

Kind Operations Inc. v AUA Private Equity Partners, LLC
2022 NY Slip Op 31000(U)
March 22, 2022
Supreme Court, New York County
Docket Number: Index No. 653788/2019
Judge: Margaret Chan
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SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49M

-----X
 KIND OPERATIONS INC.,

INDEX NO. 653788/2019

Plaintiff,

MOTION DATE 10/22/2021

- v -

MOTION SEQ. NO. 004

AUA PRIVATE EQUITY PARTNERS, LLC, AOG, LLC, PA
 CO-MAN, INC. F/K/A TRUFOOD MFG., IN., TSUDIS
 HOLDING COMPANY, PETER TSUDIS, GEORGE
 TSUDIS, ANDY UNANUE, DAVID BENYAMINY, KYCE
 CHIH, JACK LIN,

**DECISION + ORDER ON
 MOTION**

Defendants.
 -----X

HON. MARGARET CHAN:

The following e-filed documents, listed by NYSCEF document number (Motion 004) 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 101, 102, 103, 104, 105, 106, 107, 108, 109

were read on this motion to/for

AMEND CAPTION/PLEADINGS

Plaintiff KIND Operations Inc. (KIND) moves pursuant to CPLR 3025 (b) for an order granting it leave to amend its complaint to assert a breach of contract claim against former defendant AOG, LLC (AOG) and a tortious interference with contract claim against former defendant AUA Private Equity Partners, LLC (AUA). Both AUA and AOG (AUA/AOG defendants) oppose the motion and defendants PA Co-Man Inc. f/k/a TruFood Manufacturing (TruFood), Peter Tsudis and George Tsudis adopt certain arguments in support of AUA/AOG defendants' opposition.

Background

This action arises out of a Manufacturing Agreement between KIND, which sells snack bars containing fruit, nuts and other natural ingredients, and TruFood (NYSCEF # 17-Amended and Restated Manufacturing Agreement dated July 1, 2015, as amended on November 1, 2015 and January 18, 2018). The Manufacturing Agreement requires TruFood to notify KIND 45 days before entering into a "change of control transaction," which includes "the sale, transfer or exclusive license ... of substantially all of the KIND assets" (*id.*, § 7.1 [b], [g]). Upon receiving notice, KIND has fifteen days to grant or withhold consent to the transaction, which consent is in its "sole and absolute discretion;" however, KIND's failure to reject the proposed transaction in writing, within the fifteen-day period is deemed a grant of consent to the transaction (*id.*, § 7.1 [b]).

In this action, KIND alleges that despite its failure to obtain its consent as required under section 7.1, TruFood entered into a change of control transaction with AUA and its affiliate, AOG, in June 2019 (the Transaction). Prior to the Transaction, TruFood defaulted on various secured loans and had surrendered its collateral to its secured creditors. The Transaction involved AOG's purchase of TruFood's assets from these secured creditors pursuant to a Purchase and Sale Agreement dated June 7, 2019 (PSA) (NYSCEF # 18-PSA).

KIND commenced this action on July 1, 2019, against TruFood, its CEO and President, Peter Tsudis, and the AUA/AOG defendants (NYSCEF # 1-Complaint). The initial complaint asserted claims against these defendants for breach of contract, breach of the covenant of implied faith and fair dealing, tortious interference with contractual relations, and for a declaratory judgment (*id.*, ¶¶ 33-58). KIND filed an amended complaint on September 1, 2019, which, *inter alia*, added as defendants certain individual principals of AUA and AOG (the Individual Defendants), and asserted additional claims, including for fraudulent omissions, aiding and abetting fraud, misappropriation of trade secrets and conversion (NYSCEF # 3-Amended Complaint, ¶¶ 85-97, 118-127).

