New Millennium Capital Partners III v Systems Evolution, Inc.
2012 NY Slip Op 33380(U)
February 15, 2012
Supreme Court, New York County
Docket Number: 600893/2010
Judge: Shirley Werner Kornreich

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

HON. SHIRLEY W. KORNREICH

PR

Index Number : 600893/2010
NEW MILLENNIUM CAPITAL
vs.
SYSTEMS EVOLUTION, INC.,
SEQUENCE NUMBER : 001
DISMISS ACTION

Th

PART 54

INDEX NO. 600893/10

MOTION DATE 5/12/11

MOTION SEQ. NO. 001

MOTION CAL. NO.

This NIR Group's and Ribotsky's motion to/~~for~~ dismiss counterclaims and third party causes of action

Papers Numbered
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Replying Affidavits	47

Transcript of 4/28/11 argument

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

Dated: 2/15/12

HON. SHIRLEY W. KORNREICH J.S.C.

JUSTICE SHIRLEY WERNER KORNREICH

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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NEW MILLENNIUM CAPITAL PARTNERS III; LLC, NEW MILLENNIUM CAPITAL PARTNERS II, LLC; AJW PARTNERS, LLC; AJW OFFSHORE, LTD.; AJW QUALIFIED PARTNERS, LLC; AJW MASTER FUND, LTD.; AJW PARTNERS II, LLC; AJW OFFSHORE II, LTD.; AJW QUALIFIED PARTNERS II, LLC; and AJW MASTER FUND II, LTD.,

Plaintiffs,

-against-

SYSTEMS EVOLUTION, INC.,

Defendant.

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SYSTEMS EVOLUTION, INC.,

Counterclaim and Third-Party Plaintiff,

-against-

NEW MILLENNIUM CAPITAL PARTNERS III, LLC, NEW MILLENNIUM CAPITAL PARTNERS II, LLC; AJW PARTNERS, LLC; AJW OFFSHORE, LTD.; AJW QUALIFIED PARTNERS, LLC; AJW MASTER FUND, LTD.; AJW PARTNERS II, LLC; AJW OFFSHORE II, LTD.; AJW QUALIFIED PARTNERS II, LLC; and AJW MASTER FUND II, LTD.,

Counterclaim Defendants,

-against-

COREY RIBOTSKY; N.I.R. GROUP, LLC; STEVEN HUMPHRIES; CABAL COMMUNICATIONS CORPORATION (f/k/a DealerAdvance, Inc.); STI GROUP, INC.; MONARCH BAY CAPITAL GROUP, LLC; and DAVID WALTERS,

Third-Party Defendants.

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Index No.: 600893/2010

DECISION and ORDER

KORNREICH, SHIRLEY WERNER, J.:

By Amended Complaint filed December 8, 2010, plaintiffs investment funds (NIR Funds or plaintiffs) sue defendant Systems Evolution, Inc. (SEVI) for multiple breaches of contract arising from SEVI's defaults on over $6 Million of callable secured convertible notes (Notes) purchased by plaintiffs in the years 2004 through 2008. Plaintiffs also seek an order directing SEVI to marshal its assets in preparation for foreclosure.

In its Amended Answer, SEVI denies the claims and asserts counterclaims against plaintiffs and a third-party complaint against Corey Ribotsky (Ribotsky), N.I.R. Group, LLC (N.I.R. Group), Steven Humphries (Humphries), Cabal Communications Corporation (f/k/a DealerAdvance) (DealerAdvance), STI Group, Inc. (STI), Monarch Bay Capital Group, LLC (Monarch Bay), and David Walters (Walters). SEVI alleges: fraud, conversion and larceny by false pretenses against Humphries; breach of fiduciary duty against Humphries and Walters; fraud and aiding and abetting breach of fiduciary duty against all counterclaim defendants and third-party defendants; breach of the implied covenant of good faith and fair dealing against the NIR funds; and contribution against STI. SEVI seeks rescission and compensatory and punitive damages.

In their joint motion (Motion Seq. 001), plaintiffs and counterclaim defendants NIR Funds and third-party defendants N.I.R. Group and Ribotsky seek dismissal of the counterclaims and third-party claims under CPLR 3211(a)(1) and (7) (documentary evidence and failure to state a claim), CPLR 3016(b) (lack of particularized allegations of fraud), and the equitable doctrine of *in pari delicto*. SEVI opposes. The remaining third-party defendants have not submitted a motion to dismiss. Walters, Monarch Bay and STI submitted an untimely answer to the third-

party complaint and have filed a motion to compel arbitration, or alternatively, for a stay and protective order, which the court denies in a separate decision and order. Mot. Seq. 010. In that same decision, the court grants SEVI's motion to rejoin its third-party claims (limited to claims that have not been dismissed) with the main action (Mot. Seq. 009).

