

<b>Slater v Edcomm, Inc.</b>
2016 NY Slip Op 31670(U)
September 6, 2016
Supreme Court, New York County
Docket Number: 652635/11
Judge: Kelly A. O'Neill Levy
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SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: PART 19

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DEBORAH R. SLATER,

Plaintiff,

-against-

EDCOMM, INC., LINDA EAGLE,  
CLIFFORD BRODY, DAVID SHAPP,

Defendants.  
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EDCOMM, INC.,

Third-Party Plaintiff,

-against-

LINDA EAGLE, CLIFFORD BRODY and  
DAVID SHAPP,

Third-Party Defendants.  
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**KELLY O'NEILL LEVY, J.:**

In this breach of contract action, third-party defendant David Shapp (Shapp) moves, pursuant to CPLR 3126, for an order staying these proceedings until defendant, third-party plaintiff Edcomm, Inc. (Edcomm) complies with this court's September 9, 2015 order directing Edcomm "to reply to defendants' document requests and produce all material, non-privileged documents in its possession within 30 days of service of a copy of this order with notice of entry" (Berwisch affirmation, exhibit A [Decision] at 10). Shapp also seeks sanctions for Edcomm's failure to comply with the court's order.

Index No.: 652635/11

DECISION/ORDER

Mot. Seq. 009

Edcomm cross moves, pursuant to CPLR 2221, for “reconsideration” of the decision of September 9, 2015.

### **BACKGROUND**

In 1987, Clifford Brody (Brody) and Linda Eagle (Eagle) founded Edcomm, a New York corporation that specializes in providing consulting and training to the banking industry. Brody was the chief executive officer and Eagle was Edcomm’s president. Shapp joined Edcomm in 1995 as chief financial officer.

It appears that Edcomm was experiencing financial difficulties and, in order to ameliorate some of the problem, between 2007 and 2010, Brody, Eagle and Shapp deferred their salaries and, in addition, they made several loans to Edcomm.

Edcomm also had a \$900,000 line of credit with nonparty SmartPros, Ltd. (SmartPros) and in September 2010, Edcomm had a loan balance of \$740,000 with SmartPros.

In addition, from 2008 through 2009, plaintiff in this action, Deborah R. Slater (Slater), a friend of Eagle’s, made more than \$725,000 in loans to Edcomm which, Edcomm believes, were designated in Edcomm’s books as shareholder loans to Eagle (amended third-party complaint, ¶ 26). Edcomm also believes that, in 2009 or 2010, Eagle redesignated those shareholder loans as additional paid in capital to Edcomm (amended third-party complaint, ¶ 28).

Edcomm made no payments on any of the loans until early 2010, when it repaid approximately \$37,000 to Slater.

In September 2010, Eagle approached nonparty Sawabeh Information Services Company (SISCOM) to discuss whether SISCOM would be interested in making a loan and/or investing in Edcomm. SISCOM and Edcomm engaged in extensive negotiations and due diligence and,

although SISCOM acquired all of Edcomm's stock in October 2010, the parties continued to engage in due diligence through at least April 2011, with a view of restructuring the transaction. It was during this continuing due diligence that SISCOM allegedly discovered \$14.5 million in undisclosed liabilities.

### **FEDERAL COURT ACTION**

SISCOM and Edcomm commenced a federal court action against Brody, Eagle and Shapp<sup>1</sup> alleging, among other things, securities fraud, fraud in the inducement, breach of contract, and breach of fiduciary duty. Brody, Shapp and Eagle counterclaimed, seeking, among other things, indemnification.

In a decision dated January 6, 2014, Judge Shira Scheindlin found that, although the plaintiffs had failed to prove their fraud or breach of contract claims, they had established that Brody, Eagle and Shapp breached their fiduciary duty to disclose the Slater loans to SISCOM. In that decision, Judge Scheindlin stated, "SISCOM and Edcomm have not yet suffered damages as a result of this breach. However, Slater has brought an action against Edcomm in New York State court . . . should Edcomm be found liable as a result of that litigation, [Brody, Eagle and Shapp] have a duty to indemnify plaintiffs because such a judgment would arise as a direct result of defendants' breach of their fiduciary duty to SISCOM" (*Sawabeh Information Services Company*, 2014 WL 46479 at \*15, 2014 US Dist LEXIS 1050 at \*55-56).

