222). On May 14, 2003, the Bankruptcy court issued an order approving the motion to terminate the stay.

On August 5, 2003, Rothstein sent the bankruptcy trustee a "Notification of Strict Foreclosure." The notice advised the trustee of Rothstein's election to accept all of AdBrite's tangible and intangible property in full satisfaction of his loans to the corporations, and stated that the trustee's failure to object to the notice within 20 days would be deemed consent to the proposal. The trustee executed the notice, his signature appearing under the words "No objection."

In December 2003, the bankruptcy trustee filed a report indicating that AdBrite had no assets to distribute and requested to be discharged. However, upon learning that certain shareholders intended to file this state court action, the trustee withdrew the report and, in February 2004, made an application to employ special counsel to pursue claims on behalf of the debtor's estate. By order dated December 20, 2004, the bankruptcy court granted that motion.

The instant action was commenced on December 22, 2004. The case was removed to federal court, but remanded by order dated

July 7, 2005 (see, Buechner v Avery, 2005 WL 3789110 [SDNY 2005]). The complaint sets forth thirteen causes of action, for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, violation of the notice and voting provisions of Delaware General Corporations Law, tortious interference with existing and prospective contractual relations, tortious interference with fiduciary duty, fraud and fraudulent conveyance. The complaint also seeks imposition of a constructive trust, a receivership and other injunctive relief.

Discussion

The motion to dismiss the complaint in its entirety is granted. All of plaintiffs' claims rest upon the premise that defendants misappropriated AdBrite's intellectual property by inducing the company to accept a loan that they knew it could not repay, and by sabotaging the proposed merger with AB Media. However, the shareholder plaintiffs lack the capacity to bring derivative claims on behalf of the corporation. The trustee's claims must be dismissed because they fail to identify the alleged wrongdoing in a nonconclusory manner and are flatly contradicted by the relevant transactional documents and the record established in the bankruptcy proceedings. Furthermore, various claims are barred under principles of estoppel and under the statute of limitations.

Shareholder Standing

The shareholder plaintiffs are not proper parties to the complaint. Claims of breach of fiduciary duty, including charges of corporate waste and mismanagement, may only be enforced by the corporation or through a shareholder's derivative action (Abrams v Donati, 66 NY2d 951, 953 [1985]; Kramer v Western Pacific Indus., 546 AD2d 348, 353 [Del 1988]). Once a company has filed for bankruptcy protection, such claims become property of the estate and are enforceable by the trustee alone (see, ABF Capital Management, LP, 957 F Supp 1308, 1332 [SDNY 1997]; In Re Granite Partners, LP, 194 BR 318, 327 [Bkrtcy SDNY 1996]). A shareholder may seek relief only where the alleged conduct violated a separate duty independent of the duty owed to all shareholders, or whether the injury suffered is distinct from that harm caused to the corporation (Id. at 325). However, where the only injury is the diminution of the value of the company's stock, a direct action is barred (Id.).

The core claim in this case is that AdBrite's sole asset was misappropriated. As a consequence, the complaint alleges, the shareholders "were deprived of their ability to properly protect and benefit from the value of their equity investments in AdBrite." The injury to the shareholders is thus entirely derivative of that of the corporation and their right to seek recovery on its behalf was extinguished by the bankruptcy filing.

The shareholder plaintiffs have not established the existence of any cognizable direct claims against defendants. Their allegation that they were excluded from or discriminated against in the merger transaction with AB Media mischaracterizes the operative facts. As confirmed by the complaint, the transaction never occurred because AdBrite rejected it in favor of filing for bankruptcy. Accordingly, plaintiffs were not harmed, on an individual basis, by an inequitable allocation of shares in the new entity. Rather, the injury was solely to their stock interests in AdBrite, resulting from the company's loss of its intellectual property assets in foreclosure. Similarly, those damages are the only kind arising from the alleged violation of the shareholders' disclosure and voting rights in connection with the Rothstein loan and the OLI.

