Healthwave Inc. v New York Socy. for the Relief of the Ruptured & Crippled
2011 NY Slip Op 33825(U)
July 1, 2011
Sup Ct, New York County
Docket Number: 650234/2009
Judge: Barbara R. Kapnick
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BARBARA R. KAPNICK PART 39

Index Number : 650234/2009
HEALTHWAVE INCORPORATED
vs
NEW YORK SOCIETY FOR THE
Sequence Number : 001
DISMISS ACTION

INDEX NO. 650234/09
MOTION DATE
MOTION SEQ. NO. 001
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

MOTION IS DECIDED IN ACCORDANCE WITH
ACCOMPANYING MEMORANDUM DECISION

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

Dated: 7/1/11

BARBARA R. KAPNICK J.S.C.
J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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HEALTHWAVE INCORPORATED, HWLI INCORPORATED, and RICHARD RADOCCIA,

Plaintiffs,

-against-

NEW YORK SOCIETY FOR THE RELIEF OF THE RUPTURED AND CRIPPLED MAINTAINING THE HOSPITAL FOR SPECIAL SURGERY d/b/a HOSPITAL FOR SPECIAL SURGERY, JOHN R. REYNOLDS, MICHAEL H. KEMP, THOMAS GORDON, and PROFESSIONAL BILLING CONTROLS, INC.,

Defendants.

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DECISION/ORDER
Index No. 650234/2009

Motion Sequence Nos. 001, 002 and 004

BARBARA R. KAPNICK, J.:

In this action, the plaintiffs are Healthwave Incorporated ("Healthwave"), a healthcare billing services corporation, HWLI Incorporated ("HWLI"), a wholly-owned subsidiary of Healthwave, and Richard Radoccia ("Radoccia"), the CEO and principal shareholder of Healthwave; and the defendants are New York Society for the Relief of the Ruptured and Crippled Maintaining the Hospital for Special Surgery d/b/a Hospital For Special Surgery ("HSS"), a New York hospital providing healthcare services, John R. Reynolds ("Reynolds"), the former CEO of HSS, Professional Billing Controls, Inc. ("PBC"), a medical services billing company, and Michael H. Kemp ("Kemp"), the CEO and sole shareholder of PBC.[1]

[1] Pursuant to a stipulation dated December 10, 2009, the action against Thomas Gordon, an HSS employee, was discontinued.

In 2003, Healthwave formed HWLI to acquire PBC's assets, which included the servicing of billing accounts of certain HSS-based physicians and non-HSS based physicians pursuant to an Asset Purchase Agreement, effective May 1, 2003. Following the acquisition, HWLI suffered significant economic losses as to the HSS-based accounts. In an effort to curb further losses, HWLI transferred and assigned its assets to Healthwave, which sold the assets to a third party in 2008.

In their Complaint filed in 2009, plaintiffs allege that the defendants hid from them a complicated fraud scheme that not only enriched the defendants, but also made PBC appear to have value and quality that it, in fact, lacked. Plaintiffs further allege that the scheme caused them to undertake repeated attempts to salvage an unsustainable business relationship with their most important client, HSS, which resulted in substantial losses. The Complaint asserts twenty-one causes of action, including: fraudulent inducement, fraudulent concealment, breach of contract, breach of the implied covenant of good faith and fair dealing, and unjust enrichment.[2] Defendants' motions (motions sequence numbers 001, 002 and 004) to dismiss the causes of action as to them are consolidated herein for disposition.

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[2] The twentieth and twenty-first causes of action are against Thomas Gordon only. Because the action against Gordon has been discontinued with prejudice, such causes of action are moot.

Background

In May 2000, plaintiff Radoccia and non-party Joseph Drohan ("Drohan") formed Healthwave to collaborate in the development of medical billing software and a commercial medical business model that would utilize an internet-based technology platform. (Complaint, ¶ 17). In March 2003, Healthwave and PBC entered into a letter of intent for an asset purchase. As part of its due diligence, Healthwave reviewed, inter alia, various PBC financial and business documents, as well as PBC's relationship with its largest customer, HSS. (*Id.*, ¶ 22). Because the most valuable of PBC's assets were its twenty-five HSS-based contract physician accounts, Healthwave requested an opportunity to meet with these physicians.[3] However, the only HSS contact permitted by Kemp, as the sole owner of PBC, was a meeting with Reynolds, the then-CEO of HSS. Healthwave was told by Kemp that Reynolds had complete authority to determine whether the physicians' billing work would be sent to HWLI (which was intended to be merged into Healthwave after the asset purchase), and if HWLI purchased PBC, Reynolds would direct the billing work to HWLI. (*Id.*, ¶ 24).

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[3] A contract physician (as opposed to an independent physician) is one whose practice is located at and operated by HSS, which controlled the administrative and business aspects of the physician's medical practice, including the choice of billing service vendors. (*Id.*, ¶ 26).

Kemp arranged a meeting among Radoccia, Drohan, Reynolds and himself on April 24, 2003. During the approximately one-hour meeting, the parties discussed PBC's prior performance and its terms of engagement at HSS. Reynolds spoke about the fees, the terms for the HSS on-site office leasehold, and the number of HSS physician accounts that would be transferred to HWLI. (*Id.*, ¶ 25). Reynolds credited HSS's long-term relationship with PBC to its superior billing performance and the physicians' satisfaction with its services.[4] (*Id.*, ¶ 28). At the conclusion of the meeting, Reynolds indicated that if HWLI were to purchase PBC, "HSS would expect that HWLI would service the same representative share of HSS physician accounts that were previously serviced by PBC." (*Id.*, ¶ 29).

HWLI, PBC and Kemp closed the asset sale on May 16, 2003. Kemp received $700,000 at the closing, and the remaining $231,000 purchase price was payable on a sliding scale, based on HWLI's collection results/revenues over the ensuing 12-month period. (*Id.*, ¶ 32). On May 17, 2003, the day after the closing, when HWLI's management met with the HSS physicians for the first time, it became clear to HWLI that some of the physicians were unhappy with PBC due to its excessive surcharges. (*Id.*, ¶¶ 33-35). After

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[4] While PBC used a paper-based system for its billing services, HWLI was offering an electronic billing system.

[* 6]

evaluating the physicians' dissatisfaction, HWLI invested extra resources for the delivery of services, including hiring more staff to work on-site at HSS. *(Id.*, ¶ 36). Despite such efforts, HWLI found out (within one month of closing) that four physicians had already noticed their termination of relationship with PBC prior to the closing, and within six months after the closing, two more physician accounts were cancelled. *(Id.*, ¶ 37).

Due to the dwindling physician accounts, which impacted upon HWLI's revenues, Kemp's entitlement to additional payment under the Asset Purchase Agreement (the "Earnout") was affected, and he was advised that he would likely not receive an Earnout in June 2004. *(Id.*, ¶¶ 38-39). Drohan met with Reynolds in April 2004 to discuss how HWLI could regain the physician accounts, still believing that the solution lay in better service or using a different approach. *(Id.*, ¶ 43). Drohan even proposed to lower HWLI's fees charged to the physicians so as to assuage their dissatisfaction, but Reynolds was not receptive to the proposal. *(Id)*. On May 13, 2004, when the 12-month Earnout calculation was completed, Kemp was told that he definitively would not receive an Earnout. *(Id.*, ¶ 44).

