

Higher Educ. Mgt. Group, Inc. v Aspen Univ. Inc.

2014 NY Slip Op 32106(U)

August 4, 2014

Sup Ct, New York County

Docket Number: 650457/2013

Judge: Melvin L. Schweitzer

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This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

-----X
 HIGHER EDUCATION MANAGEMENT :
 GROUP, INC. and PATRICK SPADA, :
 :
 Plaintiffs, :
 :
 -against- :
 :
 ASPEN UNIVERSITY INC., ASPEN GROUP, :
 INC. MICHAEL MATHEWS, JOHN :
 SCHEIBELHOFFER, MICHAEL D'ANTON, C. :
 JAMES JENSEN, DAVID E. PASI, SANFORD RICH, :
 PAUL SCHNEIER, and DAVID GARRITY :
 :
 Defendants. :
 -----X

Index No. 650457/2013
 DECISION AND ORDER
 Motion Sequence No. 003

MELVIN L. SCHWEITZER, J.:

Plaintiffs/counterclaim defendants move to dismiss Aspen Group and Aspen University's (collectively, Aspen), counterclaims pursuant to CPLR 3016 (b), 3211 (a) (1), and 3211 (a) (7) and for sanctions pursuant to 22 NYCRR 130-1.1 and CPLR § 8303-a.

Background

The following facts are taken from the answer.

Patrick Spada (Mr. Spada) founded Aspen University, an online post-secondary education university, in October 1999. Prior to May 2011, Aspen University was owned principally by Higher Education Management Group (HEMG), which was and still is wholly owned by Mr. Spada.

Prior to May 2011, Mr. Spada served as Aspen University's CEO and Chairman of its board of directors. During this time, Mr. Spada maintained and oversaw bank accounts, which were used for depositing and withdrawing proceeds from the sale of Aspen University stock belonging to HEMG, and for advancing certain costs and expenses of Aspen University.

Pursuant to a May 19, 2011 agreement (Merger Agreement), Aspen University merged (Merger) with Education Growth Corporation (EGC), a start-up company controlled by Michael Mathews (Mr. Mathews). Mr. Mathews replaced Mr. Spada as CEO of Aspen University. Aspen University acquired all of the capital stock of EGC, and was the surviving entity. The Merger Agreement contained numerous representations and warranties relating to Aspen University's equity capitalization, financial statements, outstanding debt, lack of undisclosed liabilities, and material contracts (Spada Representations). The Merger Agreement also provided that (a) all of the pre-Merger directors of Aspen University – John Scheibelhoffer, Michael D'Anton and Paul Schneier – would remain as directors after the Merger, with Mr. Mathews and James Jensen added as additional directors, and (b) all of the pre-Merger officers of Aspen University would remain as officers in their present positions, except that Mr. Mathews was elected CEO.

On March 13, 2012, Mr. Mathews merged Aspen University with Aspen Group (Reverse Merger), an inactive publicly registered shell company, pursuant to which Aspen Group became a publicly traded corporation, and the corporate parent of Aspen University, carrying out the online education business of Aspen University as Aspen Group's sole line of business. In November 2011, during the process of preparing for the Reverse Merger, Aspen discovered that the Spada Representations were materially false and misleading, and that Mr. Spada had allegedly perpetrated an extensive fraud in connection with the Merger.

Discussion

On a motion to dismiss for failure to state a claim, the court accepts all factual allegations pleaded in plaintiff's complaint as true and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court

must determine whether “from the [complaint’s] four corners[,] ‘factual allegations are discerned which taken together manifest any cause of action cognizable at law.’” *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319, 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations, however, are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.* 306 AD2d 113 (1st Dept 2003).

Fraud

Aspen’s first counterclaim alleges fraud against HEMG and Mr. Spada. Counterclaim defendants’ motion to dismiss the fraud claim pursuant to CPLR 3211 (a) (7) is denied for the following reasons.

