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

PRESENT: MELVIN L. SCHWEITZER J.S.C. Justice

PART 45

Harvest Court LLC

INDEX NO. 602281/01

MOTION DATE

- v -

Nanopierce Technologies, Inc.

MOTION SEQ. NO. 030

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 by defendant for leave to amend its previously amended verified answer is DENIED per the attached Decision and Order.

FILED
OCT 27 2009
COUNTY CLERK'S OFFICE
NEW YORK

Dated: October 21, 2009

J.S.C.

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

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

HARVEST COURT LLC,	:	
Plaintiff,	:	Index No. 602281/01
-against-	:	DECISION AND ORDER
NANOPIERCE TECHNOLOGIES, INC.,	:	Motion Sequences: 030, 031
Defendant.	:	

MELVIN L. SCHWEITZER, J.:

Motion sequence numbers 030 and 031 are consolidated for disposition.

In motion sequence number 030, defendant Nanopierce Technologies, Inc. (Nanopierce) moves, pursuant to CPLR 3025 (b), for leave to amend its amended verified answer and counterclaims to assert two additional counterclaims against Harvest Court LLC (Harvest Court) for (1) breach of the implied covenant of good faith and fair dealing and (2) unjust enrichment.

In motion sequence number 031, Harvest Court moves for summary judgment against Nanopierce on its first and second causes of action for breach of contract.

Background

The facts underlying this action are detailed in several prior orders and decisions of this court, familiarity with which is presumed.[1]

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[1] Additional background regarding this dispute can be found in various decisions rendered in a related action between the parties that is still ongoing in the United States District Court for the Southern District of New York (*see e.g. Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2008 WL 1882702, 2008 US Dist Lexis 34560 (SD NY 2008); *Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2008 WL 250553, 2008 US Dist LEXIS 6225 (SD NY 2008); *Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2003 WL 22882146, 2003 US Dist LEXIS 21848 or 21854 (SD NY 2003); *Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2003 WL 22052894, 2003 US Dist LEXIS 15206 (SD NY 2003); *Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2003 WL 21507294, 2003 US Dist LEXIS 11108 (SD NY 2003); *Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2002 WL 31819207, 2002 US Dist LEXIS 24049(SD NY 2002).

This action arises out of Nanopierce's alleged breach of a stock purchase agreement which was executed by the parties in October of 2000. At the time the purchase agreement was executed, Nanopierce was a small development-stage technology company that was operating at a loss and depended upon outside financing for its survival. Nanopierce sought to obtain the needed financing through the sale of shares of its publicly traded common stock.

Under the terms of their purchase agreement, Harvest Court agreed to purchase up to an aggregate principal amount of $15 million in Nanopierce common stock, in two installments of $7.5 million each. The agreement called for Harvest Court to provide Nanopierce with an initial $7.5 million in financing in exchange for 4,531,613 shares of Nanopierce stock, and to provide a further $7.5 million in financing toward the purchase of additional shares at a future date, upon condition that the stock price and volume remained above certain levels. At Harvest Court's insistence, the purchase agreement also required Nanopierce to provide Harvest Court with certain "reset rights," which would entitle Harvest Court to obtain additional shares of common stock, without further payment, in the event of a decline in the stock's market price. Under the terms of the agreement, the number of any reset shares would be calculated pursuant to a predetermined formula on three "reset" dates, occurring at 65, 130, and 195 days after the initial closing.

Immediately after executing the agreement, Harvest Court began selling its shares of Nanopierce common stock in the open market, and continued to sell its shares on a nearly daily basis over the next six months. The price of Nanopierce stock steadily declined during this period, triggering the agreement's reset provision. As required by the purchase agreement, Nanopierce issued Harvest Court an additional 2,143,975 in reset shares following the first reset

date. Thereafter, although the market price of Nanopierce stock continued to decline, Nanopierce refused to issue Harvest Court reset shares following the second reset date. Nanopierce also indicated it would not issue any additional reset shares in the future.[2]

On May 7, 2001, following Nanopierce's refusal to issue further reset shares, Harvest Court commenced this suit, asserting causes of action against Nanopierce for (1) breach of contract, (2) anticipatory repudiation of contract, (3) breach of the implied covenant of good faith and fair dealing, and (4) unjust enrichment. In its answer, Nanopierce acknowledged it failed to issue the reset shares as required under the purchase agreement, but contends its refusal was justified and its performance thus was excused by Harvest Court's own fraud and bad faith. Specifically, in its amended answer, Nanopierce alleges it was the victim of a "death spiral" financing scheme organized by Harvest Court to drive down the price of Nanopierce stock and thereby to trigger the agreement's reset provision. Nanopierce asserts as a first affirmative defense that Harvest Court breached the implied duty of good faith and fair dealing by manipulating the price of Nanopierce's stock with wrongful intent to force Nanopierce to issue additional "reset" shares and also to avoid plaintiff's additional financing obligations under the contract (Verified Amended Answer, ¶ 41).[3] Nanopierce also asserts two causes of action for "fraudulent inducement" and "fraud," alleging that Harvest Court through its agents, non-parties Southridge Capital Management, LLC (Southridge), Patricia Singer, and Dan Pickett (two

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[2] Due to the continuing decline in price of Nanopierce stock, Harvest Court was relieved of its contractual obligation to provide the second $7.5 million in financing toward the purchase of further shares.

