Smolev v Carole Hochman Design Group, Inc.
2010 NY Slip Op 34013(U)
March 24, 2010
Supreme Court, New York County
Docket Number: 600081/08
Judge: Richard B. Lowe III
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56

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STEVEN SMOLEV, ARLENE SMOLEV and HAYLEY DENMAN,

Plaintiffs,

Index No. 600081/08

-against-

CAROLE HOCHMAN DESIGN GROUP, INC.,

Defendant.

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Hon. Richard B. Lowe, III

Plaintiffs Steven Smolev (S. Smolev), Arlene Smolev (A. Smolev) and Hayley Denman (Denman) move, pursuant to CPLR 3212, for summary judgment: (1) on their causes of action for declaratory judgment and breach of contract, granting them the earn-out payments, note payment and commissions they seek in this action; and (2) dismissing the two remaining counterclaims of defendant Carole Hochman Design Group, Inc. (CHDG).[1] CHDG cross-moves, pursuant to CPLR 3212, for summary judgment dismissing the complaint.

Background

S. Smolev and A. Smolev (collectively, the Smolevs) are husband and wife, and Denman is their daughter. In about 1988, A. Smolev created a brand of women's intimate apparel called On Gossamer, of which she was the chief designer. She founded On Gossamer, Inc., to design, merchandise and sell the product line. Denman assisted her with the merchandising and sale of the On Gossamer products.

On March 31, 2006, the parties to the instant action entered into a number of agreements. The Smolevs, each of whom owned 50% of the shares of On Gossamer, Inc. at the time, and

[1]CHDG voluntarily discontinued the third counterclaim.

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CHDG executed a document entitled "Asset Purchase Agreement by and among Carole Hochman Design Group, Inc. (Buyer), On Gossamer, Inc. (Seller) and Sole Shareholders of Seller" (the APA). Pursuant to the APA, CHDG purchased substantially all of the business and assets of On Gossamer, Inc. In connection with the APA, On Gossamer, Inc., as well as the Smolevs in their individual capacities as On Gossamer Inc.'s shareholders, entered into a Non-Compete, Non-Disclosure and Non-Disparagement Agreement with CHDG, also dated March 31, 2006 (the Non-Disparagement Agreement). At the same time, A. Smolev entered into a Consulting Agreement with CHDG (the Smolev Consulting Agreement), as did Denman (the Denman Consulting Agreement) (collectively, the Consulting Agreements).

Under paragraph 2 (d) of the APA, CHDG was to pay On Gossamer, Inc. a percentage of CHDG's net sales of On Gossamer products on a quarterly basis for four years, through the first quarter of 2010 (the Earn-Out Payments). Pursuant to paragraph 15 (d) of the APA, On Gossamer, Inc. had the right to assign the Earn-Out Payments to the Smolevs. Plaintiffs explain that, after the asset sale to CHDG, CHDG made the Earn-Out Payments payable to the Smolevs, and On Gossamer, Inc. was later dissolved.

Plaintiffs state that CHDG paid the Earn-Out Payments due through the second quarter of 2007, but that it has not paid the Smolevs any Earn-Out Payments since then. Plaintiffs assert that, in the course of the instant action, months after the Earn-Out Payment for the third quarter of 2007 was due, they learned that CHDG was purportedly paying the Earn-Out Payments that were due for the third quarter of 2007 and for each quarter of 2008 into an interest-bearing escrow account.

Pursuant to 2 (a) of the APA, CHDG also assumed certain liabilities, including a March 31, 2006 promissory note, payable to S. Smolev in three equal annual installments beginning on

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March 31, 2007. The final installment was due March 31, 2009 in the principal and interest amount of $140,284.91. CHDG paid S. Smolev the first two installments, but it has failed to pay him the final installment and it has purportedly paid this installment into an escrow account.

Pursuant to the Consulting Agreements, A. Smolev and Denman were each entitled to consideration of $10 for the "Initial Term," defined as March 31, 2006 through April 30, 2010. At the end of the Initial Term, the Consulting Agreements were renewable at the option of each of A. Smolev and Denman for a "Renewal Term" of two additional years, provided they had complied with their obligations. During the Renewal Term, CHDG would pay each of them commissions of 2% of defined net sales of On Gossamer products, payable on a quarterly basis (the Commissions). A. Smolev and Denman state that one reason they were willing to work as consultants to CHDG was the expectation that they would receive the Commissions during the Renewal Term.

A. Smolev and Denman each received an August 28, 2007 letter informing them that CHDG was terminating the Consulting Agreements on the ground that they had breached the non-disparagement covenants found in, respectively, the Non-Disparagement Agreement signed by A. Smolev and the Denman Consulting Agreement executed by Denman.

CHDG's first counterclaim alleges breach by A. Smolev and Denman of the non-disparagement clauses. Pursuant to paragraph 2(c) of the Non-Disparagement Agreement and paragraph 4(b)(i) of the Denman Consulting Agreement, A. Smolev and Denman, respectively, agreed that they would not

> disparage in any manner, whether orally or in writing (or make any statement orally or in writing that would reasonably be expected to adversely affect the reputation of) [CHDG], or any product or services offered by [CHDG] (including,

> without limitation, On Gossamer products), or any affiliated entity of [CHDG] (whether now or hereafter existing) or any of their respective officers, directors ... employees ...