To state a claim of fraud, a counterclaim plaintiff must allege “a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely on it, justifiable reliance of the other party on the misrepresentation or material omission, and injury.” *Chung v Wang*, 79 AD3d 693, 694-95 (2d Dept 2010). In any claim of fraud, New York law requires that “the circumstances constituting the wrong shall be stated in detail.” CPLR 3016 (b). Under this heightened pleading standard, a claim of fraud must be supported by factual allegations that sufficiently detail the allegedly fraudulent conduct and give rise to a reasonable inference of the alleged fraud. *Pludeman v Northern Leasing Systems, Inc.*, 10 NY3d 486, 492 (2008). Vague and conclusory allegations or speculative inferences lacking factual support do not suffice. *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009).

Counterclaim plaintiffs’ answer pleads sufficient details for a cause of action for fraud.

Misrepresentations and Omissions

Aspen contends that counterclaim defendants made materially false and misleading representations and omissions in the Spada Representations, including (a) the incorrect number of Aspen University students who had opted to enroll in a tuition pre-payment plan developed by Mr. Spada, (b) the failure to disclose a \$200,000 loan Aspen University took from three separate investors, and (c) the failure to disclose that, shortly before the Merger, HEMG had pledged 100% of its assets to a third party, and Mr. Spada did not have unencumbered title to his Aspen University shares.

Counterclaim defendants contend that Aspen fails to plead a material misrepresentation or omission with the particularity required by CPLR 3016 (b). Counterclaim defendants assert that the claims with respect to the Spada Representations consist of bare allegations without supporting factual basis for the falsity of such representations. Next, counterclaim defendants contend that Aspen fails to establish any actionable omission, arguing that Aspen provides bare conclusions without any factual support to satisfy the materiality element of a fraudulent omission claim.

Counterclaim defendants' argument is unpersuasive. The rule requiring that in causes of action of fraud the circumstances constituting the wrong be stated in detail constitutes a directive that the transactions and occurrences constituting the wrong be pleaded in sufficient detail to give adequate notice thereof. *Foley v D'Agostino*, 21 AD2d 60, 64 (1st Dept 1964). Aspen's pleadings are not bare allegations and are sufficient to give counterclaim defendants adequate notice of the alleged fraud. For instance, the counterclaim alleges the motive for misrepresenting the number of students who had enrolled in the tuition pre-payment plan. This allegedly was Mr. Spada's theft of cash flow. This element of fraud is adequately plead.

Scienter

In order to satisfy the element of scienter, a complaint must present facts supporting a “reasonable inference that the defendant participated in, or knew about, the fraud.” *China Dev. Indus. Bank v Morgan Stanley*, 2011 NY Misc LEXIS 1808, at *16-18. A reasonable inference can be established either through allegations that defendants had the motive and opportunity to commit fraud, or through strong circumstantial evidence of conscious misbehavior and recklessness. *Woodward v Raymond James Fin., Inc.*, 732 F Supp 2d 425, 435-36 (SDNY 2010) (citing *ECA & Local 134 IBEW Joint Pension Trust of Chicago*, 553 F.3d at 198). However, “because the element of scienter is most likely to be within the sole knowledge of the defendant and least amenable to direct proof, the requirement of CPLR 3016 (b) should not be interpreted strictly when analyzing the scienter allegations in a complaint.” *Aris Multi-Strategy Offshore Fund, Ltd. v Devaney*, 2009 WL 5851192, at *9 (Sup Ct, NY County, Dec. 14, 2009, No. 602231/08) (internal citation omitted).

Counterclaim defendants contend that Aspen provides no factual support for the statement that counterclaim defendants made representations knowing they were false. Aspen contends, among other things, that counterclaim defendants knowingly violated the Spada Representations by failing to disclose loan agreements and that counterclaim defendants knowingly misrepresented the number of Aspen University students who had opted to enroll in a tuition pre-payment plan allegedly for the purpose of Mr. Spada withdrawing funds for his personal use and lifestyle.

The court finds that Aspen has alleged sufficient facts to support a reasonable inference that counterclaim defendants participated in or knew about the fraud. The element of scienter is most likely to be within the sole knowledge of the counterclaim defendants and is least amenable

to direct proof. *Houbigant, Inc. v Deloitte & Touche, LLP* 303 AD2d 92, 98 (1st Dept 2003).

This element of fraud is adequately plead.