[3] As additional affirmative defenses, Nanopierce asserts that (1) Harvest Court failed to mitigate its damages; (2) Harvest Court breached the purchase agreement by failing to provide additional financing; (3) Harvest Court's allegations of punitive and exemplary damages are insufficient; and (4) Harvest Court is estopped from seeking relief for breach of contract due to its own misconduct and unclean hands in manipulating the price of Nanopierce stock.

Southridge employees), intentionally induced Nanopierce to enter into the purchase agreement by misrepresenting that Harvest Court would not engage in these types of manipulative practices.

Meanwhile, at around the same time Nanopierce was serving its verified amended answer and counterclaims in this action, it also was commencing a separate action against Harvest Court, Southridge, Picket, and Singer, among others, in the United States District Court for the Southern District of New York (*see Nanopierce Tech., Inc. v Southridge Capital Mgt., LLC, et al.*, 02 Civ 0767 [Sand, J.]) (federal action). In its complaint in the federal action, Nanopierce asserted causes of action for, inter alia, violations of the federal securities laws and common-law fraud, as well as for Harvest Court's alleged breach of the purchase agreement by its failure and refusal to honor its financing obligations and its violations of the securities laws.

The factual allegations underlying Nanopierce's federal causes of action and the counterclaims it has asserted here essentially are the same. In both actions, Nanopierce alleges that on September 26, 2000, Nanopierce's president and CEO, Paul Metzinger, met with Singer and Pickett at Southridge's offices to negotiate new financing for Nanopierce. Nanopierce alleges it needed this new financing, in part, to buy out its then-current investor, non-party Equinox Investors, LLC (Equinox), whose own conduct and investment practices were causing problems for Nanopierce. Specifically, Nanopierce alleges that through short sales and other methods, Equinox artificially had depressed the price of Nanopierce stock in order to trigger its contractual rights to convert its preferred shares into shares of Nanopierce common stock, thus creating further downward pressure on the price of Nanopierce stock.

Nanopierce alleges that, during its negotiations with Southridge to obtain replacement financing, Metzinger had informed Singer and Pickett of his particular concerns regarding any

repeat of the type of practices engaged in by Equinox. Singer and Pickett allegedly had assured Metzinger that Southridge would not engage in such practices. Even though Southridge insisted that the purchase agreement contain the provision for "reset rights," which function somewhat similarly to the convertible debentures at issue with Equinox, Nanopierce allegedly agreed to execute the agreement in reliance on these two individuals' assurances. The agreement ultimately was executed between Nanopierce and Harvest Court, a Cayman Islands corporation, which allegedly was substituted as a "straw man" for Southridge just prior to closing.

Nanopierce alleges that, contrary to the representations of Singer and Pickett, Harvest Court planned and intended to manipulate the price of Nanopierce stock in order to trigger the reset provisions in the agreement and thereby receive additional reset shares without adequately compensating Nanopierce. Nanopierce further alleges that Southridge, and various individuals and entities associated with it, long had been engaged in a pattern and practice of inserting reset rights, or similar provisions, into stock purchase agreements with companies to which they provided financing. These entities then would proceed to drive down the price of the stock in order to trigger those rights and enrich themselves at the expense of those companies and their shareholders.

Nanopierce alleges that Harvest Court, aided by various Southridge entities and individuals, was engaged in just such a scheme regarding Nanopierce, and that it proceeded to sell its Nanopierce shares in such high volumes, and in such a continuous manner, as to cause Nanopierce's stock price to decline. It alleges that Harvest Court's conduct was improper because, due to the inclusion of the reset provision, Harvest Court was protected against any

declines in the price of Nanopierce stock; and that Harvest Court had no legitimate reason to sell its stock in either the volume or manner that it did.

Shortly after Nanopierce commenced its federal action, Harvest Court commenced a further federal action in which it asserted causes of action against Nanopierce and its principals for fraud and misrepresentation. Subsequently, Harvest Court's federal causes of action (which did not include the contract claims Harvest Court already had asserted against Nanopierce here) were recast as counterclaims by Harvest Court in the federal action commenced by Nanopierce. Due to the similarity and overlap in the claims, counterclaims, and underlying allegations in Nanopierce's federal action and those here, the two cases were coordinated for purposes of discovery. Upon the conclusion of discovery, the parties moved for summary judgment in the federal action.

