Scher v CMJ Holdings Corp.
2014 NY Slip Op 30750(U)
March 17, 2014
Supreme Court, New York County
Docket Number: 651858/13
Judge: Melvin L. Schweitzer
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[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COM. DIV. PART 45

JOHN SCHER and METROPOLITAN TALENT, INC.,	:	
Plaintiffs,	:	DECISION & ORDER
-against-	:	Index No. 651858/13.
CMJ HOLDINGS CORP., CMJ NETWORK, INC., RH ACQUISITION, INC., ROBERT K. HABER and JOANNE HABER,	:	Motion Sequence Nos. 001 and 002
Defendants.	:	

MELVIN L. SCHWEITZER, J.:

Motion sequence numbers 001 and 002 are hereby consolidated for disposition. All of the defendants move to dismiss the complaint, pursuant to CPLR 3211 (a) (1) and (7), based on documentary evidence and failure to state a cause of action, with the exception of the first cause of action as against defendant CMJ Network, Inc. Defendant CMJ Holdings Corp. also moves to dismiss the complaint, pursuant to CPLR 3211 (a) (8) and 306-b, based on improper service of the summons and complaint. Plaintiffs cross-move, pursuant to CPLR 306-b, to extend the time for service.

Factual Allegations

The complaint alleges that the plaintiff John Scher is a principal shareholder and the chief executive officer of his co-plaintiff, Metropolitan Talent, Inc. (Metropolitan) (Cmplt., ¶ 5). Both plaintiffs have been engaged in various aspects of the entertainment industry for many years (*id.*). Defendant CMJ Network, Inc. (Network) has been engaged in the business of promoting college or alternative music by publishing the CMJ New Music Report and hosting the CMJ Music Marathon, a major music festival in New York City for many years, during which time defendant

Robert K. Haber served as either Network's principal shareholder and/or president (*id.*, ¶ 6). Defendant Joanne Haber is Mr. Haber's wife (*id.*, ¶ 4).

Beginning in 2008, Messrs. Scher and Haber engaged in negotiations towards a business affiliation between Metropolitan and Network, culminating in a letter of intent dated January 14, 2009, which was extended by the parties by written amendments dated May 1, 2009 and August 27, 2009, the latter amendment extending the termination date to December 31, 2010 (Cmplt., ¶¶ 7, 9). Plaintiffs allege that, per the letter of intent, "the assets being acquired by Metropolitan were valued by the parties as being worth no less than $2,400,000, plus the amount of Network's liabilities to be assumed under the parties' agreement plus other 'earn-outs' as defined in the aforesaid letter of intent'" (*id.*, ¶ 8).

Beginning February 17, 2009 and ending October 25, 2010, the complaint alleges that "Metropolitan extended financial accommodations to Network" (Cmplt., ¶ 10). However, this indebtedness is evidenced by 27 promissory notes, payable not to Metropolitan, but to Mr. Scher and bearing interest at the rate of 10% per annum (Cmplt., ¶ 10 & Exh. A thereto). It is alleged that the combined principal balance due on the notes is $595,307.22, plus accrued interest to the date of the complaint in the approximate amount of $178,827, for a total due and owing of $744,134 (*id.*, ¶ 10). Mr. Scher sent a letter addressed to Mr. Haber, as "CEO" of Network, demanding payment of the notes on August 21, 2012, but Network has failed to repay any of the notes (*id.*, ¶¶ 12, 13 & Exh. B thereto).

The complaint further alleges that, on October 14, 2009, Network executed a written "Security Agreement," attached to the complaint as exhibit C, whereby, in order to secure the repayment to Metropolitan of the sum of $79,200, Network assigned to Metropolitan a security

position in the following: "1) Sonic Bids renewal; 2) New Zealand government cultural affairs annual marketing deal; and 3) court-ordered distribution of Cable & Wireless bankruptcy distribution" (Cmplt., ¶ 15 & Exh. C thereto). In addition, on October 19, 2009, Network executed a written "Assignment of Receivable" to Metropolitan (the Assignment) (*id.*, ¶ 16 & Exh. D thereto). According to the complaint, the purpose of the Assignment was to secure repayment of the sum of $20,000, and plaintiffs contend that the document assigns to Metropolitan a security position in the following two receivables: "1) Canadian Heritage Trade and Investment Branch Contract #45263698; and 2) rVibe Purchase Order dated September 16th, 2009" (*id.*, ¶ 16).

