SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. MARGARET A. CHAN** **PART** **IAS MOTION 33EFM**

Justice

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JOHN LEVINSON AND ELLEN LEVINSON, INDIVIDUALLY AND AS TRUSTEE OF THE CHRISTOPHER TODD LEVINSON IRREVOCABLE TRUST ONE AND THE CORY JAMES LEVINSON IRREVOCABLE TRUST ONE,

Plaintiffs,

- v -

TWIAGE, LLC, JOHN HUI, GREGORY P. SANTULLI,

Defendants.

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INDEX NO. 657020/2017

MOTION DATE 03/28/2018

MOTION SEQ. NO. 001

DECISION AND ORDER

The following e-filed documents, listed by NYSCEF document number (Motion 001) 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16

were read on this motion to/for DISMISSAL.

In this action for breach of an investment agreement, breach of fiduciary duty, and fraudulent inducement, plaintiffs seek rescission of the parties' agreements and restitution of their investment in defendant Twiage, LLC, (Twiage). Defendants move pursuant to CPLR 3211(a)(7), or in the alternative CPLR 3211(a)(1) to dismiss the complaint. Plaintiffs oppose the motion.

Background

Defendants John Hui and Gregory P. Santulli were both members and managers of Twiage, LLC (Twiage), a tech startup company. Plaintiff John Levinson (Levinson) invested a total of $500,000 in Twiage in 2016 under four separate Simple Agreements for Future Equity (SAFE Agreements). For Levinson's investments, Hui and Santulli agreed to provide Levinson with a seat on Twiage's Board of Managers, which is reflected in an Addendum to the SAFE Agreements (NYSCEF doc nos 8 and 9). In September 2017, Hui and Santulli voted to remove Levinson from the Board in accordance to Twiage's Operating Agreement.

Plaintiffs claim that Levinson was fraudulently induced to invest in Twiage. Hui and Santulli met Levinson on four occasions: December 17, 2015, February 4, 2016, March 24, 2016, and April 25, 2016, to solicit Levinson's investment in Twiage (NYSCEF doc no 1 – complaint, ¶11). At the March 24 meeting, both Hui and Santulli represented that they each contributed $200,000 in cash to Twiage (*id.*, ¶¶14-15). Based on their representations, Levinson invested a total of $500,000 in Twiage (*id.*, ¶¶34-35). Plaintiffs claim that Hui and Santulli's representations that

they made cash contributions to Twiage were material to Levinson on deciding whether to make a substantial investment in Twiage, since Twiage was a startup and in need of cash (*id.*, ¶17).

Plaintiffs learned that Hui and Santulli's representations of their cash contributions to Twiage were false from their review of Twiage's March 31, 2017 financial statement (March Statement), which showed that neither Hui nor Santulli contributed $200,000 (*id.*, ¶¶19-20; 27-29, 41). The March Statement made specific references to "notes receivable" from both Hui and Santulli and indicated that both Hui and Santulli's "notes receivable" exceeded $100,000, but that neither had actually paid $200,000 (*id.*, ¶¶ 44-45). Plaintiffs claim that Hui and Santulli arranged to have Santulli's "notes" forgiven by Twiage and that Hui took over a portion of Santulli's equity in Twiage (*id.*, ¶¶ 48, 50). The March Statement also showed that Hui only contributed money sufficient to cover the shortfall from his own failure to invest $200,000, but that neither Hui nor Santulli covered the cash shortfall from Santulli's $200,000, resulting in the company being short-changed by more than $100,000 (*id.*, ¶¶52-53). Plaintiffs conclude that Hui and Santulli voted to remove Levinson from Twiage's Board effective September 30, 2017, in an effort to protect themselves from potential charges of misconduct (*id.*, ¶¶57-58).

In their motion to dismiss, defendants argue that plaintiffs' fraudulent inducement claim is precluded by the SAFE Agreements. Notably, paragraph 3 which contains the "Company Representations" does not include whether Hui and Santulli made monetary contributions prior to Levison's investment. Defendants also argue that the fraud in the inducement claim is actually a breach of contract claim as it concerns the terms and performance of the SAFE Agreement. Defendants add that the breach of contract claim against Twiage and the breach of fiduciary duty claims against Hui and Santulli are also precluded by the Operating Agreement. They contend that neither the SAFE Agreement nor the Operating Agreement provide for Levinson to participate as a Board Member indefinitely. They conclude that Plaintiffs' breach of contract claim should be dismissed because a sophisticated businessman such as Levinson had reason to believe that while the company was providing him with a seat on the Board, it was conditional upon the Operating Agreement rules for termination of his Board membership. Finally, defendants argue that plaintiffs are sophisticated investors, and as such, plaintiffs do not have a colorable fraudulent inducement claim.

