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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY
PRESENT: HON. MARYLIN G. DIAMOND PART 48
Justice

INDEX NO. 601567/08

JEFFREY ERVINE and EILEEN PATRICK,

MOTION DATE

Plaintiff,

MOTION SEQ. NO. 001

-against-

MOTION CAL. NO.

BARBARA LAURENCE, LYNN WELSHMAN and CRANSTON, LLC.,

Defendant.

Cross-Motion: [] Yes [X] No

Upon the foregoing papers, it is ordered that: This action arises from an agreement which the plaintiffs entered into with defendant Cranston, LLC on April 6, 2005 titled "Assignment of Economic Interest Agreement." The economic interest referred to was an interest in a company named Bela LLC. Bela was created by defendant Barbara Laurence and nonparty Robert Behar in order to purchase a company, Biltmore Broadcasting, which owned a California televison station. It was anticipated that Laurence, a specialist in this area, would "enhance" the station's value after its purchase and that it would then be resold by Bela at a profit. Laurence claims that in order to pursue the purchase of a televison station without anyone knowing that she was involved, the actual owner of her shares in Bela was her husband, defendant Lynn Welshman, who held her interests passively. However, under Bela's operating agreement, she was entitled to a seat on the Board of Directors.

According to Laurence, prior to Bela's purchase of Biltmore, she and Welshman had made payments to Biltmore in order to keep the purchase agreement with that company alive after the investment group was unable to close on the date called for under that agreement. She claims that she and Welshman expected to be repaid at the closing of the Biltmore purchase out of the loan proceeds used to fund the purchase but, instead, were given a Series B Equity Interest in Bela which was assigned a "conversion amount," i.e., value of $400,000. She claims that she and Welshman objected that this valuation was far too low but nevertheless accepted the Interest.

Under the Bela operating agreement, there were three levels of interest. The first was Series A, held largely by a company named Pan Atlantic, which provided the primary financing for the acquisition. The second was Series B, held by those who provided some financing to Bela. The third was Series C, the common shares held by Welshman, Behar and a third investor.

The Bela operating agreement provided that in the event that Bela's assets were sold in a "liquidity event," the proceeds would be distributed first to Series A holders, then to Series B holders and then to Series C holders. As to Series B, each member would be entitled to the larger of (1) the conversion amount plus 25% annual interest accruing thereon from March 5, 2004 and (2) 60% of the net proceeds remaining after distribution to Series A holders, shared ratably among Series B holders in proportion to the percentage of Series B Interest each member holds.

In 2004, all of Welshman's Series B and Series C interests were transferred to Cranston, a company which he and Laurence created. In early 2005, Laurence and the plaintiffs began discussions about the plaintiffs' purchase of an economic interest in Cranston's Series B Interest. These discussions led to the execution in early April of the "Assignment of Economic Interest Agreement"("Assignment Agreement"). Under the Assignment Agreement, plaintiffs paid a purchase price of $500,000 for the right to receive any

dividends or distributions which Cranston is entitled to receive from Bela relating to the Series B Interest and all proceeds relating to this Interest "upon any assignment, transfer or other conveyance of the Interest." The Agreement specified, however, that Cranston retained "title and all other rights relating to the Interest."

Thereafter, in January, 2008, Bela began negotiations with Hero Broadcasting LLC for Hero's acquisition of Bela. Laurence, however, refused to agree to the transaction because she believed that she and Cranston had a claim against Bela for additional monies. Since her consent was necessary in order for Bela to consummate its transaction with Hero, the parties entered into negotiations which led to an agreement under which Laurence and Cranston received $575,000 in return for Laurence's consent to the sale.

Following the sale, the plaintiffs received from Bela $188,385.49 in cash and two notes having a combined face value of $452,000, for a total of $640,385.49. However, skeptical of whether the face value of the notes reflected the monies which they would ever actually receive, they sold these notes back to Bela for $162,000 in cash. Thus, on their $500,000 investment, they received cash back in the amount of approximately $350,000.

