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

PRESENT: HON. MARYLIN G. DIAMOND PART 48

Justice

40 EAST 52ND STREET L.P.,

Plaintiff,

-against-

CARRET AND COMPANY LLC et al.,

Defendants.

INDEX NO. 105397/05

MOTION SEQ. NO. 001

Cross-Motion: [] Yes [X] No

Upon the foregoing papers, it is ordered that: Plaintiff is the owner of a building located on East 52nd Street in Manhattan. This is an action alleging, *inter alia*, (1) breach of an agreement between the plaintiff and the defendant Carret and Company LLC for the lease of premises in the building, (2) the fraudulent transfer or conveyance of Carret and Company's assets to either the defendant Carret Asset Management or the defendant XYZ Corp. in order to avoid Carret and Company's obligations under the lease ands (3) tortious interference with the lease by defendant Castle Harlan, Inc.

Background

On or around September 4, 2001, plaintiff and Carret & Company entered into a lease agreement in which plaintiff agreed to lease the entire 19th floor of the building for a term of 15 years and five months, commencing October 5, 2001. Plaintiff and Carret and Company were the only parties to the lease. In June, 2004, Carret and Company failed to make its monthly rent payment and plaintiff served a notice of default advising it that if the outstanding rent was not paid within ten days, plaintiff would seek to terminate the lease. When Carret and Company failed to pay the outstanding rent, plaintiff terminated the lease and took possession of the premises. Plaintiff also drew down on a $750,000 letter of credit which Carret and Company had provided as security.

Before vacating the premises, Carret and Company sold most of its assets, which consisted of its investment management business and an affiliated broker dealer, to a holding company controlled by an individual named Alan G. Quasha. According to the complaint, Quasha owned a controlling interest in Carret and Company and/or defendant Castle Harlan, a company which controlled Carret and Company. Plaintiff alleges that Quasha, with the assistance of Castle Harlan, set up Carret Asset as a holding company and structured and executed a sale of assets from Carret and Company to Carret Asset which excluded the lease as a liability and left Carret & Company with assets insufficient to honor its obligations under the lease. Castle Harlan was allegedly involved in the negotiations and sale of Carret and Company's assets on behalf of Carret and Company's majority owner, Castle Harlan Partners III. Castle Harlan and Castle Harlan Partners III are ultimately controlled by the same individuals.

The complaint alleges that Carret and Company was rendered insolvent by its sale of assets to Carret Asset and/or XYZ Corporation, an unknown entity allegedly controlled by defendants, and that the asset sale lacked fair consideration, was made in bad faith and was made with the intent to hinder and defraud Carret and Company's creditors, including plaintiff. Plaintiff further alleges that the management, personnel, assets and general business of Carret and Company and Carret Asset are "largely the same" and,

as such, Carret Asset is a successor tenant under the lease, a fraudulent transferee and the successor to the liabilities of Carret and Company.

The complaint asserts seven causes of action. The first cause of action alleges that both Carret and Company and Carret Asset are liable for breach of the lease. The second cause of action, brought pursuant to section 273 of the Debtor Creditor Law, alleges that Carret and Company fraudulently conveyed its assets to Carret Asset and/or XYZ Corporation and seeks an order voiding the sale and/or monetary damages. The third cause of action, brought pursuant to Debtor Creditor Law § 275, and the fourth cause of action, brought pursuant to Debtor Creditor Law § 276, are otherwise duplicative of the second cause of action. The fifth cause of action seeks attorney's fees, pursuant to Debtor Creditor Law § 276(a). The sixth cause of action alleges that Carret Asset is liable under the lease as a successor corporation to Carret and Company. Finally, the seventh cause of action alleges tortious interference with contract against Castle Harlan.

Defendants have moved to dismiss the first cause of action as against Carret Asset and to dismiss the remainder of the complaint in its entirety, pursuant to CPLR 3211 (a)(1) and (7), based upon documentary evidence and failure to state a cause of action.

Discussion

A. Successor Liability and De Facto Merger - The first and sixth causes of action seek to hold Carret Asset liable for breach of contract on the ground that it is a successor corporation to Carret and Company and, as such, assumed the liability of Carret and Company under the lease. Under New York law, a corporation which purchases the assets of another entity is not liable for the prior debts and liabilities of the seller unless (1) the purchaser expressly or impliedly assumed the liability, (2) there was a *de facto* merger between the seller and the purchaser, (3) the purchaser is a mere continuation of the seller or (4) the transaction was fraudulent. *See Schumacher v. Richards Shear Co.*, 59 NY2d 239, 244-45 (1983); *Gratz v. Allied Prods. Corp.*, 171 AD2d 611, 612 (1st Dept. 1991); *Goldman v. Packaging Indus., Inc.*, 144 AD2d 533, 534-36 (2nd Dept. 1988). *See also Fitzgerald v. Fahnestock & Co.*, 286 AD2d 573, 574 (1st Dept. 2001). Here, plaintiff alleges that there was a *de facto* merger between Carret and Company and Carret Asset and that Carret Asset is therefore responsible for all of the pre-existing liabilities of Carret and Company. It is well settled that a *de facto* merger is found where the acquiring corporation has effectively merged with the acquired corporation, as opposed to merely holding it as a subsidiary. *See Fitzgerald v. Fahnestock & Co.*, 286 AD2d at 574. The elements of a *de facto* merger include continuity of ownership, cessation of ordinary business and dissolution of the acquired company, assumption by the successor of the liabilities necessary for the continuation of the business of the acquired corporation, and continuity of management, personnel, physical location, assets and general operations. *Id.* at 574.