As to Brody, Eagle and Shapp's counterclaim for indemnification, Judge Scheindlin found:

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<sup>1</sup>*Sawabeh Information Services Company* (2014 WL 46479, 2014 US Dist LEXIS 1050 [SD NY 2014]; *aff'd in part, rev'd in part* 598 Fed Appx 794 [2d Cir 2015]) (the district court action).

“Section 724 of New York’s Business Corporation Law authorizes the court to award indemnification ‘to the extent authorized under section 722’ and ‘subject to the same standards and qualifications where applicable as in the case of voluntary corporate indemnification.’ While section 722 (c) permits corporations to indemnify directors and officers in suits brought ‘by or in the right of the corporations to procure a judgment in its favor,’ indemnification is not appropriate if the director or officer did not act ‘in good faith for a purpose which he reasonably believed to be in . . . the best interests of the corporation.’

“I find that indemnification is not warranted *in this case* because [Brody, Eagle and Shapp] failed to act in good faith or in the best interests of the corporation by failing to maintain appropriate accounting records, by inappropriately treating the Slater loans as shareholder loans and by fabricating the Brody agreements. This is a case where both parties acted poorly and neither party should benefit from its own wrongdoing”

(*id.* at \*18, at \*62-63 [emphasis added]).

In addition, Judge Scheindlin dismissed the fraud claims against Brody, Eagle and Shapp on the ground that Edcomm failed to prove reasonable reliance, and she dismissed the breach of contract claim for failure to prove that Shapp breached paragraph 10 of the term sheet.

In March 2015, the Second Circuit Court of Appeals affirmed Justice Scheindlin’s January 6, 2014 decision in all respects but one, finding that, “because any injury to SISCOM resulted from defendants’ failure to disclose the Slater loans *before* the acquisition, when defendants did not yet owe SISCOM a fiduciary duty,” Eagle, Brody and Shapp did not breach their fiduciary duty to SISCOM. As a consequence, the court reversed the portion of the judgment requiring Eagle, Brody and Shapp to indemnify Edcomm for any judgment entered in the state court litigation concerning the Slater loans (*Sawabeh Information Services Co. v Eagle*, 598 Fed Appx 794, 795-796 [2d Cir 2015]).

**NEW YORK ACTION**

Slater commenced this action against Edcomm in 2011, seeking repayment of the principal of the loans she made to Edcomm plus interest.<sup>2</sup>

Thereafter, Edcomm commenced a third-party action against Eagle, Brody and Shapp. The amended third-party complaint states causes of action for: 1) a declaratory judgment that Slater's loans to Eagle were Eagle's personal responsibility and/or that Eagle was without authority to enter into the loans on behalf of Edcomm; 2) indemnification against the third-party defendants for repayment of the Slater funds; 3) unjust enrichment against the third-party defendants; 4) breach of fiduciary duty against the third-party defendants; 5) breach of contract against the third-party defendants; 6) fraudulent misrepresentation against the third party defendants; and 7) violation of General Business Law (GBL) § 349 (Deceptive Trade Practices Act).

Brody and Eagle each answered the amended third-party complaint and interposed counterclaims for indemnification against Edcomm.

Shapp contended that he was never properly served with the amended third-party complaint and he never interposed an answer to that complaint.

In motion sequence 007, Edcomm moved to dismiss Brody and Eagle's counterclaims for indemnification on the ground that they were barred by res judicata and collateral estoppel.

Brody and Eagle cross-moved to dismiss the amended third-party complaint.