On or about April 17, 2012, Network and the Habers negotiated an asset purchase agreement (APA) with defendants CMJ Holdings Corp. (Holdings)[1] and RH Acquisition, Inc. (Cmplt., ¶ 18). Pursuant to that agreement, Holdings acquired certain assets of Network in exchange for a cash payment of $100,000 and the assumption by Holdings of certain of Network's liabilities (*id.*, ¶¶ 18, 21). However, plaintiffs allege that the debt owed by Network to "Plaintiffs" was not included amongst the liabilities to be assumed by Holdings, and that, in fact, it was listed as an unsecured and overdue indebtedness to Mr. Scher in the amount of $610,557 (*id.*, ¶¶ 19, 20). The complaint describes this transaction as a "fraudulent transfer" and it is alleged that the transfer of Network's assets to Holdings "was for an amount of money

[1] The complaint mistakenly identifies this entity as "CMJ Holdings, Inc." and purports to attach a copy of the APA as an exhibit (Cmplt., ¶ 17), but it does not. However, a copy of the APA is submitted by plaintiffs' counsel in opposition to the motions (*see* Pearl 10/17/13 Affirm., Exh. 3), and the APA identifies the purchasing entity as "CMJ Holdings Corp.," the defendant named in this lawsuit.

representing far less than the value of the said assets and did not represent 'fair consideration'" within the meaning of Debtor and Creditor Law § 274 (*id.*, ¶¶ 22, 23).

This action was commenced on May 23, 2013. The complaint alleges three causes of action. The first cause of action alleges that Network has defaulted under the terms of the 27 promissory notes and that Network owes "Plaintiffs" the sum of $595,307.22 plus interest (Cmplt., ¶¶ 27, 28). The second cause of action purports to state a claim for fraudulent conveyance against all defendants. The third cause of action is for the alleged violation of plaintiffs' collateral security interests.

On July 19, 2013, plaintiffs' counsel e-filed an affidavit of service of the summons and complaint on defendant Holdings. According to the affidavit, the process server plaintiffs hired to effect service on the defendants served "**CMJ HOLDINGS LLC** the **Defendant** in this action" on July 16, 2013 by serving the New York Secretary of State pursuant to "Section 303 LLC." According to the online records of the New York Department of State, CMJ Holdings LLC is a domestic limited liability company whose address for service of process is 315 East 70th Street, #8H, New York, New York 10021.

Discussion

Service of Process on Holdings

There is no dispute that plaintiffs' process server served the wrong entity via the Secretary of State. In fact, plaintiffs' counsel admits that the wrong entity was served and accepts the claim that defendant Holdings has no connection to CMJ Holdings LLC, the entity that was actually served (*see* Pls. Reply Mem. of Law at 1-2). Plaintiffs, however, contend that it was Holdings' conduct in failing to register for authority to do business in New York that caused

the incorrect party to be served and acts as an estoppel to deny proper service. Plaintiffs also complain that Holdings waited until CPLR 306-b's 120-day period expired before raising the issue of service, and that proper service has now been effected through the Delaware Secretary of State (*see* Pearl 10/17/13 Affirm., Exh. 1). This occurred on October 9, 2013, one day after defendant filed its motion to dismiss, and thus plaintiffs argue, at the very least, that the court should validate, nunc pro tunc, this untimely service by granting an extension of time for service pursuant to CPLR 306-b.

Plaintiffs' estoppel argument lacks merit. While it may well be the case that Holdings is doing business in New York and should have registered to do business here in accordance with Business Corporation Law § 1301, plaintiffs' counsel was fully cognizant of the fact that Holdings is a Delaware corporation, as such is pleaded in the complaint (Cmplt., ¶ 3). Thus, Holdings could easily have been found through an online search of Delaware's business entity records, and served via its registered agent. Plaintiffs's counsel was also apparently aware that Holdings was, in fact, doing business at 1201 Broadway, Suite 706, New York, New York 10001, since that is the address for Holdings that is listed on the summons, and service could have been attempted at that location. It is the plaintiffs' burden to effect proper service of the summons and complaint (*Matter of 72A Realty Assoc. v New York City Envtl. Control Bd.*, 275 AD2d 284, 285-286 [1st Dept 2000]), and that was not accomplished here by the July 2013 service on CMJ Holdings LLC.

