Marc Fisher LLC v Milberg Factors, Inc.
2019 NY Slip Op 33207(U)
October 17, 2019
Supreme Court, New York County
Docket Number: 656276/2017
Judge: O. Peter Sherwood
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49
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MARC FISHER LLC, FISHER LICENSING LLC, M.B. FISHER LLC, MBF HOLDINGS LLC, FISHER DESIGN LLC, MBF LICENSING LLC, UNISA FISHER WHOLESALE LLC, FISHER SIGERSON MORRISON LLC, MARC FISHER HOLDINGS LLC, MARC FISHER JR BRAND LLC, MFKK LLC, AND MF-TFC LLC,

Plaintiffs/Counterclaim-Defendants,

-against-

MILBERG FACTORS, INC.,

Defendant/Counterclaim-Plaintiff.
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DECISION AND ORDER

Index No.: 656276/2017
Motion Seq. Nos.: 002-004

O. PETER SHERWOOD, J.:

Plaintiffs Marc Fisher LLC, Fisher Licensing LLC, M.B. Fisher LLC, MBF Holdings LLC, Fisher Design LLC, MBF Licensing LLC, Unisa Fisher Wholesale LLC, Fisher Sigerson Morrison LLC, Marc Fisher Holdings LLC, Marc Fisher Jr Brand LLC, MFKK LLC, and MF-TFC LLC (collectively, "Companies") are in the business of designing, sourcing and marketing of brand-named footwear. Defendant Milberg Factors, Inc. ("Milberg") provided financing to the Companies by purchasing their accounts receivable at a discount pursuant to factoring agreements (Agreements). Plaintiffs allege that Milberg breached the Agreements by making improper charges and unjustified reserves against their accounts. In their amended complaint (NYSCEF Doc. No. 49), plaintiffs assert four causes of action: breach of contract; breach of implied covenant of good faith and fair dealing; conversion; and specific performance. In its answer to the amended complaint and counterclaim ("Answer") (NYSCEF Doc. No. 298), Milberg asserts various affirmative defenses and a counterclaim for attorneys' fees, costs and expenses.

This Decision and Order addresses three motions. In motion sequence number 002, Milberg seeks to dismiss the first (breach of contract) and third (conversion) causes of action to the extent they claim that Milberg established improper reserves, declined to provide financing,

and improperly charged default interest and fees, as well as the second (breach of the covenant of good faith and fair dealing) and fourth (specific performance) causes of action in their entirety, all pursuant to CPLR 3211(a)(1) and (7); or, alternatively, granting summary judgment as to the foregoing pursuant to CPLR 3212. In motion sequence number 003, plaintiffs seek partial summary judgment as to the first and fourth causes of action pursuant to CPLR 3212. In motion sequence number 004, plaintiffs request an order dismissing the second (fraud), third (alter ego) and eighth (setoff and recoupment) affirmative defenses pursuant to CPLR 3211(b).

I. BACKGROUND

The following facts are taken from the amended complaint (hereinafter, Complaint). The Companies, known as Marc Fisher Footwear, are a leading manufacturer of "coveted" footwear brands. Complaint, ¶ 17. Between 2009 and 2017, the Companies financed their business operations through Agreements with Milberg which were identical except for the name of the specific Company. *Id.*, ¶ 18. Pursuant to the arrangement, Milberg agreed to purchase the Companies' accounts receivable and to collect directly from their customers the amounts due on their accounts, less factoring commissions, interests owed by the Companies and any chargebacks up to an aggregate amount of the lesser of $75 million or 85% of the face value of the receivables purchased. *Id.* Pursuant to the Agreements, Milberg held a security interest that was over-collateralized by assets of the Companies and certain of their affiliates. *Id.*, ¶ 29. In addition, Milberg received guarantees from certain parties and non-parties to the Agreements, including Moda, LLC (Moda), an affiliate of the Companies. Moda did not have a factoring agreement with Milberg. *Id.*, ¶ 30.

In September 2016, Marc Fisher (Fisher), the Companies' principal shareholder, reached out to Milberg to discuss the Companies' interest in acquiring from Nine West the non-retail business and intellectual property rights of Easy Spirit. He invited Milberg to "put forth an offer" to finance acquisition of the Easy Spirit brand. *Id.*, ¶¶ 37, 38. At no time during those discussions did Fisher offer to reimburse Milberg for its costs and expenses in connection with the Easy Spirit transaction. *Id.*, ¶ 39. Milberg never made a final offer even though it told Fisher that it could; nor did it make funds available under a proposed factoring agreement to finance the acquisition. *Id.*, ¶ 40. In December 2016, Easy Spirit, LLC (ES), a newly-formed

entity related to the Companies, acquired Easy Spirit with no financing from Milberg. *Id.* Thereafter, Milberg contacted ES for an opportunity to factor its receivables. The Companies rejected Milberg, and instead gave the business to CIT Commercial Services (CIT). *Id.*, ¶ 44. Milberg then charged the Companies $398,473 in legal and audit fees allegedly incurred in connection with the Easy Spirit transaction, without providing any basis for the charge. *Id.*, ¶ 41.

After the Companies refused to grant Milberg the ES business or to extend the term of the then existing Agreements (all of which had an expiration date of October 1, 2017), Milberg retaliated, in April 2017, by falsely accusing the Companies of "financial irregularities." *Id.*, ¶ 3. Using these accusations, Milberg wrongfully charged $4.4 million to the Companies' accounts, established $11 million of unjustified reserves against the accounts, and repeatedly threatened to terminate the Companies' financing before the expiration of the Agreements. *Id.* Milberg also attempted to force the Companies to renew or extend the Agreements, and to grant Milberg the factoring business with Moda. *Id.*, ¶ 4. Despite its accusation of "financial irregularities" by the Companies, Milberg did not declare an event of default and seek an early termination of the Agreements. Rather, it continued the relationship and funded the Companies until the contract expiration date, while repeatedly breaching the Agreements by, among other things, assessing wrongful charges and holding unjustified reserves. *Id.*, ¶ 5.