I. Background

A. The Counterclaims and Third-Party Complaint

SEVI is an information technology services company incorporated in Idaho. Its principal place of business was in Texas but now appears to be in Arkansas. It is undisputed that pursuant to an August 29, 2009 Share Exchange Agreement, SEVI acquired controlling interests in two businesses, Highline Hydrogen Hybrid, Inc. (HHHI) and Hoss Motorsports, Inc. (collectively, the Highline Companies), in exchange for 112,500,000 shares of SEVI stock. SEVI then changed its name to Highline Technical Innovations, Inc. Fleming Affirmation ¶4, Exhs. O, S & T. The following facts are taken from SEVI's counterclaims and third-party complaint.

1. Third-Party Defendants (TPD)

The NIR Funds are managed by the N.I.R. Group, a Roslyn, New York based investment management company. Ribosky is the managing member of the N.I.R. Group.

Cabal Communications Corporation, a Colorado corporation, is the successor entity to DealerAdvance, a software company that was incorporated in Nevada, headquartered in Texas, and traded as a penny stock on the over-the-counter market. Humphries was Chief Executive Officer (CEO) of SEVI from December 2008 through February 2010, and he also served as CEO

of DealerAdvance. Humphries is a Texas resident. In October 2010, he pled guilty to unrelated Federal securities fraud charges in Florida.[1]

STI is a software company incorporated in Delaware that trades as a penny stock on the over-the-counter market. Walters is the CEO of STI and the managing member of California based Monarch Bay. He was CEO of SEVI from February 2007 until Humphries took over in December 2008.

2. The Alleged Scheme

"Counterclaim and Third-Party Defendants conspired together and acted in concert to defraud and injure Systems Evolution, its shareholders and the market as a whole." ¶10. The scheme allegedly involved Ribotsky's and the N.I.R. Group's installation and control of "co-opted managers" at penny-stock companies. Ribotsky and the N.I.R. Group (NIR collectively with NIR Funds), with assistance from the "co-opted managers," made investments in the companies, "with little or no concern for [their] financial viability," in return for convertible notes "that not only [paid] very high interest rates but also [could] be converted into the companies' common stock, at N.I.R. Group's option, at a conversion rate that was a fraction of the trading price of the stock." ¶¶11-13. These rates were unfavorable to the companies. Assistance by these co-opted managers included sharing "inside" information. *Id.*

The managers and NIR then "engaged in transactions and publicity campaigns designed to affect the stock price and trading liquidity so that NIR could convert their investments into common stock and sell that stock in the market at a profit." ¶14. They also "[used] the penny-

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[1]Humphries filed three petitions for bankruptcy in Texas during 2011. The automatic bankruptcy stay under 11 USC 362(a) is not in effect, as the court explains in its decision and order granting the motion to rejoin third-party claims, issued on this date.

stock 'shells' under their control to acquire small or start-up companies for the purpose of driving the liquidity and stock price of the shell so that the N.I.R. Group could convert its investments and sell the stock at a profit." *Id.*

3. NIR, SEVI, DealerAdvance, STI and Monarch Bay

SEVI alleges that Walters and Humphries were "loyal" to NIR, which made "purported" investments in several companies they managed. These included over $6 Million in DealerAdvance when Humphries was CEO and $2.3 Million in SEVI from 2004 to 2007. Walters took over as CEO from Rhodes for the year 2008. ¶¶24-25 (citing to ¶¶ 13-41 and 81-85 of Amend. Comp). In return, the NIR Funds held promissory notes from the companies that were convertible into common stock.[2]

According to SEVI, after these Notes were issued,

> [I]n or about December 2008, Humphries and Walters, with the knowledge, approval and financial support of N.I.R. Group and Ribotsky, caused [SEVI], DealerAdvance and STI Group to engage in a series of sham transactions without consideration in which [SEVI] assumed a majority of DealerAdvance's debt to the N.I.R. Funds and STI Group assumed [SEVI]'s debt to the N.I.R. Funds.

¶18.[3] By Asset Purchase Agreement (APA), dated December 31, 2008 (12/31/08 DA/SEVI Agreement), approved by the lender NIR, SEVI assumed more than $6 Million of debt that DealerAdvance (managed by Humphries) owed to NIR. In return, DealerAdvance "purportedly conveyed [its] 'web-based integrated Customer Relationship Management Software' and the

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[2]SEVI denies having sufficient knowledge or information to form a belief as to whether the funds were actually provided by NIR. ¶22. There are no alleged facts indicating that the funds were not provided.