Because of the poor performance of and prognosis for the HSS accounts, HWLI's financial supporter, Bergman Industrial Holdings,Ltd. ("Bergman"), withdrew its support in June 2004, and

consequently all of HWLI's assets (including its accounts) were transferred and assigned to Healthwave. (*Id.*, ¶ 46). In March 2005, Reynolds announced that he would eventually retire as CEO of HSS. (*Id.*, ¶ 48). Soon thereafter, Healthwave would lose the remaining 13 HSS physician accounts at the rate of approximately one doctor per month. (*Id*). In September 2005, when Drohan spoke to Kemp, who was retained by plaintiffs as a consultant post-closing, about the continued loss of accounts, Kemp told him that "you have to pay them," as the means of restoring business. (*Id*).

In December 2005, Radoccia met with Kemp to probe whether PBC had paid kickbacks to Reynolds and others at HSS, as a cost of doing business. Kemp admitted that he had paid Reynolds kickbacks, which were depicted as "consulting fees" in PBC's check registers and tax returns. (*Id.*, ¶ 51). The kickback scheme was implemented by placing a surcharge upon the physician billing collections, and half of the surcharge would be paid to Reynolds (via "KMC Healthcare") as a "consulting fee" for the referrals. (*Id*). Kemp rationalized these kickbacks by stating that the first time he actually started to make money on the HSS accounts was when the kickbacks began. (*Id*). Upon learning of the scheme, Radoccia and Drohan realized and understood how and why PBC's business with HSS was actually sustained over the years. (*Id.*, ¶ 52).

Radoccia then began to search through the books and records that PBC had provided to HWLI in the asset sale, for evidence of such kickbacks. *(Id.*, ¶ 54). In a pile of boxes containing old claims information, Radoccia found 11 kickback checks paid by PBC to "KMC Healthcare" ("KMC"), all of which were endorsed by Reynolds. (*Id*). After finding these checks, Radoccia held another meeting with Kemp, in March 2006, to discuss the kickback scheme. *(Id.*, ¶ 55). Thereafter, Healthwave received overt hostility from Reynolds, and "even Healthwave's most loyal physician clients were influenced by Reynolds ... to discontinue their use of the Healthwave service, as Healthwave was no longer welcome at HSS." *(Id.*, ¶ 56). Over time, even though Healthwave's non-HSS client base grew progressively larger while the HSS client base shrank, "the scale of [the HSS] portfolio's revenue was inadequate for the business model," requiring Radoccia to loan money to Healthwave to sustain its business operations. (*Id)*.

In an effort to curb further losses, Radoccia began to look for buyers for Healthwave. In June 2008, most of Healthwave's assets were sold to a third party called Sonix Medical Technologies, at a price of approximately $1.4 million. *(Id.*, ¶¶ 57-58). In 2009, plaintiffs commenced the instant action against the defendants, seeking over $10 million in damages.

Discussion

In considering a CPLR 3211 (a) (7) motion to dismiss, the court is to determine whether plaintiff's pleadings state a cause of action. "The motion must be denied if from the pleadings' four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law [internal quotation marks omitted]." *Richbell Info. Servs. v Jupiter Partners,* 309 AD2d 288, 289 (1st Dept 2003), quoting *511 W. 232nd Owners Corp. v Jennifer Realty Corp.*, 98 NY2d 144, 151-152 (2002). The pleadings are to be afforded a "liberal construction," and the court is to "accord plaintiffs the benefit of every possible favorable inference." *Leon v Martinez*, 84 NY2d 83, 87 (1994).

However, if the complaint's allegations consist of bare legal conclusions and "documentary evidence flatly contradicts the factual claims, the entitlement to the presumption of truth and the favorable inference is rebutted." *Scott v Bell Atl. Corp.*, 282 AD2d 180, 183 (1st Dept 2001), *affd as mod sub nom Goshen v Mutual Life Ins. Co. of New York*, 98 NY2d 314 (2002).

A. HSS' Motion to Dismiss (Motion Sequence Number 001)

Plaintiffs' Complaint asserts the following causes of action against HSS: fraudulent inducement (first cause of action),

fraudulent concealment (second cause of action), breach of contract (third and fifth causes of action), and breach of the implied covenant of good faith and fair dealing(fourth and sixth causes of action). (Complaint, ¶¶ 59-70).

1. Fraudulent Inducement or Misrepresentation

The Complaint alleges that HSS, through its agent, Reynolds, "made representations of material facts that were false and were known to be false and misleading by failing to disclose: (i) the kickback scheme, (ii) the HSS physician dissatisfaction [with PBC], (iii) the control that Reynolds exerted as CEO in order to further the kickback scheme, and (iv) Reynolds' [and others] interest in the Asset Sale proceeds and Earnout proceeds." (*Id.* ¶ 60). The Complaint further alleges that such false representations were made to induce plaintiffs' reliance upon them and that plaintiffs justifiably relied upon such representations to their detriment, which caused them to sustain damages. (Complaint, ¶ 60).

HSS argues that the fraudulent inducement claim should be dismissed because (1) Reynolds acted outside his scope of authority and employment, such that his alleged representations cannot be imputed to HSS; (2) plaintiffs cannot establish reasonable reliance upon such representations under the facts of this case; and (3) a

specific disclaimer provision in the Asset Purchase Agreement precludes plaintiffs' assertion of reasonable reliance.

Apparent Authority and Scope of Employment

With respect to whether Reynolds acted outside the scope of his authority and employment, HSS argues that "[w]hen an agent abandons the object of his agency and acts for himself, by committing a fraud for his own exclusive benefit, he ceases to act within the scope of his employment and, to that extent, ceases to act as agent." *Credit Alliance Corp. v Sheridan Theater Co.*, 241 NY 216, 220 (1925). Because Reynolds had allegedly solicited and received kickbacks from PBC for his own benefit, and because the kickbacks harmed HSS physicians (by surcharging their collections) and adversely impacted upon HSS's interest (in having satisfied physicians on its staff), HSS argues that the "adverse interest" or "adverse agent" doctrine acts as an exception to the general rule that an agent's misconduct is imputed to the principal.

Plaintiffs contend that the "adverse interest" or "adverse agent" defense was "clarified" and "narrowed" by the Court of Appeals after its *Credit Alliance* decision in *Prudential-Bache Securities, Inc. v Citibank, N.A.*, 73 NY2d 263 (1989) and *Parlato v Equitable Life Assurance Society of U.S.*, 299 AD2d 108 (1st Dept 2002), *lv denied* 99 NY2d 508 (2003).

