REDF-Organic Recovery, LLC v Rainbow Disposal Co., Inc.
2017 NY Slip Op 31935(U)
September 11, 2017
Supreme Court, New York County
Docket Number: 654492/2012
Judge: Saliann Scarpulla

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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REDF-ORGANIC RECOVERY, LLC

Plaintiff,

-against-

RAINBOW DISPOSAL CO., INC.,

Defendant.

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DECISION/ORDER

Index No. 654492/2012
Motion Seq. No. 007, 008

HON. SALIANN SCARPULLA, J.:

In this action arising from an alleged breach of a confidentiality agreement, defendant Rainbow Disposal Co. ("Rainbow") moves for summary judgment dismissing plaintiff REDF-Organic Recovery LLC's ("REDF") complaint pursuant to CPLR 3212 (mot. seq. no. 008). Rainbow also moves for leave to file an amended answer asserting a defense of lack of personal jurisdiction (mot. seq. no. 007). The two motions are consolidated for disposition.

Background

In 2008, REDF licensed a proprietary process to convert food into liquid organic fertilizer – the H2H Solution – from Organic Recovery LLC ("Organic Recovery"). Under the license, REDF obtained exclusive rights to use the H2H Solution ("the Technology") in California, as well as non-exclusive rights for the rest of the United States.

According to the complaint, REDF's managing member Dan Morash ("Morash") then "sought to identify potential candidates that might be interested in investing in REDF's food recycling and conversion project" involving the H2H Solution. Morash eventually developed a business relationship with Bruce Shuman, chief executive officer of Rainbow – a trash hauling and recycling business that served the City of Huntington Beach, California. Specifically, Morash and Shuman discussed "the possibility of creating a joint-venture H2H Solution business between REDF and Rainbow."

REDF alleges that, in order to protect its disclosure of confidential information to Rainbow during the negotiation process, REDF's managing member – Renewable Energy Development and Finance, LLC ("Renewable Energy") – entered into a Confidentiality Agreement with Rainbow on May 13, 2008. The complaint alleges that Renewable Energy merged into REDF in February 2012.

REDF asserts that it then disclosed certain confidential information to Rainbow, under the protection of the Confidentiality Agreement. The alleged confidential information included: (1) an engineering report that demonstrated the viability of REDF's conversion process; (2) the feasibility of obtaining a "no action" letter from California Integrated Waste Management which would permit REDF to operate without a solid waste permit; and (3) a shipment of REDF's organic fertilizer, Harvest to Harvest.

Subsequently, the licensor of the H2H Solution, Organic Recovery, filed for bankruptcy. As a result of the bankruptcy, a different company, Organic Dynamics, became the owner of the patent rights to the H2H Solution.

In August 2009, Morash allegedly learned that Rainbow became interested in gaining access to the H2H Solution business by directly investing in Organic Dynamics, rather than pursuing a joint-venture between REDF and Rainbow. The complaint alleges that Rainbow ultimately invested $1.2 million in Organic Dynamics and provided $2 million in mortgage financing to Organic Dynamics. According to REDF, Rainbow now holds a 66% equity interest in Organic Dynamics.

In 2012, REDF commenced this action against Rainbow alleging three causes of action for breach of the confidentiality agreement, unfair competition, and unjust enrichment. In the first cause of action, REDF asserts that Rainbow breached the Confidentiality Agreement "by disclosing, revealing and using the Confidential Information" for improper purposes. Specifically, REDF alleges that Rainbow used the Confidentiality Agreement to enter into an investment transaction with Organic Dynamics whereby it gained a supermajority controlling interest, and then cooperated with Organic Dynamics to interfere with REDF's exclusive rights in California.

In the second cause of action, REDF asserts that after disclosing confidential information, Rainbow misappropriated REDF's labors, skill, and expenditures without compensation and entered into a transaction with Organic Dynamics to REDF's detriment. Specifically, REDF alleges that "Rainbow learned that it could circumvent the limitations of its own exclusive franchise agreement with the City of Huntington Beach and earn greater revenues, while effectively driving REDF out of the very same market for which REDF had obtained an exclusive license at great effort and cost."

