

Kahn v Garg
2016 NY Slip Op 31516(U)
August 10, 2016
Supreme Court, New York County
Docket Number: 652334/2013
Judge: Jeffrey K. Oing
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 48

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RAZA KAHN, individually, in his official
capacity as 50% owner of, and on behalf
of EDUCATION INVESTMENT FINANCE
CORPORATION,

Plaintiff,
-against-

VISHAL GARG and EDUCATION INVESTMENT
FINANCE CORPORATION,

Defendant.

Index No.: 652334/2013

Mtn Seq. No. 010

DECISION AND ORDER

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JEFFREY K. OING, J.:

Plaintiff Raza Khan ("Khan"), on his own behalf and on behalf of Education Investment Finance Corporation ("EIFC"), commenced this action against defendants Vishal Garg ("Garg") and EIFC asserting claims for fraud, breach of fiduciary duty, conversion and corporate deadlock.

Khan moves for an order rejecting certain settlement agreements reached: 1) in the arbitration captioned Activist Special Advisory Services, LLC v Phoenix Real Estate Solutions, Case No. 011400002627, pending before the American Arbitration Association; and (2) in two actions captioned EIFC v Embark Corp., Index No. 155818/2014, and Embark Holdco I, LLC v Embark Corp., et al., Index No. 652552/14. Khan also seeks reconsideration of this Court's decision to remove him and place Garg in charge of EIFC and Embark on the ground that this Court erred in making such a decision.

For the reasons stated below, the motion is denied.

Parties

EIFC is a Delaware corporation that Khan and Garg co-founded in 2009 with each owning 50%. EIFC provides asset management and advisory services for private student loan portfolios and mortgage-backed securities. Originally, Khan and Garg served as Co-Chief Executive Officers of EIFC. The complaint alleges that Khan continues to own 50% of EIFC, while Garg has diluted his ownership interest.

The complaint further alleges that Khan has been responsible for EIFC's technology and product development, as well as development of EIFC's loan origination and asset management platform, while Garg has been responsible for sales and managing EIFC's finances, including corporate structure and tax compliance.

Non-party Embark Corp. ("Embark"), is a company which creates and manages software used by students across the country to submit college applications. Garg is a Director of Embark and also a Vice President of Embark. Khan was a Director of Embark until he resigned from the Board on June 20, 2013. EIFC is a 25% owner of Embark. Embark has licensing agreements with colleges and universities in which they pay Embark a base license fee and a per pupil application fee in order to utilize Embark's college application software. Embark also handles payment processing

of college applications, collects the application fee, and holds the application fees in a separate account, for the benefit of the colleges and universities.

Non-party Phoenix Real Estate Solutions ("Phoenix Real Estate") is a company founded by Garg in 2011, of which he is one of two directors. According to Khan, in March of 2011, EIFC entered into a contract with Phoenix Real Estate (the "Phoenix Contract") wherein Phoenix Real Estate engaged a subsidiary of EIFC, Activist Special Advisory Services, LLC ("Activist"), to provide services to Phoenix Real Estate clients. Specifically, Activist would provide due diligence and implementation services to Phoenix Real Estate on behalf of ICP Asset Management, LLC, the collateral manager of three collateralized debt obligations (the "CDOs"). In return, Phoenix Real Estate paid EIFC a monthly fee. Khan alleges that the Phoenix Contract was EIFC's largest source of income.

Khan alleges that in June of 2013 Garg terminated the Phoenix Contract effective June 29, 2013. One day later, Phoenix Real Estate allegedly entered into a contract with a company created by Garg called Phoenix Advisors and Managers, Ltd. to perform the same services for Phoenix Real Estate that were previously performed by EIFC and Activist.

Khan further alleges that at or around the same time a large amount of EIFC's intellectual property, including source codes

and client lists, were transferred from EIFC to other companies created by Garg to service Phoenix Real Estate.

Litigations

Khan commenced the instant action in July 2013 asserting claims against Garg for fraud, breach of fiduciary duty, conversion, and corporate deadlock. The complaint also alleges that, inter alia, Garg: converted money belonging to EIFC by improperly wiring funds from EIFC bank accounts into his personal accounts; falsified EIFC financial records; failed to file tax returns for EIFC since 2009; unilaterally terminated the service contract between Activist and Phoenix Real Estate; failed to assign certain asset purchases to EIFC; and improperly seized EIFC equipment on June 24, 2013.