This lawsuit was then brought. The gist of this action is the plaintiff's belief that the $575,000 which the defendants received in the settlement of their claims against Bela are proceeds which relate to the defendants' Series B Interest. They suggest that it reflects an upward adjustment of the $400,000 conversion amount which Laurence had complained was fixed too low. They argue that, under the Assignment Agreement, they are entitled to the $575,000 because it represents the economic value of the defendants' Series B Interest. They also argue that the Assignment Agreement contains a number of material misrepresentations or warranties without which they would not have entered into the contract.

The complaint asserts five causes of action. The first cause of action is against all of the defendants for fraud. The second is against Laurence for breach of a guaranty to pay them the difference between the $500,000 they paid defendants and the amount of distributions they stood to receive from the sale of Bela if such amount was less than $500,000. The third cause of action is against Laurence and seeks the imposition of a constructive trust comprised of the $575,000 she received from Bela in settlement of her claims. The fourth alleges that Laurence has been unjustly enriched by her receipt of the $575,000 from Bela. The fifth cause of action seeks attorney's fees pursuant to the terms of the Assignment Agreement.

The defendants have now moved for summary judgment dismissing the complaint in its entirety. The plaintiffs have cross-moved for leave to amend the complaint so as to assert additional claims for breach of contract, breach of fiduciary duty, conversion and fraudulent conveyance in violation of the Debtor and Creditor Law. In his proposed breach of contract claim, plaintiff alleges that Cranston is the alter ego of Welshman and Laurence and that these two individual defendants are therefore liable for Cranston's breach.

Discussion

A. Fraud/Breach of Contract - - In their first cause of action for fraud, the plaintiffs allege that the Assignment Agreement contains six representations or warranties which are false, which the defendants knew to be false and which fraudulently induced them to sign the contract. These representations are (1) Cranston has the legal authority to convey its economic interest in the Series B Interest to the plaintiffs, (2) the Interest is not subject to any pledge, lien, encumbrance, security interest or other claim of any kind, (3) the assignment did not require the consent or authorization of any third party, (4) the assignment constituted a complete transfer of Cranston's economic rights and interests in the Series B Interest, including any distributions which Cranston is entitled to receive from Bela relating to the Interest and all proceeds relating to the Interest, (5) the capital account balance relating to the Interest was, as of December 31, 2004, $400,000 with an accrued dividend payable of $83,888.87 and (6) Cranston was not in default under the Bela operating agreement.

It is well settled that a cause of action sounding in fraud is not stated when the only fraud charged relates to the breach of a warranty or representation made in a contract. *See Davidson Metals Corp.*, 238 AD2d 463, 464 (2nd Dept 1997); *Joseph v. Creek & Pine*, 217 AD2d 534, 535 (2nd Dept 1995); *T.A.T.*

Property v. Concrete Sealants (U.S.), 184 AD2d 689 (2nd Dept 1992). Although New York permits a cause of action for fraudulent inducement to contract, the plaintiff who asserts this claim must show that factual misrepresentations, separate from false promises included in the contract, were made and justifiably relied upon by a contracting party to its detriment. *See Deerfield Communications Corp. v. Chesebrough-Ponds, Inc.*, 68 NY2d 954, 956 (1986); *Channel Master Corp. v. Aluminum Limited Sales, Inc.*, 4 NY2d 403408 (1958). Here, the plaintiffs' first cause of action for fraud is based entirely on the breach of warranties made by defendants in the Assignment Agreement. As such, the first cause of action for fraud fails to state a cause of action and must therefore be dismissed.

Clearly recognizing that their claims in the first cause of action for fraud are more appropriately asserted in a cause of action for breach of contract, the plaintiffs have moved for leave to amend the complaint so as to include a breach of contract claim. Although leave to amend pleadings should be freely granted, it is incumbent upon the movant to make an evidentiary showing that the claim can be supported. *See Morgan v. Prospect Park Associates Holdings, L.P.*, 251 AD2d 306 (2nd Dept. 1998). The First Department has stated that the evidentiary proof must be identical to that which could be considered upon a motion for summary judgment. *See Marinelli v. Shifrin*, 260 AD2d 227, 229 (1st Dept. 1999).