In the third cause of action, REDF alleges that Rainbow was unjustly enriched by REDF's disclosure of confidential information regarding the H2H Solution. Rainbow now moves for summary judgment dismissing the complaint.[1]

Discussion

I. Motion to Amend

CPLR 3025 [b] provides that leave to amend "shall be freely given upon such terms as may be just." Upon "a motion for leave to amend, plaintiff need not establish the merit of its proposed new allegations, but simply show that the proffered amendment is not palpably insufficient or clearly devoid of merit" (*MBIA Ins. Corp. v Greystone & Co., Inc.*, 74 AD3d 499, 500 [1st Dept 2010] [citations omitted]). Leave should be "denied only if there is prejudice or surprise resulting directly from the delay" (*McGhee v Odell*, 96 AD3d 449, 450 [1st Dept 2012] [internal quotation marks and citations omitted]).

Rainbow moves to amend its answer to assert a defense of lack of personal jurisdiction. Rainbow argues that its amendment should be permitted because its proposed defense of personal jurisdiction is presumptively valid, and REDF cannot show prejudice or surprise from Rainbow's delay in raising it. In response, REDF argues that Rainbow failed to raise lack of personal jurisdiction in its first responsive pleadings to either the original or amended complaints, and therefore has waived the defense. Further,

[1] Rainbow filed two counterclaims against REDF for unfair competition and unjust enrichment. The parties stipulated to discontinue Rainbow's counterclaims with prejudice on April 7, 2016.

REDF points out that Rainbow has raised the issue of lack of personal jurisdiction at various times during this litigation since 2014, and has never sought leave to amend its answer until now. In addition, because the statute of limitations has now run on REDF's claim, REDF argues it will be prejudiced if the court allows Rainbow to assert a personal jurisdiction defense.

CPLR 3211 (a)(8) provides that a party may move to dismiss a claim asserted against it where "the court has not jurisdiction of the person of the defendant." CPLR 3211 (e) provides that such a defense is "waived if a party moves on any of the grounds set forth in subdivision (a) without raising such objection."

Rainbow does not deny that it failed to raise the defense of personal jurisdiction in its motions to dismiss the original and amended complaints, or in the answer to the amended complaint. Accordingly, Rainbow has waived the defense of lack of personal jurisdiction pursuant to the plain language of CPLR 3211 (e) (*McGowan v Hoffmeister*, 15 AD3d 297, 297 [1st Dept 2005]) (stating that "the waiver of a jurisdictional defense cannot be nullified by a subsequent amendment to a pleading adding the missing affirmative defense").

Further, Rainbow has actively participated in this case for more than three years, for almost two of which Rainbow argued that the court had no personal jurisdiction over it without seeking to amend its answer. Rainbow has thus consented to jurisdiction, an additional ground for finding waiver (see *Gager v White*, 53 NY2d 475, 488 [1981] ["a defendant's voluntary participation in litigation in which [jurisdiction] can be raised, in and of itself, constitutes a submission to the jurisdiction of the courts of our State and, as

such, acts as a predicate for basis jurisdiction"]; *CDR Creances S.A.S. v Cohen*, 77 AD3d 489, 490 [1st Dept 2010]. Accordingly, Rainbow's motion for leave to amend is denied.[2]

II. Motion for Summary Judgment

1. Breach of Contract (First Cause of Action)

a. Standing

The Confidentiality Agreement provides that only Renewable Energy, Rainbow, or their successors may enforce it. Rainbow argues that the breach of contract claim should be dismissed because REDF is not a party to the Confidentiality Agreement, and therefore does not have standing to enforce the agreement. Rainbow asserts that even though REDF claims that it merged with Renewable Energy in 2012, REDF did not properly merge until 2015.[3]

In opposition, REDF contends that it has standing to enforce the agreement because it merged with Renewable Energy in February 2012. According to REDF, the merger took place when its managing member, Dan Morash, amended REDF's operating agreement to reflect the merger. In the alternative, REDF asserts that it merged with Renewable Energy when Morash filed a certificate of merger with the Delaware Secretary of State on December 11, 2015.

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[2] Rainbow also moved for summary judgment based on lack of personal jurisdiction. This portion of the motion for summary judgment is now moot, because Rainbow waived its' personal jurisdiction defense.

[3] For purposes of this motion, Rainbow accepts that Renewable Energy merged into REDF, according to the certificate of merger filed in December 2015.