In the Decision dated September 9, 2015, the court determined that, based on the Second

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<sup>2</sup> On or about December 4, 2013, the complaint was amended to add Brody, Eagle and Shapp as direct defendants. Also added as defendants were Myron Eagle and Amy Eagle, against whom the action was discontinued by stipulation and order dated April 6, 2015 (Singh, J.).

Circuit Court of Appeals decision that Eagle, Brody and Shapp did not owe a fiduciary duty to Edcomm or SISCOM and that they were not liable to indemnify Edcomm or SISCOM (*Sawabeh Information Services Co. v Eagle*, 598 Fed Appx at 795-796), “the question of Edcomm’s liability to indemnify [Brody and Eagle] in this action remains extant [*see* Business Corporation Law § 722 (c)]” (Berwisch affirmation, exhibit A at 8). The court also granted the cross motion to dismiss the amended third-party complaint based on, among other things, collateral estoppel.<sup>3</sup>

By decision and order dated April 25, 2016 on motion seq. 008, the court granted plaintiff’s request to file a second amended verified complaint to amend certain causes of action based on an alter ego theory against the individual defendants Linda Eagle, Clifford Brody, and David Schapp.

### **THE MOTION AND CROSS MOTION**

#### **A. Motion to Stay and for Sanctions**

In support of the motion to stay these proceedings until Edcomm complies with this court’s September 9, 2015 Decision directing Edcomm to reply to third-party defendants’ discovery requests and produce all material, non-privileged documents within 30 days of service of a copy of this order with notice of entry, Shapp argues that Edcomm’s failure to comply with the discovery order has prejudiced him and that the discovery he is seeking is necessary so he can adequately defend himself. Moreover, Shapp takes the position that Edcomm’s failure to comply constitutes frivolous conduct because it was undertaken to delay or prolong the resolution of this matter and/or to harass or maliciously injure him.

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<sup>3</sup>Based on the dismissal of the amended third-party complaint, the court determined that Shapp’s request for alternative service of that third-party complaint was moot.

In opposition to the motion for a stay, Edcomm, Inc. contends that Shapp's document requests are overbroad, burdensome and not calculated to uncover admissible or relevant evidence and that the requests have been interposed to harass Edcomm and increase the costs of the litigation. Edcomm argues that there already has been substantial document production in this case, in that document production in the federal litigation has been deemed produced in this action and that Edcomm has produced an additional 27 compact discs which contain voluminous information.

Slater also opposes Shapp's motion to stay this matter. Slater takes the position that there has been no default in complying with the Decision because Shapp failed to serve a copy of that order with notice of entry on Edcomm. In addition, Slater argues that a stay of this matter unfairly punishes her for Edcomm's alleged recalcitrance.

At the oral argument of this motion on May 11, 2016, the court ordered Edcomm to produce a certain Quickbooks data file and a certain "Hotlist File" by May 27, 2016. In a June 7, 2016 letter, Shapp alleges that those files have not been produced. However, on June 16, 2016, Edcomm responded to Shapp's letter stating that, although delayed, the Quickbooks and Hotlist files now have been produced.

As to the remainder of Shapp's discovery requests, CPLR 3101 (a) provides that "[t]here shall be full disclosure of all evidence material and necessary in the prosecution or defense of an action . . ." (*Hoenig v Westphal*, 52 NY2d 605, 608 [1981]). The courts have construed this provision to require disclosure when the material sought will "assist [in] preparation for trial by sharpening the issues and reducing delay and prolixity" (*id.* [internal quotation marks and citation omitted]). However, "[t]he court may at any time . . . make a protective order denying, limiting,

conditioning or regulating the use of any disclosure device. Such order shall be designed to prevent unreasonable annoyance, expense, embarrassment, disadvantage, or other prejudice to any person or the courts (CPLR 3103 [a]).

Here, Shapp has failed to establish the materiality of the information sought for the years 2004 and 2007. Eagle and Brody did not start deferring their salaries because of Edcomm's financial straits until 2007 and the first Slater loan was not made until 2008. Accordingly, to the extent not already provided, Edcomm is directed, within 60 days of service of a copy of this order with notice of entry, to produce all outstanding material, non-privileged discovery for the years 2007 through 2010, only.