CPLR 306-b authorizes a court-ordered extension of time to serve past the 120 days "upon good cause shown or in the interest of justice." The Court of Appeals has clarified that "although law office failure and the lack of reasonable diligence in effectuating service generally

do not constitute good cause, the interest of justice standard of the statute [is] a separate, broader and more flexible provision which could encompass a mistake or oversight as long as there was no prejudice to the defendant" (*Leader v Maroney, Ponzini & Spencer*, 97 NY2d 95, 102 [2001]). Plaintiffs have not demonstrated "reasonable diligence in attempting to effect service" that would justify an extension under the first "good cause" standard. The affidavit of service received back from the process server which shows service on a limited liability company pursuant to Section 303 of the Limited Liability Company Law should have warranted some further investigation regarding proper service on Holdings, a corporation, rather than misplaced reliance on the process server.

However, an extension is warranted under the interest of justice standard. The delay in effecting proper service on Holdings is relatively minor, and Holdings can demonstrate no prejudice from the delay. It was Holdings' failure to register as a foreign corporation in New York that resulted in the plaintiffs' process server serving a similar sounding, but different, entity. Plaintiffs' counsel, though careless, acted with diligence in re-serving Holdings when the mistake in service became known upon the filing of Holdings' motion to dismiss. The court is also unwilling to reward defense counsel for their gamesmanship in waiting until shortly after the 120-day period expired to raise the issue of improper service after being granted the courtesy of multiple extensions of time. The upshot of Holdings' argument is that judicial resources should be wasted and a meaningless exercise be required to address the service issue, since a dismissal would only force the commencement of a new action – a second service on Holdings, and then a motion to consolidate the two actions.

Since plaintiffs have now served Holdings via service on the Delaware Secretary of State, there is no question that Holdings has been properly served and its motion to dismiss based on improper service is denied.

Breach of the Promissory Notes

The first cause of action alleges that Network has defaulted under the terms of the 27 promissory notes and that Network owes "Plaintiffs" the sum of $595,307.22 plus interest (Cmplt., ¶¶ 27, 28). In the wherefore clause, plaintiffs demand judgment against all defendants on all three of the causes of action. Defendants argue that the complaint fails to state a claim on the promissory notes against Holdings, the Habers and RH Acquisition, Inc., none of whom were parties to the notes. In response, plaintiffs contend that Holdings is liable for breach of the notes, as well as the security agreements, under the principle of successor liability.

On a motion to dismiss a claim pursuant to CPLR 3211 (a) (7) for failure to state a cause of action, the court is not called upon to determine the truth of the allegations (*see Campaign for Fiscal Equity v State of New York*, 86 NY2d 307, 318 [1995]; *219 Broadway Corp. v Alexander's, Inc.*, 46 NY2d 506, 509 [1979]). Rather, the court is required to "afford the pleadings a liberal construction, take the allegations of the complaint as true and provide plaintiff the benefit of every possible inference. Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBC I, Inc. v Goldman, Sachs & Co.*, 5 NY3d 11, 19 [2005] [citation omitted]).

As a general rule, the purchaser of a corporation's assets does not, as a result of the purchase, become liable for the seller's debts (*Schumacher v Richards Shear Co.*, 59 NY2d 239, 244–245 [1983]). However, there are four exceptions under which the purchasing corporation

becomes liable for the debts and liabilities of the selling corporation: (1) where the purchaser expressly agrees to assume such debts; (2) where the transaction amounts to a consolidation or de facto merger of the two corporations; (3) where the purchasing corporation is a mere continuation of the selling corporation; or (4) the transaction was entered into fraudulently to escape the predecessor's debts (*Broadway 26 Waterview, LLC v Bainton, McCarthy & Siegel, LLC*, 94 AD3d 506, 507 [1st Dept 2012], citing *Schumacher,* 59 NY2d at 245; *Nationwide Mut. Fire Ins. Co. v Long Is. A.C., Inc.*, 78 AD3d 801, 801-802 [2d Dept 2010]).