[3]The court notes that these transactions occurred when the U.S. and the world economy were sinking into recession.

associated intellectual property and trademarks . . .to [SEVI]," which was being managed by Walters. That agreement also provided that Humphries would replace Walters as manager of SEVI. ¶24. SEVI asserts that: the DealerAdvance trademark was never transferred to SEVI. Rather, it "remained held in the name of Stronghold Technologies, Inc., a subsidiary of DealerAdvance, until its cancellation on November 5, 2010" (¶31), and "on information and belief," none of the software or intellectual property was transferred to SEVI, as the 12/31/08 DA/SEVI Agreement required (*Id.*). In July 2009, DealerAdvance announced that it had reduced its NIR debt by $2.98 Million by selling "that same software to an undisclosed purchaser." ¶32.

SEVI alleges further that in a separate APA, also dated December 31, 2008 (12/31/08 SEVI/STI Agreemt) and which NIR approved, STI (also managed by Walters) assumed "nearly $2.9 million of [SEVI]'s obligations, including more than $2.3 million in obligations to [NIR]." In return, SEVI "purportedly sold [SEVI]'s 'software development services, managed network support services and other consulting services,' including all of the shares and assets of . . . [SEVI]'s Texas-incorporated subsidiary, to STI Group (also managed by Walters)." ¶25. " [O]n information and belief," SEVI avers that STI never received these services. Instead, SEVI had previously sold the services in 2007 to another company, DataLogic International, Inc., which was managed by an affiliate of Walters. That sale had been made in return for DataLogic stock and an assumption of certain SEVI liabilities. Further, SEVI asserts that even though the consideration it was required to pay STI included DataLogic stock from this 2007 asset-purchase deal, DataLogic had ceased operations some time in 2007. ¶35. The DataLogic deal resulted in NIR directing Walters to assume control of SEVI. ¶37.

SEVI avers that Walters and Humphries benefitted personally. Simultaneously with the two 12/31/08 APAs, in a separate Stock Assignment, Monarch Bay (managed by Walters) transferred more than 453 million shares of [SEVI] to Humphries in exchange for $10,000 in cash and a convertible note issued by [SEVI] in a face value amount of $50,000." Monarch Bay also received an $80,000 SEVI note and SEVI's release by other entities "for certain fees and other compensation." ¶26. Additional allegations include that: Walters and SEVI entered into a 12/31/08 Settlement Agreement and Release, which "was procured by fraud . . . [and] thus was void *ab initio*" (¶27); "Walters, through Monarch Bay, received cash and $130,000 in convertible promissory notes" (¶¶26-28); NIR assisted with and helped fund the 12/31/08 APAs (¶38); Walters, Humphries and Ribotsky knew that SEVI was a "shell" company with no substantial assets (¶39); and the purpose of the 2008 transactions and related publicity was to boost the stock price, enabling the NIR Funds to convert the Notes to stock and sell at a profit. ¶¶41-42.

4. Highline Companies

SEVI alleges that the purpose of the Highline Companies purchase was to "roll them into DealerAdvance and [SEVI] to build liquidity in those two companies." ¶43. HHHI is a manufacturer of hydrogen fuel systems, and Hoss is a manufacturer of all-terrain vehicles. Humphries allegedly shared confidential information with Ribotsky about the proposed deal:

> In an email dated January 23, 2009, to Ribotsky, Humphries referenced the proposed deal terms with the Highline entities and opined that "[w]e can create some great PR on this deal to drive" a capital raise. In a subsequent email, dated April 17, 2009, Humphries told Ribotsky that, by doing the acquisition with the Highline Companies, "[w]e could turn SSEV [SEVI] into a real company, you get your convertible debt and I get my company."

¶44. The amended complaint describes the Share Exhange Agreement dated August 29, 2009:

> [SEVI] acquired 70% of the stock of HHHI and Hoss in exchange for 112,500,000 shares of [SEVI] stock (purportedly representing 15% of the outstanding common stock) to the shareholders each of HHHI and Hoss. . . . In addition, the Share Exchange Agreement provided that the debts owed by HHHI and Hoss to Charles Foster, one of the founders of HHHI and Hoss, would be restructured; Mr. Foster was to receive a total of $1 million in cash, payable immediately, and promissory notes in the amounts of $1.3 million and $500,000 from Hoss and HHHI, respectively.

¶¶45-46. Additionally, SEVI claims that: Foster has not received the payments due him; Humphries did not disclose SEVI's NIR debts to the Highline Companies; SEVI represented and warranted in the Share Exchange Agreement that "[e]xcept as disclosed pursuant to this Agreement and/or contained in [SEVI]'s financial statements posted using the Pink Sheets News Service, there are no contracts, actual or contingent obligations, agreements . . . between [SEVI] and other third parties which are material to the business, financial condition, or results of operation of [SEVI], taken as a whole [and] no existing or threatened liabilities . . . with respect to . . issuance of stock, or any dealings with stockholders, the public, the brokerage community.. .." (¶47); and the NIR debts were not in SEVI's financial statements posted using the Pink Sheets News Service. ¶49.

