ATSCO Footwear Holdings, LLC v KBG, LLC
2020 NY Slip Op 30931(U)
April 9, 2020
Supreme Court, New York County
Docket Number: 654336/2018
Judge: O. Peter Sherwood

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

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ATSCO FOOTWEAR HOLDINGS, LLC f/k/a ATSCO FOOTWEAR, LLC,

Plaintiff,

-against-

KBG, LLC,

Defendant.

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DECISION AND ORDER
Index No.: 654336/2018

Motion Sequence No.: 001

O. PETER SHERWOOD, J.:

I. FACTS

According to the Verified Amended Complaint (Complaint, Dkt. 6), the facts are as set forth below. Plaintiff Atsco Footwear LLC (Atsco) is a wholly owned subsidiary of non-party Atsco Footwear Holdings LLC (Holdings, and together the Atsco Parties).[1] Nonparties Alan Colman and Mark Itzkowitz are members and principals of Holdings. Atsco was in the business of importing, marketing, distributing, and selling footwear.

On November 1, 2012, the Atsco Parties entered into an asset purchase agreement with defendant KBG (the APA) by which KBG would purchase certain inventory, intellectual property, and other assets. In connection with the APA, Atsco, Colman, Itzkowitz, and KBG entered into a Management Agreement (MA) by which KBG engaged Atsco to provide Colman and Itzkowitz's services for five years, 2013-2017 (the Engagement Period), to manage the day-to-day operations of Atsco's legacy business (the Business) under KGB's ownership. Pursuant to the MA, KGB was to pay Atsco incentive fees based, in part, on the net gross profit of the Business during the Engagement Period (*id.* ¶¶ 13- 19). The Engagement Period ended as planned, on December 31, 2017.

On March 14, 2018, Atsco invoked its contractual right to audit the books (*id.*, ¶ 23). On May, 23, 2018, Colman challenged KBG's Computation Statement for 2017, claiming KBG undervalued the amount due Atsco for that year. KBG then revised the Computation Statement. On June 18, 2018, Colman found additional errors. Atsco informed KBG it was hiring an

[1] The amended complaint lists Atsco as the sole plaintiff (Doc. No. 30) but the parties now list Holdings as the plaintiff (*see, e.g.*, Pl. Opp., Doc. No. 45).

accountant. KBG revised the statement again, walking back the prior changes and making new changes that lowered the amount due Atsco (*id.*, ¶¶ 31,33). Atsco then asked for documents to support those revisions. KBG has not complied fully (*id.*, ¶ 34).

Atsco asserts a single claim for breach of contract for failure to pay the proper Incentive Fees for 2013 through 2017 (*id.*, ¶ 41), and claims to be entitled to its attorneys' fees pursuant to the prevailing party clause in the MA (*id.*, ¶ 35).

II. ARGUMENTS

A. KBG's Arguments in Support of Dismissal

Defendant moves to dismiss the action pursuant to CPLR 3211(a)(1) and (7), based on documentary evidence and failure to state a claim. It argues that Atsco waived (in writing) any right to audit the Business for the first four years of the MA (Memo at 1-2). The agreement requires timely objection, and there was no such objection. Accordingly, the statements and calculations became final and cannot be challenged now (*id.* at 12). Instead, Atsco expressly agreed to the validity of the Computation Statements for each of the first four years (*id.* at 10-11, citing emails from Alan Colman, attached as Exhibits 2, 4, 6, and 8 to Mizrachi Aff, NYSCEF Docs. No. 36, 38, 40, and 42). In each communication, Colman indicates that he and Itzkowitz feel the statement of account is in order and they "are giving up [their] right to audit for" those fiscal years. The computation statements also qualify as an account stated, which Atsco admitted were correct (*id.* at 13). While an account stated is usually used as the basis for a claim for payment, it can also be used as a defense to a claim (*id.* at 14). Atsco did not merely remain silent when presented with the statements, it affirmatively accepted the statements and waived its audit rights. It cannot bring a challenge now (*id.*).

The court should also dismiss Atsco's claim that two particular revenue streams should be included in Net Gross Profits (from which Atsco's fee is calculated).