The AUA/AOG defendants and the Individual Defendants separately moved to dismiss the Amended Complaint (NYSCEF #s 11-19; NYSCEF #s 21-22), and defendants TruFood, Peter Tsudis, and George Tsudis, (TruFood defendants), moved to dismiss the third count against them for fraudulent omissions (NYSCEF #s 25-26). By Decision and Order dated September 16, 2020 (the September 16 Decision), Justice O. Peter Sherwood (ret.) granted the motions and dismissed the Amended Complaint against the AUA/AOG defendants and the Individual Defendants and dismissed the third count against the TruFood Defendants (NYSCEF # 51).

In dismissing the first and second counts for breach of contract, and the eighth count for a declaratory judgment against AOG, Justice Sherwood rejected KIND's position that AOG was subject to liability under the Manufacturing Agreement, to which it was not a party, based on a theory that AOG was the successor in interest of TruFood as a result of a de facto merger (NYSCEF # 51, at 5-7). In reaching this conclusion, Justice Sherwood examined the terms of the PSA and found that allegations that AOG purchased "all or substantially all of TruFood's assets from secured creditors" did not support a finding of a de facto merger since the Transaction did not involve the acquisition of TruFood's stock (*id.*, at 7-8). Additionally, the court found that there was no de facto merger since the PSA specifically provided that AOG would not assume the liabilities of TruFood (*id.*, at 7, citing NYSCEF 18, § 2); and "there are few allegations about the continuing of personnel and management and the continuity of ownership," which would be indicative of de facto merger (*id.*).

As for the count five against AUA for tortious interference with contract, Justice Sherwood found that allegation that AUA “directed” TruFood to breach the Agreement was insufficient to show that a procurement of the breach was without justification, and that the purchase from secured creditors was not the cause of KIND’s injury (*id.*, at 11).

KIND appealed the September 16 Decision; the Appellate Division, First Department affirmed (*KIND Operations, Inc v AUA Private Equity Partners, LLC*, 195 AD3d 446 [1st Dept 2021]). Of relevance here, the First Department wrote that “[t]he allegations of the complaint do not establish a continuity of ownership following AOG’s purchase of [TruFood’s] assets from third-party secured creditors, and therefore fail to establish that the asset purchase transaction was a de facto merger, [and that] the other indicia of de factor merger, such as assumption of the predecessor’s debts, are not alleged (*id.*, at 447 [internal citation omitted]). Regarding the dismissal of the count for tortious interference with contract, the First Department affirmed, writing that “the allegations do not establish the element of lack of justification,” and that the allegations that TruFood’s CEO “was ‘directed’ by AUA to conceal the asset purchase from [KIND] [are not] sufficient to establish procurement since the CEO was free to reject that ‘direction’” (*id.*).

KIND now moves for leave to amend the Amended Complaint to assert a claim for breach of contract against AOG and for tortious interference with contract against AUA, and submits a proposed Second Amended Complaint (SAC) (NYSCEF # 98). In support of its proposed breach of contract claim, KIND argues that documents produced during discovery support KIND’s claims “in the precise areas where [Justice Sherwood] and the First Department found KIND’s allegations lacking” (NYSCEF # 97-KIND MOL of Support, at 10). Specifically, KIND argues that the documents establish that the Transaction was a de facto merger, and that AUA exerted substantial influence over Peter Tsudis, including by directing him not to inform KIND of the details of the Transaction.

The AUA/AOG defendants oppose the motion, asserting that KIND is precluded from asserting a claim against AOG based on successor liability as the September 16 Decision dismissed the claims against AOG based on documentary evidence which was with prejudice, and KIND failed to appeal the prejudice aspect on appeal. In addition, the AUA/AOG defendants argue that, under an acknowledgement agreement between AOG and KIND (NYSCEF # 106-Acknowledgement), KIND relinquished any purported claim against AOG predicated upon successor liability in exchange for AOG’s assumption of certain contractually liability. Moreover, they argue that the documentary evidence fails to establish a viable cause of action against AOG for breach of contract based on successor liability.

As for the proposed claim for tortious interference with contract against AUA, the AUA/AOG defendants argue that the claim remains flawed as it fails to allege that AUA “procured” TruFood’s breach of a contractual obligation, or that the conduct was “improper” or lacked adequate justification.