In the *Prudential-Bache* case, plaintiff's manager fraudulently issued company checks to fictitious entities, deposited the checks into certain bank accounts, including ones maintained at Citibank, and succeeded in embezzling millions of dollars before the scheme was discovered. To recoup a portion of its losses, plaintiff sued Citibank, and asserted, *inter alia*, a claim of "commercial bad faith." The claim rested on allegations that Citibank, through its agents who had been bribed by plaintiff's manager to open improper accounts and had pled guilty to criminal charges, knew of the fraudulent scheme and became a participant in laundering plaintiff's funds. In its motion seeking dismissal of the claim, Citibank argued that by accepting bribes and servicing illegal accounts, its employees acted outside the scope and authority of their employment, and thus that their guilty acts and knowledge should not be imputed to Citibank. *Prudential-Bache*, 73 NY2d at 276.

While acknowledging that Citibank might well succeed in proving its contention that the involved employees were "adverse agents" and that such issue might be resolved by motion short of trial, the Court of Appeals, nonetheless, reversed the lower court's decision granting dismissal of this claim. The Court reasoned that because the alleged activities of such employees "have not yet been the subject of discovery by plaintiff, who

insists that they were also promoting the bank's interest and therefore not truly 'adverse agents' [of the bank]," the Court "cannot conclude ... that any and all misconduct of [such employees] with respect to the laundering scheme was necessarily selfish and antagonistic to their employer, so as to insulate Citibank from any imputation of their wrongdoing." *Id.* at 277. The Court, applying the standards for a motion to dismiss, held that "courts are obliged to view plaintiff's assertions most favorably because [granting] the motion would terminate the action before there has been any opportunity for discovery." *(Id.* at 275).

HSS contends that the *Prudential-Bache* case is inapposite, because in that case, the claim was based on a theory that the bank's principals actually knew of and participated in a massive money laundering scheme, whereas in this case, plaintiffs do not allege that HSS had actual knowledge of, or benefitted from, Reynolds' alleged kickback scheme.

However, as noted in *Prudential-Bache*, a corporation (such as HSS) is a legal entity and its acts are necessarily carried out by its agents, "whose knowledge and conduct may be imputed to the entity under the doctrine of respondeat superior," so long as its agents acted in furtherance of its business and within the scope of

employment. (*Id.* at 276). Still, the employer may not be held liable for the acts of its agents or employees who, while acting with apparent or actual authority, "in fact totally abandon[ed] the employer's interests and act[ed] entirely for their own or others' purposes." (*Id*).

In this case, although HSS was not a party to the Asset Purchase Agreement between PBC and HWLI and had no financial interest in the underlying transactions, HSS did have an interest in the "billing services contracts" that its physicians had with PBC, and its successor HWLI. As noted, HSS administered such contracts on behalf of its physicians, and the contracts were PBC's "crown jewels." Thus, when Reynolds made representations with regard to the historical relationship between HSS and PBC and the satisfaction of HSS' physicians with PBC's services, it cannot be said that he "totally abandoned" HSS' interests and acted "entirely" for his own benefit, even if such representations were allegedly made in furtherance of a scheme from which he could personally benefit.[5] Whether HSS received any benefit from the

[5] HSS' characterization of Reynolds' representations as investment advice given to plaintiffs, and its further claim that HSS is not in the business of providing such advice, is unpersuasive. Viewed in the light most favorable to plaintiffs, which the Court must do in the context of this motion to dismiss, the representations were given by Reynolds in response to the information sought by plaintiffs as part of their due diligence. It does not seem credible that plaintiffs, who were represented by accountants and lawyers, would be seeking and/or relying on Reynolds for investment advice.

scheme is an issue of fact that cannot be determined at this early stage of the litigation. It is also noteworthy that Radoccia stated in his Affidavit dated November 25, 2009 that "HSS relied upon billing companies [such as PBC or HWLI] in order to generate revenue for the services rendered by the Contract Physicians," and that HSS had collected approximately $52 million as a result of plaintiffs' billing services. (Radocccia Affidavit, ¶¶ 11-12).

Plaintiffs also cite the *Parlato* case, *supra*, in support of their proposition that a principal may be held liable in tort for its agent's misconduct, if such agent acted with apparent authority in defrauding a third party, even if the agent committed the fraud solely for his own benefit and to the detriment of the principal. *Parlato*, *supra* at 113. The Appellate Division, First Department held in *Parlato* that where "the asserted basis for the principal's liability is apparent authority, there is no requirement that the tortious act be committed in furtherance of the principal's business," and the plaintiff is only required to show that "the principal created an appearance of authority on which the plaintiff *reasonably relied*, thereby enabling the agent to successfully perpetrate the tort." *(Id.* at 114) (emphasis added).

In this case, it is undisputed that Reynolds, as HSS's then-CEO, was cloaked with apparent authority to make the

representations which he made. This Court thus turns next to whether plaintiffs could have "reasonably relied" on such representations and whether such reliance was justifiable under these circumstances.

Reasonable Reliance

The elements of a fraudulent inducement or misrepresentation claim are: (1) a misrepresentation of a material fact; (2) which was false and known to be false by the defendant; (3) made for the purpose of inducing the other party to rely upon it; (4) justifiable reliance by the other party; and (5) resulting injury. *Lama Holding Co. v Smith Barney*, 88 NY2d 413, 421 (1996). The Court of Appeals has recently stated that "[t]he question of what constitutes reasonable reliance is always nettlesome because it is so fact-intensive." *DDJ Mgt., LLC v Rhone Group L.L.C.*, 15 NY3d 147, 155 (2010) (quoting *Schlaifer Nance & Co. v Estate of Warhol*, 119 F3d 91, 98 [2d Cir 1997]).

In *Global Mins & Metals Corp. v Holme, 35 AD3d 93, 100 (1st Dep't 2006), lv denied 8 NY3d 804 (2007)*, the Court held that "New York imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions and the business they are acquiring." (citing *Abrahami v UPC*

Construction Co., 224 AD2d 231, 234 [1st Dept 1996] [sophisticated businessmen must exercise ordinary diligence and conduct independent appraisals of the risks they are assuming]). The Court noted that where representations contained hints of falsehood, a heightened degree of diligence would be required, and it would be unreasonable to simply rely on representations without conducting additional inquiry. *(Id)*. (citations omitted).

However, in *Global Minerals* the plaintiffs were sophisticated investors which plaintiffs here were not, although they were represented by counsel and financial consultants. Also, in the *Global Minerals* case, the dismissal of the fraudulent inducement cause of action was done on a motion for summary judgment, and not on a 3211 motion to dismiss. As the Appellate Division recognized in *Global Minerals*,

> In *J.A.O. Acquisition Corp. v Stavitsky* (18 AD3d 389 [1st Dep't 2005]), we concluded that occasionally the facts in the case may present a *rare circumstance* in which the issue of reasonable reliance can be resolved at the stage of summary judgment (emphasis supplied).

35 AD3d at 99.

Plaintiffs here allege in paragraphs 28-30 of their Complaint that Reynolds made numerous representations to them during their meeting that HSS would continue the former PBC agreements with HWLI and that the PBC-HSS relationship was based on a history of arms

length dealing that had been fully disclosed to them, which turned out to be false.