After reviewing the parties' submissions, I find that REDF did not properly merge until it filed a certificate of merger in December 2015.[4] Although Rainbow contends that this merger was untimely, REDF cured its lack of standing by properly effectuating a merger after commencing this action (*Cortlandt St. Recovery Corp.*, 47 Misc 3d at 555, 558 (finding that "an objection to an assignee's lack of standing to recover on a note is curable"); *see also Springwell Nav. Corp. v Sanluis Corporacion, S.A.*, 81 AD3d 557, 557 [1st Dept 2011].

In addition, REDF has standing to enforce the Confidentiality Agreement because it is "closely related to one of the signatories" (*Freeford Ltd. v Pendleton*, 53 AD3d 32, 39 [1st Dept 2008] [internal quotation marks and citation omitted]). While Rainbow is correct that a clause barring third-party beneficiaries from enforcing the contract is normally decisive (*see e.g. Davis v Scottis Re Group Ltd.*, 138 AD3d 230, 239 [1st Dept 2016]), an exception exists where "the nonparty's enforcement of the [contract] is foreseeable by virtue of the relationship between the nonparty and the party sought to be bound" (*Tate & Lyle Ingredients Ams., Inc. v Whitefox Tech. USA, Inc.*, 98 AD3d 401, 402 [1st Dept 2012] [internal quotation marks and citation omitted]).

Here, it was foreseeable that REDF would seek to enforce the Confidentiality Agreement. Rainbow was aware, as far back as the parties' initial discussions, that REDF was the entity that held the investment in the Technology. For example, when

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[4] Rainbow argues that REDF's documents regarding the 2015 merger should be precluded because they were produced after the discovery deadline in this action. However, I exercise my discretion to permit REDF to use the documents regarding the 2015 merger based on their relevance to a significant issue pressed by Rainbow.

Morash emailed a draft confidentiality agreement to Shuman at Rainbow on April 25, 2008, Morash wrote "[i]n anticipation of moving forward, I have attached a draft confidentiality agreement, which I would ask you to review . . . It is in the name of Renewable Energy Development and Finance, LLC . . . which I control, and which is the Managing Member of the special-purpose investment vehicle [REDF] which holds our equity investment in Organic Recovery, LLC." Indeed, Rainbow was aware that REDF and Renewable Energy were closely related, and that REDF was the license holder of the Technology that might seek to enforce the agreement. In fact, in the letter of intent agreement that Rainbow entered into with Organic Dynamics, Rainbow specifically requested that Organic Dynamics indemnify it "for any liability arising from any claims from Dan Morash and [REDF]." Thus, the relationship between REDF and Rainbow is "sufficiently close . . . that enforcement of the [confidentiality agreement] is foreseeable" (*Freeford Ltd.*, 53 AD3d at 39). Accordingly, REDF has standing to enforce the Confidentiality Agreement.

b. Breach

Next, Rainbow argues that the information disclosed by REDF is not confidential because it was made public as part of various patent filings. In response, REDF claims that the patent filings do not overlap with the information it disclosed to Rainbow.

The definition of "Confidential Information" under the Confidentiality Agreement is broad, encompassing "all material non-public information . . . relating to" Rainbow and REDF's potential development of the Technology. This broad provision covers information related to the business development and manufacturing of the Technology,

beyond the technical information related to the Technology itself that Rainbow asserts must have been included in the patent filings. Accordingly, a question of fact exists as to whether the alleged Confidential Information became public knowledge after it was disclosed to Rainbow. As REDF correctly argues, "it is for [the factfinder] to decide whether the [disclosed] information was confidential or ascertainable through public records" (*Ashland Mgt. Inc. v Altair Invs. NA, LLC*, 59 AD3d 97, 104 [1st Dept 2008]).

c. Damages

In addition, Rainbow argues that the breach of contract claim should be dismissed because REDF fails to allege damages. Rainbow claims that REDF's contractual damages are either barred by the terms of the Confidentiality Agreement, too speculative as a matter of law, or unsupported by the record. Further, to the extent that any of REDF's damages are attributable to money loaned by CSS, Rainbow argues that such funds cannot be recovered.

REDF responds that its damages are compensable under the agreement as they are direct damages, rather than consequential; that REDF agreed to sell itself to CSS if it failed to pay back the funds loaned, thus obligating it to repay and linking the expenses to Rainbow's breach; and that challenges to the calculation of damages as speculative present issues of fact that must be resolved at trial.