Moreover, to the extent that Shapp seeks documents from SISCOM, a nonparty to this action, CPLR 3120 requires service of a subpoena on a nonparty witness for the production of specified documents that are in the nonparty's custody or control. In addition, CPLR 3101 (a) (4) states that the nonparty be given "notice stating the circumstances or reasons such disclosure is sought or required" (*see, Velez v Hunts Point Multi-Serv. Ctr, Inc.*, 29 AD3d 104, 109-110 [1<sup>st</sup> Dept 2006]). Accordingly, if Shapp requires documents from SISCOM that have not already been produced, he must properly serve SISCOM with a subpoena requesting such documents.

#### B. Cross Motion for Reconsideration

Edcomm's motion for "reconsideration" is actually one for reargument because Edcomm contends that this court misapprehended the district court's decision by failing to dismiss Eagle and Brody's indemnification counterclaims (CPLR 2221 [d] [2]; *Sachar v Columbia Pictures Indus., Inc.*, 129 AD3d 420, 421 [1<sup>st</sup> Dept 2015]; *William P. Pahl Equip. Corp. v Kassis*, 182

AD2d 22, 27 [1<sup>st</sup> Dept 1992]).<sup>4</sup>

It is Edcomm's position that reargument is warranted because the decision expressly contradicts the district court's finding "that indemnification is not warranted [in the federal court] case because [Brody, Eagle and Shapp] failed to act in good faith or in the best interests of the corporation by failing to maintain appropriate accounting records, by inappropriately treating the Slater loans as shareholder loans and by fabricating the Brody agreements" (*Sawabeh Information Services Co.*, 2014 WL 46479 at \*18, 2014 US Dist LEXIS 1050 at \*63 [emphasis added]).

Edcomm's motion for reargument is granted. However, upon reargument, the court adheres to its earlier decision.

Regarding the breach of fiduciary duty claim, Judge Scheindlin found that Eagle, Brody and Shapp had a fiduciary duty to SISCOM from October 13, 2010, the date that SISCOM became a shareholder in Edcomm, until Eagle, Brody and Shapp's termination on June 20, 2011 and that "[d]uring this period, [Eagle, Brody and Shapp] breached their fiduciary duty to SISCOM by failing to disclose . . . that [the Slater] loans had been inappropriately converted to paid-in capital" (*id.* at \*15, at \*55). The district court then stated that if Edcomm was found liable to Slater in the matter before this court, that Eagle, Brody and Shapp have a duty to indemnify Edcomm because a judgment in the New York action would be a direct result of the breach of Eagle, Brody and Shapp's breach of their fiduciary duty to SISCOM.

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<sup>4</sup> The reargument motion is timely because Shapp did not serve Edcomm with a copy of the Decision with notice of entry until December 31, 2015 (*see*, CPLR 2221 [d] [3] which states that a motion for reargument shall be made within 30 days after service of a copy of the order determining the prior motion and written notice of its entry").

However, the Second Circuit Court of Appeals explicitly reversed the district court's finding that Eagle, Brody and Shapp breached their fiduciary duty to SISCOM stating,

"The district court found that defendants . . . entered into a fiduciary relationship with SISCOM when SISCOM acquired Edcomm. But by that point, it was already too late for SISCOM to avoid any loss or potential liability arising out of the Slater Loans; SISCOM became liable for those loans, if at all, upon its acquisition of Edcomm. To the extent that defendants breached a fiduciary duty . . . *after* the acquisition there were no damages resulting therefrom<sup>5</sup> because any injury to SISCOM resulted from defendants' failure to disclose the Slater Loans *before* the acquisition, when defendants did not yet owe SISCOM a fiduciary duty. On the facts found by the district court, SISCOM's claim fails as a matter of law"

(*Sawabeh Information Services Co.*, 598 Fed Appx at 795-796).<sup>6</sup>

Moreover, the Second Circuit also explicitly reversed the portion of the district court's judgment that required Eagle, Brody and Shapp to indemnify SISCOM and Edcomm for any judgment entered in the state court litigation concerning the Slater loans.