5. Humphries' Forgeries and Termination

The amended complaint contains detailed allegations of Humphries' falsification of corporate documents and forgeries of signatures of Foster and another Highline Companies' manager, resulting in the wrongful issuance of large amounts of SEVI stock. These alleged acts of forgery and falsification allegedly occurred after the Highline stock purchase, from September through April 2009. The owners and managers of the Highline Companies terminated Humphries in February 2010. Foster, HHHI and Hoss entered into a Release and Settlement

Agreement, dated February 23, 2010, in which they agreed not to pursue civil or criminal charges against Humphries or any other SEVI employee. SEVI asserts that this agreement does not preclude it from pursuing Humphries, but in any event the agreement was obtained by fraud and is void *ab initio*. ¶¶50-58.

B. Motion to Dismiss

Plaintiffs' and third-party defendants' argue: (1) the fraud claim is insufficient as a matter of law because it fails to identify with particularity which of the defendants made the alleged misrepresentations, what misrepresentations were made and when they were made (CPLR 3016); (2) the claim for fraudulent inducement is based on the alleged non-performance of the restructuring contracts, which does not establish breach of a duty distinct from that arising from the contract [*Baker v Norman,* 226 AD2d 301, 304 (1st Dept), *lv dismissed* 88 NY2d 1040 (1996)]; (3) the claim for aiding and abetting breach of a fiduciary duty does not establish that plaintiffs, the N.I.R. Group and Ribotsky had actual knowledge of, or provided substantial assistance to Walters' or Humphries' breach of fiduciary duty [*Kaufman v Cohen,* 307 AD2d 113, 125 (1st Dept 2003)]; (4) there is no independent cause of action for breach of the duty of good faith and fair dealing, and the claim does not identify the specific contract allegedly breached [*Quail Ridge Assoc. v Chemical Bank,* 162 AD2d 917, 919 (3d Dept), *app dismissed* 76 NY2d 936 (1990)]; and (5) SEVI's claims are barred by the doctrine of *in pari delicto* [*Kirschner v KPMG, LLP,* 15 NY2d 446, 464 (2010)].

In support, movants submit, *inter alia*: SEVI's Form 8-K Report filed with the SEC on January 3, 2005, including the December 30, 2004 securities Purchase Agreement between SEVI and plaintiffs, and the form of Note. (Exh F); Registration Statement for stock underlying Notes,

filed with SEC January 10, 2005. (Exh G); Form 10-Ks filed by SEVI with the SEC for years ending May 31, 2006, and April 6, 2007. (Exhs H, J); Schedule 13D filed by Walters describing SEVI's business combination in early 2007. (Exh I); December 31, 2008 Purchase Agreements between SEVI and: STI (Exh K), and DealerAdvance (Exh L); Resolution of SEVI Board of Directors approving Asset Purchase Agreements. (Exh M); August 24, 2009 Share Exchange Agreement between SEVI and Highline Companies. (Exh N); and SEVI balance sheets. (Exhs P, S-U.)

In opposition, SEVI argues that: (1) the fraud claims are pled with sufficient particularity and relate to an intention to perform and a manipulative course of conduct, which can form the basis for fraud [*GoSmile, Inc. v Levine,* 81 AD3d 77 (1st Dept), *lv dismissed* 17 NY3d 782 (2011)]; (2) the claims for aiding and abetting breach of fiduciary duty are sufficient because allegations that the NIR Parties orchestrated the transactions constituting the breaches, establish substantial assistance; (3) the claim for breach of the duty of good faith and fair dealing is sufficient because it alleges that the NIR Parties and Ribotsky deprived SEVI of the benefit of the bargain; and (4) the doctrine of *in pari delicto* does not bar SEVI's claims because they come within the "adverse interest" exception.

In support, SEVI submits, *inter alia,* a series of emails between NIR and Humphries, Monarch Bay, Walters, and Rhodes (SEVI CEO 2004-2007). (Exhs B-V.)

No affidavits have been submitted, other than attorney affirmations not based on personal knowledge.

II. Discussion

On a motion to dismiss pursuant to CPLR 3211(a)(7) (failure to state a claim), the court must accept the facts as alleged in the complaint as true, accord plaintiff the benefit of every possible favorable inference and determine only whether the facts as alleged fit within any cognizable legal theory. *Morone v Morone,* 50 NY2d 481, 484 (1980); *Rovello v Orofino Realty Co.,* 40 NY2d 633, 634 (1976); *Skillgames, L.L.C. v Brody*, 1 AD3d 247, 250 (1st Dept 2003). "[T]he criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one." *Rovello, supra,* 40 NY2d at 636. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames,* 1 AD3d 250. A court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint. *Rovello* at 635-636. On the other hand, "[a]ffidavits submitted by a respondent will almost never warrant dismissal under CPLR 3211[(a)(7)] *unless* they 'establish conclusively that [petitioner] has no [claim or] cause of action.'" *Lawrence v Miller,* 11 NY3d 588, 595 (2008), quoting *Rovello*, 40 NY2d at 635-636.

