Oorah, Inc. v Covista Communications, Inc.

2014 NY Slip Op 32484(U)

September 25, 2014

Supreme Court, New York County

Docket Number: 652316/2011

Judge: Eileen Bransten

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 3

OORAH, INC. d/b/a CUCUMBER COMMUNICATIONS,

Plaintiff,

-against-

Index No. 652316/2011
Motion Seq. No. 005
Motion Date: 5/15/2014

COVISTA COMMUNICATIONS, INC. and BIRCH TELECOM, INC. d/b/a BIRCH COMMUNICATIONS,

Defendants.

BRANSTEN, J.:

Defendant Birch Telecom, Inc. ("Birch") brings the instant motion to dismiss, pursuant to CPLR 3211(a)(1) and (7). Plaintiff Oorah, Inc. ("Oorah") opposes. For the reasons that follow, defendant Birch's motion is granted.

I. Background[1]

In this breach of contract action, plaintiff Oorah seeks to recover damages from defendants Covista Communications, Inc. ("Covista") and Birch for breach of contract. Specifically, plaintiff contends that defendants breached certain agreements, including a June 6, 2004 Independent Authorized Master Agent Agreement ("Agency Agreement" or "Agreement"), which provided for the payment of commissions to Oorah for its efforts in

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[1] The facts as described in this section are drawn from the second amended complaint unless otherwise noted.

marketing residential long distance and calling card telecommunications services provided and managed by Covista. (Second Am. Compl. ¶¶ 1-3.) Oorah claims that Birch is liable for Oorah's commissions as a successor-in-interest to Covista.

Pursuant to the Agreement entered into by Oorah and Covista, Oorah acted as an agent in soliciting customers for services provided by Covista. *Id.* ¶ 14. The Agency Agreement authorized Oorah to solicit orders in exchange for commissions set as a percentage of the rates paid by those solicited customers. *Id.* ¶ 16. Beginning May 2009, Covista failed to remit its monthly commission payments to Oorah. *Id.* ¶ 18. While Covista remitted some payments thereafter, by April 2011, it stopped making payments altogether. *Id.* ¶¶ 19-22.

In August 2011, Oorah commenced this action asserting claims against Covista for breach of the Agency Agreement and breach of fiduciary duty, seeking payment of approximately $600,000 in commissions.

On November 30, 2012 – while this action was pending – Birch entered into an asset purchase agreement (the "APA") with Covista to purchase Covista's assets for $4 million. The assets purchased by Birch included: Covista's customer accounts; its accounts receivable; all of its customer contracts and other rights to provide service associated with Covista's account; all of its switches, switching, network, routing, and interconnection equipment; soft-switch and related software licenses; all of Covista's

equipment supporting its assets, including inventory, spare parts, and diagnostic tools; all assigned contracts; furniture and office equipment; all intellectual property rights and assets; all web domains, phone numbers, and the goodwill of the business. *See* Birch's Notice of Motion Ex. B § 2.1 (the APA). The APA excluded certain Covista assets, including any of its cash or cash equivalents. *Id.* § 2.2. With regard to liabilities, the APA also provided that "[i]n no event shall [Birch] assume any liabilities of [Covista], other than the liabilities arising under the Assigned Contracts [set forth in schedule 2.1(g)]." *Id.* § 2.3.

Oorah asserts that the asset sale left Covista as a shell company with no assets and significant liabilities. (Second Am. Compl. ¶ 34.) Oorah likewise alleges that Birch is a mere continuation of Covista, and that the purpose of the transaction was for Birch to absorb and continue Covista's operation in another form. *Id.* ¶ 35.

Oorah also alleges that Covista undertook the transaction with Birch for the purpose of fraudulently avoiding its obligations to Oorah. Oorah asserts that almost immediately after the transaction, Covista informed Oorah that it was effectively judgment-proof, and that by the time Oorah could obtain a judgment, the proceeds of the transaction would be fully dissipated. *Id.* ¶ 38.