In reply, KIND argues that the motion to amend should be granted as the opposing parties have not shown any prejudice or surprise resulting from the proposed amendment and that their focus on the merits of the proposed amendment is an attempt to “highjack the motion and convert it to a motion to dismiss” (NYSCEF # 109-Reply Mem, at 6). KIND also argues that under the standard for a motion to amend, it cannot be shown that the proposed claims are “patently without merit” (*id.*, at 7).

Discussion

Leave to amend a pleading pursuant to CPLR 3025 (b) “shall be freely given,” in the absence of prejudice or surprise (*see e.g. Thompson v Cooper*, 24 AD3d 203, 205 [1st Dept 2005]). That said, in order to conserve judicial resources, examination of the underlying merit of the proposed amendment is mandated (*Zaid Theatre Corp. v Sona Realty Co.*, 18 AD3d 352, 355 [1st Dept 2005]). Thus, leave to amend will be denied when “the proposed action fails to state a cause of action, or is palpably insufficient as a matter of law” (*Thompson v Cooper*, 24 AD3d at 205 [internal citations omitted]; *see also MBIA Ins. Corp. v Greystone & Co., Inc.*, 74 AD3d 499, 500 [1st Dept 2010]). As there is no claim of prejudice or surprise resulting from the proposed claims, at issue is whether the proposed claims are of sufficient merit to permit their addition.

Proposed Breach of Contract Claim Against AOG

At the outset, this court rejects the AOG/AUA defendants’ argument that Justice Sherwood’s dismissal of the claims related to AOG’s breach of the Agreement precludes KIND from seeking to add the proposed breach of contract claim against AOG. Although Justice Sherwood considered documentary evidence, particularly the PSA, in dismissing the claims, the dismissal and its affirmance by the First Department were also based on an examination of the pleadings. Thus the law of the case does not apply (*see generally Caso v Miranda Sambursky Slone Sklarin Verveniotis LLP*, 180 AD3D 611, 613 [1st Dept 2020]; *Colbalt Partners, L.P. v GSC Capital Corp.*, 97 AD3d 35, 39 [1st Dept 2012]). Accordingly, the court will consider whether the allegations in the SAC and the documentary evidence submitted by KIND provide sufficient support for its proposed breach of contract claim against AOG based on the theory that the AOG’s acquisition of TruFood constituted a de facto merger.

New York law recognizes de facto merger “when a transaction, although not in form a merger, is in substance a consolidation or merger of seller and purchaser” (*Cargo Partner AG v Albatrans, Inc.*, 352 F3d 41, 45 [2d Cir 2003][applying New York law]). A de facto merger occurs “when the acquiring corporation has not purchased another corporation merely for the purpose of holding it as a subsidiary, but rather has effectively merged with the acquired corporation” (*Fitzgerald v Fahnestock & Co., Inc.*, 286 AD2d 573, 574 [1st Dept 2001]). Underlying the de facto merger doctrine is the concept that “a successor that effectively takes over a company in its entirety should carry the predecessor's liabilities as a concomitant to the benefits it derives from the good will purchased” (*id.*, at 575).

The “hallmarks” of a de facto merger include: (i) continuity of ownership; (ii) cessation of ordinary business and dissolution of the acquired corporation as soon as possible; (iii) assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and (iv) continuity of management, personnel, physical location, assets and general business operation (*Fitzgerald*, 286 AD2d at 575). The finding of a de facto merger does not “necessarily require” the presence of each factor (*id.*, at 574). However, “[i]t has [also] been held that because continuity of ownership is ‘the essence of a merger,’ it is a necessary element of any de facto merger, although not sufficient to warrant such a finding by itself” (*In re New York City Asbestos Litigation*, 15 AD3d 254, 256 [1st Dept 2005]). Continuity of ownership has been found to exist “where the shareholders of the predecessor corporation become direct or indirect shareholders of the successor corporation as the result of the successor's purchase of the predecessor's assets, as occurs in a stock-for-assets transaction” (*id.*).