The Trustee's Claims

Breach of Fiduciary Duty/Aiding and Abetting/Fraud

The first claim for breach of fiduciary duty is premised on the theory that defendants Avery and Willen "forced" AdBrite to default on the Rothstein loan and declare bankruptcy as part of a conspiracy to seize control of its intellectual property. However, the complaint fails to identify the precise wrongdoing in any meaningful way, and the record demonstrates that the bankruptcy ensued after the company voluntarily and knowingly entered into a series of transactions to secure financing.

To establish a claim for breach of fiduciary duty against a corporate officer, a plaintiff must overcome the presumption of the business judgment rule (Cinerama, Inc. v Technicolor, Inc., 663 A2d 1156, 1162-64 [Del 1995]). "In the absence of facts showing self-dealing or improper motive, a corporate officer or director is not legally responsible . . . for corporate losses that may be suffered as a result of decision that an officer made or that directors authorized in good faith" (Gagliardi v Trifoods Int'l, Inc., 693 A2d 1049, 1051-52 [Del Ch 1996]). Where self-dealing is alleged, Delaware Corporation Law § 144 provides a safe harbor for transactions between a corporation and another entity in which the corporation's officers have financial interest, where the material facts are disclosed and the transaction is properly approved (see, Cede & Co. v Technicolor, Inc., 634 A2d 345, 365 [Del 1993], modified, 636 A2d 956 [Del 1994]). Moreover, "the pleadings must contain specific factual allegations as to the conduct that constituted a breach of fiduciary duty, and not be based merely on conclusory allegations" (Shah v Metropolitan Ins. Co., 2003 WL 728869 [Sup Ct NY Co 2003]; see Fischbein v Beitzel, 281 AD2d 167, 515 [1st Dept], aff'd 96 NY2d 715 [2001]); In re General Motors Class E Stock Buyout Sec. Litigation, 694 F Supp 1119 [D Del 1988]; see CPLR 3016[b], unless the relevant facts are particularly within defendants' knowledge (Yatter v William Morris Agency, Inc., 256 AD2d 260 [1st Dept 1998]).

The complaint and the record belie plaintiffs' claim that Adbrite's bankruptcy was brought about by Avery and Willen through wrongful means or in derogation of their fiduciary duties. It undisputed that Adbrite's chairman, Caesar Passannante, negotiated and executed the Rothstein loan and the OLI while represented by counsel. The OLI confirms that Passannante held the right to vote a majority of the company's common stock, and the record demonstrates that Passannante held proxies for 95% of the shareholders. The complaint concedes that Avery advised Passannante and other officers and directors of Adbrite that he had formed AB Media to receive investment funds and engage in a proposed transaction with the company. Accordingly, the transactions were validly entered into on behalf of the shareholders after disclosure by the interested parties. The record rebuts the allegation that Avery "forced" the corporation into bankruptcy. That the decision was made on behalf of the shareholders by Passannante, not Avery.

Plaintiffs' conclusory allegations that the transactions were induced by fraud (seventh cause of action) fail in view of the specific concessions identified above. Neither the Rothstein loan nor the OLI obligated Avery or AB Media to guarantee Adbrite's indebtedness. Plaintiffs may not rely upon vague claims that they relied on promises of financing or loan forbearance where such representations contradict the terms of

the transactional documents (see, Richbell Information Svcs. v Jupiter Partners, LP, 309 AD2d 288, 305 [1st Dept 2003]). Furthermore, reliance on such representations, if made, would have been unreasonable, as the future ability of Adbrite or AB Media to pay off the loan presented an issue that Passannante could have resolved by resort to the companies' records (UST Private Equity Investors Fund, Inc. v Salomon Smith Barney, 288 AD2d 87, 88 [1st Dept 2001] ["[a] a matter of law, a sophisticated plaintiff cannot establish that it entered into an arm's length transaction in justifiable reliance on alleged misrepresentations if that plaintiff failed to make use of the means of verification that were available to it, such as reviewing the files of the other parties"]). Beyond this, plaintiffs' allegations that defendants made false promises to extend or reschedule the loan are contradicted by the record, which shows that the foreclosure did not occur until after Adbrite declared bankruptcy.

