SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. BARRY R. OSTRAGER** **PART** **IAS MOTION 61EFM**

Justice

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MADEOF, LLC, RYAN J. BONIFACINO, and IGOR A. BEKKER,

Plaintiffs,

- v -

DAWN KELLAS BRONSON and BABY CHINA PRODUCTS CO.,

Defendants

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INDEX NO. 655107/2018

MOTION DATE N/A

MOTION SEQ. NO. 004

DECISION AND ORDER

The following e-filed documents, listed by NYSCEF document number (Motion 004) 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 57, 58, 59, 60, 68

were read on this motion to/for DISMISS.

OSTRAGER, BARRY R., J.S.C.:

Before the Court is plaintiffs' pre-answer motion to dismiss defendants' counterclaims. For the reasons stated herein and in the transcript of proceedings held on March 8, 2019 and efiled on April 2, 2019 (NYSCEF Doc. No. 69), the motion is granted in part and denied in part.

Background[1]

Inspired by the sensitive skin condition of her four young children, defendant/ counterclaim plaintiff Dawn Kellas Bronson developed a line of organic baby products in her home, such as shampoo, soap, sunscreen and detergent. Considering whether to commercialize her formulations for the U.S. and Chinese markets, Ms. Bronson formed Baby China Products Co. in February 2016 and assigned all her formulations and proprietary information to that company. (Counterclaim ¶¶ 9-16).

[1] The facts stated herein are based on allegations in Defendants' Answer and Counterclaims (NYSCEF Doc. No. 32). For the purposes of this pre-answer motion to dismiss, the allegations must be accepted as true. *Leon v Martinez,* 84 NY2d 83 (1994). Disagreements between the parties are nevertheless noted, although no party has submitted a verified pleading or affidavit based on personal knowledge.

About that same time, Bronson began speaking with plaintiff Ryan Bonifacino about establishing a business for her products. Bonifacino brought in plaintiff Igor Bekker, and the three began an informal business relationship, with Bronson receiving some guidance from her husband, a non-practicing attorney. After some discussion, the three settled on the name "Bornganic" for their company. They also decided to formalize their relationship by entering into a written agreement. *Id.* at ¶¶17-18.

In mid-April 2016 the parties signed an undated seven-page "Memo of Understanding for Bornganic, LLC" naming each of them as a 33.3% partner in the limited liability company they had formed in Delaware (the "MOU", NYSCEF Doc. No. 39). The stated purpose of Bornganic was "the creation and sale of baby care products in North America and China," and the stated purpose of the MOU was to define "the co-operation principles between the Partners, and related measures and responsibilities." Bronson was identified as the Chief Product Officer and Creative Director responsible mainly for product development, certification and testing, Bonifacino was the Chairman and Chief Executive Officer responsible mainly for general business management, and Bekker was the President and Chief Operating Officer responsible mainly for sales. Bronson was the *only* party obligated to make a capital commitment, which was set at $1million. As particularly relevant here, the MOU also contained a non-compete clause at ¶6 and a confidentiality provision at ¶14. The MOU at ¶4 also provides that "IP, trademark and other property rights created during or directly related to The Company business development process will become property of The Company unless agreed otherwise in writ[ing] by all Partners." Significantly, the MOU does *not* include a license from Baby China to Bornganic allowing the use of formulations created before the MOU was signed.

Bronson claims the three partners met at least weekly and frequently spoke on the phone and emailed regarding the business, discussing issues such as the status of the business, the marketing plan, and strategy, as well as Bronson's work with potential suppliers and manufacturers to coordinate the creation of product samples. (¶¶ 38-40). Bronson contends that, unbeknownst to her, Bonifacino and Bekker had created their own company named "MadeOf" and had begun manufacturing products for that company in July 2016 using some of Baby China's formulations, while simultaneously representing to Bronson that Bornganic was still nearly a year away from manufacturing products for their joint company. (¶¶ 41-42).