Regarding continuity of ownership, KIND asserts that Tsudis, who was a shareholder of TruFood and its CEO, also owns an interest in AOG and was made the CEO of the new successor entity, and that his Employment Agreement was “integral” to the Transaction (NYSCEF #98, at ¶ 50). Specifically, KIND points to allegations in the SAC as supported by a Unit Issuance Agreement and Peter Tsudis’ Employment Agreement showing that Peter Tsudis acquired stock in AOG, specifically 1,000 Class B units and 30 Class C units, and thus had an equity ownership interest in AOG (NYSCEF # 97-MOL in Support, at 11, citing NYSCEF # 98 -SAC ¶¶ 4, 16, 49, 50; NYSCEF # 89-Unit Issuance Agreement). KIND also points out that as alleged in the SAC, the Amended Directors and Officers Insurance Liability Policy covers AOG and AUA prior to the Transaction and defines AOG and AUA as the “Successor Company,” to TruFood (*id.*, ¶ 57; NYSCEF # 92-Amended Insurance Policy). KIND further relies on communications with TruFood employees and customers including that AOG would “continue to operate much as [TruFood] before the sale,” and that AOG had “formed a new entity to own [TruFood’s] assets, use TruFood as a trade name and produce the same products [customers] have come to rely on,” and that the transition would be “seamless” (*id.*,

¶¶ 59, 60; NYSCEF #'s 94, 95). In addition, KIND notes that TruFood assigned its lease to AOG (NYSCEF # 90-Lease Assignment).

KIND also maintains that contrary to the AOG/AUA defendants' characterization, the Transaction did not involve a two-step arms-length Article 9 sale in which TruFood surrendered its assets to its lenders followed by AUA's purchase of those assets. Instead, KIND alleges that AUA "orchestrated the entire ...[T]ransaction" including the creation of AOG for the purpose of paying the \$35.7 million to TruFood's lenders to acquire TruFood assets that had been pledged to the lenders as collateral, and to receive a \$40 million loan from the banks secured by the very same assets as collateral (NYSCEF # 97, at 13; NYSCEF # 98, ¶ 54). KIND also alleges that AUA "papered over" its uninterrupted relationship with the secured lenders through a web of interconnected contracts (NYSCEF # 97, at 13; NYSCEF # 98, ¶ 47). KIND further alleges that under the terms of PSA, TruFood's lender, AloStar, agreed to sell its interest in TruFood to AOG for a purchase price of \$35,676,654.92—the amount outstanding on TruFood's loans (NYSCEF # 97, at 13; NYSCEF # 98, ¶ 47). The Transaction was also conditioned on the "concurrent purchase by [AOG] from [TruFood] of any and all assets of the Business which do not constitute Surrendered Collateral," and providing AOG with debt financing (*id.*). In addition, TruFood allegedly ceased to exist following the Transaction and eventually filed for bankruptcy (NYSCEF #98, ¶¶ 58, 88)

These allegations and evidence are insufficient to demonstrate the prima facie merit of the breach of contract claim against AOG based on the doctrine of de facto merger. In reaching this conclusion, the court finds that KIND has failed to establish continuity of ownership. In this regard, while the SAC alleges that Peter Tsudis was a "shareholder" of TruFood (NYSCEF # 98, ¶¶ 6, 83), as noted by the AOG/AUA defendants in opposition, it also identifies Tsudis Holding Company as TruFood's "sole shareholder" and defendant George Tsudis as shareholder of the parent entity (NYSCEF # 103-MOL in Opp., at 18, citing NYSCEF 98, ¶¶ 15, 17). Moreover, even assuming the allegations in the SAC are sufficient as to Peter Tsudis' ownership interest in TruFood, the SAC does not adequately plead continuity of ownership in AOG based on Peter Tsudis' contingent right to an undefined percentage of AOG stock received as an employment incentive and which did not afford Peter Tsudis "the right to participate in management" (NYSCEF #88-Amended Reinstated LLC Agreement, §§ 3.4, 4.2)).

