SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. MELISSA CRANE** **PART** **60M**

Justice

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GU, DING

Plaintiff,

- v -

DPW HOLDINGS, INC.

Defendant.

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INDEX NO. 650438/2020

MOTION DATE 07/28/2021

MOTION SEQ. NO. 001

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 001) 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 59

were read on this motion to/for DISMISSAL.

This is an action for a declaratory judgment, specific performance, and damages arising from two transactions between the parties. The plaintiffs are individual investors and defendant DPW Holdings, Inc. ("DPW") is a holding company that deals in "undervalued" technologies. Defendant Milton C. Ault III is DPW's principal. In May 2019, plaintiff Ding Gu purchased a convertible note ("Note") and a stock warrant from defendant DPW Holdings, Inc. ("DPW") pursuant to a May 2019 term sheet ("May Term Sheet"). In July 2019, plaintiffs Gu and Xiaodan Wang entered into a term sheet agreement ("July Term Sheet") with DPW for the purchase of another note and stock warrant, but DPW did not issue those instruments.

In August 2019, DPW effectuated a reverse split (40-to-1) of its common stock. Gu then sought to convert a portion of the remaining balance on the Note into common stock and DPW refused to effectuate the conversion. Gu generally contends that he is entitled to convert the Note's remaining principal at the $0.22 rate specified in the Note and in the contemporaneous

Securities Purchase Agreement ("SPA"). DPW contends that the Notice of Conversion is invalid because the conversion rate must be adjusted to reflect the stock split.

The May 2019 Transaction

In May 2019, plaintiff Gu met with defendant Ault, the CEO of DPW, and they executed a term sheet. Under the May Term Sheet, dated May 8, 2019 (Doc 8), Gu purchased a 4% Original Issue Discount Convertible Note ("Note") in the principal amount of $660,000 and a stock warrant to purchase 500,000 shares of DPW common stock for $500,000. Gu tendered $500,000 and the Note (Doc 9), stock warrant (Doc 10), and a Securities Purchase Agreement ("SPA") (Doc 16) were issued on May 13, 2013.

The Note has a term of five years and accrues interest at the rate of 4% per annum. Under Article 1 the Note, Gu is entitled to convert any or all portion of the then outstanding principal and interest into DPW's common stock at any time after July 15, 2019. The conversion price under § 1.6 of the Note is $0.22 per share (Doc 9). The Note contains a "blocker provision" plaintiff Gu can waive upon 61 days' notice. It provides: "in no event shall the Holder [Gu] be entitled to convert any portion of this Note in excess of that portion of this Note upon conversion of which the sum of (1) the number of shares of Common Stock beneficially owned by the Holder and its affiliates . . . and (2) the number of Conversion Shares issuable upon the conversion of the portion of this Note . . . would result in beneficial ownership by the Holder and its affiliates of more than 4.99% of the then outstanding shares of Common Stock" (*id.* § 1.1).

Section 1.3 of the Note requires DPW to "reserve from its authorized and unissued Common Stock a sufficient number of shares, . . . to provide for the issuance of a number of Conversion Shares equal to the sum of (i) the number of Conversion Shares issuable upon the

full conversion of this Note (assuming no payment of Principal or interest) as of any issue date (taking into consideration any adjustments to the Conversion Price pursuant to Section 2 hereof or otherwise) multiplied by (ii) three." The conversion price can be adjusted upon "any merger, consolidation, exchange of shares, recapitalization, reorganization, or other similar event, as a result of which shares of Common Stock of the Borrower shall be changed into the same or a different number of shares of another class or classes of stock or securities of the Borrower or another entity" (*id.*, § 1.6 [a]). The Note does not specifically provide for adjustment to reflect changing stock valuation after a reverse stock split. However, DPW is not prohibited from effectuating a reverse stock split under those documents.

The July 2019 Transaction

Plaintiffs allege that Ault "solicited another investment" in the amount of $400,000 in July 2019. Plaintiffs agreed to "provide the loan under similar terms as the May 2019 Note" and executed the July Term Sheet on July 11, 2019 (Doc 35). Plaintiffs paid $400,000 in consideration for a short-term convertible note and another stock warrant, but the note and warrant were never issued. Plaintiffs allegedly wired the funds to DPW on July 12, 2019, and DPW retained those funds without providing the corresponding instruments. DPW did not return the money.