In an opinion dated January 29, 2008, the district court, inter alia, granted Harvest Court's motion for summary judgment and dismissed all of the claims asserted against it by Nanopierce (*see Nanopierce Technologies, Inc., v Southridge Capital Management, LLC*, 2008 WL 250553, 2008 US Dist LEXIS 6225, *supra*). The district court held that Harvest Court's open market sales of stock, even if accompanied by a subjective intent to affect the price of stock, were insufficient, standing alone, to establish market manipulation as a matter of law (*id.*).

In its opinion, the district court noted that although the law regarding open-market manipulation had not been fully settled at the time Nanopierce had commenced its federal action, the Second Circuit had since settled the issue in *ATSI Communications, Inc. v Shaar Fund, Ltd.* (493 F3d 87 [2d Cir 2007]), a case alleging similar conduct in the sales of securities to that allegedly engaged in by Harvest Court. As the district court explained, the Second Circuit in

ATSI had determined that allegations of "death spiral financing" were insufficient, standing alone, to establish market manipulation absent some other manipulative behavior. Rather, to constitute market manipulation, a defendant would have had to "inject[ ] inaccurate information into the marketplace or create a false impression of supply and demand for the security ... for the purpose of artificially depressing or inflating the price of the security." *ATSI* at 101. (*Nanopierce Technologies, Inc.*, 2008 WL 250553, *2, 2008 US Dist LEXIS 6225). The district court found that Harvest Court's sale of Nanopierce shares on the open market, even by means of the "unusually large sales" alleged by Nanopierce, did not inject false information into the marketplace and thus could not be the basis of a market manipulation claim (*id.*).

The district court based its decision, in part, on the Second Circuit's emphasis in *ATSI* that these types of financing agreements "are negotiated by sophisticated parties who are aware of the potential consequences" (*id.*, *3). The district court observed that the Second Circuit, in dismissing the claim for market manipulation in *ATSI*, had noted there was a "plausible nonculpable explanation" for the defendants' actions, which was that "ATSI and the defendants had simply entered into mutually beneficial financing transactions" (*id.*, quoting *ATSI*, at 104). The district court found the facts of this case clearly demonstrated that Nanopierce knew when it entered into the purchase agreement that Harvest Court was not a long-term investor and it understood the potentially unfavorable consequences of the purchase agreement. As in *ATSI*, the district found Nanopierce nevertheless had executed the purchase agreement because it had needed the financing.

As for Nanopierce's contention that Harvest Court's selling activities were improper because its investment carried virtually no risk and was merely a scheme to drive down the price

of Nanopierce stock, the district court found that Nanopierce overestimated the certainty involved with Harvest Court's investment strategy. It noted that "Harvest Court was investing in a very distressed company, as is evidenced simply by the fact that Nanopierce agreed to the 'death spiral' financing at all" *(id.*, *4). The district court further found Harvest Court was subject to a number of risks inherent in the transaction, and that the structure of the purchase agreement, and in particular the inclusion of the reset provision, did not necessarily protect Harvest Court from all declines in the price of Nanopierce stock or from other risks inherent in the transaction.

Following dismissal of its federal causes of action against Harvest Court, Nanopierce moved, inter alia, for leave to amend its federal complaint to interpose an additional claim against Harvest Court for breach of the implied covenant of good faith and fair dealing.[4] In a memorandum in support of its motion, Nanopierce said it sought to do so in order to make clear that its previously asserted cause of action for breach of contract against Harvest Court already was based, in part, on Harvest Court's alleged breach of this implied covenant. Although Nanopierce acknowledged Harvest Court had listed the breach of contract claim in its notice of motion as one for which it was seeking dismissal, Nanopierce argued Harvest Court had offered no independent ground to justify such dismissal; and that Nanopierce thus had seen no reason to defend the contract claim in its opposition to that motion. Nanopierce further argued that since the district court had not separately addressed the merits of the contract claim in its decision granting Harvest Court summary judgment, this cause of action remained part of the federal action; therefore, Nanopierce should be permitted to clarify that the claim included the theory of

[4] Nanopierce also sought leave to add a further cause of action for tortious interference with contract.

breach of the implied covenant of good faith and fair dealing (*see* Schechtman Affirm. in Further Support of Harvest Court's Motion for Summary Judgement, Exh. D, at 1-2).