On or about the expiration date of the Agreements, the Companies, through their new factor CIT, were forced to pay Milberg the full loan balance allegedly due under the Agreements, including the improper charges of $4.4 million, so as to enable the Companies to transition to CIT and continue receiving funds for their business. *Id.*, ¶ 6. After termination of the Agreements, Milberg continued to wrongfully charge the Companies for reimbursement of legal fees to which it was not entitled. *Id.*, ¶ 7. Milberg was able to do so because it was still collecting payments on the Companies' receivables from the Companies' customers. Instead of remitting to CIT all of the funds it collected, Milberg improperly deducted the wrongful charges before transmitting the balance to CIT. *Id.*

The Companies sustained reputational harm as a result of the cash shortages caused by the improper charges and reserves. The shortages prevented the Companies from making

timely payments to their factories and vendors, which resulted in increased costs, delays in meeting customer deadlines, cancellation of orders and penalty chargebacks from customers. *Id.*, ¶ 9. Milberg also engaged in bad faith failure to provide accurate funding availability information that was designed to disrupt the Companies' business. *Id.*, ¶ 10. Such failure deprived the Companies of the fruits of the Agreements by frustrating their ability to borrow and to timely pay their factories and vendors. *Id.* Lastly, Milberg breached the Agreements by denying the Companies the contractual right to review the records used to complete Milberg's monthly accountings. Milberg finally agreed, after repeatedly ignoring the Companies' requests, to allow their representatives to review the records in January 2018, more than three months after termination of the Agreements. *Id.*, ¶ 11. Even so, Milberg hampered the Companies' ability to perform the review by not providing adequate monthly accounting information backup, details and explanations.

II. LEGAL STANDARDS

In considering a CPLR 3211 (a) (7) motion to dismiss, the court is to determine whether the pleadings state a cause of action. "The motion must be denied if from the pleadings' four corners, factual allegations are discerned which taken together manifest any cause of action cognizable at law [internal quotation marks omitted]." *Richbell Info. Servs., Inc. v Jupiter Partners*, 309 AD2d 288, 289 (1st Dept 2003), quoting *511 W. 232nd Owners Corp. v Jennifer Realty Corp.*, 98 NY2d 144, 151-152 (2002). The pleadings are to be afforded a liberal construction, and the court is to "accord plaintiffs the benefit of every possible favorable inference." *Leon v Martinez,* 84 NY2d 83, 87-88 (1994). While factual allegations are given a favorable inference, "bare legal conclusions" and "inherently incredible facts" are not entitled to a preferential treatment. *Matter of Sud v Sud*, 211 AD2d 423, 424 (1st Dept 1995). "Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBCI v Goldman Sachs & Co.,* 5NY 3d 11, 19 [2005]). The court's role is limited to determining whether the complaint has a cause of action, not whether it has stated one. *Asgahar v Tringali Realty, Inc.*, 18 AD3d 408, 409 (2d Dept 2005).

The standards for summary judgment pursuant to CPLR 3212 are well established. Because summary judgment is a drastic remedy, it is granted only when the moving party has

established that there are no triable issues of fact. *Alvarez v Prospect Hosp.*, 68 NY2d 320 (1986); *Genesis Merchant Partners, L.P. v Gilbride, Tusa, Last & Spellane, LLC,* 157 AD3d 479, 481 (1st Dept 2018). The movant must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient proof in admissible form to show the absence of disputed material issues of fact. *Gammons v City of New York*, 24 NY3d 562, 569 (2014). Once the initial showing is made, the burden then shifts to the party opposing the motion by producing proof in admissible form sufficient to require a trial of the material issues of fact. *Kaufman v Silver*, 90 NY2d 204, 208 (1997). In weighing a summary judgment motion, "evidence should be analyzed in the light most favorable to the party opposing the motion." *Martin v Briggs*, 235 AD2d 192, 196 (1st Dept 1997). Bare allegations or conclusory assertions are insufficient to create genuine issues of fact necessary to defeat a summary judgment motion. *Zuckerman v City of New York,* 49 NY2d 557 (1980). On the other hand, "[w]here different conclusions can reasonably be drawn from the evidence, the motion should be denied." *Sommer v Federal Signal Corp.*, 79 NY2d 540, 555 (1992); a*ccord Jaffe v Davis*, 214 AD2d 330 (1st Dept 1995) (conflicting inferences require denial of motion).

III. DISCUSSION

The Complaint alleges that Milberg breached the Agreements, including the implied covenant of good faith and fair dealing, by making improper charges and reserves, as well as failing to provide financing (Counts 1 and 2); that Milberg wrongfully converted funds (Count 3); and that Milberg must allow the Companies to examine its accounting so as to enable them to object to improprieties that have caused injury to the Companies (Count 4).

A. Milberg Motion to Dismiss or for Partial Summary Judgment (Seq. No. 002)

Milberg asserts it was the Companies and their principal shareholder, Fisher, who defrauded Milberg.[1] Milberg Br. at 1; NYSCEF Doc No. 53. Specifically, Milberg asserts that Fisher and the Companies falsely represented only $6 million would be taken out of the Companies' funds to finance the Easy Spirit acquisition, but in reality they "secretly stripped at least $23 million" from the Companies, in addition to the $10 million of 2016 earnings that were

[1] The assertions made by Milberg are based primarily on the affidavit of William Zisfein, its executive vice president (Zisfein Aff.; NYSCEF Doc. No. 55).

distributed out of the Companies in late 2016. *Id.* Milberg also asserts a $10 million "prepayment" was made to the Companies by a significant customer, Designer Shoe Warehouse (DSW). That prepayment should have been promptly paid over to Milberg but was not. Such actions constituted clear breaches of the Agreements. *Id.* at 1-2. Milberg further asserts it was unaware of the misrepresentation at that time. It offered to finance the Easy Spirit acquisition subject to a field examination in December 2016, but its offer was declined on the ground that Milberg could not meet the December 31, 2016 closing deadline. It was told that the Companies were able to arrange financing from other sources. *Id.* at 2. After discovering "certain anomalies" in the Companies' sales data in connection with its due diligence performed for the Easy Spirit acquisition, Milberg exercised the contractual right to conduct a field examination of the Companies in February 2017, but the Companies declined to permit the examination of an affiliated entity, Moda, a guarantor of the Companies "through which much of the fraud was perpetrated." *Id.* Milberg asserts that the Companies used Moda to divert sales for which Milberg was entitled to factoring commissions, and that while Moda was "originally represented to Milberg as conducting only a small commissioned-based business with one customer, Guess Europe, [Moda] was in fact annually recording significant amounts of sales that had not been assigned to Milberg ...." *Id.* at 3.