The Reverse Stock Split and Request to Convert Part of the May Note

On August 5, 2019, DPW effectuated a reverse, 40-to-1 split of its common stock. In late-August 2019, Gu contacted defendants by email to convert a portion of the Note's outstanding principal. DPW advised that the Note could be converted at a rate of $8.80 (adjusted from $0.22 to reflect the reverse stock split). DPW did not convert the principal. On January 6, 2020, Gu sent a new request by formal Notice of Conversion to convert $41,800 of the Note's

outstanding balance into common stock at a rate of $0.22 per share (for a total of 190,000 shares). DPW again refused to issue the converted stock.

With regard to the May Transaction and the Notice of Conversion, Gu seeks: (1) a declaratory judgment that they are entitled to convert the balance of the Note into common stock at the rate of $0.22 per share; (2) specific performance of the January 2020 Notice of Conversion; (3) damages of $1,558 per day from January 10, 2020 pursuant to § 1.4 (d) of the Note for DPW's alleged breach; (4) damages exceeding $311,600 for DPW's conversion of shares triggered by the Notice of Conversion; (5) attorneys' fees under the SPA; (6) an injunction forcing DPW to comply with any future notices to convert; (7) to enforce the personal guarantee executed by Ault in connection with the Note. As for the July Transaction, plaintiffs seek damages for: (8) DPW's breach of the July Term Sheet; (9) unjust enrichment; (10) money had and received; and (11) defendants' alleged fraud.

Defendants now move, pre-answer, to dismiss the complaint pursuant to CPLR 3211 (a) (1) and (a) (7). The court heard oral argument for this motion on July 28, 2021 and dismissed the fraud claim (plaintiffs' 11th cause of action).

Discussion

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. [The court] accept[s] the facts as alleged in the complaint as true, [and] accord[s] plaintiff[] the benefit of every possible favorable inference" (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994] [citation omitted]). However, bare legal conclusions and "factual claims which are either inherently incredible or flatly contradicted by documentary evidence" are not "accorded their most favorable intendment" (*Summit Solomon & Feldesman v Lacher*, 212 AD2d 487, 487 [1st Dept 1995]). Dismissal under subsection (a) (1) is warranted where the documentary

evidence "conclusively establishes a defense to the asserted claims as a matter of law" (*Leon v Martinez,* 84 NY2d 83, 88 [1994]).

The First Seven Causes of Action Involving the May 2019 Transaction

The court rejects defendants' argument that the first seven causes of action must be dismissed because the January 2020 Notice of Conversion is invalid.

Defendants contend that the May Term Sheet is inseparable from the Note and provides that the conversion price must be adjusted for the reverse stock split. The May Term Sheet defines "Conversion Price" as "$0.22 per share (subject to adjustment . . .)," and states that "[t]he Conversion Price will, . . . be subject to standard anti-dilution provisions in connection with any stock split, stock dividend, subdivision or similar reclassification of the Common Stock" (Doc 8).

The SPA supersedes the May Term Sheet. The SPA contains a merger clause incorporating only "the Note, the Warrant and the instruments referenced [in the SPA]" (Doc 16 § 8 [e]). The Term Sheet is not referenced in the SPA, the Note, or the stock warrant issued in connection with that transaction. The Term Sheet itself states: "This proposed term sheet . . . dated as of May 8, 2019 summarizes the principal terms of a transaction contemplated by DPW . . . that is anticipated to be fully delineated in a Securities Purchase Agreement" (Doc 8). The Term Sheet does not survive the SPA and has no application to whether plaintiff is entitled to convert the Note into shares at the contractual "Conversion Rate" of $0.22 per share or whether the rate must be adjusted to account for the reverse stock split.

The Note and the SPA do not expressly address whether the conversion price must be adjusted in the event of a reverse stock split. The Note states that "[t]he per share conversion price into which Principal and interest (including Default Interest) under this Note shall be

convertible into shares of Common Stock hereunder shall be $0.22" (Doc 9, § 1.2). Section 1.6 (a) ("Adjustment Due to Merger, Consolidation, Etc.") provides for an adjustment of the conversion price as a result of "any merger, consolidation, exchange of shares, recapitalization, reorganization, or other similar event, as a result of which shares of Common Stock of the Borrower shall be changed into the same or a different number of shares of another class or classes of stock or securities of the Borrower or another entity" (*id.* § 1.6 [a]). Section 1.6 (a) applies when shares of common stock are changed into "the same or a different number of shares of another class or classes of stock or securities." The reverse stock split here simply reduced the total number of shares of DPW's common stock, it did not alter the class of those shares. The only mention of a stock split (or reverse stock split) in the Note is in § 1.7. Section 1.7 concerns only the "Exchange Cap" and is therefore inapplicable.