With respect to the alleged kickback scheme, plaintiffs argue that the documents that were provided to them by PBC contained limited information such that they were unable to connect the "seemingly innocent pieces." Plaintiffs also concede that "they had reviewed the PBC checkbook register which revealed regular consulting fees paid to KMC Healthcare," but had no reason to investigate further as to the nature and identity of the "true payee" of such fees, i.e. Reynolds.

Plaintiffs' failure to conduct a detailed investigation, especially where Kemp's refusal to permit them to meet with the HSS physicians prior to closing should have raised red flags, HSS contends, indicates that they did not adequately exercise an "affirmative duty" to protect themselves from misrepresentations where there were hints of falsity, and that they did not make use of available means of verification. *UST Private Equity Investors Fund, Inc. v Salomon Smith Barney*, 288 AD2d 87 (1st Dept 2001)(plaintiff cannot show justifiable reliance where it failed to use verification means available). *See also, Ventur Group, LLC v Finnerty*, 68 AD3d 638 (1st Dept 2009) (court dismissed fraudulent inducement claim, finding plaintiff could not show reasonable

reliance where plaintiff failed to verify defendant's misrepresentations about a key employee's role in the business, even though plaintiff had requested a meeting with such employee, but defendant refused to schedule one until the asset purchase agreement was signed).

However, the United States District Court of the Southern District of New York, (Lynch, J.) in *JPMorgan Chase Bank v Winnick*, 350 FSupp 2d 393 [2004], after examining the facts of several state and federal cases applying New York law, found that when

> [v]iewed together [they did] not support the interpretation that a duty to inquire is necessarily triggered as soon as a plaintiff has the slightest "hints" of any "possibility" of falsehood. In each of these cases, the notice to the plaintiff was clear and direct: it was either provided by plaintiff's own direct knowledge of the fraud, by the terms of an operative contract, or by circumstances surrounding the parties' relationship (*e.g.* litigation) that would normally arouse suspicion. In each of these circumstances, the plaintiff may be said to have been "placed on guard or practically faced with the facts" of the complained of fraud (citation omitted), and fulfilling the duty to inquire was a necessary precondition to proceeding with a misrepresentation claim. Thus, whether a duty to inquire is triggered is a context-specific and fact-based inquiry, rather than a bright-line rule, as defendants argue (citations omitted). The outcome on this summary judgment motion therefore turns on the factual question of whether, when faced with the available information, the plaintiffs should necessarily have inquired further.

350 FSupp2d at 408.

It is fair to say here, as the Court of Appeals stated in *DDJ Mgt., LLC v Rhone Group L.L.C. supra* at 156 that "there were hints from which plaintiffs might have been put on their guard in this transaction." But this Court declines to hold at this pre-answer, pre-discovery stage of this litigation, that plaintiffs were not justified in relying on the representations made by Reynolds as CEO of HSS.

Disclaimer Provision - Merger Clause

HSS also argues that the fraudulent inducement claim cannot be maintained because of the express disclaimer in the Asset Purchase Agreement, which provides, in relevant part, that:

> Each party to this Agreement acknowledges that no representations, inducements, promises, or agreements, orally or otherwise, have been made *by other party(ies), or by anyone acting on behalf of any party,* that are not embodied herein, and that no other agreement, statement or promise not contained in this Agreement shall be valid or binding.

Asset Purchase Agreement, ¶ 10.1 (emphasis added). HSS argues that this provision is a specific merger clause that "defeats a claim for fraud by eliminating the claiming party's ability to establish reliance." *See, Danann Realty Corp v Harris*, 5 NY2d 317 (1959). HSS further argues that because this provision was "included [in the agreement] after extended negotiations between sophisticated

business people," it is "entirely inconsistent with Plaintiffs' current claim against HSS for fraudulent inducement."

Plaintiffs, on the other hand, argue that this is a *general* merger clause, not a *specific* merger clause which would have to enumerate the specific matters as to which the party disclaimed reliance, and thus "does not operate to bar parol evidence of fraud in the inducement ... only where the parties expressly disclaim reliance on the particular misrepresentations is extrinsic evidence barred." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Wise Metals Group, LLC*, 19 AD3d 273, 275 (1st Dep't 2005) (*citing Citibank v Plapinger*, 66 NY2d 90, 95-96 [1985]). Plaintiffs further argue that since HSS was not a party to the Asset Purchase Agreement, it is not entitled to any relief therefrom.

In reply, defendant HSS argues, without any legal support, that this is not a general merger clause, because it specifically disclaims reliance on representations made by non-parties or third parties, which is "highly unusual."

This Court finds that the merger clause in this Agreement does not specify the representations about which the fraud is claimed, is a boilerplate provision inserted into the "Miscellaneous Provisions" section of the Agreement, and was not negotiated by the

parties. Therefore, this merger clause does not bar plaintiffs' claim for fraudulent inducement. See, *Superior Technical Resources v Lawson Software, Inc.*, 17 Misc 3d 1137(A) at *11 (Sup Ct, Erie Co. 2007).

2. Fraudulent Concealment

The Complaint alleges in the second cause of action that HSS had "exclusive and superior knowledge of material facts that it intentionally withheld" from plaintiffs during their negotiations with respect to the kickback scheme and physician dissatisfaction, and that plaintiffs had justifiably relied upon the "half-truths and misinformation provided by HSS" to their detriment. (Complaint, ¶ 62).

In addition to pleading all of the required elements for a claim of fraud, a plaintiff alleging fraudulent concealment must also allege "that the defendant had *a duty to disclose* material information and that it failed to do so (citation omitted)." *P.T. Bank Cent. Asia. N.Y. Branch v. ABN AMRO Bank N.V.*, 301 AD2d 373, 376 (1st Dep't 2003). Defendant HSS argues that this cause of action must be dismissed because it did not owe plaintiffs a duty of disclosure. In fact, defendant asserts, plaintiffs do not allege that they had a confidential fiduciary relationship with it, nor

could they, and that HSS was not even a party to the Asset Purchase Agreement.

"It is well established that, absent a fiduciary relationship between the parties, a duty to disclose arises only under the 'special facts' doctrine where '"' one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair'"'" *Jana L. v West 129th St. Realty Corp.*, 22 AD3d 274, 277 (1st Dep't 2005) (*quoting Swersky v Dreyer & Traub*, 219 AD2d 321, 327 [1st Dep't 1996]). The "special facts" doctrine requires that the material fact was "peculiarly within [the] knowledge" of the defendant, and that the information was not such that it could have been discovered by plaintiffs through the exercise of ordinary intelligence. *Jana L. v West 129th St. Realty Corp., supra* at 278.

HSS contends that plaintiffs had full access to PBC's books and records (including records that showed the payment of "consulting fees" to KMC Healthcare about which plaintiffs now complain) and thus, plaintiffs were in a better position than HSS, who did not have such access, to uncover the alleged fraudulent scheme. Again, HSS argues that if plaintiff had exercised "ordinary intelligence" by insisting to speak directly with the HSS physicians regarding the extent of their satisfaction (or not) with

PBC, rather than settling for speaking only to Reynolds, they would have learned of the problems before entering into the Asset Purchase Agreement.