In opposition, plaintiffs argue that defendants breached the Addendum by removing Levinson as a Board Member, since the text of the Addendum provides that the Levinson is to have a Board seat at the company. Plaintiffs also argue that while Section 5.13 of the Operating Agreement provides for Levinson's removal from the Board, doing so breaches the Addendum. Next, Plaintiffs argue that Hui and Santulli's misrepresentations are not barred by the parole evidence rule, since the SAFE Agreement does not reference the particular misrepresentations.

Discussion

Defendants move pursuant to CPLR 3211 (a)(1) to dismiss one or more causes of action asserted against them on the ground that "a defense is founded upon documentary evidence." Where a motion to dismiss is based on documentary evidence pursuant to CPLR 3211(a)(1), the claim will be dismissed "only where the documentary evidence utterly refutes plaintiffs 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]; *Mill Financial, LLC v Gillett*, 122 AD3d 98 [1st Dept 2014]). "Dismissal pursuant to CPLR 3211(a)(1) is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law" (*Mill Financial*, 122 AD3d at 24).

In the alternative, defendants move to dismiss the complaint pursuant to CPLR 3211(a)(7). The court's role is in a CPLR 3211 (a)(7) motion is deciding "whether the pleading states a cause of action, and if from its four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law" (*African Diaspora Maritime Corp. v Golden Gate Yacht Club*, 109 AD3d 204, 211 [1st Dept 2013]), if so, "a motion for dismissal will fail" (*id.*). On a motion to dismiss made pursuant to CPLR 3211, the court must "accept the facts as alleged in the complaint as true, accord plaintiffs "the benefit of every possible favorable inference," and "determine only whether the facts as alleged fit into any cognizable legal theory" (*Siegmund Strauss, Inc. v E. 149th Realty Corp.*, 104 AD3d 401, 403 [1st Dept 2013]).

Breach of Contract and Fiduciary Duty Claims

To state a claim for breach of contract, a plaintiff must plead: (1) the existence of a valid contract; (2) plaintiff's performance of the contract; (3) defendant's material breach of the contract, and (4) damages (*US Bank Nat. Ass'n v Lieberman*, 98 AD3d 422, 423 [1st Dept 2012]).

The elements of a claim for breach of fiduciary duty are: "(1) defendant[s] owed [plaintiffs] a fiduciary duty, (2) defendant[s] committed misconduct, and (3) [plaintiffs] suffered damages caused by that misconduct" (*Burry v Madison Park Owner LLC*, 84 AD3d 699, 700 [1st Dept 2009]). A cause of action for breach of fiduciary duty must be pled with sufficient detail pursuant to CPLR 3016 (b) (*see Chiu v Man Choi Chiu*, 71 AD3d 621 [2d Dept 2010]).

The complaint alleges, and the Addendum to the SAFE Agreement states, that upon Levinson's initial investment of $250,000 into the company pursuant a SAFE Agreement, "John Levinson will have a board seat at Twiage (Compl. ¶¶37-39; Addendum ¶3). The complaint further alleges that despite investing $500,000 into the company, Hui and Santulli removed Levinson as a board member (Compl.

¶¶74, 82). While section 5.13 of the Operating Agreement speaks to the removal of a board member for cause or without cause, the Operating Agreement was made by and among Hui, Santulli, and non-party Yiding Yu. Levison was not part of this Operating Agreement and this Operating Agreement was not made part of plaintiffs' SAFE Agreements or Addendum by incorporation or reference. Hence, the Operating Agreement does not dispel plaintiffs' claims for breach of contract and breach of fiduciary duty for removing Levison from the Board.

Fraudulent Inducement Claim

To sustain a cause of action for fraudulent inducement, a plaintiff must allege that there was a false representation, made for the purpose of inducing another to act on it, and that the party to whom the representation was made justifiably relied on it and was damaged (*see Perrotti v. Becker, Glynn, Melamed & Muffy LLP*, 82 AD3d 495 [1st Dept 2011], citing *Lama Holding Co. v. Smith Barney*, 88 NY2d 413, 421 [1996]). Generally, the question of what constitutes reasonable reliance is not generally a question to be resolved as a matter of law on a motion to dismiss (*see ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 25 NY3d 1043, 1045 [2015]). However, a "plaintiff's allegations do not establish justifiable reliance as required to prove fraud [where] plaintiff is a sophisticated investor that had the means available to it to learn the true nature and real quality of the investment it made" (*MP Cool Investments Ltd. v. Forkosh*, 142 AD3d 286, 287 [1st Dept 2016]).