While silence does not equate to contractual ambiguity (*Greenfield v Philles Records, Inc.*, 98 NY2d 562, 573 [2002]), an omission as to a material issue can create an ambiguity in some instances (*see e.g. Louis Dreyfus Energy Corp. v MG Ref & Mktg., Inc., 2* NY3d 495, 500, 780 NYS2d 110 [2004]). Without a provision for adjustment in the event of a reverse stock split in the Note, defendants cannot establish that the Notice of Conversion was "invalid" based on the $0.22 conversion price.

Defendants next argue that the Note's "blocker" provision requires dismissal of the claims relating to the May 2019 Transaction. The court disagrees. While the Note contains a blocker provision to protect the holder [plaintiff Gu] from being deemed a "beneficial owner" under Article 16 of the Securities Exchange Act of 1934, Gu [the holder] is entitled to waive that protection upon 61 days' notice to the DPW [the borrower]. The Note does not specify how that notice should be transmitted. Defendants do not dispute that Gu advised them, by email on August 26, 2019, that

he intended to convert a portion of the Note. In that email, Gu stated "after this conversion, [he would] own shares more than 5% of total DPW Shares" (Doc 36). Gu did not submit the formal Notice of Conversion until January 6, 2020, more than 61 days after that email. There is at least an issue of fact as to whether plaintiff gave timely, effective notice of his intent to waive the blocker provision.

Accordingly, defendants' motion to dismiss is denied as to the first (declaratory judgment), third (breach of contract), fifth (attorneys' fees), and seventh (enforce guarantee) causes of action.

However, the second cause of action, for specific performance, is dismissed. New York does not recognize a standalone claim for specific performance. Specific performance is a remedy for breach of contract that may be available instead of, or in addition to, money damages (*Cho v 401-403 57th St. Realty Corp.*, 300 AD2d 174, 175 [1st Dept 2002] ["(S)pecific performance is an equitable remedy for a breach of contract, rather than a separate cause of action."]). The fourth cause of action sounding in conversion is also dismissed. Plaintiffs' conversion claim is duplicative of the breach of contract causes of action and there is no separate or ancillary duty or measure of damages alleged that would support this claim. In addition, the sixth cause of action for a permanent injunction is dismissed. Plaintiffs do not demonstrate that they have no adequate remedy at law for what is, in essence, an ordinary breach of contract claim (*see e.g. Lemle v Lemle*, 92 AD3d 494, 500 [1st Dept 2012]).

The Eighth to Eleventh Causes of Action Involving the July 2019 Transaction

Defendants do not dispute that they received $400,000 from plaintiffs or offer an excuse for their alleged failure to tender the note and stock warrant contemplated in the July Term Sheet. Instead, defendants incorrectly assert that the July Term Sheet is void because it contains

a criminally usurious rate of interest. Criminal usury is an affirmative defense that may be interposed by an entity or its guarantor for loans bearing interest rates greater than 25% of the principal amount per annum, provided that the principal amount did not exceed $2.5 million (*see* General Obligations Law [GOL] § 5-501 [1], [6] [b]; Banking Law § 14-a [1]; Penal Law § 190.40; *AJW Partners LLC v Itronics Inc.*, 68 AD3d 567, 568 [1st Dept 2009]). Corporations and their guarantors may invoke a criminal usury defense only to offset claims relating to nonpayment of a loan (*see Fred Schutzman Co. v Park Slope Advanced Med., PLLC*, 128 AD3d 1007, 1008 [2d Dept 2015]). Here, there is an issue of fact as to whether the July 2019 transaction was a loan, an investment, or a failed purchase agreement. Dismissing the eighth cause of action is therefore not warranted.

Defendants next argue that the ninth and tenth causes of action for unjust enrichment and money had and received should be dismissed as duplicative of the contract and fraud claims. The court declines to dismiss those causes of action at this juncture. Plaintiffs are permitted to plead, in the alternative, these claims for unjust enrichment and money had and received because defendants have taken the position that the contract is void or voidable.

The eleventh cause of action for fraud is dismissed for the reasons stated on the record at oral argument.

Accordingly, it is

ORDERED that defendants' motion to dismiss (MS 01) is granted to the extent that the second, fourth, sixth, and eleventh causes of action are dismissed. The motion is otherwise denied; and it is further

ORDERED that defendants must answer the complaint within 20 days of the court's entry of this order on NYSCEF; and it is further

ORDERED that the parties must appear for a preliminary conference (remotely via Microsoft Teams) on January 25, 2022 at 10:00 a.m.

This constitutes the decision and order of the court.

12/13/2021
DATE

MELISSA CRANE, J.S.C.

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
		GRANTED		DENIED	X	GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN				FIDUCIARY APPOINTMENT	REFERENCE