Plaintiffs rely not only upon the "special facts" doctrine as set forth in *Swersky v Dreyer & Traub, supra*, but also the "half-truths" doctrine set forth in *Juman v Louise Wise Services*, 254 AD2d 72 (1st Dep't 1998), under which a duty to disclose arises when a party's partial disclosure creates a false impression with the plaintiff.

In *Swersky, supra*, the court stated that, even if the facts came within the "special facts" doctrine, an inquiry should still be made as to "whether plaintiffs could have through 'the exercise of ordinary intelligence' independently ascertained" that the defendant had concealed material information. *Swersky*, 219 AD2d at 328 (citations omitted). Here, with respect to physician dissatisfaction, plaintiffs do not argue that with the exercise of "ordinary intelligence," they could not have verified whether the physicians (who were PBC's clients) were happy with PBC's services. Instead, plaintiffs argue that "prior to closing on the acquisition of PBC, there was no reason to question the veracity or motives" of the defendants. Radoccia Affidavit, ¶ 6. However, since plaintiffs cannot show that the "special facts" were "peculiarly

within [defendant HSS's] knowledge" or could not have been discovered through plaintiffs' exercise of "ordinary intelligence", the "special facts" doctrine is not applicable.

Similarly, the "half-truth" doctrine enunciated in *Juman* is inapplicable. In that case, the defendant adoption agency placed plaintiffs' adopted son with them allegedly without disclosing material facts, and the court held that "[g]iven plaintiffs' total dependency on defendant for the relevant facts, such a misleading partial disclosure ... would be actionable as fraud." *Juman*, 254 AD2d at 74. In this case, as to the kickback scheme, plaintiffs do not argue that they totally depended on HSS to provide them with information in evaluating the asset purchase transaction between HWLI and PBC, or that such information was peculiarly within HSS' knowledge, since HSS was just one of PBC's vendors, although the largest and most significant. Indeed, they stated that they hired accountants and other professionals to assist them and were given full access to PBC's books and records, but that through KMC Healthcare, "Reynolds, PBC and Kemp disguised the true transactional history among them." Radoccia Affidavit, ¶ 4. Under these facts, plaintiffs cannot take advantage of the "half-truth" doctrine.

3. Breach of Contract Claim

The third and fifth causes of action of the Complaint allege that plaintiffs performed pursuant to their billing services

agreement with HSS by providing services to the HSS physicians, but that "HSS failed to performed its obligations pursuant to said contract, which resulted in damages to Healthwave in the amount of $10,000,000." (Complaint, ¶ 64, 68).

Notably, plaintiffs have neither produced the alleged billing services agreement, nor identified specific provisions of the agreement that HSS has purportedly breached, which is fatal to their breach of contract claims. *767 Third Ave. LLC v Greble & Finger LLP*, 8 AD3d 75, (1st Dept 2004)("Plaintiff's failure to identify any portion of the lease allegedly breached was fatal to its cause of action for breach of contract").

However, HSS concedes that the billing services contract at issue "was an oral service contract without a set duration," pursuant to which "HSS engaged HWLI to provide billing services to its contracted physicians." In this regard, HSS has produced a copy of (1) Schedule 4.9 to the HWLI-PBC Asset Purchase Agreement, which provides in item 13 that PBC did not enter into any written agreements with its clients, but that the clients were provided with a proposal outlining "the client's responsibilities, PBC's responsibilities and services, and the rate to be charged for PBC's services", and that the proposal indicated that such services could be discontinued upon 30 days' notice; and (2) a sample billing

services proposal between PBC and a physician, which stated that if the physician was not completely satisfied with PBC's services, the relationship could be terminated with a 30-day notice. HSS indicated that it obtained these documents from PBC.

Despite the fact that they have not produced documents nor identified specific contract provisions which support their breach of contract claims, plaintiffs object to the Court's consideration of the documents submitted by HSS, arguing that the "Sample Proposal Letter" is not part of the Asset Purchase Agreement, and that neither document is probative of PBC's deal with HSS. (Letter of Plaintiffs' counsel [Peter Birzon, Esq.] dated April 7, 2010).[6] However, not having received any evidentiary materials from plaintiffs in support of their breach of contract claim, the two documents submitted by defendant HSS have probative value.

In New York, where a personal services contract does not specify "a term certain for its duration," the law permits the

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[6] Birzon argues in his Affirmation in Opposition to the Motion that this Court should imply a "reasonable duration" into the contract, and that such duration would be a one-year term, with annual renewals. Birzon Affirmation, ¶¶ 59-61. Birzon also argues that the terms of the contract are stated in paragraph 28 of the Complaint. *Id.*, ¶ 56. However, paragraph 28 merely lists the alleged representations made by Reynolds, as opposed to stating the contractual terms to which the parties had allegedly agreed. Similarly, paragraph 29 only states that Reynolds represented that HSS would expect HWLI to service the same HSS physician accounts that were serviced by PBC.

parties to treat the contract as "terminable at will." *Interweb, Inc. v iPayment, Inc.*, 12 AD3d 164, 165 (1st Dept 2004), *lv dismissed* 4 NY3d 776 (2005); *see also, Double Fortune Prop. Invs. Corp. v Gordon*, 55 AD3d 406, 407 (1st Dept 2008). Thus, HSS's termination of the billing service contract, which contained no definite duration and thus was terminable at will, does not give rise to a breach of contract claim based on premature or wrongful termination.

Even assuming that the contract had a one-year term, plaintiffs do not allege that HSS breached the contract during the first year after the asset purchase which occurred in 2003, because the Complaint states that the parties continued to perform until 2008. Hence, if HSS decided to terminate the contract any time after the first year, it had the right to do so. Also, paragraph 4.24 of the Asset Purchase Agreement contained a representation that "[a]s of the Closing Date, neither [PBC] nor [Kemp] knows, has reason to know, suspects or has reason to suspect that [HSS] had any intention to terminate or materially alter its relationship with the Business." Such a representation may well be interpreted to mean that HSS had the right to terminate the services contract in its discretion. Thus, the breach of contract claims against HSS must be dismissed.

4. Breach of the Implied Covenant of Good Faith and Fair Dealing

The Complaint next alleges that HSS disregarded HWLI-Healthwave's rights under the services contract and undertook actions that injured their rights to receive the fruits of such contract, which constitute a breach of the implied covenant of good faith and fair dealing. (Complaint, ¶¶ 66, 90).

"In New York, all contracts imply a covenant of good faith and fair dealing in the course of performance (citations omitted)". *511 West 232nd Owners Corp. v Jennifer Realty Co., supra* at 153. Here, HSS acknowledges that an oral services contract existed between the parties, but argues that because it could terminate the contract at any time in its discretion, such termination may not give rise to a claim for breach of the covenant of good faith and fair dealing. HSS relies upon the decision in *Rather v CBS Corp.* 68 AD3d 49 (1st Dept 2009), *lv denied* 13 NY3d 715 (2010) for the proposition that a breach of the implied covenant claim may be dismissed as being duplicative of a breach of contract claim.