- Management fees paid between KBG and its affiliates are not part of the Business and are not defined as part of Net Gross Profits. The Business is defined as Atsco's historical business of importing, marketing, distributing, and selling footwear (*id.* at 15). This does not include fees paid to KBG by its affiliates for KBG's management services.
- Royalty fees paid by KBG to its affiliate are not revenue to KBG, and such intra-company payments are excluded from Net Gross Profits, which also prohibits such

double-counting of revenue. The MA references preparation of the Computation Statement based on KBG's financials, and not those of its affiliates (*id.* at 16). The MA alsoprovides that fees should be calculated "without duplication," so that these fees, which were already accounted for when KBG received the funds as part of the Business, should not be double counted when KBG paid them to its affiliate (*id.* at 17).

B. Atsco's Opposition

Atsco argues that the Complaint should stand because defendant never alleges it did not breach the MA (Opp at 8). The arguments of waiver are full of issues of fact, and waiver of that right does not eliminate a claim for breach of section 3(a)(iii) of the MA. The letters provided by defendant do not definitively show defendant did not breach that section of the MA, only, at most, that Atsco accepted the computation statement at that time and waived its audit right (*id.* at 11).

As far as defendant claims a failure to timely object made the computations and payments final for all but the last year, nothing in the MA requires Atsco to invoke a particular process or to act at risk of allowing the computation and payment to become binding (*id.* at 11-12). There is no time limit in the MA by which Atsco must complain (*id.* at 12-13).

The doctrine of account stated does not bar the Complaint. All but one of the cases cited by defendant are in the context of lawyers seeking to be paid pursuant to their invoices for legal services (*id.* at 13). This doctrine does not relieve a party of its contractual obligations. When KBG failed to properly calculate the amount due Atsco, it breached the MA. There is no claim for breach of any other agreement (*id.* at 14). Even if the doctrine applied, the statement of an account is not binding where "fraud, mistake, or other equitable considerations are shown" (*id.*, quoting *Cushman & Wakefield, Inc. v Kadmon Corp., LLC*, _NYS3d _ , 2019 WL 4264393 [1st Dept., Sept. 10, 2019]). Equity requires further investigation, as, at the time, KBG had all of the relevant information and hid it.

Even if Atsco waived its audit right, that does not waive the right to enforce the MA. Breach of the MA is what is at issue here, not the right to audit. If there was any waiver, it was made before Atsco knew the extent of KBG's breach of the MA, because of KBG's subterfuge (*id.* at 16). Atsco did not know the extent of the injury it was waiving, and any waiver should be a nullity.

As for defendant's arguments regarding the specific revenue streams, those go only to the extent or amount of damages, and are not appropriate for this motion. Further, revenues from management allocations and royalty fee are included in Net Gross Profits, under the MA.

Net Gross Profits is defined in the MA as:

> "all revenues of the Business and (but without duplication) all revenues from Business Products and Business Marks run through the Business (including license revenues from the Business Marks) during such period."

Section 3(a)(iii) of the MA defines "Business" as:

> "the importing, marketing, distributing and selling worldwide of men's, women's and children's footwear under or using any of the Khombu Business Marks with respect to Business Products or any other Business Mark with respect to Business Products sold by the Company's sale organization and/or licensed by or on behalf of the Business as set forth herein, as well as other products historically sold by Atsco Footwear, which are sold by [KBG, LLC's] sales organization, and/or licensed by or on behalf of the Business as set forth herein".

Atsco argues that, as far as revenue from the Management Allocations is related to the Business, that money falls with "revenues of the Business."

Regarding the Royalty Fees, KBG and KBG IP entered into a Master License Agreement by which KBG would pay KBG IP 6% of the net sales attributable to the Business Marks, and now argues that those payments are revenue to KBG IP, and not to the Business (Opp. at 18). Revenue from use of the Business Marks is revenue of the Business, no matter what entity it comes from. The MA also lists a variety of deductions. The parties knew how to deduct items from the calculation when they wished to do so (*id.* at 19). KBG chose to transfer rights to the marks to an affiliate and, thus, to incur a fee of 6% on all net sales. To find otherwise would rewrite the MA.