At some point in the Fall of 2016, before making her $1M capital contribution, Bronson learned from a third party and online news articles that criminal charges had been brought against Bonifacino for having stolen certain property. Fearing that information would deter investors and diminish the company's value, Bronson told Bekker and Bonifacino she wanted to terminate the business relationship, but she made no mention of the criminal allegations. The parties agreed and entered into a five-page Termination Agreement on October 15, 2016, terminating the MOU, including the non-compete provision, but maintaining certain confidentiality requirements for Bronson only (NYSCEF Doc. No. 41). Among the most controversial provisions is paragraph 3 entitled "Release" which broadly states that:

> All Parties hereby release all other Parties from any and all duties, promises, agreements, payments of monies, torts, claims and/or damages resulting therefrom, whatsoever that are or would be related to or that have or could, in the future, arise out of the MOU.

Any right Bornganic may have had to use Baby China's product formulations arguably expired in October 2016 when the Termination Agreement was signed and Bronson left the company. Soon after, Bronson learned that Bonifacino and Bekker had been using the formulations for months to benefit their own company MadeOf without advising Bronson. Based

on ¶18 of the MOU setting Delaware as the forum to resolve disputes, Bronson commenced suit in Delaware. Bonifacino and Bekker commenced this suit asserting thirteen causes of action and sought dismissal of the Delaware action based on the New York forum selection clause in ¶ 14 of the Termination Agreement. Bronson then discontinued the Delaware action without prejudice and asserted those claims as ten counterclaims included in her Answer here (NYSCEF Doc. 32).

Analysis

In lieu of a Reply to the Counterclaims, Bonifacino and Bekker made the instant motion to dismiss all of Bronson's counterclaims based on the above-quoted Release in the Termination Agreement and failure to state a claim. The Court on the record on March 28 denied dismissal of the First and Sixth Counterclaims asserted by Baby China alleging misappropriation of trade secrets. It is undisputed that Baby China is not bound by the Release as it is not a party to the Termination Agreement, and the allegation that defendants used Baby China formulations for its own company MadeOf without a license or other permission states a claim under the liberal pleading standard applicable to CPLR 3211 motions. *See Leon, supra.* Although Bronson had the right to use Baby China's formulations for the Bornganic business, Bonifacino and Bekker were not given the right to use the formulations for their own competing business.

Additionally, the Court on March 28 dismissed the Fifth Counterclaim for breach of fiduciary duty, the Seventh Counterclaim for unjust enrichment, the Ninth Counterclaim for breach of the implied covenant of good faith and fair dealing, and the Tenth Counterclaim for a declaratory judgment as to the import of the Termination Agreement, finding those claims duplicative of the claims under the parties' agreements. *See, e.g., Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.,* 70 NY2d 382, 388 (1987) (affirming dismissal of unjust enrichment claim on ground that the "existence of a valid and enforceable written contract governing a particular

subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter"). The Eighth Counterclaim alleging deceptive acts and practices under General Business Law §349 was dismissed, as the conduct at issue does not fall within the type of deceptive acts, that, if permitted to continue, would have a broad impact on consumers at large. *See Thompson v Parkchester Apts. Co.*, 271 AD2d 311 (1st Dep't 2000), *lv dismissed* 92 NY2d 946 (1998). Decision was reserved on the remaining three Counterclaims: the Second against Bronson and Baby China for Unfair Competition, the Third against Bronson only for Breach of Contract and the Fourth against Bronson only for Fraudulent Inducement. Those claims are determined here.

Turning first to Count II Common Law Unfair Competition, Bronson and Baby China allege that Bonifacino and Bekker, through their operation of MadeOf, intentionally interfered with the business opportunity of Bronson and Baby China to sell products based on formulations owned by Baby China. Bronson's claim is duplicative of her breach of contract claim, as ¶ 6 of the MOU includes a lengthy Competition Restriction Clause that even includes a penalty for breach. The stated restriction is quite broad, stating that:

> The Partners who have an active role in The Company undertake not to compete in any way, directly or indirectly, with the business of The Company.