In the Second Amended Complaint, Oorah brings two claims against Birch. The first claim, asserted against both of the defendants, is for breach of the Agency

Agreement and is premised on Covista's failure to pay commissions to Oorah. Oorah alleges that Birch is liable for Covista's breach under a successor liability theory. *Id.* ¶¶ 40-46. The third claim, asserted only against Birch, is for breach of contract. In this claim, Oorah contends that the APA rendered Birch directly liable to Oorah for certain commissions due under the Agency Agreement for the months of April, May and June 2013, and for each month thereafter. *Id.* ¶¶ 51-56.

II. Discussion

Defendant Birch seeks dismissal of the two claims asserted against it, contending that that there is no basis for successor liability and that the claims amount to speculation and bare legal conclusions, which are belied by the terms of the APA between Covista and Birch.

A. *Motion to Dismiss Standard*

On a motion to dismiss a complaint for failure to state a cause of action, all factual allegations must be accepted as truthful, the complaint must be construed in a light most favorable to the plaintiffs and the plaintiffs must be given the benefit of all reasonable inferences. *Allianz Underwriters Ins. Co. v. Landmark Ins. Co.*, 13 A.D.3d 172, 174 (1st Dep't 2004). "We . . . determine only whether the facts as alleged fit within any

cognizable legal theory." *Leon v. Martinez,* 84 N.Y.2d 83, 87-88 (1994). This Court must deny a motion to dismiss, "if from the pleadings' four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law." *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 152 (2002) (internal quotation marks and citations omitted).

However, on a CPLR 3211(a)(1) motion, "[i]t is well settled that bare legal conclusions and factual claims, which are either inherently incredible or flatly contradicted by documentary evidence . . . are not presumed to be true on a motion to dismiss for legal insufficiency." *O'Donnell, Fox & Gartner v. R-2000 Corp.*, 198 A.D.2d 154, 154 (1st Dep't 1993). The court is not required to accept factual allegations that are contradicted by documentary evidence or legal conclusions that are unsupported in the face of undisputed facts. *See Zanett Lombardier, Ltd. v. Maslow*, 29 A.D.3d 495, 495 (1st Dep't 2006) (citing *Robinson v. Robinson*, 303 A.D.2d 234, 235 (1st Dep't 2003)). Ultimately, under CPLR 3211(a)(1), "dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Leon*, 84 N.Y.2d at 88.

B. *Count One – Breach of Contract (Successor Liability)*

Although "[i]t is the general rule that a corporation which acquires the assets of

another is not liable for the torts of its predecessor," *Schumacher v. Richards Shear Co.*, Inc., 59 N.Y.2d 239, 244–45 (1983), a corporation may be held liable for the debts of its predecessor if (1) there was a consolidation or merger of seller and purchaser, (2) it expressly or impliedly assumed the predecessor's liability, (3) the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction is entered into fraudulently to escape such obligations. *Id.* at 245.

Oorah's first claim for breach of contract stems from Covista's alleged failure to pay commissions in breach of the Agency Agreement. Oorah brings this claim not only against Covista but also against Birch, on the grounds that Birch should be held liable under a successor liability theory for Covista's breach because of its purchase of substantially all of Covista's assets through the APA. Oorah asserts that Birch is liable under three separate successor liability theories: (1) de facto merger; (2) fraud; and (3) implied assumption of liabilities.

1. <u>De Facto Merger</u>

New York law recognizes de facto merger "when a transaction, although not in form a merger, is in substance a consolidation or merger of seller and purchaser." *Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41, 45 (2d Cir. 2003).[2] A de facto merger occurs

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[2] The federal cases cited in this section apply New York state law in their analyses.

"when the acquiring corporation has not purchased another corporation merely for the purpose of holding it as a subsidiary, but rather has effectively merged with the acquired corporation." *Fitzgerald v. Fahnestock & Co.*, 286 A.D.2d 573, 574 (1st Dep't 2001). Underlying the de facto merger doctrine is the concept that "a successor that effectively takes over a company in its entirety should carry the predecessor's liabilities as a concomitant to the benefits it derives from the good will purchased." *Id.* at 575. De facto merger is aimed at avoiding the "patent injustice which might befall a party simply because a merger has been called something else." *Cargo Partner AG*, 352 F.3d at 46.