According to CHDG, both A. Smolev and Denman insulted, demeaned and disparaged the head designer and design staff, the merchandisers and the national sales manager of the CHDG On Gossamer Division with whom they were supposed to work. They also allegedly disparaged the products they created and the direction of the business. CHDG states that they also insulted, demeaned and disparaged the president of CHDG in letters to him. Furthermore, according to CHDG, A. Smolev and Denman sabotaged, frustrated and misdirected the presentation and showing of the On Gossamer line by CHDG staff at three marketing meetings with three different important customers of CHDG.

The second counterclaim alleges breach by A. Smolev and Denman of the Consulting Agreements, based on their failure to perform their consulting services in accordance with paragraph 1 of the Consulting Agreements, which defines the "Services" required of A. Smolev and Denman as:

> "Services" means: (1) research services regarding new products, ideas and concepts relating to the Business as operated by us, including working as needed with our designers and merchandisers to develop saleable products from commercially viable ideas and concepts within our specified time periods and action calendars; (2) working with retailers during industry "market weeks" as well as at such other times as our customers may reasonably request to promote the sale of our products; and (3) such other related services as may be reasonably requested by us from time to time in connection with the foregoing.

CHDG argues that A. Smolev and Denman did not perform the consulting services they agreed to. It asserts that they did not adhere to crucial time and action calendars. CHDG also asserts that A. Smolev and Denman were so dissatisfied with CHDG's refusal of Denman's demand for a $150,000 annual salary that they took no part in the creation or development of the

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line for the August 2007 market, and they virtually disappeared from rendering consulting services.

CHDG explains that it does not seek any damages resulting from A. Smolev's and Denman's breaches of their contractual obligations because, although their misconduct damaged CHDG, the damage is difficult to quantify in dollars. CHDG asserts, however, that, due to the breaches of the Non-Disparagement Agreement and the Consulting Agreements, it was within its rights to terminate the agreements among the parties. It contends that its obligations under the APA and the Consulting Agreements therefore ceased as a matter of law.

Plaintiffs argue that CHDG has not produced evidence of any damages caused by any alleged statement made by A. Smolev or Denman that violated the non-disparagement clauses. They further assert that CHDG has not produced evidence of any damages caused by an alleged failure by A. Smolev or Denman to perform the services set forth in the Consulting Agreements.

Plaintiffs contend that discovery has shown that there is no evidence to support either of CHDG's counterclaims. They assert that, although CHDG claims disparagement, none of its witnesses described a specific factual circumstance in which any disparagement took place. Plaintiffs maintain that, although there is evidence that various CHDG employees disliked A. Smolev and Denman, conclusory assertions as to interpersonal relations between A. Smolev and Denman and CHDG personnel cannot defeat plaintiffs' summary judgment motion.

Plaintiffs argue that CHDG cannot defeat their summary judgment motion by citing to alleged internal criticism of CHDG employees or its business by A. Smolev and Denman while they were consultants. According to plaintiffs, disparagement does not include internal statements between then-current colleagues that were not published or communicated by the alleged disparager to a third party.

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Plaintiffs further argue that, even if CHDG could identify a technical breach by A. Smolev or Denman of their respective Consulting Agreements, any such breach would not, as a matter of law, constitute a material breach and, thus, would not entitle CHDG to terminate those agreements and deprive them of the future Commissions to which they are entitled during the Renewal Terms. Plaintiffs point out that, pursuant to paragraphs 2 and 3 of the Consulting Agreements, A. Smolev and Denman have the unilateral right to renew the agreements and are entitled to the Commissions during the Renewal Terms unless they have "materially" breached the agreements.

Plaintiffs explain that, under paragraph 5 of the Non-Disparagement Agreement and paragraph 7 of the Denman Consulting Agreement, "in the event of a material breach," after providing notice, which CHDG failed to do, CHDG was entitled to place payments, including the Earn-Out Payments and payments under the promissory note, into an interest-bearing escrow account "subject to an ultimate finding of fact by a court of competent jurisdiction [as] to injunctive relief and/or damages."

Plaintiffs further maintain that CHDG is not entitled to cease making the accrued and future Earn-Out Payments under the APA or the final installment payment under the promissory note.

The complaint contains two causes of action against CHDG, sounding in declaratory judgment and breach of contract. Plaintiffs contend that, because the counterclaims are without merit, they are entitled to judgment as a matter of law on their two causes of action, which seek to recover: (a) the undisputed, unpaid accrued quarterly Earn-Out Payments pursuant to section 2(d) of the APA, plus interest; (b) the undisputed, final installment of the promissory note, plus interest; and (c) damages, to be determined at a hearing, for the future Earn-Out Payments that

have continued and would have continued to accrue and the future Commissions that would have accrued during the Renewal Term of the Consulting Agreements but for CHDG's anticipatory breach of those agreements.