Here, the plaintiffs have not submitted any evidence that Cranston provided inaccurate information about its capital account and accrued dividends or was in default under Bela's operating agreement. As to Cranston's legal authority to convey its economic interest in the Series B Interest to them and the presence of an encumbrance held on the Series B Interest by a third party, even if these representations were false, they are not actionable since the plaintiffs did not suffer any damages by reason of any such breach of warranty and, in the absence of such damages, there is no cause of action for breach of contract. *See Noise in Attic Productions v. London Records*, 10 AD3d 303 (1st Dept 2004); *Arcidiacono v. Maizes & Maizes*, 8 AD3d 119, 120 (1st Dept 2004). Indeed, neither Bela nor any third party holding an encumbrance on the Series B Interest prevented Cranston from performing under the Assignment Agreement and distributing monies and notes to the plaintiffs. Nor did Bela or any such third party have any impact on the amount so distributed. As the defendants point out, the plaintiffs received on their $500,000 investment a return of approximately $640,000, representing a cash payment and two promissory notes. Although the plaintiffs contend that the notes were overvalued, they have not submitted any evidence to support this assertion. In any event, the amount of distributions the plaintiffs received had nothing to do with any of these alleged misrepresentations. Leave to assert a breach of contract claim based on these representations must therefore be denied.

Nevertheless, there is evidence in the record that the defendants' did not, as represented in paragraph 3.5 of the Assignment Agreement, assign to plaintiffs all of their rights and interests relating to the Series B Interest and all proceeds relating to the Interest. As already noted, Laurence had complained to Bela from the inception that the $400,000 value assigned to their Series B Interest was far too low. At her deposition, Laurence testified that she annually advised Bela's accountant that her Series B Interest should have been valued at $1,900,000. In addition, she conceded that at least part of her reason for initially refusing to consent to Hero's acquisition of Bela was her claim that the conversion amount of $400,000 on her Series B Interest should be higher. Laurence has now submitted an affidavit in which, claiming confidentiality, she refuses to specify the nature of the claims for which she received the $575,000 payment from Bela in return for her consent to the Hero sale, but expressly denies that the claims were related to Cranston's Series B Interest. It is, however, well settled that a party cannot eliminate or create an issue of fact by submitting a self-serving affidavit contradicting prior sworn testimony. *See Mestric v. Martinez Cleaning Co., Inc.*, 306 AD2d 449 (2nd Dept. 2003); *Phillips v. Bronx Lebanon Hospital*, 268 AD2d 318, 319-20 (1st Dept. 2000).

If, in fact, any portion of the $575,000 payment to Laurence reflected an upward adjustment of the $400,000 conversion amount which had been assigned to the defendants' Series B Interest, it would constitute proceeds relating to the Interest which, under the Assignment Agreement, the plaintiffs would be entitled to receive. In reaching this conclusion, the court appreciates the fact that had the value of the defendants' Series B Interest been initially fixed at an amount higher than $400,000, the plaintiffs would

have had to pay a commensurately higher price for the assignment of the defendants' economic interests. Thus, insofar as the $575,000 payment reflects Laurence's claim that the Interest was undervalued, the plaintiffs may well be receiving a windfall based on efforts which Laurence made long after the Assignment Agreement was executed. Indeed, Laurence may never have made any such efforts had she known that the plaintiffs would be entitled to payments reflecting an increase in the value of her Series B Interest. Nevertheless, under the terms of the Assignment Agreement, the plaintiffs are entitled to receive any proceeds paid by Bela which relate to the value of the defendants' Series B Interest. Since there is a question of fact as to whether any portion of the $575,000 payment to Laurence related to the value of the defendants' Series B Interest, the plaintiffs should be permitted to assert a claim that the defendants breached their contractual obligation to completely transfer to them their economic rights and interests in the Series B Interest, including the right to receive all proceeds relating to this Interest.

Finally, in their proposed second cause of action for breach of contract, the plaintiffs seek to pierce the corporate veil and hold Welshman and Laurence individually liable for any breach of the Assignment Agreement despite the fact that Laurence was a nonsignatory and that Welshman signed only in his capacity as a managing member of Cranston. Generally, a plaintiff seeking to pierce the corporate veil must show that "complete domination" was exercised over a corporation with respect to the "transaction attacked," and "that such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury." *Matter of Morris v. New York State Dept. Of Taxation & Fin.*, 82 NY2d 135, 141 (1993). However, the corporate veil may also be pierced to achieve equity, even in the absence of fraud, when "a corporation has been so dominated by an individual or another corporation and its separate entity so ignored that it primarily transacts the dominator's business instead of its own and can be called the owner's alter ego." *Matter of Island Seafood Co. v. Golub Corp.*, 303 AD2d 892, 893 (3rd Dept. 2003). Here, applying this criteria, there is substantial evidence that Cranston can be characterized as the alter ego of Laurence and Welshman and that Cranston's corporate veil should be pierced so as to reach them. The plaintiffs' claims against these two individual defendants for breach of contract must therefore also be permitted to go forward.