Reliance

The third element of fraud is reasonable reliance on a material misrepresentation. “To determine, on a motion to dismiss, whether a plaintiff has alleged reasonable reliance, a court may ‘consider the entire context of the transaction, including . . . the sophistication of the parties, and the context of any agreements between them.’” *Terra Securities Asa Konkursbo v Citigroup, Inc.*, 740 F Supp 2d 441, 448 (SDNY 2010).

Counterclaim defendants contend that counterclaim plaintiffs are precluded from showing justifiable reliance because they were either aware of the allegedly false and undisclosed information, or such information was readily available to them. The law in New York is clear that if knowledge of the facts underlying the allegation of fraud are in the sole possession of counterclaim defendants, and due diligence would not have uncovered them, a counterclaim defendant cannot assert counterclaim plaintiffs’ lack of due diligence to defeat reliance. *China Dev. Indus. Bank v Morgan Stanley & Co. Inc.*, 86 AD3d 435, 436 (1st Dept 2011). Here, it is alleged that Mr. Spada secretly pledged his stock to Aspen. No amount of due diligence is likely to have discovered this element of the alleged fraud. The court is satisfied that Aspen would not have been able to discover the alleged fraud at the time of the Merger. Aspen has plead the element of reasonable reliance with particularity, as the facts relating to the fraud were in the sole possession of Mr. Spada, and not discoverable through any investigation by Aspen.

Damages

While CPLR 3016 (b) requires the circumstances constituting fraud to be stated in detail, it is not necessary for the measure of damages to be plead so long as facts are alleged from which damages may be properly inferred. *See Black v Chittenden*, 69 NY2d 665, 668 (1986). Here, Aspen has asserted that it suffered \$6,000,000 of damages from counterclaim defendants' alleged fraud in connection with the consummation of the Merger. Facts supporting these damages include a loan to Mr. Spada and his encumbering the Aspen stock. This element of fraud is adequately plead.

Money Lent, Money Had and Received, and Unjust Enrichment

Aspen's money lent, money had and received, and unjust enrichment causes of action are precluded as duplicative, as these claims assert the same underlying facts and damages as the fraud claim. *See American Mayflower Life Ins. Co. of New York v. Moskowitz*, 17 AD3d 289, 293 (1st Dept 2005) ("The court was correct in dismissing the twelfth and thirteenth causes of action for unjust enrichment and money had and received. They are duplicative of the sixth cause of action to the extent they allege underlying fraud[.]").

Sanctions

Counterclaim defendants move for Aspen to be sanctioned pursuant to 22 NYCRR § 130-1.1 and CPLR § 8303-a. Counterclaim defendants contend that Aspen's counterclaims and the material statements of fact alleged therein constitute frivolous conduct and that Aspen's statements intended to harass counterclaim defendants and waste the court's time and judicial resources. The court, in its discretion, may award to any party or attorney in any civil action or proceeding before the court financial sanctions resulting from frivolous conduct. 22 NYCRR

130-1.1(a). Referencing its holding regarding fraud, the court does not find a basis for sanctioning Aspen, and the motion for sanctions is denied.

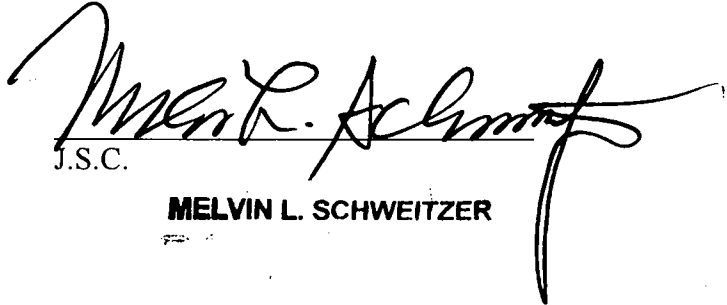
ORDERED that counterclaim defendants' motion to dismiss Count 1 of the answer (fraud against Mr. Spada and HEMG) is denied; and it is further

ORDERED that counterclaim defendants' motion to dismiss Count 2 of the answer (money lent against Mr. Spada and HEMG), Count 3 of the answer (money had and received against Mr. Spada and HEMG), and Count 4 of the answer (unjust enrichment) is granted; and it is further

ORDERED that counterclaim defendants' motion for sanctions is denied.

Dated: August 4, 2014

ENTER:


J.S.C.
MELVIN L. SCHWEITZER