And, as noted by KIND, although continuity of ownership does not require identity of ownership between the predecessor and successor companies (*Highlands Crusader Offshore Partners, L.P. v Targeted Delivery Tech Delivery Tech. Holdings, Ltd.*, 184 AD3d 127 [1st Dept 2020]), the allegations in the SAC regarding Peter Tsudis' contingent ownership interest in AOG's stock are insufficient (*compare Matter of Abreu v. Barkin & Assoc. Real Estate, LLC*, 2015 WL 195097, *5 [Sup Ct NY County, Jan. 13, 2015], *modified on other grounds* 136 AD3d 600, 602 [1st Dept

2016] [finding de facto merger where sole shareholder in predecessor company owned 51 % in successor company and party holding 49% shareholder received nothing from the interest, which was a “sham”]; *Ladenburg Thalmann & Co. v Tim's Amusements*, 275 AD2d 243, 248 [1st Dept 2000][shareholder owned 20% of predecessor and 72% of successor]). Additionally, allegations that the Transaction was orchestrated by AUA and did not involve an arms-length sale do not alter that the Transaction was structured as a purchase by AOG of TruFood's assets from secured creditors, as opposed to a stock-for-assets transaction, in which the shareholders of TruFood would have become owners of AOG giving rise to continuity of ownership (*see In re New York City Asbestos Litigation*, 15 AD3d at 256, quoting *Cargo Partner AG v Albatrans, Inc.*, 352 F3d at 47 [“continuity of ownership ‘describes a situation where the parties to the transaction become owners together of what formerly belonged to each’”]).

As for continuity of management, while Peter Tsudis was the CEO of both TruFood and AOG, the other officers and senior management, including the president, had no connection with TruFood (NYSCEF # 98, ¶¶ 4, 6, 19; NYSCEF # 93). And the transaction did not result in AOG assuming TruFood's liabilities since the PSA disclaimed the assumption by AOG of any of TruFood's liabilities or obligations (NYSCEF 18, § 2) (*see Washington Mut. Bank, F.A. v SIB Mortg. Corp.*, 21 AD3d 953, 954 [2d Dept 2005] [finding that complaint did not adequately allege a claim against successor corporation based de facto merger doctrine, because, *inter alia*, successor did not acquire the predecessor's liabilities]). Further, allegations that AOG used the TruFood name, continued the majority of TruFood's business operations with TruFood's customers and that TruFood ceased to exist after the Transaction are insufficient to infer a de facto merger in the absence of other factors, most significantly, continuity of ownership (*see generally, In re New York City Asbestos Litigation*, 15 AD3d at 256).

In view of the above, the motion for leave to add the proposed breach of contract claim against AOG is denied, and the court need not reach defendants' arguments regarding the effect of the Acknowledgment on AOG's liability under the Manufacturing Agreement, or whether the acquisition of TruFood's by AOG constituted a “change of control transaction” under section 7.1 of the Agreement.

Proposed Tortious Interference Claim Against AUA

A plaintiff seeking to recover for tortious interference with contract must allege the existence of its valid contract with a third party, the defendant's knowledge of the contract, the defendant's intentional procurement of a breach without justification, and damages (*see Oddo Asset Mtg. v Barclays Bank PLC*, 19 NY3d 584, 594 [2012]).

Here, while there is no dispute that KIND sufficiently alleged that Manufacturing Agreement was a valid contract, that AUA knew of the Management Agreement, and that the TruFood Defendants breached it, the claim was dismissed based on the failure to adequately allege that AUA intentionally procured the breach of the agreement, and that AUA acted without justification.