In June 2014, EIFC commenced an action in this Court against Embark for breach of contract and unjust enrichment arising from Embark's alleged failure to pay EIFC for certain services and for invoices paid on Embark's behalf by EIFC.

Also in June 2014, Embark Holdco I, LLC, which is a subsidiary of Embark, commenced an action in this Court against Embark for summary judgment in lieu of complaint arising from Embark's failure to make payment due under a Note.

In October 2014, Activist commenced an arbitration proceeding against Phoenix Real Estate (the "Activist arbitration") asserting, inter alia, claims for breach of

contract for failure to pay certain invoices, and for misappropriation of intellectual property.

In the instant action, on March 4, 2015, after hearing arguments and thoroughly frustrated with the parties' conduct, this Court removed Khan and placed Garg in charge of the companies involved in the several actions, including, relevant here, EIFC and Embark (March 4, 2015 Order [NYSCEF Doc. No. 248 at pp. 47-52]).

On March 13, 2015, the parties settled each of the Embark actions, both of which were discontinued with prejudice on March 18, 2015. Thereafter, on June 11, 2015, the parties reached a settlement in the Activist arbitration. On June 21, 2015, the Appellate Division, First Department, denied Khan's motion for leave to appeal this Court's March 4, 2015 Order.

Reargument

Khan's motion to reargue this Court's March 4, 2015 Order, which, inter alia, placed Garg in charge of EIFC and Embark is denied. Khan has failed to demonstrate that this Court overlooked or misapprehended any matters of fact or law in the underlying decision. In that regard, this Court reminds Khan that he was placed in charge of the entities, but after having the first-hand opportunity since that appointment to observe the clear personality clashes of the parties, and to entertain the never-ending bickering and disputes that bedeviled this Court,

with no end in sight, this Court was compelled to change course and place Garg in charge.

Embark Actions

As set forth, supra, on March 13, 2015, the parties settled the Embark actions and both actions were discontinued with prejudice on March 18, 2015. Khan now moves for an order rejecting the settlement.

The motion is denied. First, although Khan argues that Court approval is required for any settlement of the Embark actions, the March 4, 2015 Order only specifically stated that Court approval was required for settlement of the Activist arbitration. Thus, Garg was not required to seek Court approval to settle the Embark actions.

In any event, Khan has not demonstrated that the Embark settlements should be rejected. As a threshold matter, Khan argues that the Court erred in authorizing Garg to settle the Embark actions on behalf of EIFC. That argument is unavailing given this Court's denial of Khan's reargument motion. More importantly, the record demonstrates that Khan has failed to demonstrate that the terms of the settlement, which provided, inter alia, for Embark to pay EIFC \$120,000, were unfair or unreasonable.

Activist Arbitration

As noted in the March 4, 2015 Order, this Court granted authority to Garg to settle the Activist arbitration, subject to Court approval of the terms of the settlement. On June 11, 2015, the parties reached a settlement of the Activist arbitration. Khan now moves for an order rejecting the settlement.

To begin, Khan's repeated argument that this Court erred in placing Garg in charge of EIFC and giving him authority to settle the Activist Arbitration is unavailing for the above-stated reasons.

Khan next argues that Garg had a potential conflict of interest in that he was in charge of EIFC whilst simultaneously being a director of Phoenix Real Estate. This Court noted that fact in the March 4, 2015 Order, and cautioned Garg on that issue. In response to the instant motion, Garg has demonstrated that the settlement negotiations were handled by third-parties and he did not have internal communications with Phoenix Real Estate in connection with the settlement. Under these circumstances, Khan failed to demonstrate the existence of a real conflict that would compel this Court to find that the settlement of the Activist arbitration was not fair and reasonable.

Khan also argues that the terms of the settlement should be rejected because they do not sufficiently benefit EIFC. This argument is unpersuasive. A review of the settlement terms demonstrates that they were sufficiently fair and reasonable to

EIFC. In that regard, there is no dispute that the main issues in the Activist arbitration were six invoices allegedly unpaid by Phoenix Real Estate to EIFC, and the alleged misappropriation of EIFC's intellectual property by Phoenix Real Estate through the hiring of former EIFC employees.

With respect to the six invoices, Garg states that he determined that two of them were not valid. One of the invoices concerned sums allegedly owed to the law firm of Kramer, Levin. Documentary proof demonstrates that Phoenix Real Estate paid that invoice. The record demonstrates that the second invoice for \$321,000 owed to a company called CoreLogic was for services on EIFC's behalf, and therefore not attributable to Phoenix Real Estate.