The non-compete clause expressly indicated it was valid not only during the term of the MOU, but also for 12 months after a Partner ceased to have an active role in Bornganic. Thus, the MOU controls and precludes any claim by Bronson for common law unfair competition.

As noted earlier, Baby China is not a party to the MOU. However, Bronson does not allege that Baby China was engaged in a separate business while Bornganic was in operation. Quite the contrary, Bronson alleges she contacted Bonifacino in the first instance to discuss "the possibility of entering into a business venture to commercialize Baby China Products Co.'s

confidential and proprietary formulations for the U.S. and Chinese markets." (Counterclaim ¶17). Bornganic was then formed for that purpose. As Baby China was not operating on its own, there was no ongoing business against which defendants could unfairly compete. The alleged "reasonable probability of a business opportunity" alleged in ¶76 is too vague and speculative to state a claim for unfair competition. Count II is therefore dismissed. This finding, however, does not detract from the misappropriation of trade secrets claims asserted in the surviving Counterclaims I and VI.

Bronson in Count III seeks damages for Breach of Contract. The referenced contract is the MOU, and the breaches include direct competition by Bonifacino and Bekker in violation of the Competition Restriction Clause in ¶6 of the MOU through their undisclosed company MadeOf, coupled with misrepresentations that Bornganic needed more time to commence manufacturing when MadeOf had, in fact, already begun manufacturing.

The allegations fit squarely within the terms of the Competition Restriction Clause quoted above and thus state a claim for breach of contract, if the Court accepts the allegations as true as one must on a 3211 motion. The Court rejects the argument by Bonifacino and Bekker that Bronson cannot enforce the MOU because she failed to perform by not making the $1M capital contribution. The MOU did not contain any deadline for the contribution, and Bornganic was still in its relative infancy (only six months old) when the Termination Agreement was signed. Moreover, Bronson had many other obligations under the MOU related to matters such as product development, and Bronson indisputably fulfilled at least some of those obligations.

Thus, enforcement of the MOU is not barred as a matter of law based on nonperformance by Bronson. However, the hotly contested issue is whether the Breach of Contract claim is barred by the broad Release set forth in ¶3 of the Termination Agreement and quoted in full

above at page 3. The analysis of that issue is intertwined with Bronson's claim of fraudulent inducement.

In Count IV Fraudulent Inducement, Bronson seeks damages for having divested herself from Bornganic via the Termination Agreement. Specifically, Bronson claims she was fraudulently induced by affirmative misrepresentations and omissions by Bekker and Bonifacino intended to induce Bronson to give up her rights to Bornganic and that she reasonably relied on those misrepresentations and omissions in deciding to sign the Termination Agreement. Although the pleaded damages are circumscribed, the claim has the potential for broad impact, as a finding of fraudulent inducement would invalidate the entire Termination Agreement, including the Release critical to the analysis of Count III Breach of Contract.

"To state a legally cognizable claim of fraudulent inducement based on a misrepresentation or omission, the complaint [or counterclaim] must allege that [Bonifacino and/or Bekker] intentionally made a material misrepresentation of fact in order to defraud or mislead [Bronson], and that [Bronson] reasonably relied on the misrepresentation and suffered damages as a result." *Connaughton v Chipotle Mexican Grill, Inc.*, 135 AD3d 535, 537 (1st Dep't 2016), *aff'd* 29 NY3d 137 (2017), citing *Oxbow Calcining USA Inc. v. American Indus. Partners,* 96 A.D.3d 646, 650 (1st Dep't 2012); and *Eurycleia Partners, LP v. Seward & Kissel, LLP,* 12 N.Y.3d 553, 559 (2009).