The pleadings should give adequate notice to the court and the adverse party of the transactions or occurrences intended to be proved. *Two Clinton Sq. Corp. v Friedler*, 91 AD2d 1193, 1194 (4th Dept 1983); *see Ackerman v 305 E. 40th Owners Corp.*, 189 AD2d 665, 666 (1st Dept 1993). A counterclaim must be complete in itself, without resort to the complaint or parts of the answer not incorporated in the counterclaim by reference or otherwise. *Davalos v Davalos*, 1954 NY Misc LEXIS 2096 (Sup Ct, New York County 1954); *accord Bates v 55 & 57 East 65th St. Corp.*, 249 AD 119 (1st Dept 1936).

Dismissal under CPLR 3211(a)(1) (documentary evidence) is warranted only if the documentary evidence conclusively establishes a defense to the asserted claims as a matter of law. Siegel, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C3211:10; *Leon v Martinez,* 84 NY2d 83, 88 (1994); *see Bishop v Maurer,* 33 AD3d 497, 498 (1st Dept 2006) ("The court, however, is not required to accept factual allegations, or accord favorable inferences, where the factual assertions are plainly contradicted by documentary evidence"); *see Sokol v Leader*, 74 AD3d 1180, 1182 (2d Dept 2010) (when court considers evidentiary material on 3211 motion, criteria is whether plaintiff has cause of action, not whether he has stated one).

A. Fraud (First and Second Counterclaims and Third-Party Cause of Action)

In brief, the first counterclaim and third-party cause of action allege that the NIR Funds, N.I.R. Group, Ribotsky, Humphries, Walters, DealerAdvance, STI and Monarch Bay "conspired together and acted in concert to defraud [SEVI], its shareholders and the market by among other things, engaging in a series of sham transactions in or about December 2008 through which [SEVI] was defrauded into assuming the purported obligations of DealerAdvance to the N.I.R.. Funds." ¶60. The second counterclaim and third-party cause of action allege that the NIR Funds, Humphries, Ribotsky and the N.I.R. Group conspired together and acted in concert to defraud [SEVI] and its shareholders by, among other things, falsely representing [SEVI]'s financial condition and ability to pay, thereby inducing the owners of the Highline Companies to exchange 70% of each of Hoss and Highline and 100% of Bo-Tie's stock in exchange for [SEVI] stock and a promise to restructure and pay two promissory notes in favor of Mr. Foster." ¶68. "Bo-Tie" is not identified or defined in the pleading. The motion papers explain that the reference is to Bo-Tie Manufacturing, which SEVI/Highline acquired in March 2010 after Humphries had left and

while the owners of the Highline Companies were in control. *See* Fleming Aff, Exh V (3/31/10 Press Release).

SEVI's claim is for fraudulent inducement, which requires allegations of "a knowing misrepresentation of material present fact, which is intended to deceive another party and induce that party to act on it, resulting in injury." *GoSmile, Inc. v Levine, supra,* 81 AD3d at 81. A "plaintiff needs to plead and prove 'a breach of duty distinct from, or in addition to, the breach of contract.'" *Id.*, quoting *Non-Linear Trading Co. v Braddis Assocs.*, 243 AD2d 107, 118 (1st Dept 1998). Where the only fraud alleged is that the defendant was not sincere when it promised to perform under the contract, the "only fraud charged relates to a breach of contract." *Sound Communications, Inc . v Rack & Roll, Inc.*, 2011 N.Y. App. Div. LEXIS 7129, 2011 NY Slip Op 7262 (1st Dept Oct. 18, 2011) (reversing lower court and dismissing complaint); *see Gordon v Dino De Laurentiis, Corp.,* 141 AD2d 435, 436 (1st Dept 1988) (reversing lower court and dismissing fraud claims).

Where the plaintiff pleads that it was induced to enter into a contract based on the defendant's promise to perform and that the defendant, at the time it made the promise, had a "preconceived and undisclosed intention of not performing" the contract, such a promise constitutes a representation of present fact collateral to the terms of the contract and is actionable in fraud. *Deerfield Communications Corp.,* 68 NY2d 954, 956 (1986) (internal quotation marks and brackets omitted). Causes of action for breach of contract and fraud based on the breach of a duty separate from the breach of the contract are designed to provide remedies for different species of damages: the damages recoverable for a breach of contract are meant "to place the nonbreaching party in as good a position as it would have been had the contract been performed."

Brushton-Moira Cent. School Dist. v Thomas Assoc., 91 NY2d 256, 261 (1998); the damages recoverable for being fraudulently induced to enter a contract are meant to "indemni[f]y for the loss sufferec through that inducement." *Deerfield Communications Corp.*, 68 NY2d at 956 (internal quotation marks and brackets omitted).