Plaintiffs argue that Holdings is liable for the debts of Network under the "mere continuation" and fraud exceptions, and requests leave to replead in the event the court finds that the complaint does not adequately allege a claim against Holdings based on successor liability.

The analysis for the "mere continuation" exception is a flexible approach, and the court must determine if, in substance, it was the intent of the successor corporation to absorb and continue the operation of the predecessor corporation (*Kaur v American Tr. Ins. Co.*, 86 AD3d 455, 458 [1st Dept 2011], *revd on other grounds* 19 NY3d 827 [2012]). "Relevant factors include transfer of management, personnel, physical location, good will and general business operation" (*id.*, citing *NTL Capital, LLC v Right Track Rec., LLC*, 73 AD3d 410, 411 [1st Dept 2010]).

Plaintiffs argue that "it is readily apparent that Holdings is conducting the same business as its predecessor, using the same corporate assets, with similar personnel and similar assets, most notably the intellectual property associated with the CMJ Music Marathon" (Pls. Mem. of Law at 12). This, however, is not readily apparent from the existing complaint, and if plaintiffs believe that they can prove a successor liability claim against Holdings, it is incumbent upon

them to plead the elements of such a claim. Holdings, while correct in arguing that no claim for successor liability had been pled in the complaint, is not correct that such a claim would fail as a matter of law, since their legal arguments focus on the "de facto merger" exception and not the two exceptions on which plaintiffs rely. And even if Network has not been dissolved and is still a registered Delaware corporation, its continued existence does not preclude a finding of successor liability if the April 2012 transaction has rendered it a mere shell without any assets (*Kaur v American Tr. Ins. Co.*, 86 AD3d at 458).

Accordingly, the first cause of action is dismissed against all defendants save Network, with leave to replead a claim against Holdings under a successor liability theory. In addition, any recovery will be in favor of Mr. Scher only, who is the note holder, unless there is evidence of (and an allegation in the amended complaint regarding) a valid assignment of the notes to Metropolitan. The claim is dismissed against the remaining defendants who are not parties to any of the 27 promissory notes sued upon.

Fraudulent Conveyance

The second cause of action alleges that the transfer of Network's assets to Holdings under the terms of the APA was for an amount of money representing far less than the value of Network's assets and did not represent "fair consideration" within the meaning of section 274 of the Debtor and Creditor Law. Defendants argue that plaintiffs have failed to plead the alleged fraudulent conveyance with the particularity required by CPLR 3016 (b).

Under section 274 of the Debtor and Creditor Law,

> "Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is

> fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent."

Contrary to defendants' contentions, plaintiffs are not required to plead violations of Debtor and Creditor Law § 274 with the heightened particularity required by CPLR 3016 (b) (*Gateway I Group, Inc. v Park Ave. Physicians, P.C.*, 62 AD3d 141, 149 [2d Dept 2009]; *Menaker v Alstaedter*, 134 AD2d 412, 413 [2d Dept 1987]; *cf. NTL Capital, LLC v Right Track Rec., LLC*, 73 AD3d at 412 [noting that a section 276 claim is subject to CPLR 3016 [b], but that a claim under section 274 need only be based on factual allegations and not legal conclusions]).

Here, the complaint identifies a particular transaction – the conveyance of Network's assets to Holdings in April 2012 -- for a cash payment of only $100,000 and the assumption of "certain liabilities," the value of which plaintiffs allege is far less than the proposed $2.4 million purchase price that plaintiffs were proposing to purchase the same assets for in January 2009 (Cmplt., ¶¶ 8, 18, 22, 23, 30). Thus, unlike the pleading at issue in *IDC (Queens) Corp. v Illuminating Experiences* (220 AD2d 337 [1st Dept 1995]), the complaint contains specific allegations showing why the consideration given by Holdings for Network's assets was inadequate.

The Habers and RH Acquisition, Inc. move for dismissal of the fraudulent conveyance claim, arguing that they do not owe any money to either Mr. Scher or Metropolitan Talent and did not fraudulently transfer any of their assets. The remedy for a fraudulent conveyance is not an award of damages, but a judgment setting aside the conveyance or disregarding the conveyance in order to levy upon the property conveyed (*D'Mel & Assoc. v Athco, Inc.*, 105 AD3d 451, 453 [1st Dept 2013], citing Debtor and Creditor Law § 278 [1]). Since these

defendants are all parties to the APA, they are properly sued on the second cause of action, which is sustained.

