Starr v Fuoco Group LLP
2014 NY Slip Op 32768(U)
October 21, 2014
Supreme Court, New York County
Docket Number: 151755/2014
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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MARC STARR,

Plaintiff,

-against-

FUOCO GROUP LLP, LOUIS J. FUOCO, NIXON PEABODY LLP, ALLAN H. COHEN, EUREKA CAPITAL MARKETS, LLC, MARK HYMAN and LANA SIMKINA,

Defendants.

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Index No.: 151755/2014

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Defendants Eureka Capital Markets, LLC (Eureka), Mark Hyman and Lana Simkina (collectively, Individual Defendants, with Eureka, Movants) move, pursuant to CPLR 3211(a)(1) and (a)(7), to dismiss the third and fourth causes of action in the Complaint. For the reasons that follow, defendants' motion to dismiss is granted.

I. Background

As this is a motion to dismiss, the facts recited are taken from the Complaint. Plaintiff Marc Starr is the former owner of non-party Centroid Inc. (Centroid), a defense contracting company located in Plainview, New York. Complaint (Compl.) ¶4. Starr became CEO of Centroid in the late 1980s and owned 100% of the company by 2010. *Id.* In 2009, Starr decided to sell the company. He hired attorneys, accountants, and financial advisors to facilitate a future sale.[1] Compl. ¶¶ 5-6. On June 14, 2010, Starr retained Eureka for financial advice in connection

[1] The non-moving defendants are the accountants and attorneys Starr hired to advise him in connection with the sale of Centroid.

[* 2]

with the sale of Centroid. Engagement Letter, *See* Dkt. 19 at 8.[2] The Engagement Letter sets forth the scope of Eureka's services:

> CONTRACT TERMS
>
> PROFESSIONAL SERVICES: In connection with the potential Sale, Eureka will provide assistance to the Company in the following areas, as requested by the Company:
>
> Negotiating the financial terms of a Sale, including selling price, form of consideration, and ***transaction structure***.
>
> ---
>
> SCOPE OF SERVICES: Eureka's services are limited to those expressly set forth in this Agreement, and do not include legal, ***accounting***, tax or consulting services (other than as specifically provided herein).
>
> The Company recognizes that Eureka has been retained to advise the ***Company only*** and that Eureka's services hereunder shall constitute services of an independent contractor. Any duties arising out of Eureka's engagement hereunder shall be owed ***solely*** to the Company.
>
> ---
>
> INDEMNIFICATION/LIMITATION OF LIABILITY: Since Eureka will be acting on the Company's behalf, the Company agrees to indemnification and other obligations set forth in Exhibit 1, which is an integral part hereof.
>
> In addition, the Company hereby releases Eureka from any liability relating to the services rendered hereunder (regardless of form of action, whether in contract, ***negligence*** or otherwise); provided however, if it is determined that any such liability is due to Eureka's ***gross negligence*** or willful misconduct, Eureka's maximum liability relating to Eureka's services and this engagement shall be limited to the fees paid to Eureka. In no event shall Eureka be liable for consequential, special, incidental or punitive loss, damage or expense (including without limitation, lost profits, opportunity costs) even if it has been advised of their possible existence. The provisions of this Section 7 (including Exhibit 1) shall remain in full force and effect regardless of the completion of this engagement or termination of this Agreement.

[2] References to "Dkt" followed by a number refer to documents in this action filed in the New York State Electronic Filing System.

[emphasis supplied] *Id.* at 1-2, 5.

Eureka's responsibilities included screening potential purchasers and negotiating financial terms, including the sale price and transaction structure. *Id.* at 1. Eureka provided advice to Centroid from June 14, 2010 through Mach 4, 2011, when the sale to the purchaser, discussed below, took effect.[3] Compl. ¶6; *See* Dkt. 20 at 7.