In support of her fraudulent inducement counterclaim, Bronson alleges several misrepresentations and omissions by plaintiffs Bonifacino and Bekker implicitly intended to mislead Bronson. They include plaintiffs' misrepresentation that Bornganic could not commence manufacturing for several months, omitting that plaintiffs were self-dealing by manufacturing under the trademark MadeOf using Baby China's formulations without permission for their own

profit (Counterclaim ¶¶42-47). Bronson's allegation that she met regularly with plaintiffs to discuss the status of Bornganic's business, including a review of financial models, the marketing plan, and strategy (id. ¶¶38-40), at a minimum creates an issue of fact as to whether Bronson made sufficient inquiry to justify reliance under the specific circumstances of this case. *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.,* 25 NY3d 1043, 1044-45 (2015) (when a party has hints that a representation is false, a heightened degree of diligence is required before reliance is justified). Nevertheless, "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." *ACA,* 25 NY3d at 1045, citing *DDJ Mgt., LLC v Rhone Group LLC,* 15 NY3d 147, 156 (2010); *see also Gonzalez v 40 W. Burnside Ave. LLC,* 107 AD3d 542, 544 (1st Dep't 2013) (reversing dismissal of complaint at the pleading stage, finding issues of fact as to whether plaintiff had reasonably relied on misrepresentations that fraudulently induced her to sign a release).

However, Bronson has failed to allege compensable damages, which is also an essential element of the counterclaim for fraudulent inducement. As the Court of Appeals recently explained in *Connaughton, supra* at 142-43 (with citations omitted):

> The true measure of damage is indemnity for the actual pecuniary loss sustained as the direct result of the wrong or what is known as the "out-of-pocket" rule … Under that rule, damages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained … There can be no recovery of profits which would have been realized in the absence of fraud … Moreover, this Court has consistently refused to allow damages for fraud based on the loss of a contractual bargain, the extent, and indeed … the very existence of which is completely underminable and speculative…

The only damages alleged by Bronson are those related to her decision to divest from Bornganic pursuant to the Termination Agreement (Counterclaim ¶¶85-87). Those damages are the "quintessential lost opportunity" to profit from Bornganic were the

company able to proceed, and not a recoverable out-of-pocket loss. Such damages are not available here, just as the *Connaughton* Court found no compensable damages based on plaintiff's claim that he was fraudulently induced to work with defendant and abandon efforts to solicit others to purchase his restaurant concept on potentially better terms.

For these reasons, Bronson cannot pursue Counterclaim IV that she was fraudulently induced to enter into the Termination Agreement. This conclusion, however, is not dispositive of the issue whether Bonifacino and Bekker can rely on the Release in the Termination Agreement to compel dismissal of the remaining Counterclaim III for breach of contract. The question is a close and difficult one to answer.

The leading case cited by both parties on the issue whether a release can operate as a complete bar to an action or claim is *Centro Empresarial Cempresa S.A. v America Movil, S.A.B. de C.V.,* 17 NY3d 269 (2011). Plaintiffs in *Centro* signed two releases in connection with the sale of their ownership interests in a company co-owned by the parties. Some time after, plaintiffs commenced suit claiming that defendants had supplied them with fraudulent financial information on which they had relied to negotiate the sales price, and defendants moved to dismiss claiming the suit was barred by the release. The Appellate Division dismissed the action based on the release, and the Court of Appeals affirmed.

The Court of Appeals began its analysis reiterating that: "A release may be invalidated … for any of the traditional bases for setting aside written agreements, namely, duress, illegality, fraud, or mutual mistake." 17 NY3d at 276, *quoting Mangini v McClurg*, 24 NY2d 556, 563 (1969). Generally, to invalidate a release based on fraudulent inducement, the releasor must establish the basic elements of fraud; namely a

misrepresentation of material fact by the releasee (Bonifacino and Bekker), justifiable reliance by the releasor (Bronson), and resulting injury. However, even if the allegations fall short of that standard, the release may not be construed to bar *unknown* claims unless the parties intended such a broad application and the releasee demonstrates that the release is "fairly and knowingly made". *Id., quoting Mangini,* 24 NY2d at 566-67. Further, the party challenging the release as fraudulently induced must identify a "separate fraud from the subject of the release." *Id.* Finding that the value of the ownership interest that was sold "falls squarely within the scope of the release," the Court found the release barred plaintiff's claims and compelled the dismissal of the action.