The Confidentiality Agreement provides that, in the event of a breach, neither party would be liable for "punitive, consequential, special or indirect damages." Consequential damages are those that "do not so directly flow from the breach" (*Bi-Economy Mkt., Inc. v Harleysville Ins. Co. of N.Y.*, 10 NY3d 187, 192 [2008] [internal

quotation marks and citations omitted]). "[S]uch unusual or extraordinary damages must have been brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting" (*Kenford Co. v County of Erie*, 73 NY2d 312, 319 [1989] [Kenford II]). As the Court of Appeals has said, "where the damages reflect a loss of profits on collateral business arrangements, they are only recoverable when (1) it is demonstrated with certainty that the damages have been caused by the breach, (2) the extent of the loss is capable of proof with reasonable certainty, and (3) it is established that the damages were fairly within the contemplation of the parties" (*Biotronik A.G. v Conor Medsystems Ireland, Ltd.*, 22 NY3d 799, 806 [2014] [internal quotation marks and citation omitted]).

Here, REDF seeks three categories of damages, all of which are consequential and barred by the Confidentiality Agreement. First, REDF claims that it has incurred significant litigation expenses in other actions related to defending its license and prosecuting patents for the Technology. REDF argues that these damages should be contemplated as flowing from the breach of the Confidentiality Agreement. Rainbow correctly points out, however, that it was not a party to any of the other lawsuits, or a party to the license agreement at the center of the dispute. Such litigation expenses, not involving Rainbow or the Confidentiality Agreement, cannot have been "fairly within the contemplation of the parties" (*Biotronik A.G.*, 22 NY3d at 806).

The second and third categories of damages are somewhat intertwined with the litigation expenses. REDF argues that money it spent on litigation with Organic Dynamics and other entities would otherwise have been invested in the company and

yielded $795,948 in investment returns that REDF lost as a result of the breach. When REDF and CSS attempted to raise additional capital to continue funding operations, they were required to disclose ongoing litigations regarding the license to develop the Technology. This disclosure, according to REDF's expert, Joseph Cipolla, reduced the price both companies obtained for selling equity by $3,062,228 in total, across both companies. These damages are a direct consequence of the litigation expenses, and the litigation expenses themselves are consequential damages barred by the contract as set forth above. Thus, both the loss of investment returns and lowered sale price categories of damages do not flow directly from Rainbow's breach of the Confidentiality Agreement, and are barred by its terms.

Further, both the loss of investment returns and lowered sale price categories of damages are not "capable of proof with reasonable certainty" (*Biotronik A.G.*, 22 NY3d at 806). When dealing with similar kinds of damages, such as lost profits, the Court of Appeals has held that "[t]he law does not require that they be determined with mathematical precision. It requires only that damages be capable of measurement based upon known reliable factors without undue speculation" (*Ashland Mgt. v Janien*, 82 NY2d 395, 403 [1993]). "New York law does not countenance damage awards based on speculation or conjecture" (*Wathne Imports, Ltd. v PRL USA, Inc.*, 101 AD3d 83, 87 [1st Dept 2012] [internal quotation marks and citation omitted]).

Here, Cipolla's report makes clear that it relies upon several assumptions in arriving at these damages, specifically "that investors in both REDF and CSS expect to receive a 35% annual return on their equity investment" because "venture capitalists

require a rate of return of at least 35% to 50% for undertaking the risk associated with an investment in start-up and early stage companies." Further, Cipolla assumed that "there are no hidden or unexpected conditions that would adversely affect [his] conclusions unless [he was] advised otherwise." Finally, he assumed that "delay in developing the business and the increased cost of capital were caused by [Rainbow's] action," because "other than the litigations and issues relating to the litigation, it is [his] understanding that there have been virtually no impediments with proceeding with the business plan."

Based on Cipolla's report, REDF argues that it would have been able to garner a return on investment in the company and attract potential equity buyers at a higher rate. Cipolla's conclusions, however, "are still projections, and as employed in the present day commercial world, subject to adjustment and modification" (*Kenford Co. v Erie County*, 67 NY2d 257, 262 [1986] [*Kenford I*]). It is completely speculative that REDF would have achieved its hoped for rate of return, and that no other factors would have affected REDF's use of cash reserves for investment. Further, as REDF is a relatively new business, "a stricter standard is imposed for the obvious reason that there does not exist a reasonable basis of experience upon which to estimate lost profits with the requisite degree of reasonable certainty" (*id.* at 261).

