

NSI Intl., Inc. v Wagenheim

2007 NY Slip Op 30877(U)

April 11, 2007

Supreme Court, Suffolk County

Docket Number: 0021878/2006

Judge: Emily Pines

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**Supreme Court - State of New York
J.A.S. Term, Part 23, Suffolk County**

Present:

Hon. Emily Pines
Justice Supreme Court

Original Motion Date: 12-22-2006
Motion Submit Date: 02-08-2007
Motion Sequence No.: 001 MG
CASE DISP

NSI INTERNATIONAL, INC.,

Plaintiff,

-against-

LESLIE WAGENHEIM,

Defendant .

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ORDERED, that this motion by Plaintiff for summary judgment on the issue of its corporate status is granted as set forth herein below.

Plaintiff, NSI INTERNATIONAL, INC., (“NSI” or Plaintiff) commenced this declaratory judgment action against Defendant by the filing of a Summons and Complaint on August 4, 2006 and issue was joined by Defendant’s service of an Answer on or about August 25, 2006. The gravamen of the action is Plaintiff’s claim that it is not the corporate successor and/or alter ego of Natural Science Industries, Ltd. (“Natural Science”), and thus not responsible for the debts of that corporation. Specifically, Plaintiff seeks a declaration that Defendant cannot enforce an Ohio judgment granted in his favor against Natural Science, against Plaintiff herein, NSI.

FACTUAL AND PROCEDURAL HISTORY

Natural Science was a privately held business¹, that since May of 1997, was majority owned by Heritage Partners, Inc. (“Heritage Parnters”), a private equity firm. In 2002, a consortium of banks led by Bank of America became a minority shareholder in Natural Science. The transactions that resulted in the instant litigation are detailed herein as set forth in the affidavit of Thomas Pawluk (“Pawluk”), Chief Executive Officer of NSI and former employee of Natural Science.

The Xonex Transaction and Litigation in Ohio

In 2000, Natural Science purchased the assets of an Ohio based stationary and gifts product company named Xonex International, Inc. (“Xonex”). Defendant LESLIE WAGENHEIM (“WAGENHEIM”) was the sole shareholder of Xonex. As part of that transaction, Natural Science acquired a lease for the prior Xonex corporate headquarters, which lease had been guaranteed by Defendant WAGENHEIM. In 2002, Natural

¹Natural Science was in the business of the design and sale of educational toys and crafts.

Science discontinued the Xonex division and terminated all employees except WAGENHEIM and one other employee. Natural Science vacated the Xonex headquarters building and the landlord of that building, Parkway Business Limited Partnership (“Parkway”) commenced an action against Natural Science and WAGENHEIM in Ohio and WAGENHEIM filed a cross-claim against Natural Science for indemnification. A judgment of \$774,531.39 has been entered in Ohio against Natural Science and WAGENHEIM and a judgment was entered in favor of WAGENHEIM on his cross-claim against Natural Science in the amount of \$774,531.39.

WAGENHEIM thereafter brought an ex-parte application seeking discovery of NSI, Plaintiff herein, purportedly in aid of the Ohio action and such application was granted by this Court on July 12, 2006. Thereafter, by Order to Show Cause dated August 4, 2006, NSI moved to vacate the Order on the ground that there was no proceeding pending in Ohio because a final judgment had been rendered in that action. By Order (PINES, J.) dated November 1, 2006, the Court agreed with NSI, and granted the motion to renew and upon renewal vacated the July 12, 2006 Order. The Court directed Wagenheim to CPLR Articles 52 and 54 as the appropriate methods to conduct and obtain discovery in aid of enforcement of the Ohio judgment. It appears from the submissions that WAGENHEIM has not abided the Court’s decision and has not undertaken any discovery in either this proceeding or in furtherance of collecting on the Ohio judgment against Natural Science.

The GMAC Transaction and Foreclosure Sale

In 2002, Natural Science entered into a loan agreement with GMAC Commercial Finance LLC (“GMAC”), for a revolving line of credit to fund its business operations. To secure the loan, Natural Science pledged substantially all of its assets to GMAC. In 2004, Natural Science owed approximately \$10 million to GMAC under the line of credit and subsequently defaulted on the loan agreement in early 2005. Heritage Partners and Natural Science thereafter sought to find a buyer for Natural Science or its assets; meanwhile, GMAC foreclosed on the assets of Natural Science pursuant to the terms of the loan agreement and Heritage Partners and the bank consortium lost their investment in Natural Science. GMAC then sought to dispose of the assets of Natural Science which it acquired as a result of the loan foreclosure and entered into negotiations with Powerview Investments (“Powerview”), who thereafter formed the corporate entity “NSI INTERNATIONAL, INC.”, Plaintiff herein. Thereafter, Plaintiff, NSI and GMAC entered into a “Secured Party Purchase Agreement”, wherein NSI purchased all the foreclosed assets of Natural Science from GMAC for the amount of \$5,374,000. The submissions reflect that NSI is owned wholly by Powerview, a British Virgin Island investment company whose owners are Hong Kong based investors who had no ownership interest in Natural Science.