In the spring of 2010, non-party Firstmark Corp. (Firstmark) approached Starr about the potential sale of Centroid. Compl. ¶6. Over the next year, Eureka (on behalf of Starr) and Firstmark negotiated the terms of the sale. *Id.* Firstmark expressed concern that after the buyout, Centroid might not perform as well as it had historically. Compl. ¶¶ 7-8. To alleviate those concerns, Starr agreed that his buyout compensation would be comprised of (1) a guaranteed payment due at closing; and (2) future, contingent payments predicated exclusively on the company achieving certain performance benchmarks calculated pursuant to an agreed upon metric. *Id.* The future payments, or earn-out payments, would be directly tied to Centroid's performance for a 24 month period following the buyout. *Id.*

Over the course of the negotiation, Eureka and Firstmark contemplated various metrics to measure Centroid's performance for the earn-out payments, including: (1) Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA); and (2) Earnings Before Interest and Taxes (EBIT), calculated under Generally Accepted Accounting Principles (GAAP). Compl. ¶¶ 8-9. EBITDA measures earnings from core business operations, excluding the effects of capital structure, tax rates and depreciation policies. EBIT measures earnings from core business operations, excluding income taxes and interest on debt. The primary difference between the

[3] A Stock Purchase Agreement (SPA) between Starr and Firstmark became effective on March 4, 2011.

two metrics is the exclusion of depreciation and amortization under EBITDA. Compl. ¶11. Starr alleges that EBITDA was the metric considered during early stages of the negotiation. Compl. ¶8. However, after extensive negotiations, EBIT was included in the final version of the SPA. Compl. ¶¶ 8-9.

As of March 4, 2011, Starr sold his 100% ownership stake in Centroid. Compl. ¶10. Firstmark agreed to purchase Centroid for $6 million at closing, as well as a working capital adjustment, an employment contract with Starr and contingent delayed compensation payments to Starr of up to $3.8 million. Compl. ¶7; *See* Dkt. 20 at 21. The potential delayed compensation payments consisted of (1) two post-closing interim earn-out payments calculated using EBIT in accordance with GAAP; and (2) a final earn-out payment. Compl. ¶7. The post-closing interim payments were capped at $1 million per annum (for a total of $2 million) and the final earn-out payment was capped at $1.8 million, contingent on Centroid meeting performance benchmarks for the two interim payments under EBIT according to GAAP.[4] Compl. ¶10.

On June 15, 2012, Firstmark provided Starr with a financial statement for the first earn-out period that ended February 29, 2012. Compl. ¶12. Centroid did not meet the post-closing, interim earn-out EBIT target defined in the SPA.[5] *Id.* Similarly, on June 21, 2013, Firstmark provided Starr with a financial statement for the second earn-out period. *Id.* Once again,

[4] Each post-Closing earn-out period lasted 12-months following the buyout, the first and second periods ending on February 29, 2012 and February 28, 2013, respectively.

[5] The First Year Statement showed that the earn-out EBIT for that period was approximately $1.15 million, less than the $1.65 million threshold necessary for Starr to receive an interim earn-out payment.

Centroid did not meet the subsequent, interim earn-out target defined in the SPA.[6] *Id.* Due to Centroid's failure to meet earning targets, Starr did not receive either interim earn-out payment, and therefore, the conditions for a final earn-out payment of $1.8 million were never met. Compl. ¶13.

Starr alleges that under the terms of agreement he believed to have been negotiated, he should have received the full earn-out payments of $3.8 million. *Id.* Starr claims that his accountants, attorneys, and financial advisors failed to both ***appreciate*** the differences between EBIT and EBITDA and to discuss those nuances with Starr. Compl. ¶9. Starr also alleges that Movants neglected to mention that Firstmark would ***likely*** employ "push-down" accounting, which would adversely affect earn-out payments. *Id.* Push-down accounting is a way for a company to account for the controlling purchase of a subsidiary. Compl. ¶9. The push-down method is the practice of adjusting the stand-alone financial statements of an acquired entity to reflect the accounting basis of the investor. The subsidiary updates the book values of its assets and liabilities to reflect fair market value. *Id.* The new basis generally is the fair value of identifiable assets acquired and liabilities assumed and may include the recognition of the debt and equity impact of the transaction. Under SEC guidance, push down accounting is required under GAAP when an entity becomes substantially owned (95% or more of an entity is acquired) by a parent. *See* Codification Section 805-50-S99-2, SAB Topic 5J, Push Down Basis of Accounting Required in Certain Limited Circumstances.

[6] The Second Year Statement showed that the earn-out EBIT for that period was approximately $1.22 million, less than the threshold necessary for Starr to receive the second interim earn-out payment.