By decision dated April 21, 2008, the district court denied Nanopierce's motion for leave to amend (*Nanopierce Tech., Inc. v Southridge Capital Mgt. LLC*, 2008 WL 1882702, 2008 US Dist Lexis 34560). The district court stated that "Nanopierce offers no reason why it failed to include these [proposed] causes of action in its original Complaint, or at any point in the intervening *seven years*. Rather, Nanopierce seeks leave to amend now simply because its original causes of action have failed." (*Id.* at *3[emphasis in original]). Additionally, that same day, the district court issued a separate order responding to various letters it had received from the parties which requested clarification of certain portions of its January 28, 2008 opinion (*see* Schechtman Affirm. in Further Support of Motion for Summary Judgment, Exh. B). In this second order, the district court clarified that Harvest Court's summary judgment motion against Nanopierce, which had sought dismissal of *all* claims asserted against it by Nanopierce, had been granted in its entirety and thus had included the breach of contract claim. Nanopierce indicates it intends to appeal the district court's dismissal of its causes of action against Harvest Court. As no final decision has yet been entered in the federal action, however, Nanopierce does not yet have the right to appeal.

Nanopierce now seeks leave to amend its amended verified answer and counterclaims here in this action to add two additional counterclaims for breach of the implied covenant of good faith and fair dealing and unjust enrichment (Motion Sequence Number 030). In its first proposed counterclaim, Nanopierce alleges that Harvest Court breached the implied covenant of good faith and fair dealing by trading in the common stock of Nanopierce in such a way as to

intentionally cause the market price of Nanopierce stock to decline with the intent to require Nanopierce to issue additional 'reset' shares and to avoid plaintiff's additional financing obligations under the contract (*see* Sheridan Declaration in Support of Motion for Leave to Amend, Exh. 2: Proposed Second Amended Answer and Counterclaims, ¶ 105). In its second proposed counterclaim, Nanopierce alleges it bestowed a benefit on Harvest Court by issuing reset shares under circumstances as to make it unjust that Harvest Court "should have received such shares without adequately compensating [Nanopierce]" (*id.*, ¶ 108). Nanopierce argues there can be no unfair prejudice or surprise to Harvest Court in allowing the proposed amendments here because (1) it already has asserted Harvest Court's breach of the implied covenant of good faith and fair dealing as an affirmative defense in its amended verified answer, and (2) the proposed counterclaim for unjust enrichment is based on allegations of fact that also already are asserted in those pleadings.

Harvest Court opposes Nanopierce's motion to amend and moves for summary judgment on its first and second causes of action for breach of contract (Motion Sequence Number 031). Harvest Court notes Nanopierce does not dispute it breached the purchase agreement by failing to issue the additional reset shares; rather, as its defense, Nanopierce asserts its performance was excused by Harvest Court's fraud and bad faith in "manipulating" the price of Nanopierce's stock. Harvest Court argues that this affirmative defense, as well as Nanopierce's proposed new counterclaim for breach of the implied covenant of good faith and fair dealing, now have been foreclosed by the district court's complete rejection of Nanopierce's market manipulation and fraud causes of action, as well as by the express findings of fact made by the district court in rendering its decision. Harvest Court further argues that, in any event, Nanopierce's proposed

bad faith claim is inconsistent with the express terms of the purchase agreement, and that its proposed unjust enrichment claim is not viable where, as here, the existence of an express contract is undisputed.

Discussion

In its motion papers, Nanopierce concedes it is barred from re-litigating the issues of stock manipulation and fraud which were decided by the district court in the federal action. It argues, however, that because the district court never addressed, and expressly declined to consider, the merits of its claim that Harvest Court materially breached the implied covenant of good faith and fair dealing, neither res judicata nor collateral estoppel precludes Nanopierce from litigating this claim here.

Nanopierce contends the district court, in granting Harvest Court's motion for summary judgment and dismissing Nanopierce's federal causes of action, only determined that Harvest Court's open market sales of stock did not constitute market manipulation as that term of art is used in the federal securities laws. Nanopierce asserts that the basis for the district court's conclusion was its finding that Harvest Court had not injected false information into the market. It argues that, in contrast, a determination as to whether Harvest Court breached the covenant of good faith and fair dealing does not turn on whether false information was injected into the market, but on whether Harvest Court's conduct, i.e., the manner and volume in which it sold its shares of stock, had an illegitimate purpose and lacked good faith.

Nanopierce argues that any factual determinations made by the district court in rendering the decision to dismiss Nanopierce's claims against Harvest Court were made solely with respect to Nanopierce's stock manipulation and fraud claims, and thus attach only to those claims.

Nanopierce also argues that, in any event, the district court's factual determinations were not nearly as broad or encompassing as Harvest Court has represented, and did not resolve all issues of fact with respect to the legitimacy and appropriateness of Harvest Court's conduct. Specifically, it argues the district court's finding that Nanopierce knew Harvest Court was not a long-term investor does not mean Nanopierce knew Harvest Court would not be a genuine or true investor, or that it would sell all of its stock in the short term and in such a way as to depress the price of Nanopierce stock. Nanopierce further argues the district court's finding that Harvest Court's investment was not risk free does not establish, as a matter of law, that Harvest Court had a legitimate, good faith reason to sell its shares in the manner that it did.