The Subject Action

Plaintiff commenced the instant action for a declaratory judgment by the filing of a Summons and Complaint on August 4, 2006. The complaint sets forth one cause of action seeking a declaratory judgment that NSI is not the corporate successor or alter ego of Natural Science and a declaration that defendant Wagenheim could not enforce the Ohio judgment against NSI. In his Answer, Defendant essentially asserts general denials

and the affirmative defenses of lack of personal and subject matter jurisdiction, failure to state a cause of action, no justiciable controversy and that the action should be resolved in Ohio.

SUMMARY JUDGMENT

Plaintiff now moves for summary judgment pursuant to CPLR §3212 granting it a declaratory judgment of its corporate status, ruling that NSI is not the corporate successor or alter ego of Natural Science. In support of the motion, Plaintiff annexes a copy of the pleadings, an affidavit from Thomas Pawluk (“Pawluk”), Chief Executive Officer of NSI, affirmation of counsel and a copy of the Secured Party Purchase Agreement between GMAC and NSI. Plaintiff has also submitted an affidavit from David Chu, one of the Hong Kong investors in Powerview and thus an indirect investor in NSI.

The theory underlying Plaintiff’s motion is simple - NSI purchased the assets of Natural Science from GMAC pursuant to the foreclosure sale. It argues that NSI is a company unrelated to Natural Science, with different and distinct ownership and entered into an arms length transaction with GMAC to purchase Natural Science’s assets. Thus, it argues that such arms length purchase cannot as a matter of law create successor liability.

In opposition to the motion, Defendant has submitted an affidavit, together with two (2) affidavits from his Ohio counsel. Defendant argues that the motion for summary judgment should be denied as premature as he has not had the opportunity to obtain discovery regarding the ownership of the plaintiff corporation and further that NSI should be liable for the debts of Natural Science under a “de facto merger” theory.

Both parties have submitted thorough and extensive memorandum of law in support of their respective positions.

A party moving for summary judgment must make a *prima facie* showing of entitlement to judgment as a matter of law, offering sufficient evidence to demonstrate the absence of any material issues of fact. *Winegrad v. New York University Medical Center*, 64 N.Y.2d 85, 487 N.Y.S.2d 316 (1985); *Zuckerman v. City of New York*, 49 N.Y.2d 557, 562, 404 N.E.2d 718, 427 N.Y.S.2d 595 (1980). Of course, summary judgment is a drastic remedy and should not be granted where there is any doubt as to the existence of a triable issue but once a *prima facie* showing has been made, the burden shifts to the party opposing the motion to produce evidentiary proof in admissible form sufficient to establish material issues of fact which require a trial. *State Bank of Albany v. McAullife*, 97 A.D.2d 607, 467 N.Y.S.2d 944 (3d Dept. 1983).

The law in New York is well settled that a corporation which acquires the assets of another is not liable for the torts of the predecessor corporation. *Schumacher v. Richard Shear Co.*, 59 N.Y.2d 239, 464 N.Y.S.2d 437, 451 N.E.2d 195 (1983). Likewise, the purchaser of a corporation’s assets does not ordinarily become liable for the seller’s debts. *Cargo Partners v. Albatrans, Inc.*, 352 F.3d 41 (2d

Cir. 2003). However, there are four common law exceptions to this rule: “(1) a buyer who formally assumes a seller’s debts; (2) transactions undertaken to defraud creditors; (3) a buyer who has de facto merged with a seller; and (4) a buyer that is the mere continuation of a seller.” *Id.* Here, there is no allegation that NSI expressly assumed Natural Science’s debts or liabilities or undertook this transaction to defraud creditors. Although defendant alleges that NSI is a “mere continuation” of Natural Science, his analysis of this element is essentially an argument that there has been a de facto merger between the two corporations. Thus, exceptions “1”, “2” and “4” are inapplicable to the case at bar, leaving only the issue of whether there has been a de facto merger between NSI and Natural Science.