Starr filed the Complaint on May 1, 2014. Movants seek dismissal of the third and fourth causes of action alleging, respectively, negligence and gross negligence. Compl. ¶¶ 14-21; Dkt. 9 at 1. Plaintiff, who filed suit against Firstmark and lost that case, seeks the loss of $3.8 million in earn-out payments; legal fees and expenses for the federal action brought against Firstmark and independent accountants' review, the latter a contractual remedy; and fees to Grant Thornton LLP which conducted the independent review, [7] plus interest. Compl. ¶21. Starr also seeks the return of all fees, approximately $245,000, paid to Eureka in connection with the sale of Centroid. Compl. ¶22.

II. Discussion

A. Standard of Review

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept

[7] Starr commenced a lawsuit in the United States District Court for the Eastern District of New York (the EDNY Action) contesting the use of push-down accounting. *Starr v Firstmark Corp.*, 563 F. App'x 803, 806 (2d Cir. 2014). On September 9, 2013, the court granted Firstmark's motion to dismiss Starr's claims in the EDNY Action. The court ruled that, "Plaintiff could have insisted on the inclusion of language in the SPA to the effect that defendant employ the accounting methods previously utilized by Centroid prior to the Closing, or employ a specific accounting method upon which the parties mutually agreed, yet he failed to do so. Instead, plaintiff agreed to authorize defendant to prepare the Subsequent Financial Statements in accordance with GAAP and now, in hindsight, regrets his failure to insist on the inclusion of more specific language regarding the accounting methodology to be used by defendant in calculating Centroid's EBIT to prepare the Subsequent Financial Statements. Plaintiff is, in effect, improperly seeking a contractual protection that he failed to secure for himself when negotiating the SPA." *Id.* In 2013, Starr sought an independent review of the GAAP calculation of the first earn-out payment, pursuant to §2.2(c)(vii) of the SPA, claiming that he had earned it. On June 27, 2013, Gary Goldman of Grant Thornton LLP, issued a decision finding in favor of Firstmark that "the items in dispute as included in the Subsequent Financial Statement were prepared in accordance with GAAP."

2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "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 at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

B. Contractual Duty to Starr

Eureka contends that Starr was not a party to the Engagement Letter, and only signed the letter in his capacity as President of Centroid. *See* Dkt. 27 at 4. Eureka cites to the provision in the Engagement Letter that states that Eureka had been retained to advise the Company only and that its duties under the engagement were only owed to the Company.

This court disagrees and recognizes Starr's standing as a third-party beneficiary of the Engagement Letter. An intended beneficiary can enforce a contract in the absence of privity. *Ralston Purina Co. v Arthur G. McKee & Co.*, 158 AD2d 969, 970 (4th Dept 1990). Courts have found enforceable obligations to third parties even under contracts which expressly disclaim any

liability to third parties where there was sufficient evidence of an intent to confer rights on the third party. *Bd. of Mgrs. of Alfred Condominium v Carol Mgt.*, 214 AD2d 380, 382 (1st Dept 1995).

Starr was the intended third-party beneficiary of the Engagement Letter because as President and sole shareholder of Centroid, he was the only person at Centroid whom Eureka advised and the only person to be paid under the SPA. Eureka fully grasped that Starr was the real party in interest and that Centroid, which was to be sold, had no stake in the deal. Thus, while Eureka's Engagement Letter states that "Any duties arising out of Eureka's engagement hereunder shall be owed ***solely*** to the Company," [Dkt. 19 at 5], it is clear that Eureka was negotiating the selling price and the transaction for Starr's exclusive benefit. Hence, a duty arising out of a contractual relationship exists between Eureka and Starr. Starr's claim against Movants, however, is not for breach of contract but for negligence.

C. Negligence

To maintain a negligence claim, plaintiff must establish a breach of a legal duty. *Strauss v Belle Realty Co.*, 65 NY2d 399, 492 (1985). It is well established that New York law will not permit "claims sounding in contract to be converted into claims sounding in tort merely by alleging that one party to a contract owed a duty of due care to another party in performing work pursuant to a contract." *Niagara Mohawk Power Corp. v Stone & Webster Eng'g Corp.*, 725 F. Supp. 656, 659 (NDNY 1989). A simple breach of contract is not to be considered a tort unless a legal duty independent of the contract has been violated. *Clark-Fitzpatrick, Inc. v Long Island R. Co.*, 70 NY2d 382, 389 (1987).