Nanopierce additionally notes that in a prior Memorandum Decision rendered by this court on August 1, 2001, Justice Cahn stated that "[a]cting to manipulate the stock price by short selling or otherwise might well be a breach of [the] implied covenant of good faith" (*see* Schechtman Affirm in Further Support of Motion for Summary Judgment, Exh. E, at 11). Nanopierce asserts that Justice Cahn's comment constitutes the law of this case, and thus is unaffected by any rulings the district court might have made with respect to Nanopierce's market manipulation and fraud claims.

While the district court may not have expressly addressed the merits of Nanopierce's bad faith claim against Harvest Court, the record establishes that Nanopierce did not explicitly raise this issue until after the district court dismissed all of Nanopierce's other causes of action against Harvest Court, including its breach of contract claim. When Nanopierce subsequently sought leave to raise and assert this claim in the federal action, the motion was denied as untimely.

In any event, even if not explicitly addressed in the federal action, the claim for breach of the implied covenant of good faith and fair dealing which Nanopierce now seeks leave to add as a counterclaim here arises out of, and is based upon, the same factual allegations that served as the basis for the fraud, stock manipulation and breach of contract causes of action Nanopierce did assert against Harvest Court in the federal action. Nanopierce has acknowledged that the district court, in dismissing those causes of action, made a number of determinations on the underlying issues which were material to, and served as the basis for, those previously asserted claims. To the extent these underlying issues also are material to, and serve as the basis for, Nanopierce's proposed counterclaim here the parties are bound by those prior determinations regardless whether they were made in the course of adjudicating different causes of action (*see e.g. Pinnacle Consultants, Ltd. v Leucadia Natl. Corp.*, 94 NY2d 426 [2000]).

In contrast, Justice Cahn's comment that short selling *might* well be a breach of the implied covenant of good faith and fair dealing, did not constitute a legal or a factual determination in this action. His statement thus has no binding effect on the proceedings here.

Under New York law, every contract carries with it an implied duty of good faith and fair dealing *(Dalton v Educational Testing Serv.*, 87 NY2d 384 [1995]). Encompassed within this implied obligation are "'any promises which a reasonable person in the position of the promisee would be justified in understanding were included'" *(Rowe v Great Atl. & Pac. Tea Co.*, 46 NY2d 62, 69 [1978], quoting 5 Williston, Contracts § 1293, at 3682 [rev ed 1937]). The covenant requires that neither party will take any action which may "'have the effect of destroying or injuring the right[s] of the other party to receive the fruits [or benefits] of the contract'" (*511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 153 [2002],

quoting *Dalton*, 87 NY2d at 389). "Where the contract contemplates the exercise of discretion, this pledge includes a promise not to act arbitrarily or irrationally in exercising that discretion" (*Dalton*, 87 NY2d at 389).

The implied covenant of good faith and fair dealing is not without limits, however; it cannot create new duties under a contract or substitute for an insufficient contract claim (*Triton Partners LLC v Prudential Sec. Inc.*, 301 AD2d 411, 411 [1st Dept 2003]). Our courts have held that the implied covenant "will be enforced only to the extent it is consistent with the provisions of the contract" (*Phoenix Capital Investments LLC v Ellington Management Group, L.L.C.*, 51 AD3d 549 [1st Dept 2008]; *see also Murphy v American Home Prods. Corp.*, 58 NY2d 293, 304 [1983] [no obligation can be implied that "would be inconsistent with other terms of the contractual relationship"]), and will not be applied in a manner that "would effectively create an independent contractual right that was not bargained for by the parties" (*Madison Apparel Group Ltd. v Hachette Filipacchi Presse, S.A.*, 52 AD3d 385, 386 [1st Dept 2008], citing *National Union Fire Ins. Co. of Pittsburgh, Pa. v Xerox Corp.*, 25 AD3d 309, 310 [1st Dept], *lv dismissed* 7 NY3d 886 [2006]).

Here, it is undisputed that Harvest Court had the right under the agreement to sell its shares of stock on the open market. The stock purchase agreement placed no limitations or restrictions on such sales, other than to require that "[a]ny sales of the Securities shall be made in accordance with the Securities Act and the rules promulgated thereunder" (*see* Schechtman Affirmation in Opposition to Motion for Leave to Amend, Exh. A: Purchase Agreement, at 6). The district court clearly determined there were no such securities law violations when it

dismissed the stock manipulation and breach of contract claims asserted against Harvest Court in the federal action.