In light of these alleged "irregularities, breaches and defaults," when the Companies failed to provide information or justification for their actions, Milberg established "a reserve against outstanding DSW receivables to protect itself against the risk of setoff;" charged the Companies for the "factoring commissions owed on the unassigned sales diverted to Moda;" and charged the Companies "default interest;" as permitted by the terms of the Agreements. *Id.* After termination of the Agreements in October 2017, and in response to the Companies' refusal to provide a release of claims against Milberg that was apparently based upon the parties' dispute over such reserves and charges, Milberg established an additional $500,000 legal fee reserve (Legal Reserve) so as "to protect its right to enforce the Agreements in the event that [the Companies] brought legal action," and "Milberg has since charged Plaintiffs for its legal expenses in this action, as expressly permitted under the Agreements." *Id.*

In seeking dismissal of the first three causes of action which relate to the allegedly improper charges and reserves against the Companies' accounts, and defending its election in advancing only $6 million on a $8 million funding request made by the Companies (Reduced Funding), Milberg argues that the Agreements provide it with the "sole discretion" to determine whether reserves are necessary, and its decision to advance funds (and in what amount) is "entirely discretionary." *Id.* at 13-15. Milberg maintains the court should not interfere with a party's contractual discretionary determination "unless it is performed arbitrarily or irrationally," because it is the party, not the court, that is the "final arbiter" of the propriety of such determination. *Id.* at 14, citing *Dalton v Educ. Testing Serv.*, 87 NY2d 384, 292 (1995). Because plaintiffs' claims are "flatly contradicted by the plain language" of the Agreements, the claims must be dismissed or, alternatively, summary judgment must be granted dismissing them. *Id.*

1. First Cause of Action (Breach of Contract)

Section 2 of the Agreements (Zisfein Aff., exhibit 1) provides that Milberg may "reserve an amount of past sales (the 'Reserve'), and revise said Reserve from time to time, if in [its] *sole reasonable judgment* it is necessary to cover possible returns of merchandise, deductions or other claims or setoffs made by customers . . . ." Agreements, § 2 (emphasis added). The section also provides that "[a]t the time of purchases of Receivables and periodically thereafter, [Milberg] may in [its] *sole and absolute discretion* make advances to [the Companies.]" *Id.* (emphasis added). Section 7 further provides that, upon the conclusion of Milberg's services as a factor, the Companies are obligated to provide "an indemnity" to Milberg "against any item which could be charged to" the Companies, which may in Milberg's "sole and absolute discretion," include the retention of any property held by Milberg or the holding by it of any balance standing to the Companies' credit, as security for their obligations under the Agreements. *Id.*, § 7.

a. The $11 Million Reserves, Legal Reserve and Reduced Funding

(i) The $3 Million DSW Reserve and the $8 Million Additional Reserve

Plaintiffs contend that reserves are permitted under the Agreements only if made in Milberg's "reasonable judgment." The reserves taken were intended to harm the Companies in

retaliation for their refusal to continuing doing business with Milberg after contract termination, and such reserves were unreasonable because they "did not fall into any of the categories for which reserves were permitted under [section 2 of the Agreements]." Opp. Br. at 3; NYSCEF Doc. No. 214.[2] Specifically, plaintiffs contend Milberg's reserve of $3 million for DSW's $10 million prepayment was improper because, pursuant to the "Inventory Supplement" (Zisfein Aff., exhibit 2), only a "cash sale" required an immediate remittance of the payment to Milberg. The DSW prepayment was not a cash sale, as the funds were for future shipments of goods to DSW (i.e. no goods were shipped to DSW at the time of the prepayment). *Id.* at 10. Plaintiffs also contend that, contrary to Milberg's allegation, the prepayment did not represent a "substantial risk of setoff" by DSW because it is the "most credit-worthy customer," and "it always paid receivables to Milberg on open invoices and never took a setoff on account of the prepayment." *Id.* at 11. Moreover, plaintiffs contend the $3 million reserve (or 30% of the prepayment) was unreasonable, given Milberg's past practices of having chargeback reserves against DSW's sales only at 0.8%. *Id.* at 16. Plaintiffs further contend that Milberg's holding an additional $8 million of reserve (for a total of $11 million) upon the pretext of the Companies' "financial irregularities" was unreasonable because Milberg was over-secured, as the value of its collateral exceeded the loan balance owed by the Companies. *Id.* at 6, 16. Plaintiffs also allege the additional reserve reflected Milberg's attempt to force the Companies to renew the Agreements upon expiration, and to get factoring agreements with ES and Moda. *Id.* Lastly, plaintiffs contend Milberg's discretionary rights under the Agreements do not negate its obligation to exercise "reasonable judgment" in taking reserves, because the discretionary rights conferred in the contract are "not unfettered [and] remained subject to the implied duty of good faith." *Id.* at 17, quoting *Tradewinds Fin. Corp. v Repfco Sec. Inc.*, 5 AD3d 229, 230-231 (1st Dept 2004).

In its reply (Milberg Reply; NYSCEF Doc. No. 304), Milberg argues that because it has the "sole and absolute discretion" to fund the Companies in amounts that could be more or less than that requested based on the borrowing formula in the Agreements, the DSW reserve was

[2] Plaintiffs' contentions are based primarily on the affidavits of Matthew Burris, the chief financial officer of the Companies and ES; and Gary Rosen, an expert witness in accounting and auditing retained by plaintiffs (Burris Aff. and Rosen Aff.; NYSCEF Doc. Nos. 181 and 166).

"entirely immaterial," as such reserve only assisted Milberg to determine how much it was willing to fund. Milberg Reply at 2. Milberg also argues that, even if it was oversecured, as alleged by plaintiffs, the "$3 million reduction in the borrowing base resulting from the DSW reserve would have no material effect." *Id.* at 3. Milberg further argues that because "DSW ultimately did set off the prepayment against the receivables that Milberg had purchased from Plaintiffs," the $3 million DSW reserve was justifiably prudent. *Id.*, referencing Zisfein Aff., exhibits 13-14.