For the foregoing reasons, all of REDF's alleged contractual damages are barred by the Confidentiality Agreement as consequential damages. Accordingly, Rainbow's motion for summary judgment dismissing the first cause of action for breach of contract is granted.

2. Unfair Competition (Second Cause of Action)

The second cause of action alleges a claim for unfair competition. The "misappropriation theory" of unfair competition "prohibits a defendant from using a plaintiff's property right or commercial advantage . . . to compete unfairly against the plaintiff in New York" (*ITC Ltd. v Punchgini, Inc.*, 9 NY3d 467, 478 [2007]; *see also Macy's Inc. v Martha Stewart Living Omnimedia, Inc.*, 127 AD3d 48, 56 [1st Dept 2015]. The commercial advantage must "belong[] exclusively to [the plaintiff]" (*LoPresti v Massachusetts Mut. Life Ins. Co.*, 30 AD3d 474, 476 [2d Dept 2006]).

Rainbow argues that the unfair competition claim should be dismissed because: (1) the information disclosed by REDF was not confidential; and (2) REDF and Rainbow are not competitors. REDF responds that the information was confidential, and Rainbow improperly used it to compete. Further, REDF claims that Rainbow is a competitor, even if they were not in direct competition.

As set forth above, an issue of fact exists as to whether any information disclosed by REDF was confidential. Further, if REDF proves that it disclosed confidential information to Rainbow, an issue of fact exists as to whether Rainbow misappropriated this information to compete unfairly with REDF.

In regards to Rainbow's argument that it is not a competitor to REDF, the Appellate Division, First Department, has already held in this action that an unfair competition claim may be sustained "even if the parties are not actual competitors" (*REDF-Organic Recovery, LLC v Rainbow Disposal Co., Inc.*, 116 AD3d at 622 [internal quotation marks and citations omitted]). Rainbow sought to enter California to own or

co-own plants using the Technology, a State where REDF held an exclusive license to develop the Technology. Rainbow cannot now claim that they were not in competition with REDF in developing the Technology for the waste management business.

Accordingly, Rainbow's motion for summary judgment dismissing the second cause of action for unfair competition is denied.

3. Unjust Enrichment (Third Cause of Action)

The third cause of action alleges unjust enrichment. To state a claim for unjust enrichment, "a plaintiff must show that (1) the [defendant] was enriched, (2) at [the plaintiff's] expense, and (3) that it is against equity and good conscience to permit [the defendant] to retain what is sought to be recovered" (*Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 182 [2011] [internal quotation marks and citations omitted]). "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" (*Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 388 [1987]).

Rainbow first argues that if the Confidentiality Agreement is valid and enforceable between the parties, the unjust enrichment claim must fail. Further, Rainbow argues that it was not enriched at REDF's expense, because the information it disclosed was public, and Rainbow, in fact, lost money in investing with Organic Dynamics. REDF counters by continuing to assert that the information disclosed was confidential.

As set forth above with respect to the first cause of action, the Confidentiality Agreement is a valid contract, and REDF has standing to enforce it. Both the Confidentiality Agreement and the unjust enrichment claim cover the same subject

matter; namely, whether Rainbow used any confidential information belonging to REDF. Because there is a valid and enforceable contract between the parties which covers the same subject matter as the unjust enrichment claim, the third cause of action must be dismissed (*Clark-Fitzpatrick, Inc.*, 70 NY2d at 388).

In accordance with the foregoing, it is

ORDERED that defendant Rainbow Disposal Co., Inc.'s motion for leave to amend is denied (motion seq. no. 007); and it is further

ORDERED that Rainbow's motion for summary judgment is granted as to the first cause of action for breach of the Confidentiality Agreement and the third cause of action for unjust enrichment, and denied as to the second cause of action for unfair competition (motion seq. no. 008); and it is further

ORDERED that counsel for the parties shall appear for a pre-trial conference at 60 Centre Street, Room 208 on October 11, 2017 at 2:15pm.

This constitutes the decision and order of the Court.

DATE: 9/11/17

SALIANN SCARPULLA, JSC