Construing the allegations and inferences in a light most favorable to SEVI, SEVI alleges that: the counterclaim and third-party defendants knowingly and intentionally misrepresented material facts and made material omissions with the intent of making the companies appear to be in a better financial condition and inducing reliance by "the investing public"; in return for SEVI's assumption of $6 Million in NIR debt, they represented that DealerAdvance would convey valuable software that they knew had little value and was not being serviced, and which was never actually conveyed; they represented that DealerAdvance's intellectual property would be conveyed, but it never was conveyed; and they represented that the deal was at arms length, when they knew that to be false. SEVI claims that it and its shareholders relied on these omissions and misrepresentations when it assumed the $6 Million in NIR debt. As for the STI transaction, there are no specific allegations that misrepresentations made to SEVI induced it to exchange NIR debt for STI assets, rather the pleading asserts that alleged misrepresentations and omissions as to *SEVI's* condition and its intent to convey assets induced STI to assume SEVI's debt.

SEVI has not sufficiently alleged a present intent by the moving parties, NRI, and Ribotsky, to deceive SEVI by inducing its reliance on knowing misrepresentations and omissions of material facts independent of the contracts. *See generally MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 293 (1st Dept 2011). In fact, SEVI has not alleged any specific

misrepresentation or omission by Ribotsky and the NRI parties. At best, SEVI alleges a general scheme, which the counterclaim defendants/third-party defendants allegedly joined, to cause SEVI's participation in the deals. SEVI implicitly acknowledges this by alleging that the deals were not at arms length and that NRI and Ribotsky controlled Walters and Humphries. Since Walters and Humphries controlled SEVI and the other companies involved, they would have been responsible for developing and implementing the transactions and they would have been well aware of the underlying specifics, including the value of DealerAdvance's assets. For the purposes of the DealerAdvance deal, Walters *was* SEVI, and the alleged misrepresentations and omissions went through Walters. The court does not now decide whether the complaint sufficiently alleges fraud by Walters, or the other defendants who have not moved to dismiss.

Allegations that the defendants conspired to cause SEVI's assumption of DealerAdvance debt are also insufficient to establish fraud by NRI and Ribotsky. Again, there are no allegations of facts misrepresented by NRI or Ribotsky, or of facts independent of the DealerAdvance contract that were misrepresented by someone they dominated and controlled. Walters acted for SEVI and the complaint does not allege misrepresentations or omissions of material facts by Walters to anyone at SEVI in a position to commit SEVI to the deals at issue.

Even if the allegations could be read to establish a scheme involving all the defendants to misrepresent SEVI's value, or a "pump and dump" scheme, shareholders in the general market would have individual claims that the corporation could not bring in its own name. *Cf Abrams v Donati,* 66 NY2d 951, 953 (1985) (discussing individual versus derivative right to sue). Unlike Federal Securities Fraud claims based on the "fraud-on-the-market doctrine," New York law, which the parties to the SEVI/NIR Notes consented to as controlling, requires individual reliance.

See Klein v Robert's Am. Gourmet Food, Inc., 28 AD3d 63 (2d Dept 2006), quoting *Basic, Inc. v Levinson*, 485 US 224, 241 et seq. (1988).

SEVI's other assertions suggest that the transactions facilitated NIR's conversion of Notes to SEVI common stock at rates below market value, which reduced the value of existing shareholders' stock. The NIR Funds' right to convert at below market rates, and to do so whenever they elected, was bargained for by SEVI in 2004-2007 when the Notes were issued, well before Walters' or Humphries' involvement with the company and before the 2008 deals. SEVI allegedly defaulted on the Notes when it failed to pay principal and interest, and to honor Notices of Conversion in 2010. Am Comp ¶¶46-51.

As for the Second Counterclaim and Third-Party Cause of Action, the allegedly injured parties are the Highline Companies, who would be the real parties in interest. This is not a suit by shareholders claiming harm to their individual interests. This is a suit by a corporation (SEVI) claiming harm to itself, from misrepresentations to third parties (Highline Companies) made by its CEO (Humphries). The fact that the owners of the Highline Companies are now shareholders of SEVI does not make SEVI a victim of the alleged fraud. Additionally, SEVI's assertion, that the February 23, 2010 Release and Settlement Agreement between the Highline Companies and Humphries was procured by fraud and is void *ab initio*, does not cure its pleading deficiency. ¶70. Voiding that agreement would only allow the Highline Companies, not SEVI, to sue Humphries, et al.[4]

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[4]Although the court takes no position on the merit of this argument, that the release is void, SEVI's pleading does allege with particularity that misrepresentations of material facts about SEVI's financial condition were made, and material facts were not disclosed by Humphries to the Highline Companies.