With respect to the "reasonableness" of the $3 million DSW reserve, the Inventory Supplement states that "[e]xcept for sales made in the regular course of [the Companies'] business, we shall not sell, encumber or dispose of . . . Inventory without [Milberg's] prior written consent." Inventory Supplement, ¶ 5. The DSW prepayment was not made in the regular course of business, as plaintiffs do not argue that similar prepayments were made by DSW previously or that they obtained Milberg's consent. Thus, the assertion that "when DSW placed purchase orders on account of the Prepayment, the sales were done in the ordinary course of business" (Opp. Br. at 18) is unavailing, because the proper inquiry is whether the prepayment was made in the ordinary course of business, not whether the purchase orders on account of the prepayment were done in the ordinary course of business. The record also shows that plaintiffs did not immediately pay Milberg for the "cash sales" on account of the DSW purchase orders (as required by the Inventory Supplement), but were transmitted payments "40-50 days after goods were shipped to DSW against the $10 million prepayment." Milberg Reply at 9, referencing Zisfein Aff., ¶ 25, exhibits 11-12. Importantly, despite their contention that Milberg was over-secured, plaintiffs' assertion that DSW "never took a setoff on account of the prepayment," the record reveals that DSW did ultimately offset a portion of the prepayment. Zisfein Aff., exhibits 13-14. Indeed, plaintiffs' attorney, during oral argument on these motions, acknowledged that the Companies "turned over" $5.5 million of the $10 million DSW prepayment to Milberg in 2017, which implicitly meant that DSW ultimately set off the remaining $4.5 million. Transcript at 27. Because the Agreements accord Milberg the right to establish reserves to cover potential risks of setoffs by customers, the $3 million DSW reserve was reasonable under the circumstance. However, as to the additional $8 million reserve,

Milberg does not provide any explanation. Instead, it merely argues plaintiffs "fail to disclose in their pleadings what comprises that amount, much less why these reserves were improper." Milberg Br. at 13, n 7. Further, in its reply and during oral argument, Milberg failed to respond to or controvert opposing counsel's assertion that "these were inexplicable reserves," and that plaintiffs "never got any information with respect to the purpose of the reserve" or "whether it was indeed reasonable." Transcript at 27. Because Milberg bears the burden of proof to show it made a "reasonable judgment" in establishing such reserve, its failure to meet the burden warrants a conclusion that the additional $8 million reserve was not reasonable.

(ii) Legal Reserve

With respect to the $500,000 Legal Reserve, Milberg asserts section 7 of the Agreements requires the Companies to furnish "an indemnity" to Milberg upon its ceasing to act as a factor, and that Milberg has the "absolute discretion" to retain any property held by it as security for the Companies' obligations under the Agreements. Milberg Reply at 4. Milberg also asserts section 5 of the Agreements permits it to charge all costs and expenses, including reasonable attorneys' fees, incurred in the prosecution or defense of any action against it concerning any matter arising out of or relating to the Agreements. *Id.* Milberg further asserts that, since plaintiffs have contested Milberg's reserves and charges as well as refused to release potential claims against Milberg upon termination of the Agreements, its decision to establish the Legal Reserve and to subsequently charge legal fees ($332,519) against the Legal Reserve as they were incurred was "unquestionably reasonable." *Id.*

Even though section 7 of the Agreements permits Milberg to retain property of the Companies (such as in the form of the Legal Reserve), section 5 of the Agreements further states that the Companies' obligation to pay Milberg's costs and expenses, including reasonable attorneys' fees, does not include "those costs and expenses incurred in connection with any action or proceeding brought by [the Companies] and determined by the final and non-appealable decision of a court of competent jurisdiction to have resulted from [Milberg's] breach of [its] obligations under the Agreement." Agreement, § 5. It remains uncertain whether this is or will be such an action. Accordingly, Milberg is not entitled to charge any of this action's costs or expenses against the Legal Reserve at this time.

(iii) Reduced Funding

As to the Reduced Funding issue, plaintiffs allege Milberg's actions have harmed their "reputation and business" because the reduced availability of funds resulted in plaintiffs' making delayed payments to factories and vendors, which eventually caused "manufacturing delays, increased shipping costs, order cancellations, and [customers] penalty chargebacks." Opp. Br. at 20. Plaintiffs also allege the foregoing was compounded by "Milberg's bad faith refusal" to provide the Companies with "accurate funding availability information," thereby forcing them to submit "conservative funding requests" that resulted in having "less borrowed funds" available to pay their factories and vendors. *Id.*

In rebuttal, Milberg counters that the Companies "regularly accessed" the so-called "online MCIS system" that contained "all information they needed to calculate borrowing availability," and they were not "foreclosed from requesting additional funds" under the Agreements. Milberg Reply at 11-12. Milberg also contends that, besides it having absolute discretion to determine the amount of funding under the Agreements (as discussed above), any alleged harm caused by the Reduced Funding in April 2017 was "completely undermined" by Fisher having stripped $23 million of cash out of the Companies to finance the ES acquisition in December 2016, an amount significantly greater than the Reduced Funding. Milberg Br. at 19, Milberg further contends plaintiffs' "fictional assertion" of harm is belied by the fact that, in the five months after April 2017, they made more than "40 funding requests" for amounts below their actual borrowing availability, "advertently choosing not to request additional amounts they easily could have sought that would have cured any conceivable cash shortfall." *Id.*, citing Zisfein Aff., ¶ 31.

Milberg's contentions are persuasive. Because plaintiffs fail to rebut Milberg's contentions by bringing evidence of reputational damage, and applicable law requires a high threshold for seeking such damages on a breach of contract claim, the alleged reputational damages are not recoverable. *MacArthur Constr. Corp. v Coleman*, 91 AD2d 906, 906 (1st Dept 1983) (damage claim in a breach of contract action for injury to plaintiff's reputation in the industry is not actionable); *Smith v Positive Productions*, 419 F Supp 2d 437, 453 (SD NY 2005) (purported injury to reputation is generally non-recoverable in a breach of contract action

under New York law).

b. ES Transaction Charges, Other Fees and Default Interest

Plaintiffs allege Milberg improperly charged $4.4 million against the Companies' accounts by breaching various provisions of the Agreements: (1) $2,238,157 for the Moda receivables, even though Moda is not a party to the Agreements; (2) $832,519 in post-termination legal fees; (3) $768,404 in default interest even though the Companies fully complied with the Agreements and Milberg never terminated them on the basis of default or breach; (4) $398,473 for fees and costs incurred by Milberg in its attempt to win new business from ES and to finance its acquisition; and (5) $116,933 in unexplained legal fees and $33,371 in consulting and audit fees to which Milberg was not entitled to under the Agreements. Complaint, ¶ 8; Opp. Br. at 12.