On a motion to dismiss for failure to state a cause of action, the court's task is to determine only whether the facts as alleged, accepting them as true and according plaintiff every possible favorable inference, fit within any cognizable legal theory. *See Leon v. Martinez*, 84 NY2d 83, 87-88 (1994). Dismissal based upon documentary evidence is warranted only if the documentary evidence conclusively establishes a defense to the asserted claims as a matter of law. Id., at 88. In moving to dismiss, defendants assert that plaintiff's first and sixth causes of action are deficient because they fail to state a cause of action for successor liability based on a *de facto* merger. Alternatively, defendants argue that documentary evidence conclusively establishes that plaintiff's claims are without merit. The court disagrees with both of these contentions. Plaintiff has alleged that (1) either Quasha and/or Castle Harlan had a controlling ownership interest in both Carret and Company and Carret Asset Management, (2) after the sale of its

assets to Carret Asset, Carret and Company ceased to exist or, if it still exists, is nothing more than an empty "shell" and (3) the management, personnel, assets and general business operation of Carret Asset are largely the same as those of Carret and Company. These allegations, if proven, would be sufficient to demonstrate that a *de facto* merger had occurred. *See Fitzgerald v. Fahnestock & Co.*, 286 AD2d at 574. If anything, the documents provided by the defendants in support of their motion lend some evidentiary support to plaintiff's allegations. The Asset Purchase Agreement between Carret and Company and Carret Asset provides that Carret and Company would be compensated with shares of stock in Carret Asset. Defendants also acknowledge, in an exhibit to an affidavit submitted by Benjamin Sebel, the managing director of Castle Harlan, that a wholly-owned subsidiary of Castle Harlan purchased over one million shares of stock in Carret Asset in order to induce Carret Asset to purchase the assets of Carret and Company. Under the circumstances, the defendants have failed to establish that the first and sixth causes of action should be dismissed.

Defendants also argue that the complaint fatally fails to allege "continuity of ownership" because it does not actually assert that Carret Asset held a previous ownership interest in Carret and Company. However, as plaintiffs point out, they need only allege and demonstrate that the shareholders or owners of Carret and Company became owners of the successor corporation as the result of the purchase. Stated otherwise, continuity of ownership can arise where the parties to a transaction "become owners together of what formerly belonged to each." *Cargo Partner AG v. Albatrans, Inc.*, 352 F3d 41, 47 (2nd Cir.2003). *See also Matter of New York City Asbestos Litig.*, 15 AD3d 254, 256 (1st Dept. 2005). In this respect, plaintiffs have adequately alleged that the owners of Carret and Company have assumed control and/or ownership of Carret Asset pursuant to the Asset Purchase Agreement and subsequent sale of stock.

Defendants also argue that plaintiff has failed to state a cause of action for a *de facto* merger because a *de facto* merger cannot occur if the seller of assets continues to exist after the sale. Defendants claim that plaintiff does not dispute that Carret and Company continues to exist. However, actual legal dissolution of the acquired company is not a prerequisite for a finding of a *de facto* merger. It is sufficient to allege, as plaintiffs have here, that the acquired company has been shorn of its assets and exists only as a shell. *See Fitzgerald v. Fahnestock & Co.*, 286 AD2d at 574; *Ladenburg Thalmann & Co. v. Tim's Amusements*, 275 AD2d 243, 248 (1st Dept. 2001); *Sweatland v. Park Corp.*, 181 AD2d 243, 245-46 (4th Dept. 1992). Under the circumstances, the defendants' motion to dismiss the first and sixth causes of action as against Carret Asset must be denied.