The requirements to establish a de facto merger are “(1) continuity of ownership; (2) cessation of ordinary business operations and the dissolution of the selling corporation as soon as possible after the transaction; (3) the buyer’s assumption of the liabilities ordinarily necessary for the uninterrupted continuation of the seller’s business; and (4) continuity of management, personnel, physical location, assets and general business operations.” *New York City Asbestos Litigation v. A.W. Chesterton Co.*, 15 A.D.3d 254, 789 N.Y.S.2d 484 (2d Dept. 2005). Although the existence of all four elements may not be required for a finding of a de facto merger, continuity of ownership has been held to be a “necessary element” of any de facto merger finding. *Id.* See also, *Washington Mutual Bank v. SIB Mortgage Corp.*, 21 A.D.3d 953, 801 N.Y.S.2d 821 (2d Dept. 2005) (holding that in non-tort actions, continuity of ownership is the “essence of a merger”). See also, *Buja v. KCI Konecranes International PLC.*, 12 Misc.3d 859, 815 N.Y.S.2d 412 (Sup. Ct. Monroe Co. 2006). As explained by the First Department, the element of continuity of ownership exists “where the shareholders of the predecessor corporation become direct or indirect shareholders of the successor corporation as a result of the successor’s purchase of the predecessor’s assets, as occurs in a stock-for-assets transaction. Stated otherwise, continuity of ownership describes a situation where the parties to the transaction become owners together of what formerly belonged to each.” *New York City Asbestos Litigation, supra* (internal citations omitted).²

Based upon the application of the above principles to the case at bar, plaintiff has demonstrated its prima facie entitlement to summary judgment declaring that NSI is not the corporate successor to Natural Science and thus not liable for the debts of Natural Science to Wagenheim or otherwise. The uncontroverted affidavits of Pawluk and Chu unequivocally establish the lack of continuity of ownership between NSI and Natural Science. NSI purchased the assets of Natural Science from a third party - GMAC and the shareholders of the two corporations are distinct and without even any commonality. That is, NSI is owned 100% by Powerview Investment Limited and the sole shareholder of Powerview is Capital Port Finance Limited. The sole shareholder of Capital Port Finance Limited is David Chu. None of these entities or Chu had any ownership interest in Natural Science.

² *Miller v. Forge Mench Partnership*, 2005 US Dist Lexis 1524; 55 U.C.C. Rep. Serv.2d 1022 (S.D.N.Y. 2005) is inapposite to the instant case. In *Miller*, the owners in the predecessor corporation also had a significant ownership interest in the successor corporation. Thus, there was continuity of ownership, unlike the instant case where there is no common ownership between the successor corporation, NSI and the predecessor corporation, Natural Science.

In opposition to the motion, Defendant has failed to raise a triable issue of fact regarding continuity of ownership sufficient to require a trial of this matter. Essentially, although Defendant concedes that continuity of ownership is required to establish a *de facto* merger, he argues that NSI has not produced information to demonstrate whether such continuity exists between NSI and Natural Science. Thus, Defendant argues that pursuant to CPLR §3212(f), the motion for summary judgment must be denied. Pursuant to CPLR §3212(f), the Court has discretion to deny a motion for summary judgment if facts essential to justify opposition to the motion may exist but may not be stated without additional discovery. *Spatola v. Gelco Corp.*, 5 A.D.3d 469, 773 N.Y.S.2d 101 (2d Dept. 2004). For the Court to deny the motion as premature however, it must be demonstrated that there is a likelihood that further discovery will lead to such evidence and the “‘mere hope’ that evidence sufficient to defeat the motion may be uncovered during the discovery process is not enough.” *Mazzaferro v. Barterama Corp.*, 218 A.D.2d 643, 630 N.Y.S.2d 346 (2d Dept. 1995)

In the case *sub judice*, defendant argues that Plaintiff has failed to provide the information necessary for him to determine whether there is continuity of ownership between NSI and Natural Science. However, the Court finds such argument both disingenuous and lacking merit. In this Court’s earlier decision, it directed Defendant to the appropriate method for obtaining discovery in its Ohio action seeking to enforce his judgment against Natural Science. Defendant elected not to pursue any of the prescribed remedies or procedures in the C.P.L.R. Thereafter, upon Plaintiff’s commencement of the instant action, Defendant did not seek any permitted discovery pursuant to the methods contained in Article 31 of the C.P.L.R. Defendant cannot then be heard to complain that it has been denied discovery when he has chosen his own path in these litigations.


Defendant has presented satisfactory proof in admissible form demonstrating that there is no continuity of ownership between NSI and Natural Science and therefore, it cannot be considered that there was a *de facto* merger between these entities. As continuity of ownership is a critical prerequisite to a finding of a *de facto* merger, the Court need not consider whether the other elements have been satisfied. Since, in response, plaintiff has failed to raise a triable issue of fact requiring a trial, defendant’s motion for summary judgment is granted.

CONCLUSION

Plaintiff’s motion for summary judgment declaring that NSI INTERNATIONAL, INC., is not the corporate successor or alter ego of Natural Science Industry, Ltd. is granted and Defendant WAGENHEIM cannot enforce his Ohio money judgment against Plaintiff NSI.

The foregoing constitutes the **DECISION** and **ORDER** of the Court.

Dated: April 11, 2007
Riverhead, New York



Emily Pines
J. S. C.