Here, plaintiffs allege that both Hui and Santulli represented that they each contributed $200,000 in cash to Twiage (Compl., ¶¶ 14-15), that defendants' representations that they made cash contributions to Twiage were material to Levinson's decision to make a substantial investment in Twiage, and Hui and Santulli's representations were false (*id.*, ¶¶19-20, 27-29). The complaint states a claim for fraudulent inducement against Hui and Santulli.

Defendants argue that plaintiffs failed to plead that Levinson, a sophisticated investor, justifiably relied on the alleged misrepresentation of Hui and Santulli's investment. Defendants' position is that, Levison, being a sophisticated investor at the time he entered into the agreement, could and should have performed his due diligence to determine whether Hui and Santulli's claims of investing $200,000 were true. They state that Levinson had access but failed to obtain relevant documents and information concerning Defendants' investment in the company at the inception and in the five months from the initial investment and being a board member to obtain documentation verifying Hui and Santulli's purported investments.

At the outset, defendants' argument about Levinson being a sophisticated investor since the argument was first asserted in defendants' reply and cannot be considered in determining this motion (*see Wal-Mart Stores, Inc. v U.S. Fidelity and*

Guar. Co., 11 AD3d 300 [1st Dept 2004]; *Alrobaia ex rel. Severs v Park Lane Mosholu Corp.*, 74 AD3d 403 [1st Dept 2010] ["The argument on which the court relied, however, was raised for the first time in defendants' reply papers, and should not have been considered by the court in formulating its decision"]). Not only does defendants' reply argument deprive plaintiffs from redress, defendants' argument is without analysis with facts to their cited cases which were also used for their breach of contract and fiduciary duty arguments. The only supporting document defendants submit, also in its reply, is an unauthenticated and inadmissible computer printout of an "Executive Profile" purportedly belonging to Levinson (Defendants' Reply Memo of Law, Exh. A), which cannot be considered (*see Rodriguez v Weinstein Enterprises*, Inc., AD3d 483, 484 [1st Dept 2014]). What remain are assertions made by defendants' attorney in the Reply Memorandum of Law, which are insufficient.

In any event, even if Levinson were a sophisticated investor, defendants would have this court determine what actions could, would, or should constitute reasonable due diligence for Levinson to uncover defendants' alleged fraud in light of the documents provided to Levinson which concealed Hui and Santulli's investment into the company. Specifically, Exhibit A to the Operating Agreement showing that Hui and Santulli both contributed $200,000 cash to Twiage and the financial statements initially reviewed by Levinson concealed Hui and Santulli's failure to invest $200,000 each to Twiage. Defendants have no evidence to show that plaintiffs had the means to discover defendants' alleged untruthful statements (*cf MP Cool Investments Ltd.*, 142 AD3d at 292 [finding that plaintiff had total access to every aspect of defendant's company information before and after its initial investment, and invested in the company despite being aware of severe problems with the company's products]; *HSH Nordbank AG v. UBS AG*, 95 AD3d 185, 195 [1st Dept 2012] [finding that a sophisticated plaintiff failed to plead the justifiable reliance element of fraud "the true nature of the risk being assumed could have been ascertained from reviewing market data or other publicly available information"]).

Defendants argue that parole evidence may not be used to establish that plaintiffs were fraudulently induced into entering into the contract. However, defendants do not cite to a merger clause within the SAFE Agreement, or any language indicating that Levinson disclaimed reliance on defendants' representations that they each contributed $200,000 in cash to Twiage. Accordingly, the SAFE Agreements do not preclude the use of parole evidence to establish that defendants fraudulently induced Levinson from entering into the agreement (*see Laduzinski v Alvarez & Marsal Tax and LLC*, 132 AD3d 164, 169 [1st Dept 2015]; *Liberty Pointe Bank v 75 E. 125th St., LLC*, 95 AD3d 706, 706 [1st Dept 2012] [holding that the merger clause failed to make reference to the "particular misrepresentations" alleged).

Conclusion

Based on the foregoing, it is hereby

ORDERED that defendants, Twiage, LLC, John Hui, and Gregory P. Santulli's motion pursuant to CPLR 3211(a)(7), or in the alternative CPLR 3211(a)(1), to dismiss the complaint of plaintiffs, John Levinson and Ellen Levinson, individually and as Trustee of the Christopher Todd Levinson Irrevocable Trust One and the Cory James Levinson Irrevocable Trust One, is denied; it is further

ORDERED that counsel for defendants shall serve a copy of this order, along with notice entry, on all parties within fifteen (15) days of entry.

1/14/2019
DATE

MARGARET A. CHAN, J.S.C.

CHECK ONE:		CASE DISPOSED			x	NON-FINAL DISPOSITION	
		GRANTED	X	DENIED		GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		DO NOT POST				FIDUCIARY APPOINTMENT	REFERENCE