As part of its analysis, the *Centro* Court also discussed the considerations when the parties to the release have a fiduciary relationship: "A sophisticated principal is able to release its fiduciary from claims --- at least where, as here, the fiduciary relationship is no longer one of unquestioning trust --- *so long as the principal understands that the fiduciary is acting in its own interest and the release is knowingly entered into* ..." 17 NY3d at 278 (citation omitted, emphasis added). Finding that the parties were large corporations engaged in complex transactions in which they were advised by experienced counsel, the Court found the plaintiffs had "negotiated an extraordinarily broad release with their eyes wide open" and the release was therefore binding. *Id.*

Both sides have cited various cases in which the appellate courts have applied these principles to determine whether a claim was barred by a release, and the determination in each case is very fact specific. Having reviewed the cases, this Court declines to find at the pleading stage that Bronson's breach of contract counterclaim is barred by the release as a matter of law. Bronson has cited to various cases in which the

plaintiff's claims survived 3211 dismissal, despite a release, that are based on allegations similar to the allegations here.

For example, in *Mangini,* cited by both parties and quoted above, the Court of Appeals reversed a grant of summary judgment in favor of the defendant releasee and remanded the action for a trial, finding issues as to whether the release had been "fairly and knowingly made", even though the situation fell short of actual fraud. The Court found the plaintiff had the right to try to prove at trial, either directly or circumstantially, that she had not intended to release claims for unknown injuries related to an accident, despite the broad standard language of the release. The Court emphasized that the existence of "overreaching or unfair circumstances [might deem it] inequitable to allow the release to serve as a bar to the claim of the injured party …" 24 NY2d at 557 (citations omitted).

The equities were similarly considered by the First Department in *Johnson v Lebanese Am. Univ.,* 84 AD3d 427 (2011). There, the Appellate Division reversed the trial court's dismissal of the action based on the release, finding issues of fact as to whether the release had been "fairly and knowingly made" so as to extend its reach "to claims both known and unknown." 84 AD3d at 429. In explaining the "fairly and knowingly made" standard, the court stated:

> This does not necessarily mean that the releasor must show shat he or she was induced to execute the release by fraudulent means. Rather, "[t]he requirement of an 'agreement fairly and knowingly made' has been extended … to cover other situations where because the releasor has had little time for investigation or deliberation, or because of the existence of overreaching or unfair circumstances, it was deemed inequitable to allow the release to serve as a bar to the claim of the injury party"

Id. at 429, quoting *Mangini,* 24 NY2d at 567 and citing *Haynes v Ganez,* 304 AD2d 714 (2003) and *Starr v Johnsen,* 143 AD2d 130 (1988).

Applying this standard, the Johnson court reversed the trial court's grant of summary judgment dismissing the action based on a release and reinstated the complaint, finding issues of fact as to whether an employee who had signed a broad release in connection with his termination had released an unknown claim for discrimination.

In the instant case, although Bronson had some business sense, her situation is distinguishable from Centro in that she is not a large corporation that regularly engaged in complex transaction with the assistance of experienced counsel. Further, she asserts she did not know, and had no reason to know, that Bonifacino and Bekker were acting in their own self-interest, contrary to the terms of the contract and their fiduciary duty. Her focus was to end the business relationship, just as the focus of the Johnson plaintiff was to terminate the employment relationship, but issues of fact exist as to whether the release was "fairly and knowingly made" with the intent to release Bonifacino and Bekker from unknown claims related to defendants' extreme self-dealing. Therefore, this Court declines to dismiss Count II for Breach of Contract at the pleading stage.

Accordingly, defendants' motion to dismiss is granted to the extent of directing the Clerk to sever and dismiss Counterclaims II, IV, V, VII, VIII, IX and X, and the motion is denied with respect to Counterclaims I, III and VI.

Counsel shall appear at the April 30 discovery conference with full settlement authority and prepared to select a trial date.

4/12/2019
DATE

BARRY R. OSTRAGER, J.S.C.

BARRY R. OSTRAGER
JSC

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
		GRANTED		DENIED	X	GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
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