Further, SEVI's reference to additional deception occurring related to Bo-Tie stock is unsubstantiated. A press release SEVI issued on March 31, 2010 shows that SEVI/Highline acquired Bo-Tie Manufacturing on March 30, 2010, well after the share exchange between SEVI and the Highline Companies in 2009. This document is dispositive that no fraud was committed by NIR, Humphries, et al in this transaction. *See Rovello, supra,* 40 NY2d at 636.

As for SEVI's argument that it should be entitled to the benefit of the doubt until more discovery has been completed, because "concrete facts 'are peculiarly within the knowledge of the party' charged with the fraud," [*Pludeman v Northern Leasing Systems*, 10 NY3d 486, 491-92 (2008)], the pleading deficiencies identified by the court are fundamental. SEVI is lacking sufficient grounds in its pleading, as well as the requisite detail (CPLR 3016).

B. *Aiding and Abetting Breach of Fiduciary Duty (Sixth and Eighth Counterclaims and Third-Party Causes of Action*

SEVI alleges that: the N.I.R. Group, NIR Funds, Ribotsky, DealerAdvance, STI and Monarch Bay aided and abetted Walters' and Humphries' breaches of fiduciary duty to SEVI. Under New York law, a claim for aiding and abetting of a breach of fiduciary duty includes:

> (1) a breach of a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that [the] plaintiff suffered damage as a result of the breach." . . . A person knowingly participates in a breach of fiduciary duty only when he or she provides "substantial assistance" to the primary violator (*see King v George Schonberg & Co.*, 233 A.D.2d 242, 243, 650 N.Y.S.2d 107 [1996]; *National Westminster Bank USA v Weksel*, 124 A.D.2d 144, 148-149, 511 N.Y.S.2d 626 [1987] *lv denied* 70 N.Y.2d 604, 519 N.Y.S.2d 1027, 513 N.E.2d 1307 [1987]; *see also S & K Sales Co. v Nike, Inc.*, 816 F.2d at 849; *In re Sharp Intl. Corp.*, 281 BR at 516).

Kaufman v Cohen, 307 AD2d 113, 125 (1st Dept 2003).

SEVI alleges that Walters was a director, a shareholder and CEO of SEVI at the time of the DealerAdvance and STI transactions in December 2008. Therefore, SEVI has adequately pled that Walters was its fiduciary. *See e.g. Global Mins. & Metals Corp. v Holme,* 35 AD3d 93, 98 (1st Dept), *app denied* 8 NY3d 804 (2007) (discussing rule that officers and directors owe duty of loyalty and good faith to corporation), citing *Alpert v 28 Williams St. Corp.*, 63 NY2d 557, 568 (1984). "This is a sensitive and inflexible rule of fidelity, barring not only blatant self-dealing, but also requiring avoidance of situations in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty." *Global, supra,* 35 AD3d at 98, citing *Birnbaum v Birnbaum*, 73 NY2d 461, 466 (1989).

Humphries' affiliation with SEVI did not begin until the closing of the DealerAdvance transaction. SEVI submits a 12/31/08 Consent to Action by Directors (Flemming Aff., Exh. M) establishing that Humphries would succeed Walters as CEO and also become CFO, President, Treasurer and a director of SEVI "effective at closing" of the Asset Purchase Agreement with DealerAdvance.[5] The court considers this document to be dispositive in showing that Humphries did not have a direct fiduciary relationship with SEVI at the time of this transaction. *See Leon v Martinez,* 84 NY2d 83, 88 (1994) (finding CPLR 3211(a)(1) "documentary evidence" must be dispositive to require dismissal of claim). However, Humphries did owe a duty to SEVI when it purchased 70% of the Highland Companies' stock in 2009 and thereafter until his employment was terminated.

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[5]The "directors" are all allegedly implicated in the scheme.

SEVI adequately pleads Walters' breaches of fiduciary duty by alleging that as a result of the DealerAdvance transaction, Walters: benefitted personally because the sale of SEVI stock to Monarch Bay, which he controlled, would make him SEVI's largest shareholder; and he committed corporate waste by causing SEVI to purchase worthless assets (the DealerAdvance software and intellectual property). SEVI also adequately pleads Humphries' breach, but only to the extent of alleging that he created a series of false documents and forgeries purporting to authorize the issuance of stock and the assumption of debts by SEVI/Highline. *See Global, supra,* 35 AD3d at 98.