III. DISCUSSION

A. Standard

On a motion to dismiss a plaintiff's claim pursuant to CPLR § 3211 (a) (7) for failure to state a cause of action, the court is not called upon to determine the truth of the allegations (*see, Campaign for Fiscal Equity v State,* 86 NY2d 307, 317 [1995]; *219 Broadway Corp. v Alexander's, Inc.,* 46 NY2d 506, 509 [1979]). Rather, the court is required to "afford the pleadings a liberal construction, take the allegations of the complaint as true and provide plaintiff the benefit of every possible inference [citation omitted]. Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBC I v Goldman, Sachs & Co.,* 5 NY3d 11, 19 [2005]). The court's role is limited to determining whether the pleading states a cause of action, not whether there is evidentiary support to establish a meritorious cause

of action (*see Guggenheimer v Ginzburg,* 43 NY2d 268, 275 [1977]; *Sokol v Leader,* 74 AD3d 1180 [2d Dept 2010]).

To succeed on a motion to dismiss pursuant to CPLR § 3211 (a) (1), the documentary evidence submitted that forms the basis of a defense must resolve all factual issues and definitively dispose of the plaintiff's claims (*see, 511 W. 232nd Owners Corp. v Jennifer Realty Co.,* 98 NY2d 144, 152 [2002]; *Blonder & Co., Inc. v Citibank, N.A.,* 28 AD3d 180, 182 [1st Dept 2006]). A motion to dismiss pursuant to CPLR § 3211 (a) (1) "may be appropriately granted only where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law" (*McCully v. Jersey Partners, Inc.,* 60 AD3d 562, 562 [1st Dept. 2009]). The facts as alleged in the complaint are regarded as true, and the plaintiff is afforded the benefit of every favorable inference (*see Leon v Martinez,* 84 NY2d 83, 87-88 [1994]). Allegations consisting of bare legal conclusions as well as factual claims flatly contradicted by documentary evidence are not entitled to any such consideration (*see e.g. Nisari v Ramjohn,* 85 AD3d 987, 989 [2nd Dept 2011]).

CPLR § 3211 (a) (1) does not explicitly define "documentary evidence." As used in this statutory provision, "'documentary evidence' is a 'fuzzy term', and what is documentary evidence for one purpose, might not be documentary evidence for another" (*Fontanetta v John Doe 1,* 73 AD3d 78, 84 [2nd Dept 2010]). "[T]o be considered 'documentary,' evidence must be unambiguous and of undisputed authenticity" (*id.* at 86, citing Siegel, Practice Commentaries, McKinney's Cons. Laws of N.Y., Book 7B, CPLR 3211:10, at 21-22). Typically that means "judicial records, as well as documents reflecting out-of-court transactions such as mortgages, deeds, contracts, and any other papers, the contents of which are 'essentially undeniable,'" (*id.* at 84-85). Here, the documentary evidence is the MA and the waiver letters.

B. Breach of Contract

To sustain a breach of contract cause of action, plaintiff must show: (1) an agreement; (2) plaintiff's performance; (3) defendant's breach of that agreement; and (4) damages (*see Furia v Furia*, 116 AD2d 694, 695 [2d Dept 1986]). "The fundamental rule of contract interpretation is that agreements are construed in accord with the parties' intent . . . and '[t]he best evidence of what parties to a written agreement intend is what they say in their writing' . . . . Thus, a written

agreement that is clear and unambiguous on its face must be enforced according to the plain terms, and extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous [internal citations omitted]" (*Riverside South Planning Corp. v CRP/Extell Riverside LP*, 60 AD3d 61, 66 [1st Dept 2008], *affd* 13 NY3d 398 [2009]). Whether a contract is ambiguous presents a question of law for resolution by the courts (*id.* at 67). Courts should adopt an interpretation of a contract which gives meaning to every provision of the contract, with no provision left without force and effect (*see RM 14 FK Corp. v Bank One Trust Co., N.A.*, 37 AD3d 272 [1st Dept 2007]).

Plaintiff has alleged an agreement, its own performance, breach and damages. Defendant asserts several defenses to performance.