Concerning the four other invoices, totaling approximately \$419,000, which the parties considered valid for the purposes of their negotiations, Garg states that the parties added interest of 9% and arrived at a total potential value of \$497,000. The parties also agreed that EIFC had incurred legal fees of approximately \$250,000 in seeking to recover on the invoices for a total potentially due to EIFC of nearly \$750,000 with respect to these invoices.

As for the intellectual property claims, Garg engaged an expert to examine EIFC's claims and, based on the expert's report, determined that EIFC's claims for misappropriation of

intellectual property likely lacked merit. As such, Garg considered the likely possibility that the arbitration panel would rule against EIFC on that issue and possibly award Phoenix Real Estate legal fees incurred in defending that claim, which fees had already risen to over \$900,000.

Garg states that in conducting settlement negotiations the parties reduced the amount of legal fees potentially recoverable by Phoenix Real Estate by 65%, given the uncertainty as to how much, if any, of such fees would be awarded in the arbitration. The parties then reduced that amount further by \$250,000, in light of the fees incurred by EIFC in trying to recover on its invoice claims, leaving \$247,000 in net legal fees that EIFC could potentially owe to Phoenix Real Estate if the intellectual property claims failed and the panel awarded legal fees to Phoenix Real Estate.

The parties then deducted that \$247,000 from the \$497,000 potentially owed by Phoenix Real Estate to EIFC in connection with the invoice claims, and determined that Phoenix Real Estate should make a payment of \$250,000 to EIFC in settlement of the various claims in the Activist arbitration.

Garg states that, in addition to the \$250,000, EIFC will also benefit from the settlement in other ways. Particularly, he states that the settlement will permit EIFC to amend its 2013 tax return, which was improperly filed, which he states will reduce

the company's tax liability by approximately \$430,000. EIFC will also benefit by no longer incurring legal fees in having to proceed with the arbitration. Further, EIFC will benefit from mutual releases between itself and Phoenix Real Estate, as well as with its former employees.

Based on the foregoing, this Court finds that Garg has demonstrated that he took reasonable steps in settling the Activist arbitration, and that such settlement was fair and will benefit the company.

Nonetheless, Khan argues that the benefit to EIFC will not be sufficient. Specifically, he contends that EIFC has significant liabilities, including legal fees, which will exceed the amount recovered by the settlement. He further contends that EIFC's claims in the arbitration far exceed the amount received from the settlement, and asserts that EIFC is likely to prevail in the arbitration. As such, he contends that Garg should not have settled the arbitration on the terms agreed to by the parties.

Khan's argument is unavailing. To begin, there can be no dispute that a party to a settlement agreement is unlikely to receive the full benefit of the amounts it seeks in the underlying arbitration. What is clear though is the settlement will terminate the arbitration and end the mounting attorneys' fees -- no small feat given the history of this case. Thus, it

cannot be argued that the settlement is unfair simply because Garg did not recover the entire amount sought by EIFC.

Moreover, Khan's argument rests on a very speculative foundation, i.e., that EIFC would have prevailed in the arbitration. If EIFC did not prevail, it would have incurred significant, additional liabilities, which would have left the company in a worse financial position than it would be in as a result of the settlement.

Given the benefits to EIFC, and the speculative nature of Khan's opposition to the settlement terms, this Court finds that Khan failed to demonstrate that this Court should reject the terms of the Activist settlement.

Accordingly, it is

ORDERED that branch of the motion by plaintiff Raza Khan, on his own behalf and on behalf of Education Investment Finance Corporation, for reargument is denied; and it is further

ORDERED that branch of the motion by plaintiff Raza Khan, on his own behalf and on behalf of Education Investment Finance Corporation, to reject the settlement agreements reached in the arbitration captioned Activist Special Advisory Services, LLC v Phoenix Real Estate Solutions, Case No. 011400002627, pending before the American Arbitration Association, and the actions in this Court captioned EIFC v Embark Corp., Index No. 155818/2014,

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and Embark Holdco I, LLC v Embark Corp., Index No. 652552/14, is denied.

This memorandum opinion constitutes the decision and order of the Court.

Dated:

8/10/16



HON. JEFFREY K. OING, J.S.C.

JEFFREY K. OING
J.S.C.