Here, Starr has not alleged the violation of a legal duty independent of the Engagement Letter. In his cause of action for negligence, Starr alleges that defendants' failed to appreciate

the significance in the change from EBITDA to EBIT. Compl. ¶9. He argues that he "expected the financial advisors would receive the transaction documents and advise him how to proceed in order to allow him to negotiate and execute an agreement under which he would receive the full earn-out payments." Compl. ¶8. Starr's allegations of negligence merely rephrase a contract claim using tort language -- duty instead of breach. The damages Starr allegedly sustained as a consequence of Eureka's violation of a "duty of reasonable care" in negotiating the terms of the SPA is a result of Eureka's performance under the Engagement Letter. Consequently, Eureka's alleged duty to Starr emerged from the contract.

Pursuant to the indemnification clause of the Engagement Letter, Centroid cannot sue Eureka for negligence. Starr, a third party, has no greater rights or remedies than the direct parties to the contract. *See Banking Corp. v UPG, Inc.*, 985 F2d 685, 697 (2d Cir 1993), citing *Dunning v Leavitt*, 85 NY 30, 35 (1881)("it would be contrary to justice or good sense to hold that [a third-party beneficiary] should acquire a better right against the promisor than the promisee himself had"). Starr cannot evade the limitation of remedies in the Engagement Letter by reconstituting its claim as a tort. *See Abacus Fed. Sav. Bk. v ADT Sec. Servs., Inc.*, 18 NY3d 675, 682-3 (2012)(as general rule, parties may enter in contracts which absolve party from own negligence); *Cf. Clark-Fitzpatrick, Inc. v Long Island R. Co.*, 70 NY2d 382, 389 (1987) (simple breach of contract is not tort unless independent legal duty outside of contract was breached). Centroid waived the right to sue for negligence in the Engagement Letter. Therefore, Starr has no claim for negligence.

The negligence claim is dismissed against the Individual Defendants as well. They were not parties to the Engagement Letter and there is nothing in the record from which it can be inferred that they owed a duty to Starr.

D. Gross Negligence

Nor has Starr has stated a valid claim for gross negligence. Gross negligence differs in kind, not only degree, from claims of ordinary negligence. *Colnaghi, U.S.A v Jewelers Protection Services*, 81 NY2d 821, 823 (1993). To constitute gross negligence, a party's conduct must "evince[] a reckless disregard for the rights of others or 'smack[]' of intentional wrongdoing." *Sommer v Federal Signal Corp.*, 79 NY2d 540, 554 (1992). Even if conduct falls "far below professional standards and customary practice in the industry," it must rise to a level of culpability to constitute gross negligence. *Colnaghi U.S.A.*, 81 NY2d at 823.

Starr, a sophisticated businessman involved in the negotiation process, claims that Movants failed to *appreciate* the significance in the change from EBITDA to EBIT. Compl. ¶9. However, use of a different metric is neither reckless nor culpable conduct amounting to gross negligence.[8] No facts are cited which indicate either reckless disregard of Starr's rights or intentional wrongdoing on movants' part. Accordingly, it is

ORDERED that the motion to dismiss by is granted, and the Clerk is directed to enter judgment dismissing the Amended Complaint against defendants Eureka Capital Markets, LLC, Mark Hyman and Lana Simkina with prejudice and to sever the remainder of the action, which shall continue; it is further

ORDERED that the caption is amended as follows:

MARC STARR,

Plaintiff,

[8] Further, Starr knew that the metric being used to calculate future earn-out payments was EBIT. *See* Dkt. 20 at 21. Starr chose to sign the SPA and is conclusively bound by its terms, including the use of EBIT. *Pimpinello v Swift & Co.*, 253 NY 159, 162 (1930). Starr had operated as CEO for more than ten years and should have been sophisticated enough to at least question EBIT before signing the contract if he was confused.

-against-

FUOCO GROUP LLP, LOUIS J. FUOCO,
NIXON PEABODY LLP, ALLAN H. COHEN,

Defendants;

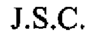
and all further papers in this action shall bear the amended caption; it is further

ORDERED that plaintiff shall serve a copy of this order with notice of entry on the Clerks of the Court and the Trial Support Office, who shall note the amended caption in their respective records; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, for a preliminary conference on November 13, 2014 at 10:30 in the forenoon.

Dated: October 21, 2014

ENTER:



J.S.C.