B. Fraudulent Conveyance - Plaintiff's second through fourth causes of action allege claims against Carret and Company and Carret Asset for fraudulent conveyance pursuant to sections 273, 275 and 276 of the Debtor Creditor Law. Under these provisions, a conveyance by a debtor which is made without "fair consideration" is deemed fraudulent if (1) the transferor is insolvent or will be rendered insolvent by the transfer in question, *see* Debtor Creditor Law §273, (2) the transferor believes that it will incur debt beyond its ability to pay, *see* Debtor Creditor Law §275, or (3) the transfer is made with the intent to hinder, delay or defraud either present or future creditors, *see* Debtor Creditor Law §276. In support of their motion to dismiss, defendants argue that plaintiffs cannot demonstrate that the asset sale was not made in good faith or that it was consummated with the intent to delay or hinder creditors. However, with the exception of the fourth cause of action, none of plaintiff's fraud claims requires a showing of actual intent to defraud. Thus, plaintiff's allegation that Carret and Company sold its assets to Carret Asset without fair consideration and that Carret and Company knew that the sale would render it unable to satisfy its debt under the lease states a cause of action under the second and third causes of action. Moreover, plaintiff has sufficiently pled detailed facts which, if true, would establish its allegation in the fourth cause of action that Carret and Company and Carret Asset entered into the transaction with the intention of avoiding

liability under the lease. For example, plaintiff has alleged that after commencing negotiations for the sale, Carret and Company and Castle Harlan attempted to sublease the premises. Upon realizing that they would be unable to do so, Castle Harlan informed plaintiff that Carret and Company intended to abandon the lease and instructed plaintiff to draw down on the letter of credit. Defendants then allegedly structured the sale of assets with the intention to avoid further liability under the lease.

Defendants also contend that the second, third and fourth causes of action are conclusively refuted by documentary evidence and must therefore be dismissed. *See Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*, 10 AD3d 267 (1st Dept. 2004). In support of this argument, they again rely on the affidavit of Benjamin Sebel and on the Asset Purchase Agreement, which they claim prove conclusively that the negotiations between Carret and Company and Carret Asset were conducted at arms-length, with both parties represented by separate counsel, and that Carret Asset gave fair consideration, including $9.5 million in cash, for Carret and Company's assets. The fact that the negotiations may have adopted the formalities of an actual sale is irrelevant to the issue of whether the conveyance was fraudulent within the meaning of the Debtor Creditor Law. As to the issue of whether Carret Asset gave fair consideration, the amount of the purchase price alone does not conclusively establish a defense to the fraudulent conveyance claims, particularly when defendants have not disputed the fact that Carret and Company is now an empty shell with little or no assets. Defendants also have not disputed the allegation that Castle Harlan purchased a substantial amount of stock in Carret Asset in order to induce the sale. Since the plaintiff's allegations sufficiently set forth the elements of a fraudulent conveyance and since defendants have failed to submit documentary evidence which conclusively refute these allegations, defendants' motion to dismiss the second, third and fourth causes of action must be denied. The fifth cause of action for attorney's fees under the Debtor Creditor Law must also go forward since it turns on the merits of the second, third and fourth causes of action.

C. Tortious Interference with Contract - Plaintiff's seventh cause of action is asserted against Castle Harlan for tortious interference with contract. The elements of the tort of interference with contract are (1) existence of a valid contract, (2) defendant's knowledge of that contract, (3) defendant's intentional procuring of the breach, and (4) damages. *See Lama Holding Co. v. Smith Barney Inc.*, 88 NY2d 413, 424 (1996); *Foster v. Churchill*, 87 NY2d 744, 749-50 (1996).

Plaintiff alleges that Castle Harlan, a related company which controlled Carret and Company, induced Carret and Company into breaching the lease by structuring the sale of Carret and Company to Carret Asset so as deprive Carret and Company of sufficient assets to meet its rent obligations under the lease while, at the same time, excluding the lease from the list of property acquired by Carret Asset. In moving to dismiss, defendants point out that under New York law, a parent company such as Castle Harlan has the right to interfere with the contract of its subsidiary or affiliated company in order to protect its economic interests and thus cannot generally be found to have tortiously interfered with the other company's contracts. *See Foster v. Churchill*, 87 NY2d at 750; *Koret, Inc. v. Christian Dior, S.A.*, 161 AD2d 156, 157 (1st Dept. 1990). Although a parent company may be liable for tortious interference with contract if it employed malice or illegal means to induce the breach, *see Foster v. Churchill*, 87 NY2d at 750, Castle Harlan is only alleged to have structured a fraudulent sale which was intended to make Carret and Company judgment-proof in the event of its breach of its obligations under the lease. Castle Harlan is not alleged to have used malice or illegal means to procure the breach or even to have fraudulently brought about the breach. As such, the complaint fails to state a cause of action against Castle Harlan for tortious interference with contract. The defendants' motion to dismiss this cause of action must therefore be granted.

Accordingly, the defendants' motion to dismiss is hereby granted to the extent that the seventh cause of action is hereby dismissed. The motion is otherwise denied. The remaining defendants shall answer the complaint within 20 days of service upon them of a copy of this order with notice of entry.

The parties shall appear before the court in Room 412, 60 Centre Street, New York, New York on February 28, 2006 at 10:30 a.m. for a preliminary conference.

ENTER ORDER

Dated: 1-23-06

MARYLIN G. DIAMOND, *J.S.C.*

Check one: [] FINAL DISPOSITION **[X] NON-FINAL DISPOSITION**