SEVI has alleged sufficient facts to support its claim that the N.I.R. Group and Ribotsky provided "substantial assistance" with these breaches of fiduciary duty. "Substantial assistance occurs when a defendant affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the breach to occur." *Kaufman v Cohen, supra,* 307 AD2d at 125. As to Walters' actions, SEVI alleges that Ribotsky approved of the Dealer/Advance and the STI Asset Purchase Agreements for the purpose of increasing the SEVI stock's liquidity, thereby enabling NIR to convert SEVI Notes and sell the stock. The emails SEVI submits, which supplement its pleading, include the following additional details: Humphries was "loyal" to Ribotsky and became CEO of SEVI at Ribotsky's direction; Walters became CEO of SEVI at Ribotsky's direction; Ribotsky knew that the DealerAdvance assets would not be transferred to SEVI; Ribotsky authorized funding of SEVI so the December 2008 deals could be accomplished; and Ribotsky knew that SEVI had few assets when he authorized the deals. The emails also support the conclusion that Walters and Humphries were trying to save the business and avoid foreclosure by NIR, which is consistent with Ribotsky directing their actions. *See e.g.* Max

Decl., Exh. C (discussing NIR assistance through funding to "move forward with our business"). The allegations sufficiently establish substantial assistance by Ribotsky and NIR in Walters' breaches of fiduciary duty, as alleged in the Sixth Counterclaim and Third-Party cause of Action. Since SEVI has not alleged that Humphries' forgeries and falsification of documents were done with either the knowledge or assistance of Ribotsky or NIR, the Eighth Counterclaim and Third-Party Cause of Action is deficient and it is dismissed pursuant to CPLR 3211(a)(1).

C. Breach of the Duty of Good Faith and Fair dealing (Ninth Counterclaim and Third-Party Cause of Action)

SEVI alleges that NIR breached the implied covenant of good faith and fair dealing by running SEVI, through the "co-opted managers" Humphries and Walters, for its own benefit. This is not sufficient. Breach of the implied covenant is a breach of contract claim requiring allegations establishing the requisite elements of a cause of action for breach of contract: (1) formation of a contract between plaintiff and defendant; (2) performance by plaintiff; (3) defendant's failure to perform; and (4) resulting damage. *Noise in Attic Productions, Inc. v. London Records*, 10 A.D.3d 303 (1st Dept. 2004). SEVI does not: identify (or attach) the specific contracts that NIR allegedly breached; plead its own performance, which it cannot because it has defaulted on the Notes; or explain how NIR's actions prevented SEVI from receiving the fruits of the contracts, which it presumably did. *See e.g. Port Parties, Ltd. v ENK Intl. LLC*, 84 AD3d 685, 686 (1st Dept 2011) (granting summary judgment dismissing complaint). The Ninth Counterclaim and Third-Party Cause of Action are dismissed.

D. In Pari Delicto

NIR and Ribotsky argue that SEVI is prevented from suing because it is *in pari delicto* with Walters and Humphries, who were acting as agents of the company when they allegedly breached their fiduciary duties and committed other acts of malfeasance. The court rejects this claim. The remaining cause of action by SEVI against Ribotsky and the NRI defendants, aiding and abetting breach of fiduciary duty, alleges malfeasance by corporate officers against the company itself, not against a third party on the corporation's behalf. Pursuant to the New York Court of Appeals' decision in *Kirschner v KPMG LLP,* 15 NY3d 446 (2010), the defense of *in pari delicto* does not lie. The presumption that an agent communicates information to its principal, which underlies the defense, has no application when the agent is defrauding its principal. *Id.* at 466. Accordingly, it is hereby

ORDERED that the motion, by Counterclaim Defendants NEW MILLENNIUM CAPITAL PARTNERS III, LLC; NEW MILLENNIUM CAPITAL PARTNERS II, LLC; AJW PARTNERS, LLC; AJW OFFSHORE, LTD.; AJW QUALIFIED PARTNERS, LLC; AJW MASTER FUND, LTD.; AJW PARTNERS II, LLC; AJW OFFSHORE II, LTD.; AJW QUALIFIED PARTNERS II, LLC; and AJW MASTER FUND II, LTD. [hereinafter referred to collectively as NIR Funds] and by Third-Party Defendants Corey S. Ribotsky and the N.I.R. GROUP, LLC, to dismiss is granted solely to the extent that the First, Second, Eighth and Ninth Counterclaims against the NIR Funds, and the First, Second and Eighth and Ninth Third-Party Causes of Action against Corey S. Ribotsky and the N.I.R.GROUP, LLC, are dismissed with prejudice; the Clerk is directed to enter judgment accordingly; and the remainder of the action is severed and shall continue; and it is further

ORDERED that the motion to dismiss the Sixth Counterclaim against the NIR Funds and the Sixth Third-Party Cause of Action against Corey S. Ribotsky and N.I.R. GROUP, LLC, is denied; and it is further

ORDERED that all remaining parties shall appear for a status conference in Part 54, Room 228, of the New York State Supreme Court, 60 Centre Street, New York, New York, on February 28, 2012 at 9:30 A.M.; and it is further

ORDERED that within 10 days of the entry of this order, the moving parties shall serve a copy of it, with notice of entry, on the Clerk of the Court and the Clerk of the Trial Support Office (Room 158M), who are directed to note the severance in their respective records.

Dated: February 15, 2012

ENTER:

J.S.C.

JUSTICE SHIRLEY WERNER KORNREICH