In this branch of the motion, Milberg seeks summary judgment dismissing the first, second and third causes of action "*to the extent* they rely on alleged improper charges by Milberg related to the Easy Spirit transaction ($398,473), other legal fees ($116,933), and consulting and audit fees ($33,371)." Milberg Br. at 25 (emphasis added). As to default interest charges ($768,404), Milberg notes in its moving brief that "section 3 [of the Agreements] permits charging interest upon the occurrence and during the continuance of plaintiffs' default" (Milberg Br. at 18), and contends that right was not waived and such interests were properly charged (Milberg Reply at 10-11). Notably, Milberg also argues the issue of whether "Plaintiffs wrongfully diverted sales to their Moda affiliate to avoid paying Milberg factoring charges [of $2.24 million]" should be left for *further [or future] litigation*." Milberg Reply at 1 (emphasis added).

(i) ES Transaction Charges

Milberg argues that, under the Agreements, plaintiffs must reimburse Milberg for legal fees and expenses incurred in connection with (a) "the administration and enforcement of this Agreement and any ancillary documents" and (b) "the preparation and negotiation of any amendments, modifications and additions to this Agreement and any such ancillary documents . . . ." Milberg Br. at 22, quoting Agreements, § 5. In support of the ES transaction charges, Milberg argues plaintiffs understood Milberg would only finance the ES acquisition on the

conditions the Companies and ES would be "jointly responsible" for the acquisition financing; they would "jointly provide collateral for the financing;" and that such financing "directly impacted, and required modifications to" the existing agreements, guaranties and security arrangements. *Id.* at 23. Milberg points out that, in October and November 2016, the Companies sent draft acquisition-related documents to Milberg for review and comment. *Id.*, referencing exhibits 3-8 to Seth Fier's affirmation (Seth Aff.; NYSCEF #88). Milberg also points out that, in December 2016, the Companies gave detailed "ownership and taxpayer information" to Milberg (Seth Aff., exhibit 14), illustrating Milberg was preparing documents to modify the Agreements to accommodate the acquisition. *Id.* at 23. Milberg further points out that, after the acquisition financing deal fell apart, the parties discussed a potential factoring deal between Milberg and ES, and the Companies' CFO (Burris) proposed to Milberg, by email dated January 5, 2017, that Milberg's consultant would be paid $1,000 per day for the time spent on working on the factoring arrangement. *Id.* at 24, referencing Zisfein Aff., exhibit 4. By email dated January 18, 2017, the Companies also proposed they would agree Milberg could incrementally "credit back" the proposed factoring deal, fees and expenses charged in connection with the ES transaction over the following two years. *Id.* at 25, referencing Fier Aff., exhibit 10.

In opposition, plaintiffs contend Milberg's fees are not reimbursable under section 5 of the Agreements because "ES was not a party to the Agreements" and Milberg's December 2016 invoice "provides no evidence that any of the fees were incurred for work done to obtain or enforce any payment under the Factoring Agreements or to administrate, enforce, amend or modify those Agreements." Opp. Br. at 22. They also contend Milberg has failed to show "it actually incurred $398,473 in fees as it has only provided invoices to substantiate the $163,473 in legal fees it allegedly incurred." *Id.*, referencing Burris Aff., ¶¶ 30-31, exhibits 8-13.

Plaintiffs further contend that although the parties negotiated to finance the ES acquisition, there was no evidence the Companies requested Milberg work on a modification of or amendment to the Agreements, or that the parties entered into an enforceable agreement in which the Companies agreed to pay Milberg's fees. *Id.* at 23.

The foregoing illustrates that the parties disagree whether Milberg's fees were incurred pursuant to section 5 of the Agreements, and if so, the amount reimbursable thereunder. For example, while it is undisputed that Milberg reviewed the draft documents for the ES acquisition, Milberg has not pointed to any specific document to show the parties exchanged comments on a modification, amendment or addition to the Agreements, or a guaranty or security arrangements, despite Milberg's allegation "Plaintiffs acknowledged their obligation to pay for the work." Milberg Reply at 13-15. Further, although the emails showed the Companies agreed to pay Milberg for work related to the Milberg-ES factoring arrangement, it is undisputed Milberg was not chosen as the factor for ES. There is no agreement requiring the Companies or ES to pay such fees if the factoring arrangement failed to materialize. Because there are material issues of fact in dispute, summary judgment cannot be granted in favor of Milberg, at this stage of the litigation, with respect to the ES transaction charges.

(ii) Other Legal Fees, Consulting and Audit Charges

Section 5 of the Agreements also provides the Companies are obligated to pay Milberg for its "customary charges for any field examination, collateral analysis or other business analysis . . . provided, however, that in the absence of an existing Event of Default . . . we will not be charged in excess of $12,500 in any contract year for such field examination or analyses." Agreements, §5. Plaintiffs argue the $116,933 in legal fees incurred by Milberg during 2017 "were not the type of fees that could be reimbursed under Section [] [sic] as evidenced by Milberg's monthly accountings," and the $33,731 consulting and audit charges exceeded the $12,500 annual cap because there was no default, "the Company was in full compliance with the Factoring Agreements." Opp. Br. at 23-24.

Milberg asserts the legal fees were incurred in the administration and enforcement of the Agreements (Milberg Br. at 25), an assertion that is apparently not challenged by plaintiffs. Under the Agreements, the Companies are required to repay Milberg for "reasonable attorneys' fees." Agreement, §5. Thus, partial summary judgment with respect to the legal fees is granted in favor of Milberg pursuant to CPLR 3212 (e) on the issue of liability, with the ultimate amount to be awarded upon a showing that the legal fees are reasonable. With respect to the consulting and audit charges, the Agreements provide that Milberg can charge the Companies for field

examinations and analyses, a fact which plaintiffs do not dispute. For the reasons explained below, the $33,731 charge is payable by plaintiffs because the $12,500 annual cap applies only in the absence of an event of default.