The aiding and abetting claim asserted against Rothstein, McNulty, Martin and AB Media (second cause of action) fails in view of the dismissal of the claim for breach of fiduciary duty. The claim would be barred in any event as the alleged wrongdoing of Adbrite's officers would be imputed to the corporation and preclude the trustee, under the doctrine of *pari delicto*, from recovering on its behalf (see ABF Capital Management, LP, 957 F Supp 1308, 1332 [SDNY 1997]; Shearson Lehman Hutton, Inc. v

Wagoner, 944 F3d 114, 120 [2d Cir 1991]; In Re Bennett Funding Group, Inc., 336 F2d 94 [2d Cir 2003]). The adverse interest exception is inapplicable because plaintiffs have not alleged that Avery totally abandoned the interests of the corporation (In Re Grumman Olson Indus., Inc., 329 BR 411, 423-24 [Bankr SDNY 2005]). Asserting that the fiduciary merely had a conflict of interest or did not act primarily in the corporation's interest is insufficient (Id. at 425).

Tortious Inference Claims

The tortious interference claims (fourth, fifth and sixth causes of action) are duplicative of the breach of fiduciary duty claim and must likewise be dismissed under the *pari delicto* doctrine (see, Hirsch v Arthur Andersen, 72 F3d 1085, 1092 [2d Cir 1995]). The tortious interference with contract claim is additionally defective because the OLI specifically recites that it did "not create legal obligations" and was subject to a series of conditions precedent which did not occur (see, Vigoda v DCA Productions Plus, Inc., 293 AD2d 265, 267 [1st Dept 2002]). Similarly, the claim for interference with prospective business relations cannot be sustained in the absence of an allegation that the conditions precedent would have been fulfilled but for defendants' conduct (Id.).

Breach of Statutory Duties

The third cause of action alleges that defendants violated an unspecified Delaware statute by failing to disclose certain material facts necessary to shareholder action. The claim is dismissed. Although defendants now identified Delaware General Corporation Law § 271 as their authority, that section applies only to the sale, lease or exchange of assets. Assuming, arguendo, that applicable section is instead 272 governing the mortgage or pledge of corporate property, that provision does not require the consent of stockholders.

Fraudulent Conveyance Claims

The eight, ninth and tenth causes of action allege that the transfer of Adbrite's intellectual property constituted a fraudulent conveyance of in violation of sections 273, 274 and 275 of the New York Debtor and Creditor Law. Insofar as these claims are based on the premise that the Rothstein loan was incurred in bad faith as part of a conspiracy to render Adbrite insolvent, they merely restate the breach of fiduciary duty claim. Even were they not duplicative, however, they would be barred by the two-year statute of limitations under section 546(a) of the Bankruptcy Code. The statute runs from the date of the order for relief in the bankruptcy case, which was October 15, 2002. The trustee did not commence this action until December 22, 2004. Contrary to plaintiffs' contention, section

108 of the Bankruptcy Code does not afford the trustee an extension of time (see, In Re Everfresh Beverages, Inc., 238 BR 558 [Bankr SDNY 199]; In Re North Shore Road Owners Corp., 187 BR 837, 855 [EDNY 1995]). Furthermore, by countersigning the "Notice of Strict Foreclosure" and declining to object to the lifting of the automatic stay, the trustee waived any claim that the assets were improperly transferred (see, In Re Vision Metals, Inc., 327 BR 719 [Bankr Del 2005]; Feldman v Philadelphia Nat. Bank, 408 F Supp 24 [ED Pa 1976]).

Constructive Trust/Receivership/Injunction

The eleventh, twelfth and thirteenth causes of action seek only remedies related to the substantive causes of action. Accordingly, because the underlying claims have been dismissed, the claims for a constructive trust, receivership, and an injunction must be dismissed as well. Finally, in view of this court's determination on the merits, it is unnecessary to reach defendant Avery's additional defense of lack of personal jurisdiction (see, Astudillo v Flushing Hosp. Med Ctr., 18 AD2d 588 [2d Dept 2005]).

Accordingly, it is

ORDERED, that the motion to dismiss is granted, and it is further

ORDERED, that the complaint is dismissed, with costs and disbursements to defendants as taxed by the Clerk of the Court, and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: April 6, 2006

ENTER:

Helen E. Freedman, J.S.C.