Nanopierce counters, however, that even if Harvest Court had a contractual right to sell its stock, it still could be liable for breaching a duty of good faith and fair dealing if its exercise of that right to sell was done for an illegitimate purpose and in bad faith (citing *Richbell Information Services, Inc. v Jupiter Partners, L.P.*, 309 AD2d 288 [1st Dept 2003]).

In *Richbell*, the First Department held that, even in cases where a defendant has acted within its express contractual rights, an apparently unlimited contractual right "may not be exercised solely for personal gain in such a way as to deprive the other party of the fruits of the contract" (*id.* at 302).

> This limitation on an apparently unfettered contract right may be grounded either on the construction of the parties' fiduciary obligations (*see Wilf v Halpern*, 194 AD2d 508 [1993], *lv dismissed* 82 NY2d 846 [1993]; *Beck v Manufacturers Hanover Trust Co.*, 218 AD2d 1, 9-11 [1995]; *Drucker v Mige Assoc. II*, 225 AD2d 427, 428 [1996], *lv denied* 88 NY2d 807 [1996]) or on the purely contractual rule that even an explicitly discretionary contract right may not be exercised in bad faith so as to frustrate the other party's right to the benefit under the agreement (*see Matter of Kaszirer v Kaszirer*, 298 AD2d 109, 110 [2002], citing *Dalton v Educational Testing Serv.*, 87 NY2d 384, 389 [1995]; *1-10 Indus. Assoc. v Trim Corp. of Am.*, 297 AD2d 630, 631-632 [2002]).

(*id.*).[5] Thus, in *Richbell*, the First Department declined to dismiss a cause of action for breach of the implied covenant of good faith and fair dealing based on allegations that defendant had exercised its contractual veto power "for an illegitimate purpose and in bad faith," as part of a secret scheme to deprive plaintiffs of the benefits of their joint venture (*id.* at 303).

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[5] In other cases, as well, our courts have sustained a claim for breach of the implied covenant where, even if not prohibited by the contract, one party intentionally or purposefully does something to prevent the other party from carrying out its part of the agreement (*see e.g. Wieder v Skala*, 80 NY2d 628 [1992]; *Advanced Safety Sys. NY, Inc. v Manufacturers & Traders Trust Co.*, 188 AD2d 1009, 1011 [4th Dept 1992]).

The parties in *Richbell* had contracted to form a corporate vehicle to carry out a joint venture to acquire a third-party company. In the complaint, plaintiffs had alleged that the defendants purposefully had structured the transactions to keep plaintiffs in debt. Defendants then allegedly had utilized their rights under the contract to block plaintiffs from raising the funds needed to pay the debt by any means other than borrowing from one of the defendants, and then had required plaintiffs to pledge all of their shares in the venture to secure the requisite note. The complaint further alleged that, unbeknownst to plaintiffs, defendants had entered into a secret "bid rigging agreement" to ensure that plaintiffs defaulted on the note so that defendants then could foreclose on the pledged shares. Specifically, defendants allegedly used their contractual veto right to block a planned IPO in order to deprive plaintiffs of the funds they needed to repay the note, thereby inducing plaintiffs' default. Defendants also allegedly participated in a collusive foreclosure sale of plaintiffs' pledged shares in which they intentionally kept the sale price of the shares artificially low. Plaintiffs alleged that as a result of this alleged malfeasance, they were forced into bankruptcy and lost all of their interest in the venture.

In upholding the cause of action for breach of the implied covenant of good faith and fair dealing, the First Department held that the allegations in *Richbell* went far beyond claiming only that the defendant should be precluded from exercising a contractual right; rather, the allegations supported a claim that the defendant had exercised a contractual right "malevolently, for its own gain as part of a purposeful scheme designed to deprive the plaintiffs of the benefits of the joint venture and of the value of their pre-existing holdings" (*id.* at 302). While recognizing the tension between the imposition of a good-faith limitation on the exercise of a contractual right

and the avoidance of using the implied covenant of good faith to create new duties that negate specific rights under a contract, the First Department held that the allegations did "not create new duties that negate [defendant's] explicit rights under a contract, but rather seek imposition of an entirely proper duty to eschew this type of bad faith targeted malevolence in the guise of business dealings" (*id.*).

Nanopierce argues that, like in *Richbell*, Harvest Court here exercised its contractual right to sell its stock solely to enrich itself at the expense of Nanopierce, and to deprive plaintiff of the benefit of its bargain. It contends that the whole point of the stock purchase agreement had been to provide Nanopierce with the financing it needed to become a successful business. Nanopierce thus contends that when it entered into the purchase agreement it expected and understood that Harvest Court would be a true investor and would act as most true investors do, which is to allow the market to determine the price of its stock in the hope the price would go up, and it would profit as a result. Nanopierce contends that by the manner and volume in which Harvest Court sold its shares, Harvest Court caused the price of Nanopierce to decline, which threatened Nanopierce's economic survival and deprived Nanopierce of the additional $7.5 million in financing to which it otherwise might have been entitled.