1. Waiver/Agreement to the Computation Statements

The documentary evidence shows plaintiff waived its right to audit in the first four years of the MA. Plaintiff argues that while the MA contained a process for contesting the Computation Statements, the MA did not explicitly state that the procedure was the exclusive way to contest the Computation Statements, and that such language was in the agreements in cases in which the court held the action was contractually barred because the plaintiff failed to use the stated procedure. Defendant contends no magic language is needed to make the contractual procedure a requirement.

"The fundamental rule of contract interpretation is that agreements are construed in accord with the parties' intent . . . and '[t]he best evidence of what parties to a written agreement intend is what they say in their writing' . . . ." (*Riverside South Planning Corp. v CRP/Extell Riverside LP,* 60 AD3d 61, 66 [1st Dept 2008], *affd* 13 NY3d 398 [2009]). In accordance with these principles, a court should interpret a contract "so as to give full meaning and effect to the material provisions" (*Beal Savings Bank v Sommer*, 8 NY 3d 318, 324 [2007], quoting *Excess Ins. Co. Ltd. v Factory Mut. Ins. Co.*, 3 NY3d 577, 582 [2004]). "A reading of a contract should not render any portion meaningless . . . . Further, a contract should be read as a whole, and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose" (*id.* at 324-325, quoting *Matter of Westmoreland Coal Co. v Entech, Inc.*, 100 NY2d 352, 358 [2003]). To read the procedure for contesting the validity of the Computation Statement as optional is to read it out of existence, to make it irrelevant. Notably, while plaintiff claims the cases are distinguishable because the contracts in those cases had language making the procedure mandatory, plaintiff cites no case in which a court interprets an agreement as it would have this court do.

2. Account Stated

"An account stated is an agreement between parties to an account based upon prior transactions between them with respect to the correctness of the account items and balance due" (*Jim-Mar Corp. v Aquatic Constr.*, 195 AD2d 868, 869 [3d Dept 1993]). The agreement can be express (*Ross v Sherman*, 57 AD3d 758, 759 [2d Dept 2008]), or "may be implied where a defendant retains bills without objecting to them within a reasonable period of time, or makes partial payment on the account" (*Am. Express Centurion Bank v Cutler*, 81 AD3d 761, 762 [2d Dept 2011]). "[R]eceipt and retention of plaintiff's accounts, without objection within a reasonable time, and agreement to pay a portion of the indebtedness, [gives] rise to an actionable account stated, thereby entitling plaintiff to summary judgment in its favor" (*Shea & Gould v Burr*, 194 AD2d 369, 370-71 [1st Dept 1993] [citation and internal quotation marks omitted]).

While it is usually used to require payment of an undisputed demand, KBG argues it works in the reverse, as well. KBG provided an account statement of what Atsco was owed, and Atsco did not contest it, in fact, agreeing to it. Atsco accepted payment. Therefore, Atsco has agreed to the amount of the debt (*see York Hunter Servs., Inc. v Brooklyn Historical Soc'y*, 14 Misc 3d 1216[A], 2007 WL 79642 at *2-3 [Sup Ct Kings Cty January 8, 2007]).

3. Management Allocation and Royalty Fees

While Atsco argues the Management Allocation and Royalty Fees issues only go to damages, they also go to the existence of a breach. Based on the terms of the MA, the Management Allocation does not appear to be related to the legacy Atsco Business, so should be excluded. The Royalty Fees would, as KBG points out, be duplicative if included, as the Royalty Fees are fees paid out of money received by KBG for legacy Atsco Business, for which money is already being taken out for Atsco. Accordingly, to factor in Royalty Fees would be to count those funds twice.

Accordingly, it is hereby

ORDERED that the motion to dismiss of defendant KBG, Inc., (Motion Sequence Number 001) is GRANTED and the amended complaint is hereby dismissed as to Gross Net Profits claimed for the period 2013 through 2016 and as to the claims for payments based on the Management Allocations and Royalty Fees.

ORDERED that counsel for the parties shall appear at a status conference on Tuesday, June 2, 2020 at 9:30 AM at Part 49, Courtroom 252, 60 Centre Street, New York, New York.

This constitutes the decision and order of the court.

DATED: April 9, 2020

E N T E R,

Hon. O. Peter Sherwood
O. PETER SHERWOOD J.S.C.