In that case, the trial court had stated that "[a] claim of breach of the implied covenant of good faith and fair dealing is not necessarily duplicative of a claim of breach of contract"; however, because the plaintiff there adduced "the same factual allegations to support both claims," the court dismissed the breach

of the implied covenant claim as redundant. *Rather v CBS Corp.*, 2008 WL 6894751 (Sup Ct, NY Co. 2008). On appeal, the Appellate Division affirmed the ruling without analysis, stating simply that "Rather's claim for breach of the implied covenant of good faith and fair dealing was properly dismissed ... for being duplicative of his breach of contract claim." *Rather v CBS Corp.*, 48 AD3d at 59.

In *Richbell Info. Servs. v Jupiter Partners, supra* at 302, the Appellate Division stated 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 (citations omitted)." The Court found that the allegations in that case "clearly [went] beyond claiming only that [defendant] should be precluded from exercising a contractual right; they support a claim that [defendant] exercised a right malevolently ... to deprive plaintiffs of the benefits of the joint venture," and concluded that the breach of the implied covenant claim was viable, even if the parties' contract contained no limitation on Jupiter's rights. *Id.* at 302-303.

Also, in *Wallace v Merrill Lynch Capital Servs., Inc.*, 29 AD3d 382 (1st Dept 2006), the Appellate Division upheld the breach of the implied covenant claim as a separate cause of action from the

breach of contract claim. *See also Chase Manhattan Bank v Keystone Distributors, Inc.*, 873 F Supp 808, 815 (SDNY 1994)("[a] party may be in breach of its implied duty of good faith and fair dealing even if it is not in breach of its express contractual obligations").

In this case, besides alleging that HSS breached the contract by wrongful termination, plaintiffs allege that HSS acted in bad faith to deprive them of the benefits of the contract by refusing to accept their proposal to lower the fees charged the HSS physicians so as to relieve their dissatisfaction, by tainting their reputation through spreading misinformation to the physicians, and by influencing physicians to discontinue their relationships with plaintiffs. (Complaint, ¶¶ 41, 43-45, 56.) These allegations support a claim for breach of the implied covenant of good faith and fair dealing against HSS, and the Court cannot conclude at this stage of the proceedings, as a matter of law, that no set of circumstances alleged by plaintiffs could give rise to a breach of the implied covenant claim. Accordingly, HSS' motion seeking dismissal of this claim is denied.

B. Reynolds' Motion to Dismiss and to Strike (Motion Sequence Number 004)

Plaintiffs assert the following causes of action against Reynolds: fraudulent inducement (seventh cause of action), fraudulent concealment (eighth cause of action), and breach of the

implied covenant of good faith and fair dealing (ninth cause of action).

1. Fraudulent Inducement and Fraudulent Concealment

The fraud claims made against Reynolds are virtually verbatim to the fraud claims made against HSS. (Complaint, ¶¶ 60, 62, 72, 74). Reynolds seeks to dismiss the fraud claims and argues that (1) plaintiffs have failed to show reasonable reliance; (2) Reynolds owed no duty to plaintiffs; and (3) the representations made by Reynolds are not actionable as fraud, since they were truthful statements, opinions as to future possibility or business "puffery".

For the reasons stated above, the Court finds that it is premature to make a finding as to justifiable reliance at this stage of the proceeding. With respect to the fraudulent concealment claim, because no contractual or fiduciary duty is owed by Reynolds to plaintiffs, and the exceptions discussed *supra* do not apply, such claim should be dismissed. *P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V., supra.*

As to actionable fraud, Reynolds asserts that plaintiffs only allege a single interaction with Reynolds prior to their execution of the Asset Purchase Agreement - namely the meeting held on April 24, 2003 which is summarized in paragraphs 26 through 29 of the

Complaint, and that most of these statements are based on predictions of something that is expected to happen in the future which is not actionable. *See Thomas v McLaughlin*, 276 AD2d 440, 441 (1st Dep't 2000) ("'a representation of opinion or a prediction of something which is hoped or expected to occur in the future will not sustain an action for fraud' [citations omitted]"); *Lanzi v Brooks*, 54 AD2d 1057 (3rd Dep't 1976), *aff'd* 43 NY2d 778 (1977) ("[a]bsent a present intent to deceive, a statement of future intentions, promises or expectations is not actionable on the grounds of fraud").

Plaintiffs agree that while an individual is not liable for the mere statement of future intent, an individual is liable for fraud when he makes misrepresentations of his present intention, which statements induce another to act or refrain from acting in reliance thereon in a business transaction. *Channel Master Corp. v Aluminum Ltd. Sales*, 4 NY2d 403, 407 (1958).

In this case, plaintiffs allege that defendant Reynolds made misrepresentations of his present intent to continue to select the billing service vendor for the HSS Contract Physicians when he knew or should have known there was dissatisfaction among the physicians with the fees charged which stemmed from the kickback scheme and the payments to KMC Healthcare, and that he could not ensure that

plaintiffs would be able to service the same representative share of HSS physician accounts that were being services by PBC.

Thus this Court declines to dismiss the fraudulent inducement cause of action asserted against Reynolds at this time.

2. Breach of the Implied Covenant of Good Faith and Fair Dealing

Plaintiffs cannot deny that they are not in privity of contract with Reynolds, and that Reynolds acted on behalf of HSS, as its then-CEO, at least in "negotiating" the billing services contract. Also, the allegations in the Affidavit of Joseph Drohan in Opposition to Reynolds' Motion to Dismiss do not contain any assertion that Reynolds had attended any meeting or made any statement in connection with certain alleged billing practices of a "Dr. DL," that would give rise to a contractual relationship between Reynolds and plaintiffs.

In *Mark Patterson, Inc. v Stephens & Co.*, 232 AD2d 178 (1st Dept 1996), the Court dismissed a breach of the implied covenant claim because the defendant broker was not a party to the contract. *Accord, Four Winds of Saratoga v Blue Cross & Blue Shield of Cent. N.Y.*, 241 AD2d 906, 907 (3d Dept 1997)("[t]here being no contractual relationship, neither can there be any 'covenant of

good faith and fair dealing' implied which itself is based on the existence of a legal contractual obligation").

Hence, the breach of the implied covenant of good faith and fair dealing claim against Reynolds should be dismissed.

3. Striking of Irrelevant and Prejudicial Statements

In his motion, Reynolds also seeks to have this Court strike from the Complaint certain material pursuant to CPLR 3024(b) which provides that "[a] party may move to strike any scandalous or prejudicial matter unnecessarily inserted in a pleading." Specifically, defendant Reynolds asks the Court to exercise its discretion and to strike plaintiffs' inclusion of an irrelevant Penal Law section set forth in paragraph 16 of the Complaint, and plaintiffs' references in non-substantive, "information and belief" fashion to alleged wrongdoing by Reynolds, and his supposed "Affiliates," which appear in several places in the Complaint. Defendant claims that the facts upon which plaintiffs seek relief are pleaded separate and apart from any innuendo regarding phantom "Affiliates", and in essence claim that PBC was improperly buying HSS business, and that they would not have acquired the company's assets had those circumstances respecting that client been revealed to them. Defendant asserts that the existence or not of any other arrangements would have no relevance to plaintiffs' determination

to go forward with this transaction or to any alleged damages from it, and thus that matter should be stricken.