Discussion

In order to prevail on their respective motion or cross motion for summary judgment, the parties herein must show that the claims of the opposing parties have no merit. In order to do so, a party must make a prima facie showing of entitlement to judgment as a matter of law, providing sufficient evidence to demonstrate the absence of any material issues of fact (*Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 [1985]). Once this prima facie showing has been made, in order to defeat a motion for summary judgment, the party opposing the motion must set forth the existence of a factual issue requiring a trial of the action (*Zuckerman v City of New York*, 49 NY2d 557, 562 [1980]).

CHDG's counterclaims, both of which sound in breach of contract, are dismissed. CHDG asserts that it is not seeking damages, and it does not offer any arguments in opposition to plaintiffs' contentions that the counterclaims should be dismissed (*see Mattesich v Hayground Cove Asset Mgt., LLC*, 61 AD3d 487 [1st Dept 2009] [proof of damages is necessary element of viable claim for breach of non-disparagement agreement]; *Furia v Furia*, 116 AD2d 694 [2d Dept 1986] [resulting damages are necessary element of breach of contract claim]).

With respect to the two causes of action in the complaint, this court finds that there are issues of fact as to whether A. Smolev and/or Denman breached their respective non-disparagement clauses and also whether they failed to provide the services set forth in the Consulting Agreements. Plaintiffs' argument that CHDG does not claim damages is unavailing. The lack of a claim of damages is fatal to a cause of action to recover for breach of contract (*see*

JP Morgan Chase v J.H. Elec. of New York, Inc., __ AD3d __, 2010 NY Slip Op 00477 [2d Dept 2010]). However, a party can be found to have breached a contract, even in the absence of damages, and the breach, if it is material, gives the non-breaching party the option to terminate the contract at issue (*see Awards.com v Kinko's, Inc.*, 42 AD3d 178, 188 [1st Dept 2007] ["(w)hen a party materially breaches a contract, the nonbreaching party must choose between two remedies: it can elect to terminate the contract or continue it"]). Furthermore, paragraph 2 of the Consulting Agreements grants CHDG the right to terminate the respective Consulting Agreements if A. Smolev or Denman "materially breach" any provision therein.

A breach is material when it is "'so substantial that it defeats the object of the parties in making the contract'" (*Robert Cohn Assoc., Inc. v Kosich*, 63 AD3d 1388, 1389 [3d Dept 2009], quoting *Frank Felix Assoc., Ltd. v Austin Drugs, Inc.*, 111 F3d 284, 289 [2d Cir 1997]). This court finds that there is a question of fact as to whether A. Smolev and Denman's alleged breaches defeated the object of the parties in entering into the Consulting Agreements.

Thus, there are issues of fact both as to whether A. Smolev and/or Denman breached the non-disparagement agreements and/or the Consulting Agreements, and as to whether such breaches, if any, were material to the Consulting Agreements. Therefore, it cannot be determined at this time whether plaintiffs are entitled to damages for the future Commissions that they would have received during the Renewal Term of the Consulting Agreements.

The Smolevs are, however, entitled as a matter of law to the payments due to them under the APA. This includes the amounts CHDG has purportedly placed in an interest-bearing escrow account for certain of the Earn-Out Payments as well as the final installment payment under the promissory note. They are also entitled to all other Earn-Out Payments due to date, beyond those placed in the escrow account.

While, as discussed above, there is a question of fact as to whether any alleged breaches by A. Smolev and Denman were material, such that the breaches defeated the purpose of the Consulting Agreements, it is clear that any such breaches were not material as applied to the obligations of the parties under the APA. The purpose of the APA was to sell the business and assets of On Gossamer, Inc. to CHDG, and that purpose cannot be said to have been defeated by any of the alleged breaches of A. Smolev and Denman.

Pursuant to paragraph 2 of the Consulting Agreements, A. Smolev and Denman had the right to terminate their respective Consulting Agreements at any time, such that it cannot be argued that their consulting services were a critical component of the purpose of the APA. Furthermore, CHDG cannot claim that the purpose of the APA has been defeated by any alleged breaches, given that it cannot point to any specific damages resulting therefrom.

Thus, plaintiffs' motion is granted in part, to the extent of finding that CHDG is liable to plaintiffs for payments due under the APA, in particular the Earn-Out Payments, as described in paragraph 2(d) of the APA, and the final installment of the promissory note, as described in paragraph 2(1)(iv) of the APA.

Conclusion

Accordingly, it is

ORDERED that plaintiffs' motion for summary judgment is granted in part, to the extent that it is ADJUDGED and DECLARED that defendant is liable to plaintiffs for amounts due under the APA, in particular, the Earn-Out Payments and the final installment of the promissory note at issue; and defendant's counterclaims are dismissed; and it is further

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ORDERED that defendant's counterclaims are dismissed; and it is further

ORDERED that defendant's cross motion for summary judgment is denied.

Dated: March 24, 2010

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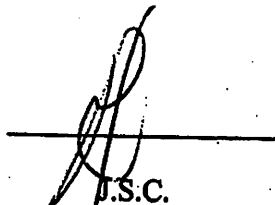

J.S.C.

HON. RICHARD B. LOWE, III