(iii) Default Interest

Section 3 of the Agreements allows Milberg to charge the Companies interest "upon the occurrence and during the continue of an Event of Default" and "such interest is due and payable at the close of each month." Agreements, §3. Plaintiffs argue the $768,404 in default interest was improperly charged by Milberg, as they were notified of such charges only after the termination of these Agreements. Opp. Br. at 21. In particular, they argue that because the Companies "were fully compliant with the Factoring Agreements and Milberg did not terminate on the basis of any Event of Default, Milberg had no right to charge default interest under Section 3." *Id.* They further argue Milberg could not "retroactively charge" default interest for nine periods because "it was required, under Section 3, to charge the Companies such interest at the close of each month." *Id.* at 24. Apparently, plaintiffs argue that Milberg's failure to charge default interest at the close of each month operated as a waiver of its right to charge such interest.

The waiver argument is unavailing because section 7 of the Agreements provides as follows: "Failure by [Milberg] to exercise any right, remedy or option under this Agreement or delay by [Milberg] in exercising the same will not operate as a waiver; no waiver . . . will be . . . effective unless it is in writing and then only to the extent specifically stated." Agreements, §7. Also, the provision that requires that default interest "is due and payable at the close of each month" may be interpreted as to impose an obligation on the Companies to pay any default interest charged after the close of a month, but does not impose a reciprocal obligation on Milberg to immediately charge default interest upon an occurrence of an event of default in a particular month. Thus, plaintiffs' "retroactive" charge argument is rejected. Moreover, the argument that Milberg did not terminate the Agreements on the basis of any event of default is misleading because, as pointed out by Milberg, it was "not required to declare a basis for termination in its June 2, 2017 [Termination] Notice, which was sent pursuant to the ninety-day written notice requirement in Section 6 of the Factoring Agreements." Milberg Reply at 11.

Further, plaintiffs' failure to notify Milberg and seek its consent with respect to the $10 million DSW prepayment in December 2016 and to immediately remit funds to Milberg for the "cash sales" on account of the DSW purchase orders in 2017 (as discussed above), constituted breaches of the Inventory Supplement and events of default under the Agreements. This, alone, supports the imposition of default interest under the Agreements. Accordingly, partial summary judgment is granted in favor of Milberg with respect to this issue, pursuant to CPLR 3212 (e).[3]

2. Second Cause of Action (Breach of the Implied Covenant)

The second cause of action alleges breach of the implied covenant of good faith and fair dealing. Plaintiffs allege Milberg breached the implied covenant by (1) failing to provide the Companies with accurate funding availability information so they could submit adequate funding requests, and (2) harassing and threatening to cut off financing to create uncertainty and disrupt their business. Complaint, ¶ 122. Plaintiffs also allege Milberg's breach deprived them of the "fruits of the Factoring Agreements by frustrating [their] ability to maintain a steady source of cash flow so that [they] could consistently pay factories and suppliers on a timely basis in order to meet customer demand." *Id.*, ¶ 123. The implied covenant is breached when a party acted in a manner that, although not forbidden by the contract, deprived the other party of the benefit of the contract. *511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 153 (2002).

The allegations in support of the breach of the implied covenant claim are substantially similar (if not virtually identical) to those asserted in support of the breach of contract claim, particularly in connection with the Reduced Funding issue, which purportedly damaged the Companies' reputation and business, as discussed earlier. Thus, the instant claim must be dismissed as duplicative of the breach of contract claim. *See e.g., Amcan Holdings, Inc. v Canadian Imperial Bank of Commerce*, 70 AD3d 423, 426 (1st Dept 2010) ("The claim that defendants breached the implied covenant of good faith and fair dealing was properly dismissed as duplicative of the breach-of-contract claim, as both claims arise from the same facts"); accord *Logan Advisors, LLC v Patriarch Partners, LLC*, 63 AD3d 440, 443 (1st Dept 2009).

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[3] Milberg also asserts the foregoing, when coupled with its other allegations that, among other things, Fisher "secretly stripped" $23 million out of the Companies to finance the ES acquisition, constituted additional "undeniable defaults" of the Agreements and caused "material adverse changes" in the financial condition of the Companies. Milberg Reply at 6-7.

3. Third Cause of Action (Conversion)

The third cause of action (sounding in conversion) alleges Milberg wrongfully charged the Companies' account for $4.4 million, and the Companies have "ownership rights over these funds, [but] Milberg has exercised intentional and unauthorized dominion and control over the funds in derogation of [their] ownership rights." Complaint, ¶ 126-127. The complaint further alleges that in "failing to reverse" the wrongful Charges and the Legal Reserve, Milberg has wrongfully converted the Companies' ownership rights in the funds. *Id.*, ¶ 128.

This claim, too, is based on the same subject matter and facts as those for the alleged breach of contract claim. Accordingly, it must be dismissed as duplicative of the breach of contract claim. *Sebastian Holdings, Inc. v Deutsche Bank*, AG, 108 AD3d 433, 434 (1st Dept 2013) (dismissing conversion claim because it was duplicative of breach of contract claim in that "both covered the same subject matter as the express contract among the parties").

4. Fourth Cause of Action (Specific Performance)

In Section 3 of the Agreements, Milberg agrees to meet with the Companies' representatives, from time to time and upon reasonable notice to "discuss and explain monthly accountings," or at the option of the Companies "to review the monthly accountings' accuracy." Agreement, § 3. In the complaint, plaintiffs request entry of an order compelling Milberg to permit plaintiffs to review the accuracy of defendants' monthly accountings and to explain same to them. Complaint, ¶ 135. In opposition, Milberg argues it has already provided "ample information" to allow plaintiffs to review the accuracy of the monthly accountings, and that this claim is "merely an attempt to obtain [information] through litigation" to which plaintiffs are not entitled under the Agreements. Milberg Reply at 14-15.