B. Laurence's Breach of Guaranty - - In the second cause of action, the plaintiffs allege that Laurence guaranteed that if the distribution they received upon a liquidity event by Bela would amount to less than the sum of $400,000 plus interest at 25% per annum from March 5, 2004, she would make up the difference. They claim that Laurence breached this guaranty.

The plaintiffs' claim is based on two e-mails which they received from Laurence in 2006 and 2007. In one, Laurence stated that, as to the plaintiffs' investment in the Series B Interest, she would "not let there be a loss." In the other, she stated that "any part of the preferred that is not returned can then be secured by my Bela shares if you like."

Even assuming that these somewhat ambiguous messages may be construed as Laurence's guarantee that she would make up the difference if the plaintiffs ultimately received less than the sum of $400,000 plus interest at 25% per annum from March 5, 2004, the plaintiffs have not suggested that Laurence received any consideration for making such a guaranty more than a year and one-half after the Assignment Agreement was executed. It is true that GOL § 5-1105 provides that a promise in writing signed by the promisor "shall not be denied effect as a valid contractual obligation on the ground that consideration for the promise is past or executed, if the consideration is expressed in the writing and is proved to have been given or performed and would be a valid consideration but for the time it was given or performed." However, since neither of Laurence's two emails states that her guaranty was being given in exchange for past consideration, they are unenforceable. The second cause of action must therefore be dismissed.

C. Plaintiffs' Claims for Unjust Enrichment, Constructive Trust, Conversion and Fraudulent Conveyance - - The third and fourth causes of action in the original complaint are against Laurence and assert claims for the imposition of a constructive trust and unjust enrichment. In the proposed amended complaint, plaintiffs seek to add claims for conversion and fraudulent conveyance under the Debtor and

Creditor Law. All of these claims are essentially duplicative of the plaintiffs' first cause of action for breach of contract since they all turn on the issue of whether any portion of the $575,000 payment which Laurence received from Bela related to the value of the defendants' Series B Interest. The apparent reason they are being asserted is to ensure that Welshman and/or Laurence will be individually liable in the event that plaintiffs succeed in their breach of contract claim against Cranston but fail in their attempt to pierce the corporate veil. Under the circumstances, the court is persuaded that the only one of these otherwise duplicative claims which should be permitted to go forward is the proposed cause of action for conversion. Thus, as to the original complaint, the plaintiffs' claims for the imposition of a constructive trust and unjust enrichment must be dismissed. As to the proposed amended complaint, leave to assert a claim for fraudulent conveyance under the Debtor and Creditor Law must be denied.

D. Plaintiffs' Claim for Attorney's Fees - - Under the Assignment Agreement, plaintiffs are entitled to recover counsel fees incurred "to enforce or collect pursuant to this agreement or any other obligations by reason of non-payment of this Agreement when due..." In moving to dismiss this claim, the defendants argue that it is only triggered in the event Bela failed to pay the amount due. This argument is without merit. The attorney's fee provision contains no such limitation. If the plaintiffs should succeed on their claim that they have not received all proceeds relating to the defendants' Series B Interest, they will be entitled to recover reasonable attorney's fees.

Accordingly, the defendants' motion for summary judgment is granted to the extent that the first, second, third and fourth causes of action are hereby dismissed. The motion is otherwise denied. The plaintiffs' cross-motion to amend is granted to the extent that leave to assert a breach of contract claim against all defendants with respect to paragraph 3.5 of the Assignment Agreement is hereby granted, as is leave to assert a claim for conversion. The motion is otherwise denied.

The plaintiffs shall serve a copy of an amended complaint which is consistent with this decision on the defendants within 15 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 November 23, 2010 at 10:00 a.m. for a preliminary conference.

ENTER ORDER

Dated: 10-22-10

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

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