Nanopierce asserts that, according to its expert, it is highly unusual for a private equity investor to sell the stock of a company that it recently has financed unless such sales are part of a credible hedging strategy, or the buyer expects to gain from the falling share price. It contends that, here, Harvest Court has produced no evidence it was pursuing a legitimate hedging strategy or that it was selling its shares in reaction to adverse changes in either the market or Nanopierce's business. Nanopierce further argues, given the protections against stock price declines afforded

by the inclusion of the reset provision, Harvest Court had no legitimate justification for the continuous manner and volume in which it exercised its right to sell the shares. It argues that under these circumstances, a jury could find Harvest Court was acting solely to enrich itself at Nanopierce's expense, and thus the exercise of its contract right was done for an illegitimate purpose and in bad faith.

Notwithstanding Nanopierce's allegations that Harvest Court was engaged in a scheme to enrich itself, neither Nanopierce's affirmative defense, nor its proposed counterclaim, alleges anything akin to the type of "targeted malevolence," upon which the court sustained the bad faith claim in *Richbell*. Nanopierce's complaint is devoid of fact allegations approaching the kind of self-dealing and collusive conduct at the core of the "secret" scheme alleged in *Richbell*. The record reflects that the inclusion of the reset provision, at the heart of what is alleged to be Harvest Court's "scheme", was negotiated by the parties as part of their bargained-for exchange. Even if Harvest Court's sales helped trigger that reset provision, the district court expressly determined that on the facts of this case Nanopierce was a sophisticated party that clearly understood not only the terms, but the consequences, of its agreement, i.e., that these types of "death spiral" financing agreements could have a depressive effect on the price of its stock.[6] Specifically, the district court held that,

> [t]he facts in this case clearly demonstrate that Nanopierce understood the terms of the agreement, and knew that Harvest Court was not a long-term investor. One executive sent a letter to Nanopierce's shareholders several months after the deal closed, which noted that "in bad market conditions, these types of financing can

[6] According to the Annual Report that Nanopierce filed with the Securities and Exchange Commission in 2000, Paul Metzinger, the CEO most involved in the negotiations, had practiced securities law in Denver, Colorado for over 32 years prior to becoming an officer and director of the company (*see* Sheridan Declaration in Support of Motion for Leave to Amend, Exh. 18).

> have an unfavorable dilutive impact and exert a depressant effect on the price of the Company's stock. We are conducting numerous discussions with many other financial sources that we believe will provide more favorable financing to the Company with less adverse features." (3/7/01 Shareholder Letter, p. 4). Further, deposition testimony by Nanopierce executives demonstrates that they knew Harvest Court was not a long-term investor. See Schrader Aff Exh. 41, Richards 10/14/02 Dep. at 173 ("Mr. Pickett said, as you know, that we are not long time investors ourselves and we may sell our stock."); Schrader Aff Exh. 41, Richards 10/14/02 Dep. at 166 ("we got out in the car and I said to Paul, can you believe this, they didn't even want to know what the company did, nothing, its [*sic*] like getting a gift from heaven, you know, okay, and we needed the money, okay?"). Nanopierce cannot reasonably have expected that an investor who "didn't even want to know what the company did" would be a long-term investor in the company's stock. Nanopierce clearly "needed the money," and knew of the potential "unfavorable" and "depressant" effect that the financing could have on the company's stock.

(*see Nanopierce*, 2008 WL 250553, *3, 2008 US Dist LEXIS 6225).

In rendering its decision, the district court did not merely determine that Harvest Court's investment was not risk free, it also expressly rejected Nanopierce's contention that given the protections against any decline in stock price afforded by the inclusion of the reset provision, Harvest Court's conduct was improper. To the contrary, the district court found that,

> the structure of the agreement only provided protection for one-third of Harvest Court's stock in every reset period. If Harvest Court failed to liquidate one-third of its stock in each reset period, that leftover stock would lose the reset provision protection and Harvest Court would be left with unprotected shares in a financially distressed company. Similarly, Harvest Court faced the risk that Nanopierce would go bankrupt during the reset provision, in which case it could lose its $7.5 million investment entirely. For a company whose auditor had expressed doubts about its survival as a "going concern," this was far from a risk-free transaction.

(*id.* at 4).

The district court's finding that Harvest Court's activities were justified by the risks inherent in the transaction directly belies Nanopierce's contention that Harvest Court had no

legitimate reason to sell its shares in the manner and volume that it did. Additionally, this finding further distinguishes this case from *Richbell*, where the complaint alleged the exercise of a contract right "*solely* for personal gain in such a way as to deprive the other party of the fruits of the contract" (*Richbell*, 309 AD2d at 302 [emphasis added]).