The Court finds that paragraph 16 of the Complaint (the only paragraph under Section V. Law Section) is unnecessary, prejudicial and inappropriate to be included in the Complaint, and should be stricken.

Regarding the "Affiliates," the Complaint alleges, inter alia, that persons affiliated with Reynolds knew or had reason to know of the PBC fraudulent kickback scheme, that Reynolds and the Affiliates had allegedly engaged in similar kickback schemes involving other HSS vendors, and that they allegedly had a financial interest in the PBC-HWLI asset sale. Plaintiffs argue that these and other allegations are "relevant to the [fraud] causes of action" asserted in the Complaint, and are intended to prove that the PBC fraud scheme "was not an anomaly." Plaintiffs also argue that the reference to "other fraud scheme actors who are believed to have taken part in the fraud" is necessary to meet the CPLR 3016 (b) requirement that a complaint must plead fraud with particularity.

The Court has reviewed the portions of the Complaint plaintiffs seek to have stricken and strikes only the next to last

sentence of paragraph 10 because it makes reference to other HSS vendors who are not relevant to this action. The other statements are at this stage only allegations made by plaintiffs to support their fraud claims, and are not deemed by this Court to be scandalous or prejudicial pursuant to CPLR 3024(b).

C. Motion of PBC and Kemp to Dismiss (Motion Sequence Number 002)

The Complaint asserts identical causes of action against PBC and Kemp, namely: fraudulent inducement (the tenth and fifteenth causes of action), fraudulent concealment (the eleventh and sixteenth causes of action), breach of contract (the twelfth and seventeenth causes of action), breach of the implied covenant of good faith and fair dealing (the thirteenth and eighteenth causes of action), and unjust enrichment (the fourteenth and nineteenth causes of action).

As a threshold matter, defendants PBC and Kemp argue that Healthwave and Radoccia have no legal standing to assert HWLI's breach of contract claim, because they are not parties to the Asset Purchase Agreement and HWLI never merged into Healthwave, as originally anticipated. Moreover, PBC and Kemp argue that because the alleged fraud was committed against Healthwave only and due diligence for the asset transaction was also performed by Healthwave only, HWLI cannot allege any fraud claims.

Plaintiffs allege that there is a valid assignment between HWLI and Healthwave pursuant to which HWLI assigned its interests in the Asset Purchase Agreement to Healthwave, and that Healthwave has the right to stand in HWLI's shoes here. Plaintiffs also assert that Radoccia was present at the "negotiation" meeting when the fraud was allegedly committed and was thereby induced to make the investment in the transaction. Since there are factual issues raised here, this Court will not dismiss plaintiffs' causes of action against PBC and Kemp on standing at this time.

1. Breach of Contract Claims

The Complaint asserts identical breach of contract claims against both PBC and Kemp. (Complaint, ¶¶ 82, 92). While the Complaint does not identify the specific provisions of the Asset Purchase Agreement that were breached, in opposing the motion to dismiss, plaintiffs point to the provisions of Article 4 (Representations and Warranties), specifically, sections 4.13, 4.15, 4.18 and 4.24.

Kemp argues that he cannot be sued for breach of contract because he "did not execute any contract - nor did he make any representations and warranties in the contract." However, Kemp did execute the Asset Purchase Agreement in his individual capacity as a shareholder of PBC and also in his capacity as the President of

PBC, and he also made certain representations and warranties therein.[7]

Moreover, Kemp's other argument that this claim "cannot properly be maintained," because the Complaint insufficiently pleads that he had complete dominion and control over PBC, which is the basis of plaintiffs' attempt to pierce the corporate veil, is unpersuasive. At this early stage of the litigation, there are sufficiently pled facts to support piercing the corporate veil, and discovery will reveal the relevant facts or the lack thereof. *First Bank of Ams. v Motor Car Funding, Inc.*, 257 AD2d 287, 294 (1st Dept 1999) (veil-piercing is a fact laden claim that is not well-suited for resolution on a summary judgment motion), let alone a pre-answer motion to dismiss such as this. *Accord, USA United Holdings, Inc. v Tse-Peo, Inc.*, 23 Misc 3d 1114(A), (Sup Ct, Kings Co. 2009). In any event, it is axiomatic that in considering a

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[7] Article 4 is prefaced by the following: "[I]n order to induce Buyer to enter into this Agreement, Seller **and** Shareholder make the following representations and warranties to Buyer ...." While some of the provisions in Article 4 are distinctly stated as representations or warranties made by **either** Seller (PBC) **or** Shareholder (Kemp), other provisions do not make any distinction. For example, section 4.4, No Violation, provides that the execution or performance by Seller **and** Shareholder of the agreement will not violate any law to which Seller **or** Shareholder is subject; but sections 4.10 Financial Statements and 4.11 Absence of Certain Events do not specify whether Seller **and/or** Shareholder made the representations or warranties therein.

motion to dismiss, allegations of the complaint should be liberally viewed in a light most favorable to plaintiffs.

PBC and Kemp also argue that the breach of contract claim is time-barred, because section 8.1 of the Asset Purchase Agreement provides that the representations and warranties therein only "survive" for two years after the closing date. Notably, the subject section also provides that, notwithstanding any term in section 8.1, "the applicable statute of limitations shall be the survival period for any matter relating to (a) fraud or .. . misrepresentation or willful omission of a material fact in connection with this Agreement ... or (c) any alleged or actual violation of the representations and warranties made in ... Section 4.15 - 'Compliance with Laws.'" Indeed, the Complaint alleges fraudulent concealment or non-disclosure of the kickback scheme.[8] Because the statue of limitations for a breach of contract claim based on violations of contractual representations and warranties or fraud is six years, the summons and notice of this action was

[8] Section 4.13, Absence of Undisclosed Liabilities provides, *inter alia*, that "Seller does not have any liability ... that could reasonably affect the Business or the Purchased Assets which has not been disclosed to Buyer, and there is no basis for any such liability or obligation." Section 4.18 Disclosures states, inter alia, that "[t]here is no fact within the best knowledge of the Seller that has not been disclosed to the Buyer which could have a Material Adverse Effect." The Complaint also appears to allege that PBC and Kemp failed to disclose that certain HSS physicians had ended their relationship with PBC prior to the PBC-HWLI closing. (Complaint, ¶ 37).

filed on April 22, 2009 and the closing date for the Asset Purchase Agreement was May 16, 2003, the breach of contract claims against PBC and Kemp are timely. CPLR 203 (c) and 213.

PBC and Kemp also argue that the checks plaintiffs found in connection with the kickback scheme showed that these payments ended "long before" the asset purchase sale closed in May 2003, and as such, the scheme was "temporally unrelated to the business loss" sustained by plaintiffs.[9]

To state a breach of contract claim, a complaint needs to allege the following four elements: existence of a contract, plaintiff's performance of the contract, defendant's breach of the contract, and damages. *See Furia v Furia*, 116 AD2d 694 (2d Dept 1986). Plaintiffs' Complaint alleges the required four elements. Also, because this case is only in the pleading stage, discovery may uncover more checks issued in connection with the scheme. Moreover, a breach of the representation or warranty in a contract does not require a showing of "proximate cause," and defendants have not cited any law in support of such a proposition.