The four "hallmarks" of de facto merger under New York law include: (1) continuity of ownership; (2) cessation of ordinary business and dissolution of the acquired corporation as soon as possible; (3) assumption by the successor of liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and (4) continuity of management, personnel, physical location, assets and general business operation. *Id.*

Plaintiff's de facto merger pleading focuses almost exclusively on the cessation of ordinary business hallmark. Oorah pleads that the APA transaction "left Covista as a shell company with no assets and significant liabilities." (Second Am. Compl. ¶ 34.) This pleading is likely sufficient to satisfy the cessation of ordinary business and dissolution hallmark for the purpose of this motion to dismiss. As explained by the *Van*

Nocker court, this dissolution criterion "may be satisfied, notwithstanding the selling corporation's continued formal existence, if that entity is shorn of its assets and has become, in essence, a shell." *Van Nocker v. A.W. Chesterton Co.*, 15 A.D.3d 254, 257 (1st Dep't 2005) (citing *Fitzgerald*, 286 A.D.2d at 575.).

Plaintiff also asserts in its brief that Birch assumed certain liabilities necessary for the uninterrupted continuation of Covista's business, including Covista's goodwill, intellectual property, customer accounts, web domains, and trade name. *See* Pl.'s Br. at 14 (citing APA § 2.1(n), 2.1(j), 2.1(a), 2.1(i), 2.1(m).)[3] There are few New York state cases defining the precise contours of this hallmark; however, New York courts have looked to whether the buyer assumed the seller's existing contracts, royalty obligations, or outstanding debts. *See Miller v. Forge Mench P'ship,* 2005 WL 267551, at *9 (S.D.N.Y. Feb. 2, 2005) (citing *McDarren v. Marvel Enter. Grp., Inc.*, 1995 WL 214482, at *9 (S.D.N.Y. Apr. 11, 1995); *see also Morales v. City of New York,* 18 Misc.3d 686, 693 (Sup. Ct. Kings Cty. 2007).[4] Here, Plaintiff appears to have made such a pleading.

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[3] While such allegations are properly brought in a pleading, as opposed to a memorandum of law, the Court nonetheless will treat these contentions as properly brought for the purpose of this motion.

[4] This hallmark, assumption of liabilities ordinarily required to continue operations, is distinct from the separate assumption of liabilities theory of successor liability, *see infra,* Point II.B.3.

While plaintiff's cessation and assumption of liabilities contentions are sufficient, its failure to include allegations in the Second Amended Complaint in support of the continuity of operations hallmark dooms its pleading. Oorah is correct that New York law counsels the court to analyze the hallmarks "in a flexible manner that disregards mere questions of form and asks whether, in substance, it was the intent of the successor to absorb and continue the operation of the predecessor." *AT&S Transp.*, 22 A.D.3d at 752. However, the continuity of operations hallmark has been deemed "essential" to a de facto merger finding, as ownership continuity "is the essence of a merger." *Van Nocker*, 15 A.D.3d at 258; *Cargo Partner AG*, 352 F.3d at 47.

Under New York law, continuity of ownership "describes a situation where the parties to a transaction 'become owners together of what formerly belonged to each.'" *Van Nocker*, 15 A.D.3d at 256. Oorah offers no facts in support of this element in its pleading. Thus, Oorah pleads that an asset sale occurred and that Covista currently has no assets – but Oorah does not plead that a *merger* occurred in the guise of an asset sale. Accordingly, Oorah fails to state a de facto merger claim.