Assuming Milberg has already provided "ample information," which is disputed by plaintiffs (Opp. Br. at 23, contending that "Milberg has not fully complied with its Section 3 obligations"), Milberg does not argue that it has met with plaintiffs "to discuss and explain" the monthly accountings, a contractual obligation under the Agreements. Also, while Milberg alleges that on August 23, 2017, it "asked Matthew Burris when he would like to come to its office to review the information ... but Burris never responded" (Milberg Br. at 22, referencing Zisfein Aff., exhibit 22 (email of 8/23/17), plaintiffs contend "Burris never received that [sham]

email because it was sent to the wrong email address" (Opp. Br. at 24). An inspection of the email (exhibit 22) reveals that it incorrectly spelled Burris's first name, and Milberg admits it inadvertently omitted a "t" in Burris's first name (Milberg Reply at 15, n 19). Therefore, Milberg's request for summary judgment dismissing this claim is denied.

B. Plaintiffs' Motion for Partial Summary Judgment (Seq. No. 003)

In motion sequence number 003, plaintiffs seek summary judgment pursuant to CPLR 3212 (a) and (e) with respect to the first (breach of contract) and fourth (specific performance) causes of action. The relief requested is virtually a "reversed image" of that sought by Milberg.

1. First Cause of Action (Breach of Contract)

While plaintiffs allege they have suffered $4.4 million of damages as a result of Milberg's breach, they seek to recover only $3.57 million, comprised of the following: (a) $2.24 million in Moda receivables Milberg charged the Companies even though Moda is not a party to the Agreements (Moda Receivables); (b) $395,534 Milberg charged in connection with the ES transaction; (c) $52,763 in legal fees Milberg charged between February 2017 and September 2017; (d) $380,813 in post-termination legal fees charged by Milberg; and (e) the $500,000 Legal Reserve. (*see* Plf. Br.; NYSCEF Doc. No. 157 at 1-3).4

a. Moda Receivables

In opposing Plaintiffs' contention that the Moda Receivables are not a part of the Companies' receivables for which Milberg is entitled to factoring commissions, Milberg asserts (Milberg Opp.; NYSCEF Doc. No. 228),[5] that in connection with the ES acquisition in 2016, the Companies suggested using their "other accounts receivables" as collateral for a $30 million increase in the combined credit facility which Milberg was going to finance, but these "other accounts receivables" turned out to be "non-factored receivables in Moda related to Plaintiffs' Guess Europe and J.C. Penney (JCP) business" (i.e. the Moda Receivables), which was inconsistent with plaintiffs' prior representations that Moda was not selling goods that generated

4 Apparently, the discrepancy in the amounts is principally due to $768,404 in default interest, as plaintiffs acknowledge they are "not moving for summary judgment on all of breach of contract claims in Count I." Plf. Br. at 1, n 2.

5 Milberg's assertions are based primarily upon the affidavits of its current CEO William Zisfein (Zisfein Aff.; NYSCEF Doc. No. 265) and its consultant and former CEO Harold Oertell (Oertell Aff.; NYSCEF Doc. No. 250).

receivables, and that Moda functioned simply as an administrative entity. Milberg Opp. at 3, 6. Milberg also asserts that, because plaintiffs failed to explain why the "other account receivables" had not been assigned to Milberg, it conducted a field examination and discovered that, since 2012, the Companies had diverted over $200 million of sales from Guess Europe and JCP into Moda. *Id.* at 6-7. Milberg further asserts that, in 2013, it imposed a one-percent surcharge on factoring commissions related to the Companies' sales to JCP (as permitted under the Agreements), and discovered that Moda recorded over $40 million of JCP sales from 2014 to 2016, which was significantly higher than the $2 million JCP sales recorded in 2013. *Id.* Milberg alleges the sharp increase in Moda's sales after 2013 reflected the Companies' use of Moda to record sales to JCP so as to avoid the one percent surcharge. *Id.* Milberg also contends that while the Agreements exclude receivables owed by one Fisher entity to another Fisher entity (i.e., the inter-company receivables), and that such an exclusion "makes sense" because it reflects "movement of funds and recording of transactions" between various Fisher entities based on the Companies' accounting practices, and not "receivables generated by sales *to a third party* [i.e. Guess Europe and JCP]." Id. at 12 (emphasis in original). Milberg further contends the Moda Receivables cannot be distinguished from the Companies' receivables, and Moda served as the Companies' alter ego to avoid their obligations to Milberg, as well as secretly funneling cash to the Companies by providing $23 million in connection with the ES acquisition (which is prohibited under Moda's security agreement and guaranty with Milberg). Milberg contends the Moda Receivables are similar to the Companies' receivables, and should be subject to the Agreements. *Id.* at 12-15.

In their reply (Plf. Reply; NYSCEF Doc. No. 335),[6] plaintiffs argue Moda was an administrative services entity in 2009 when the parties initially entered into the Agreements; that the Companies "repeatedly informed Milberg that Moda began generating revenues by providing design services to Guess Europe in 2010 and later to JCP in 2013 and acted as an intermediary for JCP and Guess Europe by paying the factories on their behalf;" that such information or representations were contained in "audited financial statements they provided to Milberg

[6] Plaintiffs' arguments are based primarily upon the affidavit of its CFO Matthew Burris in further support of their motion (Burris Aff.; NYSCEF Doc. No. 312).

annually;" and that such statements reflected "Moda had approximately $262 million of revenue and associated receivables from receiving commission and repayments from JCP and Guess Europe for paying the factories on their behalf." Plf. Reply at 5. They also argue that when the parties entered into new Agreements each year from 2011 to 2016, Milberg not only received all prior years' financial statements, but the Companies also answered Milberg's questions about Moda's sales in 2011-2014, which proved Milberg was aware of Moda's business. *Id.* Thus, plaintiffs argue Milberg cannot show that it justifiably relied on any purported misrepresentation that Moda was an administrative service entity, as it was aware of Moda's business based on its books and records and financial statements. *Id.* at 6. The foregoing reflects that the parties have significant disputes regarding whether the Moda Receivables are a part of the Companies' receivables and are subject to the Agreements. This, in conjunction with the dispute regarding whether the Companies complied with the side letter agreement executed by them (and by Marc Fisher individually) with Milberg in July 2009 (Side Letter; NYSCEF Doc. No. 362), as explained in detail below (*see* § III C), together with the dispute regarding whether the Companies' financial statements accurately and fully disclosed to Milberg the true nature of the Moda Receivables, preclude the granting of summary judgment in favor of plaintiffs.