Because the third-party defendants do not have a duty to indemnify Edcomm, there is a question of fact about whether, under the circumstances of this case, the third-party defendants acted in good faith, for a purpose they believed to be in the best interest of Edcomm, and whether, pursuant to section 722 (c) of the Business Corporation Law, they are entitled to indemnification from Edcomm regarding the Slater loans.

It should be noted that in the federal court action, Judge Scheindlin found that Edcomm

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<sup>5</sup> Damages are an essential element of a breach of fiduciary duty claim (*Soley v Wasserman*, 823 F Supp 2d 221, 232 [SD NY 2011][based on NY law]; *Rut v Young Adult Inst., Inc.*, 74 AD3d 776, 777 [2d Dept 2010]).

<sup>6</sup> The Second Circuit also found that the district court correctly dismissed Edcomm's breach of fiduciary duty claim.

and SISCOM were grossly negligent in the preservation and production of electronically stored information and she granted Eagle, Brody and Shapp's motion in the form of an adverse inference that the missing evidence would have been favorable to the defendants (*Sawabeh Information Services Co.*, 2014 WL 46479 at \*3, 2014 US Dist LEXIS 1050 at \*10).

Moreover, Judge Scheindlin dismissed Edcomm and SISCOM's claims alleging fraud and fraudulent inducement on the ground that Edcomm's insolvency and loose accounting standards were disclosed to SISCOM and SISCOM knowingly invested prior to receiving a definite representation from defendants as to Edcomm's liabilities.

As to the district court's finding that Edcomm's indemnification of Eagle, Brody and Shapp was not warranted, that ruling was limited to the matter before that court (*id.* at \*18; *id.* at \*63 ["I find that indemnification is not warranted *in this case* . . .] [emphasis added]). Judge Schiendlin did not opine about Edcomm's obligation to indemnify Eagle, Brody and Shapp in this case and, accordingly, because there are questions of fact, the question of whether Edcomm is obligated to indemnify Eagle, Brody and Shapp remains extant.

To the extent that Edcomm advances the "abstention doctrine" as a basis for reargument, the abstention doctrine is a new theory of law that was not set forth in the initial motion, and, therefore, it cannot be considered on a motion to reargue (*Onglingswan v Chase Home Fin., LLC*, 104 AD3d 543, 544 [1<sup>st</sup> Dept 2013]; *DeSoignies v Cornasesk House Tenants' Corp.*, 21 AD3d 715, 718 [1<sup>st</sup> Dept 2005]["[r]eargument is not available where movant seeks . . . to argue 'a new theory of law not previously advanced'" [citation omitted]]). Nor can Edcomm's arguments based on the abstention doctrine be considered as a basis for a renewal motion because renewal is only available if there are new facts that were not available when the movant

made the prior motion or there has been “a change in the law which would change the prior determination” and a “reasonable justification for the failure to present such facts on the prior motion” (*Ramos v City of New York*, 61 AD3d 51, 54 [1<sup>st</sup> Dept 2009] quoting CPLR 2221 [e] [2], [3]).

Accordingly, it is ORDERED that defendant/third-party defendant David Shapp’s motion for a stay of this proceeding is denied; and it is further

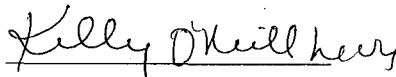
ORDERED that, to the extent not already provided, Edcomm, Inc. is directed, within 60 days of service of a copy of this order with notice of entry, to produce all outstanding material, nonprivileged discovery for the years 2007 through 2010, only; and it is further

ORDERED defendant/third-party plaintiff Edcomm, Inc.’s cross motion for reargument is granted; and it is further

ORDERED that, upon reargument, the court adheres to its September 9, 2015 decision.

Dated: September 9, 2016

ENTER:



**HON. KELLY O'NEILL LEVY**

J.S.C.