2. Fraud

Oorah next argues that the asset sale was undertaken fraudulently in order to remove assets from the reach of Covista's creditors, particularly Oorah. In support, Oorah

alleges that "almost immediately upon completion of the Transaction, Covista informed Oorah that it was effectively judgment proof and no longer had in its possession, custody or control any discovery materials demanded by Oorah in this action since February 2012." (Second Am. Compl. ¶ 38.) Further, Oorah alleges that Covista claimed that the proceeds from the asset sale would be dissipated by the time Oorah received a judgment. *Id.*

Such allegations, while serious and concerning to the Court, if true, fall short of pleading that the asset sale transaction was entered into fraudulently. In particular, these allegations do not state that the transaction itself was entered into by Birch and Covista with the intent of shielding Covista from its creditors. Instead, these allegations note the reality of the asset sale – that is, that Covista was left without the overwhelming majority of its assets and that the possibility existed for Covista to spend the proceeds of the asset sale before this case reached its resolution. Further, the purported fraud is not pleaded with any specificity. The alleged statements are pleaded generally and are attributed to "Covista" the entity. Accordingly, Plaintiff's fraud-based successor liability claim fails to state a cause of action.

3. Implied Assumption of Liabilities

Finally, Oorah contends that Birch impliedly assumed Covista's liabilities under the Agency Agreement. As its name implies, the implied assumption basis for successor liability allows a corporation to be held liable for its predecessor's debts where it expressly or impliedly agreed to assume its predecessor's liabilities. *Schumacher*, 59 N.Y.2d 239, 244-45. "While no precise rule governs the finding of implied liability, the authorities suggest that the conduct or representations relied upon by the party asserting liability must indicate an intention on the part of the buyer to pay the debts of the seller." *Ladjevardian v. Laidlaw-Coggeshall, Inc.*, 431 F. Supp. 834, 839 (S.D.N.Y. 1974).

No such pleading has been made here. While Oorah contends that the existence of an implied assumption of liability is a fact-specific inquiry that cannot be resolved on a motion to dismiss, Oorah has made no factual pleading as to conduct or representations by Birch demonstrating an intention to pay Covista's debts. To the contrary, the APA disclaims Birch's assumption of "any liabilities of the Seller [Covista]," with two clearly delineated exceptions, neither of which is applicable here. Accordingly, given plaintiff's failure to plead facts supporting an implied assumption of Covista's liabilities, plaintiff fails to state a claim for successor liability against Birch on this basis.

B. *Count Three – Breach of Contract (Birch's Breach of the Agency Agreement)*

Oorah's third claim asserts a direct breach of the Agency Agreement by Birch, premised on Birch's failure to pay commissions due under the Agreement for customers procured by Oorah and to whom Birch provided services after the close of the APA. Plaintiff contends that Birch purchased the right to service all of Covista's customers in the APA and that Birch therefore is obligated to continue paying those commissions due to Oorah under the Agreement for as long as Birch continues to service those accounts.

The APA, however, by its terms excludes the Agency Agreement from the list of contracts purchased by Covista. *See* APA § 2.1(g). Plaintiff concedes that Birch is not a party to the Agency Agreement and that the APA does not reference the Agreement specifically. Nonetheless, Oorah contends that Birch's obligation to pay it commissions should be implied since Birch is Covista's "successor-in-interest." *See* Pl.'s Br. at 8. This argument would be appealing but for the APA's exclusion of the Agency Agreement from the list of "Acquired Assets" in Section 2.01. Since the Agency Agreement was not sold to Birch, Birch cannot succeed to Covista's interest in the Agreement under the APA. Thus, while Covista's ability to service the Oorah customers was expressly subject to its obligation to pay commissions to Oorah under the Agency Agreement, this payment obligation was not sold, passed, or otherwise assumed by Birch under the APA.

III. Conclusion

Accordingly, it is

ORDERED that the motion of defendant Birch Telecom, Inc. to dismiss the complaint is granted and the complaint is dismissed as against it in its entirety, with costs and disbursements to defendant Birch Telecom, Inc. as taxed by the Clerk of the Court, and the Clerk is directed to enter judgment accordingly in favor of said defendant; and it is further

ORDERED that the action is severed and continued against the remaining defendant Covista Communications, Inc.; and it is further

ORDERED that defendant Covista Communications, Inc. is directed to serve an answer to the second amended complaint within 20 days after service of a copy of this order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a conference in Room 442, 60 Centre St, on November 25, 2014, at 10 AM.

Dated: New York, New York
September 25, 2014

ENTER:

Hon. Eileen Bransten, J.S.C.