With regard to the procurement of the breach, the First Department found that allegations that Peter Tsudis “was ‘directed’ by AUA to conceal the asset purchase from [KIND] [are not] sufficient to establish procurement since the [he] was free to reject that ‘direction’” (*KIND Operations, Inc.*, 195 AD3d at 447). KIND argues that this element of the claim is now sufficiently stated based on allegations in the SAC that Peter Tsudis had no alternative to carrying out the deal with AUA in accordance with AUA’s demands, since TruFood was struggling and had extensive debt, and the deal permitted Peter Tsudis to save his job and to transition to CEO of a company without debt in which he would have an ownership interest and significant bonus potential; and that Peter Tsudis needed the sale to occur on an expedited basis to “keep AUA engaged” (NYSCEF # 98, ¶¶ 96-98). Accordingly, KIND argues that Peter Tsudis’ only option was to follow AUA’s instructions, including concealing from KIND the terms and nature of the Transaction.

As for the lack of justification, KIND asserts that it did not initially plead this element as it was viewed as a defense, and that based on the First Department’s clarification, this defect has been corrected and the SAC adequately alleges that that AUA acted without justification because AUA lacked an “existing economic interest” in TruFood (NYSCEF # 98, ¶ 100, citing *Felsen v Sol Café Mfg. Corp.*, 24 NY2d 682, 686 [1960]), and thus its actions cannot be justified as a way to protect its “legal or financial stake in the breaching party’s business” (*id.*, quoting *White Plains Coat & Apron Co., Inc. v Cintas Corp.*, 8 NY3d 422, 426 [2007]).

In opposition, the AUA/AOG defendants argue that AUA could not procure the breach of the Manufacturing Agreement since it was not in privity with TruFood because the Transaction for the purchase of its assets was with AOG. Additionally, they argue that KIND offers no allegations in support of the procurement claim but points to documentary evidence previously rejected by the First Department. Additionally, they argue that the allegations in the SAC regarding procurement are essentially the same as the original allegations on AUA telling Peter Tsudis that informing KIND of the foreclosure and asset purchase would “blow up the deal” (NYSCEF # 3, ¶47).

The AUA/AOG defendants also argue that the SAC does not adequately plead a lack of justification which requires a showing of interference with the subject contract was “intentional and not incidental to some other lawful purpose” (*quoting Alvord & Swift v Stewart M. Muller Constr. Co.*, 46 NY2d 276, 281 [1978]).

Here, even assuming *arguendo* that the allegations as to the procurement of the breach are sufficient, the motion for leave to add tortious interference claim must be denied as the SAC does not adequately alleged a lack of justification. In particular, the conclusory allegations as to lack of justification are insufficient since the alleged interference was incidental to the lawful purpose of enabling the Transaction with AOG to be completed (*see e.g. Highland Capital Management, L.P. v Dow Jones & Co., Inc.*, 178 AD3d 572, 574 [1st Dept 2019])[tortious interference claim was properly dismissed when the defendants' alleged conduct was "incidental to the lawful and constitutionally protected process of news gathering and reporting"]; *Harris v Town of Fort Ann*, 35 AD3d 928, 939 [3d Dept 2006][dismissing tortious interference with contract claim where the underlying conduct resulting in the breach constituted "manifestly a lawful purpose"]; *compare C.H.A. Design Export (H.K.) Ltd. v Miller*, 191 AD3d 459 (complaint adequately state a cause of action for tortious interference with contract based on allegations that when defendant caused a third-party to breach its contract with plaintiff, defendant "acted separate and apart from the best interest [of the third-party]" and "sought to personally profit by causing [the third-party] not to pay for [plaintiff's] goods and services").

Conclusion

In view above, it is

ORDERED that the motion to amend plaintiff KIND Operations Inc. is denied.

3/22/2022
DATE



MARGARET CHAN, J.S.C.

CHECK ONE:

CASE DISPOSED

GRANTED

SETTLE ORDER

INCLUDES TRANSFER/REASSIGN

DENIED

NON-FINAL DISPOSITION

GRANTED IN PART

SUBMIT ORDER

FIDUCIARY APPOINTMENT

OTHER

REFERENCE

APPLICATION:

CHECK IF APPROPRIATE: