

**AOG, LLC v KIND Operations Inc.**

2022 NY Slip Op 33544(U)

October 14, 2022

Supreme Court, New York County

Docket Number: Index No. 650124/2020

Judge: Margaret Chan

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**SUPREME COURT OF THE STATE OF NEW YORK  
NEW YORK COUNTY**

PRESENT: HON. MARGARET CHAN PART 49M

*Justice*

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AOG, LLC,	INDEX NO. <u>650124/2020</u>
Plaintiff,	MOTION DATE <u>02/14/2022</u>
- v -	MOTION SEQ. NO. <u>003</u>

KIND OPERATIONS INC., KIND HOLDINGS LTD.,

**DECISION + ORDER ON  
MOTION**

Defendants.

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The following e-filed documents, listed by NYSCEF document number (Motion 003) 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94

were read on this motion to/for

PARTIAL SUMMARY JUDGMENT

In this action to recover moneys allegedly due and owing on invoices for manufactured goods, plaintiff AOG, LLC (AOG) moves for an order granting it summary judgment on Counts I and II of the Amended Complaint.<sup>1</sup> Defendants KIND Operations Inc. and KIND Holdings Ltd. (together, KIND) oppose the motion.

### Background

KIND is in the business of selling nutritional snack bars and other food products (NYSCEF # 56-Response to AOG's Rule 19-a Statement, ¶ 1). Until mid-2019, non-party TruFood Mgt. Inc. (TruFood) manufactured goods for KIND pursuant to an Amended and Restated Manufacturing Agreement entered into by and between TruFood and KIND on or about July 1, 2015, and subsequently amended on November 1, 2015 and July 1, 2018 (as amended, the Manufacturing Agreement) (*id.*, ¶¶ 2, 3). On June 18, 2019, AOG purchased the foreclosed assets of TruFood from TruFood's secured creditors (*id.*, ¶12; NYSCEF # 51-Purchase Agreement, §§ 1-3, hereinafter, the AOG transaction). AOG informed KIND directly of the asset purchase on the date of the agreement (NYSCEF # 56, ¶ 16).

Under the Purchase Agreement, the assets purchased by AOG included all "Accounts" and "Contract Rights" of TruFood, as well as all "Proceeds... products, offspring, rents, issues, profits and returns of and from any of the foregoing"

<sup>1</sup> Although AOG also moved for summary judgment as to Counts III, IV, V, and VI, in reply AOG conceded that there were triable issues of fact as to these counts (NYSCEF # 93 at 4).

including the outstanding balances on invoices TruFood issued to KIND for the manufacture of KIND products (the TruFood Invoices) (NYSCEF # 56, ¶ 13; NYSCEF # 51, Recital H, § 1). Under the Purchase Agreement, AOG disclaimed assuming TruFood's liabilities (NYSCEF # 56, ¶ 14; NYSCEF # 51, § 2).

AOG maintains that as of the date of the AOG transaction, KIND had failed to pay "TruFood in full on no less than fifty-eight TruFood Invoices, totaling \$7,239,605.38" (NYSCEF # 56, ¶¶ 17, 18; NYSCEF # 49-Sowers Aff. ¶ 5). KIND acknowledged receipt of 53 of the 58 invoices (NYSCEF # 56, ¶ 19). Shortly after the date of the AOG transaction, KIND engaged AOG to provide manufacturing services for goods previously provided by TruFood (*id.*, ¶ 23). Beginning in late June 2019, AOG began to manufacture goods for KIND (*id.*, ¶ 7). Between June 19, 2019 and September 12, 2019, AOG issued at least 91 invoices (the AOG Invoices) to KIND, totaling \$7,327,853.73 (*id.*, ¶¶ 35,36). It is undisputed that during the period from June 2019 to August 2019, KIND paid AOG \$449,826.90 due and owing on four of the TruFood Invoices and made six additional payments to KIND totaling \$5,500,000, which AOG applied to the AOG Invoices as per KIND's instruction (NYSCEF # 56, ¶¶ 27, 41, 42).

In this action, which seeks to recover the alleged unpaid balances on the TruFood Invoices and the AOG Invoices, AOG asserts counts for (1) breach of contract (Manufacturing Agreement), (2) account stated (TruFood receivables), (3) quantum meruit (based on AOG's provision of services and materials to KIND), (4) promissory estoppel (based on AOG's provision of services and materials to KIND), (5) unjust enrichment (based on AOG's provision of services and materials to KIND), and (6) breach of contract (based on KIND's engagement of AOG to manufacture products for KIND) (NYSCEF # 24-Amended Complaint, ¶¶ 71-114).

KIND answered the Amended Complaint and asserted various affirmative defenses, including a seventh affirmative defense which alleges that AOG's "claims are barred, in whole or in part, by the doctrine of equitable recoupment and/or subject setoff" (NYSCEF # 37 at 13). In response to AOG's interrogatories, KIND stated that the basis for recoupment or setoff is "the amounts [it] paid to suppliers for debts accrued by TruFood before June 18, 2019" totaling \$4,840,563.07 (NYSCEF # 47-KIND's Responses and Objections to AOG's Second Set of Interrogatories, Interrogatory 1).

In the meantime, on July 1, 2019, KIND commenced an action against AOG, TruFood and others, alleging, *inter alia*, that the Purchase Agreement violated certain provisions of the Manufacturing Agreement (*KIND Operations, Inc v AUA Private Equity Partners, LLC*, et al; Index No. 653788/2019 (KIND Action)). By Decision and Order dated September 16, 2020, Justice O. Peter Sherwood (ret.) dismissed the claims against AOG finding that, based on the allegations and documentary evidence, the claims were insufficient to support AOG's liability on a

theory of de facto merger. Of relevance here, the dismissed claims included a claim for declaratory relief against AOG based on KIND's payment of suppliers (KIND Action, NYSCEF # 51, at 5-7). Although KIND appealed Justice Sherwood's decision which was affirmed, it did not perfect that portion of the decision relating to the dismissal of the claim for declaratory relief (*KIND Operations, Inc v AUA Private Equity Partners, LLC*, 195 AD3d 446 [1st Dept 2021]).

### ***AOG's Summary Judgment Motion***

AOG moves for summary judgment, arguing that it is entitled to a judgment on Counts I and II for, respectively, breach of the Manufacturing Agreement and an account stated based on KIND's failure to pay the outstanding balance of \$6,789,778.48 on the TruFood Invoices for goods that were manufactured and shipped to KIND (NYSCEF # 49, ¶¶ 3, 7). Regarding the count for breach of the Manufacturing Agreement, KIND argues that the record demonstrates that KIND breached its obligation to pay for the goods manufactured and shipped by TruFood as evidenced by the TruFood Invoices and that it is entitled to payment as the assignee of TruFood's right to collect the amounts due and owing on the TruFood Invoices. As for the account stated claim, AOG asserts that it has submitted evidence establishing that KIND received the TruFood Invoices detailing the amounts owed for goods provided to KIND by TruFood and that KIND made partial payments and did not object to the invoices within a reasonable amount of time.

As for KIND's seventh affirmative defense for equitable recoupment/setoff, under which KIND seeks to reduce the amount allegedly due on the TruFood Invoices by the payments it made to suppliers, AOG argues that this defense is barred by collateral estoppel since in the KIND Action, Justice Sherwood dismissed all of KIND's claims against AOG including its claim for a declaratory judgment based on KIND's payments to suppliers to satisfy TruFood's debts. In addition, AOG argues that New York Uniform Commercial Code (NY UCC) § 9-404 (a) – which permits an account debtor such as KIND to assert certain defenses including recoupment against an assignee of a debt such as AOG – does not apply here because KIND's alleged payments to suppliers did not arise out of the Manufacturing Agreement, and were voluntarily made.

KIND opposes the motion, arguing that under NY UCC § 9-404(a), AOG's rights are subject to the terms of the Manufacturing Agreement, and the defenses of recoupment and set off. Specifically, KIND argues that under the Manufacturing Agreement, TruFood agreed to pay the suppliers of packaging and raw materials directly and pass on the cost to KIND based on the out-of-pocket costs to TruFood less certain discounts (NYSCEF # 43-KIND Stipulation, ¶¶ 4, 10; NYSCEF # 92-Liberatore Aff, ¶¶ 8, 13). KIND asserts that because TruFood breached its obligation to pay the suppliers and, instead, KIND paid them \$4,840,563.07, summary judgment is not warranted, and KIND has a right to recoupment or setoff

for the supplier costs included in the amounts allegedly due on the TruFood Invoices (NYSCEF # 92-Liberatore Aff., ¶¶ 8, 9; NYSCEF # 81-Johnson Aff., ¶¶ 8-11; NYSCEF ## 82-86; NYSCEF # 81, ¶ 14).

With respect to the account stated claim, KIND argues that issues of fact exist as to whether it timely objected to the TruFood Invoices, particularly as the circumstances surrounding payment of the invoices changed as a result of the June 18, 2019 AOG transaction. Specifically, KIND maintains that it declined to pay the invoices after it learned on the date of the AOG transaction that TruFood would not pay the suppliers as required under the Manufacturing Agreement and of AOG's position that it was not responsible for TruFood's liabilities, including paying the suppliers (NYSCEF # 92, ¶¶ 4, 8; NYSCEF # 79-Bendure Aff, ¶ 14). KIND also maintains that the majority of the TruFood Invoices were issued in the weeks and months immediately preceding the AOG transaction (NYSCEF # 49, ¶ 5).

KIND also argues that collateral estoppel does not bar the recoupment/setoff defense since AOG fails to show that the prior determination decided the identical issue and that the voluntary payment doctrine is inapplicable including because when TruFood defaulted in paying the suppliers and AOG refused to pay them, KIND was forced to do so to protect its business interests (NYSCEF # 81, ¶¶ 6-11, 13; NYSCEF # 79, ¶ 16). KIND further asserts that the TruFood Invoices include costs for the same packaging and raw material that KIND had been forced to cover (NYSCEF # 57-KIND Opp. MOL at 4-5; NYSCEF # 81, ¶ 12).

In reply, AOG argues that the seventh affirmative defense is without merit because this defense was rejected by Justice Sherwood in the KIND Action, the Manufacturing Agreement does not support any right to recoupment or setoff, and KIND has no contractual or other obligation to pay the suppliers but did so voluntarily. In any event, AOG argues that, at the very least, it is entitled to summary judgment on the approximately \$2 million balance remaining on the TruFood Invoices since KIND offers no argument as to these amounts which are due and owing on the invoices even if KIND were permitted to set off the \$4.8 million in payments to third-party suppliers.

## Discussion

A party moving for summary judgment must make a prima facie showing that it is entitled to judgment as a matter of law (*see Alvarez v Prospect Hosp*, 68 NY2d 320 [1986]). Once a showing has been made, the burden shifts to the parties opposing the motion to produce evidentiary proof, in admissible form, sufficient to establish the existence of material issues of fact which require a trial of the action (*see Zuckerman v City of New York*, 49 NY2d 557 [1980]). In the presence of a genuine issue of material fact, a motion for summary judgment must be denied (*see Grossman v Amalgamated Haus. Corp.*, 298 AD2d 224, 226 [1st Dept 2002]).

Regarding the count for breach of the Manufacturing Agreement, the court notes that the elements of a cause of action for breach of contract are (i) formation of a contract between plaintiff and defendant, (ii) performance by plaintiff, (iii) defendant's failure to perform, (iv) resulting damages (*Harris v Seward Park Hous. Corp.*, 79 AD3d 425, 426 [1st Dept 2010]). AOG has made a prima facie showing of entitlement to summary judgment as to this claim based on evidence that under the Purchase Agreement it was assigned TruFood's contractual rights under the Manufacturing Agreement and that, as reflected in the TruFood Invoices, the manufactured goods were shipped to KIND and KIND failed to pay for the goods, thus causing damages.

At issue on this motion is whether KIND has a viable defense of recoupment or setoff based on evidence that KIND paid suppliers on TruFood's behalf after the AOG transaction. A threshold question in this regard is whether, as AOG argues, collateral estoppel applies to bar KIND from asserting the defense based on Justice Sherwood's dismissal of KIND's seventh cause of action in the KIND Action which sought declaratory relief against AOG based on KIND's payment to the suppliers.

Collateral estoppel or "issue preclusion" prevents a party from relitigating an identical issue which has previously been decided against it in a prior action in which it had a fair opportunity to fully litigate the issue (*see Allied Chemical v Niagara Mohawk Power Corp.*, 72 NY2d 271 [1988], *cert denied*, 488 US 1005 [1989]). The party seeking to invoke the doctrine of collateral estoppel must show that the issue was necessarily decided in the earlier action, while the party who opposes the application of collateral estoppel must demonstrate that it did not have a full and fair opportunity to contest the prior determination (*Buechel v Bain*, 97 NY2d 295, 303-04 [2001]). While the two requirements must be met to apply collateral estoppel, the doctrine is "a flexible one and the enumeration of these elements is intended merely as a framework, not a substitute, for case-by-case analysis of the facts and realities" (*id.* at 304).

At issue is KIND's seventh cause of action in the KIND Action which sought a declaration as to AOG's liability for supplier payments made by KIND. In dismissing the claim, Justice Sherwood found that declaratory relief was not appropriately granted since "the amounts of payments made by [KIND] to the suppliers are known and there are other adequate remedies available in equity" (KIND Action, NYSCEF # 51 at 11). Justice Sherwood also found that because KIND failed to allege an underlying fraud, any claim KIND had in equity would lie only against TruFood as the suppliers' debtor (*id.*). Thus, Justice Sherwood's decision bars a finding that AOG is liable to KIND for its payments to suppliers made on behalf of TruFood. And, to the extent KIND argues that it is entitled to damages from AOG based on harm it suffered resulting from AOG's refusal to pay the suppliers, it would be barred from relitigating these issues.

In contrast, Justice Sherwood did not necessarily decide whether KIND has a viable defense to AOG's claims to recover under TruFood Invoices based on payments KIND made to suppliers, which supplier payments are allegedly included in the amounts AOG seeks to recovery here.<sup>2</sup> Accordingly, AOG has not met its burden of showing this issue was necessarily decided in the KIND Action.

AOG also argues that the seventh affirmative defense must be dismissed because KIND voluntarily paid the suppliers since KIND had no contractual obligation to make TruFood's suppliers whole. KIND counters that it was required to make the payments to preserve its suppliers and protect its business interests (citing *U.S. Bank Nat. Ass'n v PHL Variable Ins. Co.*, 2014 WL 2199428, \* 10-11 [SD NY 2014][finding voluntary payment doctrine did not apply as a matter of law where plaintiff asserted it had to pay premiums to preserve its business interests]).

The voluntary payment doctrine bars recovery of payments "voluntarily made with full knowledge of the facts, and in the absence of fraud or mistake of material law or fact" (*Dillon v U-A Columbia Cablevision of Westchester Co.*, 100 NY2d 525, 525 [2003]). "The doctrine, which is limited to situations in which the parties have a preexisting contractual or quasi-contractual relationship, essentially prevents the paying party from thereafter changing his or her mind by seeking to recoup that payment voluntarily made under those circumstances" (*WFE Ventures, In. v GBD Lake Placid, LLC*, 197 AD3d 824, 835 [3d Dept 2021]). However, the doctrine is not a basis for dismissing KIND's recoupment/setoff defense. Here, there is no pre-existing relationship between the parties, and the record raises issues of fact as to voluntary nature of KIND's payment to suppliers based on evidence that the payments were made in an effort to preserve KIND's business (*id.*). In any event, the doctrine does not bar KIND from asserting the defense to the extent KIND is not seeking the return of payments it made to the suppliers but to reduce the amounts owed on the TruFood Invoices to credit it for these payments.

As collateral estoppel and the voluntary payment doctrine do not bar KIND's seventh affirmative defense, the court will consider the merits of the defense for recoupment/setoff based on KIND's payment to the suppliers. NY UCC § 9-406 provides that an account debtor, such as KIND, is required to pay its debts to an assignee of the account, here AOG, upon notification of the amount due has been assigned (UCC § 9-406[a]).<sup>4</sup> Under UCC § 9-404(a)(1), the assignee's right to recover payment on an assigned account is subject, *inter alia*, to "(1) all terms of the agreement between the account debtor and assignor and any defense or claim in

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<sup>2</sup> As AOG notes in reply, the seventh cause of action in the KIND Action sought to recover the supplier payments and relief in the form of recoupment or setoff (NYSCEF # 93 at 5, citing KIND Action-Amended Complaint-NYSCEF #3, ¶¶ 109-112). However, the pleading is not dispositive here since AOG did not have any claims against KIND in the KIND Action, and thus KIND's right to assert recoupment/setoff as a defense to payment was not necessarily decided by Justice Sherwood.

recoupment arising from the transaction that gave rise to the contract” (UCC § 9-404[a]).<sup>3</sup> An account debtor may only assert this provision “to reduce the amount the account debtor owes” (UCC § 9-404[b]).

Regarding that part of the seventh affirmative defense seeking relief in the nature of setoff, the court notes that the defense applies where the “claims are mutual, i.e. owed between the same persons in the same right” but do not have to rise out of the same transaction (*Matter of Midland Ins.*, 79 NY2d 253, 260, 264 [1992]; see also *J.B.I. Indus., Inc. v Suchde*, 2000 WL 1174997 \* 9 [SD NY 2000] [“The common law doctrine of setoff allows parties who owe mutual debts to each other to assert the amounts owed, subtract one from the other, and pay only the balance”]). In the absence of any basis for finding AOG is indebted to KIND, the defense of setoff is inapplicable.

In contrast, the defense of recoupment does not require mutual debts; instead, the money sought to be recouped must arise out of the same transaction as the claim (*Capital Business Credit LLC v Tailgate Clothing Co. Corp.*, 172 AD3d 655, 656 [1st Dept 2019], citing UCC § 9-404[a]; see also *National Cash Register Co. v Joseph*, 299 NY 200 [1949] [“Recoupment means a deduction from a money claim through a process whereby cross demands arising out of the same transaction are allowed to compensate one another and the balance only to be recovered”]).

Here, the record contains sufficient evidence that the money KIND seeks to recoup based on its payment to suppliers arises out the same transaction as AOG’s claim for breach of contract based on KIND’s failure to pay the TruFood Invoices to sustain its recoupment defense (*Capital Business Credit LLC*, 172 AD3d at 656 [finding issues of fact as to whether relevant contracts were intended to be part of the same transaction]<sup>4</sup>; see also *Hispanic Independent Television Sales, LLC v Una Vez Mas, L.P.*, 110 AD3d 474, 475 [1st Dept 2013] [denying motion to dismiss defense of recoupment against purchaser of debtor’s assets in action to recover on debtor’s accounts receivable finding that debtor’s breach of a sales agreement with defendant did not constitute an “independent and unrelated transaction”]). As KIND has a viable defense for recoupment, AOG’s motion for partial summary

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<sup>3</sup> Section § 9-404(a)(2) pertains to “any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.” This subsection is inapplicable since KIND paid the suppliers after it received notice of the assignment to AOG.

<sup>4</sup> While AOG points to differences between the factual circumstances underlying *Capital Business Credit* and those in instant action, these differences are not dispositive of the issues here including whether the recoupment defense arises out of the same transaction as AOG’s claim based on the TruFood Invoices.

judgment must be denied (*Enrico & Sons Contracting Inc. v Bridgemarket Assocs.*, 252 AD2d 429, 430 [summary judgment precluded where defense of recoupment is asserted]).<sup>5</sup>

Regarding the account stated claim, the court notes that “[a]n account stated is an agreement between the parties to an account based upon prior transactions between them with respect to the correctness of the separate items composing the account and the balance due, if any, in favor of one party over the other” (*Shea & Gould v Burr*, 194 AD2d 369, 370 [1st Dept 1993][internal quotation and citation omitted]). The essential element of an account stated is that the parties have reached an agreement as to the balance of the indebtedness (*Herrick, Feinstein LLP v Stamm*, 297 AD2d 477, 478 [1st Dept 2002]). Partial payment or the failure of a party receiving an account to examine the statement and make all necessary objections may be deemed acquiescence to the correctness of the balance owed (*Morrison Cohen Singer v Weinstein, LLP v Waters*, 13 AD3d 51, 52 [1st Dept 2004]).


Assuming, for the sake of argument, that AOG has submitted sufficient evidence to meet its prima facie burden as to the account stated claim, KIND has raised issues of fact as to whether it objected to the TruFood Invoices within a reasonable amount of time based on evidence as to when it was notified of the AOG transaction and learned that neither TruFood nor AOG would pay for the supply costs reflected in the invoices (*see e.g. Capital Business Credit LLC*, 172 AD3d at 655 [affirming denial of summary judgment on account stated claim based on issues of fact as to the timeliness of defendant’s objection to the invoices]).

**Conclusion**

In view of the above, it is

ORDERED that AOG, LLC’s motion for summary judgment is denied.

10/14/2022  
 DATE

  
 MARGARET CHAN, J.S.C.

CHECK ONE:       CASE DISPOSED       NON-FINAL DISPOSITION  
 GRANTED       DENIED       GRANTED IN PART       OTHER

<sup>5</sup> In addition, the court notes that notwithstanding the merit of the recoupment defense based on evidence that KIND covered the cost of suppliers and that this cost is reflected in the TruFood Invoices, AOG has not demonstrated that KIND owes the amounts AOG seeks for damages on its breach of contract claim. Moreover, KIND disputes that the invoices are properly payable by it, including because some are for negative balances, and that a May 2019 invoice, was credited back to KIND in June 2019 (NYSCEF # 56, ¶¶ 17, 18).