Breach of the Security Agreements

The third cause of action is for the alleged "Violation of Plaintiffs' Collateral Security Interests." All of the defendants seek dismissal of this claim on the ground that there is no allegation that the assets in which plaintiffs claim a security interest were transferred to Holdings as part of the APA. However, the complaint clearly contains such an allegation in paragraph 34, which alleges:

> "Defendants, by virtue of the Fraudulent Transfer of Network's assets, including the assets collaterally assigned to Plaintiffs pursuant to the terms of the collateral assignment agreements identified in paragraphs 15 and 16 above, have violated Section 9 of New York's Uniform Commercial Code and the relevant provisions thereof"

(Cmplt., ¶ 34).

There is, nevertheless, a problem with this claim, at least with respect to the October 14, 2009 Security Agreement. As set forth above, the Security Agreement lists Metropolitan, not Scher, as Network's lender, while the promissory notes are all payable to Scher. Defendants maintain that the complaint fails to allege that there is any debt owing to Metropolitan or any other consideration was provided by Metropolitan, which renders both the Security Agreement and the Assignment a nullity. Plaintiffs argue that this discrepancy is "of no moment" (Pls. Mem. of Law at 16).

Neither side cites any legal authority for its position. However, it is well settled with regard to loans secured by real property that the "mortgage is merely security for a debt or other obligation and cannot exist independently of the debt or obligation" (*FGB Realty Advisors v*

Parisi, 265 AD2d 297, 298 [2d Dept 1999]). "Consequently, the foreclosure of a mortgage cannot be pursued by one who has [not] demonstrated [any] right to the debt" (*Bank of N.Y. v Silverberg*, 86 AD3d 274, 280 [2d Dept 2011]).

Here, both the Security Agreement and the 27 promissory notes are all freely assignable by Metropolitan. However, there is no allegation in the complaint of any assignment of the Security Agreement to the holder of the underlying debt, i.e., Mr. Scher, or vice versa. Since this is a defect that can easily be remedied by a written assignment, leave to replead a claim against Network for breach of the Security Agreement shall be granted.

The October 19, 2009 Assignment, however, is not a security agreement, but an assignment of receivables, giving Metropolitan a present right to the receipt of certain receivables owed to Network, and recites that it was given for valid consideration. Thus, Metropolitan may bring a claim for its alleged breach.

Finally, Holdings, the Habers and RH Acquisition, Inc. each request dismissal of the third cause of action. For the reasons stated above with respect to the promissory notes, plaintiffs are granted leave to replead this claim against Holdings on a successor liability theory, but the claim is dismissed as to the Habers and RH Acquisition, Inc., none of whom was a party to either the Security Agreement or the Assignment.

Conclusion and Order

For the foregoing reasons, it is hereby

ORDERED that the motion (sequence number 001) of defendants CMJ Network, Inc., RH Acquisition, Inc., Robert K. Haber and Joanne Haber to dismiss the complaint is granted to the extent of: (1) dismissing the first and third causes of action against RH Acquisition, Inc.,

Robert K. Haber and Joanne Haber; (2) dismissing the third cause of action against CMJ Network, Inc., with leave to replead; and (3) the motion is otherwise denied; and it is further

ORDERED that the motion (sequence number 002) of defendant CMJ Holdings Corp. to dismiss the complaint is granted to the extent of dismissing the first and third causes of action against CMJ Holdings Corp., with leave to replead, and the motion is otherwise denied; and it is further

ORDERED that plaintiffs' cross motion for an extension of time to effect service of process, pursuant to CPLR 306-b, on defendant CMJ Holdings Corp. to and including October 9, 2013 is granted; and it is further

ORDERED that plaintiffs are granted leave to serve an amended complaint so as to replead the first and third causes of action against CMJ Network, Inc. and CMJ Holdings Corp. within 20 days after service on plaintiffs' counsel of a copy of this order with notice of entry; and it is further

ORDERED that, in the event that plaintiffs fail to serve and file an amended complaint in a timely fashion, leave to replead shall be deemed denied.

Dated: March 17, 2014

ENTER:

J.S.C.

MELVIN L. SCHWEITZER