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[9] The last check was issued in December 2001.

Accordingly, that portion of defendants' motion seeking dismissal of the breach of contract claims against PBC and Kemp is denied.

2. Breach of the Implied Covenant of Good Faith and Fair Dealing

The Complaint again makes the identical claim against PBC and Kemp (Complaint, ¶¶ 84, 94). Defendants argue that the claims should be dismissed because they are duplicative of the breach of contract claims. Defendants also argue that the Complaint fails to allege that defendants destroyed plaintiffs' contractual rights or prevented their contractual performance, a required showing for a breach of the implied covenant claim.

While the breach of contract claims allege violations of certain representations and warranties (primarily non-disclosure provisions) in the Asset Purchase Agreement, the breach of the implied covenant claims additionally allege that PBC and Kemp failed to act in good faith post-closing, which denied plaintiffs from realizing the "fruits" of such agreement. Notably, pursuant to the Consulting Agreement made on May 16, 2003, Kemp was retained by HWLI as a consultant post-closing, to facilitate a smooth transition of

the HSS physician-clients from PBC to HWLI, and to assist in soliciting new clients.[10]

Plaintiffs allege, *inter alia*, that none of the HSS physicians were notified by Kemp or PBC that their billing work was to be transferred from PBC to HWLI, and that Kemp and PBC did nothing post-closing to reduce physicians' animosity due to PBC's prior excessive billing surcharges, which caused the HSS contract physicians to switch billing vendors when they became independent physicians, thus causing plaintiffs to lose business. (Complaint, ¶¶ 35, 37, 40-42).

Because the above allegations are separate and distinct from those contained in the breach of contract claim, they cannot be considered duplicative. Accordingly, that portion of the motion seeking to dismiss the claims for breach of the implied covenant of good faith and fair dealing claims against Kemp and PBC is denied as premature.

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[10] Apparently, the Consulting Agreement was part and parcel of the HWLI-PBC asset purchase transactions. Kemp's retention by HWLI was due to his status as "founder and sole shareholder of PBC," and his "unique knowledge and expertise regarding the provision of billing and collection services to physicians and healthcare institutions." Consulting Agreement, at 1.

3. Fraudulent Inducement and Fraudulent Concealment

The Complaint also asserts identical fraudulent inducement and concealment claims against PBC and Kemp. Defendants argue that the fraud claims must be dismissed because plaintiffs' reliance on the alleged fraud was unreasonable and, in any event, the fraud claims are duplicative of the breach of contract claims.

The fraud claims against PBC and Kemp differ from those against HSS and Reynolds, because PBC and Kemp had a contractual relationship with plaintiffs under the Asset Purchase Agreement, which contained certain representations and warranties. As the Court of Appeals held in *DDJ Mgt., LLC v Rhone Group L.L.C., supra*, in a case where a plaintiff has taken reasonable steps to protect itself against fraud, it should not be denied recovery even though "hindsight suggests that it might have been possible to detect the fraud"; and in particular, where the plaintiff had obtained a written representation that certain facts are true, "it will often be justified in accepting that representation rather than making its own inquiry." 15 NY3d at 154.

In this case, plaintiffs obtained written representations from PBC and Kemp with respect to various matters relating to the asset purchase transaction, including matters involving non-disclosure and fraud. Thus, although hindsight may reveal that there were hints of falsehood in the transactions (as discussed above) and that

plaintiffs could have conducted a more detailed investigation into the alleged fraud, based on the rationale stated in *DDJ Management*, the written representations allegedly afforded plaintiffs additional protection from potential fraud, and they might have been justified in relying on such representations.

Notwithstanding the foregoing, the fraud and breach of contract claims appear to be based upon substantially similar factual allegations, and such claims thus appear duplicative. Indeed, it appears that the viability of the breach of contract claims may be dependent on the viability of the fraud claims. However, because this case is in its infancy, plaintiffs are permitted to plead such claims in the alternative. *See e.g. Merrill Lynch, Pierce, Fenner & Smith v Chipetine*, 221 AD2d 284, 286 (1st Dept 1995)(CPLR 3014 permits the pleading of a fraud claim along with a breach of contract claim, "regardless of consistency").

4. Unjust Enrichment Claims

The Complaint also alleges identical unjust enrichment claims against PBC and Kemp. Defendants argue that such claims are not viable and should be dismissed "because they are nothing more than a reiteration of the breach of contract claims."

It is black-letter law that a valid and enforceable written contract governing a subject matter generally precludes the pursuit

of quasi-contractual remedies based on the same subject matter. *Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 388 (1987). Thus, a party cannot pursue a quasi-contractual claim, such as unjust enrichment, if it has fully performed a valid contract, the existence and scope of which cover the dispute in question. *Id. at* 389; *EBC I, Inc. v Goldman Sachs & Co.*, 5 NY3d 11, 23 (2005); *Katz v American Mayflower Life Ins. Co. of N.Y.*, 14 AD3d 195, 201 (1st Dept 2004), affd 5 NY3d 561 (2005).

Plaintiffs do not argue that the Asset Purchase Agreement is not a valid contract, or that they have not fully performed the agreement, or that the agreement does not cover the subject matter of the unjust enrichment claims. Instead, they argue that the unjust enrichment claims may be pled as an alternative to the breach of contract claims. Based on the applicable case law, the unjust enrichment claims must be dismissed. *IDT Corp. v Morgan Stanley Dean Witter & Co.*, 12 NY3d 132, 142 (2009); *see also Clark-FitzPatrick, Inc., supra.*

Conclusion

Based on all of the foregoing, it is hereby

ORDERED that the motion to dismiss by New York Society for the Relief of the Ruptured and Crippled Maintaining the Hospital for Special Surgery d/b/a Hospital for Special Surgery (motion sequence number 001) is granted with respect to dismissing the second, third

and fifth causes of action, but is denied with respect to the first, fourth and sixth causes of action; and it is further

ORDERED that the motion to dismiss by Michael Kemp and Professional Billing Controls, Inc. (motion sequence number 002) is granted with respect to dismissing the fourteenth and nineteenth causes of action, but is denied with respect to the tenth, eleventh, twelfth, thirteenth, fifteenth, sixteenth, seventeen and eighteenth causes of action; and it is further

ORDERED that that portion of the motion to dismiss by John Reynolds (motion sequence number 004) is granted with respect to dismissing the eighth and ninth causes of action; but is denied as to the seventh cause of action; and that portion of the motion seeking to strike certain statements in the Complaint is granted in part and denied in part, in accordance with this decision.

Plaintiffs have 30 days to amend the Complaint in accordance with this decision, and defendants have 30 days from the date of service thereof to serve their Answers.

All counsel shall appear for a preliminary conference in IA Part 39, 60 Centre Street, Room 208 on October 12, 2011 at 10:00 a.m.

This constitutes the decision and order of this Court.

Dated: July 1, 2011

BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK J.S.C.