Upon consideration of all of the determinations made by the district court in rendering its decision, this court thus finds that Nanopierce's proposed cause of action for breach of the implied covenant of good faith and fair dealing cannot be sustained. Accordingly, Nanopierce's motion for leave to amend its answer to add this proposed cause of action is denied. While it is true that, generally, leave to amend a pleading is freely granted provided there is no prejudice or surprise to the non-moving party (CPLR 3025 [b]; *Thomas Crimmins Contr. Co. v City of New York*, 74 NY2d 166 [1989]), our courts consistently have held that in order to conserve judicial resources, an examination of the underlying merits of the proposed causes of action is mandated (*id.*; *see also Board of Managers of Alexandria Condominium v Broadway/72nd Assoc.*, 285 AD2d 422 [1st Dept 2001]). Where a proposed pleading fails to state a cause of action or is plainly lacking in merit, leave to amend is properly denied.

That portion of Nanopierce's motion which seeks leave to amend its answer to add a second proposed claim for unjust enrichment must be denied as well. A claim of unjust enrichment, which also is described as being for restitution or on quasi-contract, is based on the equitable principles that a person shall not be allowed to enrich himself unjustly at the expense of another (*Ross v F.E.I., Inc.*, 150 AD2d 228, 232 [1st Dept 1989]). To state a cause of action for unjust enrichment, a plaintiff must allege it bestowed a benefit upon the defendant, and that the defendant will obtain such benefit without adequately compensating plaintiff therefor (*Wiener v*

Lazard Freres & Co., 241 AD2d 114 [1st Dept 1998]; *Tarrytown House Condominiums, Inc. v Hainje*, 161 AD2d 310 [1st Dept 1990]). A cause of action for unjust enrichment, however, will not lie where the purported quasi contract arises "out of the same subject matter" governed by an enforceable written contract (*Clark-Fitzpatrick, Inc. v Long Island R.R. Co.*, 70 NY2d 382, 388 [1987]).

Here, Harvest Court's entitlement to reset shares was governed entirely by the reset provision of the written purchase agreement; thus, no cause of action for unjust enrichment is stated. In any event, Nanopierce's contention that Harvest Court was unjustly enriched by the receipt of reset shares which were awarded solely as a result of Harvest Court's illegitimate sales would be foreclosed by the district court's finding that Harvest Court's sales were not improper.

In light of the above, Harvest Court's motion for summary judgment on its two causes of action for breach of contract will be granted as to the issue of liability.

A motion for summary judgment will be granted where the movant has made "a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case" (*Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 [1985]). Once a movant has made such a showing, the party opposing the motion has the burden of producing evidentiary facts sufficient to raise triable issues of fact (*see Zuckerman v City of New York*, 49 NY2d 557 [1980]).

Nanopierce "does not dispute that Harvest Court has established each of the elements of its breach of contract claim, although the amount of damages is in dispute" (*see* Defendant's Memorandum in Opposition to Plaintiff's motion for Summary Judgment, at 2). Nanopierce additionally does not dispute that the recent decisions rendered in the federal action preclude it

from re-litigating its counterclaims for fraud, or any affirmative defenses based thereon. Instead, Nanopierce asserts as its sole remaining defense to this action that its performance was excused by Harvest Court's material breach of the implied covenant of good faith and fair dealing.

As this court now has determined that Nanopierce's allegations here fail to sustain a claim or affirmative defense for breach of the implied covenant of good faith and fair dealing, there is no longer any basis on which to deny summary judgment as to liability on Harvest Court's breach of contract claims.

Accordingly, it is

ORDERED that the motion by defendant Nanopierce Technologies, Inc., for leave to amend its amended verified answer and counterclaims to assert two additional counterclaims against Harvest Court LLC (Motion Sequence Number 030), is denied; and it is further

ORDERED that the motion by plaintiff Harvest Court, for summary judgment on its first and second causes of action (Motion Sequence Number 031), is granted as to the issue of liability; and it is further

ORDERED that the issue as to the amount of damages is referred to a Special Referee to hear and report with recommendations, except that in the event of and upon the filing of a stipulation of the parties as permitted by CPLR 4317, the Special Referee or another person designated by the parties to serve as referee then shall determine the aforesaid issue; and it is further

ORDERED that this motion is held in abeyance pending receipt of the report and recommendations of the Special Referee and a motion pursuant to CPLR 4403 or receipt of the determination of the Special Referee or the designated referee; and it is further

ORDERED that counsel for the plaintiff shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet, upon the Special Referee Clerk in the Motion Support Office in Rm. 119 at 60 Centre Street, who is directed to place this matter on the calendar of the Special Referee's Part (Part 50 R) for the earliest convenient date.

This constitutes the decision and order of this court.

Dated: October 21, 2009

ENTER:

J. S. C.