b. <u>ES Transaction Charges</u>

In opposing plaintiffs' motion, Milberg substantially repeats the arguments discussed in Section III.A.1.b above. *See* Milberg Opp. at 15-18. Milberg argues it is "absurd" to suggest Milberg incurred nearly $400,000 of legal fees to review the "combined financial projections" for the ES acquisition and to prepare documents to modify the existing Agreements, "on the mere chance that Milberg might win new business," as asserted by plaintiffs. *Id.* at 16. Milberg also argues that because the Companies requested such work and the work inured to their benefit, or "was performed in connection with the addition of any existing or new affiliate as a guarantor, pledger or factored client," Milberg's fees and charges incurred in the ES transaction satisfied the reimbursement criteria of section 5 of the Agreements. *Id.*

In their reply, plaintiffs contend that "while Milberg wanted to finance the ES acquisition only if it was combined with new financing for the Companies," neither ES nor the Companies "ever agreed to that proposal, and ES only wanted a financing deal for itself." Plf. Reply at

11-12. They also argue that, even though the Companies sent draft ES transaction documents to Milberg for review, the relevant emails "do not evidence an agreement for the payment of fees." *Id.* at 12. Plaintiffs further contend that because there was no "written agreement" to amend the Agreements to allow Milberg to charge the Companies for fees incurred in connection with the ES acquisition, and since ES is not a party to the Agreements, Milberg is not entitled to be reimbursed the ES transaction fees and charges. *Id.* at 13.

In light of the disputed material facts and ongoing discovery, summary judgment as to the ES transaction charges must be denied.

c. <u>$52,763 in Legal Fees</u>

While the complaint alleges all of Milberg's $116,993 legal fee charges incurred between February and September 2017 were improper, in this branch of the motion, plaintiffs assert $52,763 of such charges were improper because Milberg's monthly accountings do not show the charges are reimbursable under section 5 of the Agreements. Plaintiffs assert that they are "not required to move on all charges at this stage and can seek discovery on the other improper charges." Plf. Reply at 13-14. This branch of the motion appears to challenge the amount of a charge and is not a distinct claim. Summary judgment is denied as premature.

d. <u>$500,000 Legal Reserve and $380,813 Post-Termination Legal Fees</u>

In reply to Milberg's opposition (Milberg Opp. at 19-21), plaintiffs assert section 7 of the Agreements entitles Milberg to retain, at the termination of the Agreements, an "indemnity" against any "item which could be charged" to the Companies pursuant to the terms of the Agreements, and that section 5 of the Agreements "limited charges for attorneys' fees to those that had been incurred." Plf. Reply at 14. Plaintiffs further assert that, at contract termination, "Milberg was only entitled to retain an indemnity for attorneys' fees that had been incurred, and thus, could be charged." *Id.*

The issues regarding the propriety of the Legal Reserve is discussed in Section III.A.1.a.(ii), *supra*, and summary judgment is denied here for the same reasons.

2. Fourth Cause of Action (Specific Performance)

In opposing plaintiffs' specific performance claim, Milberg argues, in sum, that "the overbroad scope of Plaintiffs' requests betrays their true intentions: to bootstrap themselves into a

bogus claim that they were denied disclosure under the Factoring Agreements, and to conduct an unfettered, harassing fishing expedition in hopes of finding anything to support their other baseless claims." Milberg Opp. at 24. In response, plaintiffs contend Milberg has not provided the specific categories of documents they have requested, which are "well within the scope" of section 3 of the Agreements, and that their right to meet with Milberg to discuss and explain such documents, as stated in section 3, "cannot be satisfied through discovery." Plf. Reply at 14-15.

For the same reasons stated in Section III.A.4 of this decision, which deny Milberg's motion for summary judgment dismissing this cause of action, as well as because the parties were conducting ongoing discovery pursuant to their stipulations, this branch of plaintiffs' motion seeking specific performance is granted.

C. Plaintiffs' Motion To Dismiss Milberg's Affirmative Defenses (Seq. No. 004)

In the notice of motion (NYSCEF Doc. No. 336), plaintiffs seek an order, pursuant to CPLR 3211 (b), granting their motion to dismiss: (1) the second affirmative defense for fraud, including the alleged representation that Moda was simply an administrative service entity and the alleged representation as to the financing of the ES acquisition; (2) the third affirmative defense for alter ego; and (3) the eighth affirmative defense for setoff and recoupment.

Notably, in their memorandum of law in support of the motion (Plf. Brief; NYSCEF Doc. No. 340), plaintiffs only seek to dismiss Milberg's second (fraud) and third (alter ego) affirmative defenses. Via its memorandum of law in opposition to the motion (Milberg Opp.; NYSCEF Doc. No. 366) and related documents, Milberg opposes the relief being sought.

To prevail on a motion to dismiss an affirmative defense pursuant to CPLR 3211 (b), the movant must establish that the defense has no merit as a matter of law or is not stated. *Tenore v Kantrowitz, Goldhamer & Graifman, P.C.*, 76 AD3d 556, 557 (2d Dept 2010). Indeed, the court should use the "same standard" in evaluating such motions as motions to dismiss pursuant to CPLR 3211 (a) (7). *See Bank of America, N.A. v 414 Midland Ave. Assocs.*, LLC, 78 AD3d 746, 748 (2d Dept 2010).

1. The Second Affirmative Defense (Fraud)

In addition to repeating the arguments regarding the Moda Receivables stated in its opposition to plaintiffs' motion for summary judgment, as summarized in Section III.B.1.a, Milberg asserts the Companies hid Moda's business activity from Milberg by failing to notify it of the changes in Moda's business that began in 2010, even though the Side Letter (signed in July 2009) requires such notification and disclosure. Milberg Opp. at 2-4. In relevant part, the Side Letter requires the Companies to preserve and continue their business as currently operated, and if any new or existing affiliate changes the way it operates business, the Companies and Fisher must cause such new or existing affiliate "to enter into, in Milberg's sole discretion . . . either (x) a factoring agreement with Milberg . . . or (y) a secured guaranty . . . ." Milberg also asserts that, without notification, the Companies and Fisher began to use Moda as a conduit for the design, ownership and sale of footwear to Guess Europe, even though they previously represented to Milberg that Moda was only an administrative entity that neither made products nor generated account receivables, and thus should be excluded from the Agreements. *Id.* at 5. Milberg further asserts that after it noticed in the 2010 financial statements that Moda reported, *inter alia*, $12.2 million of accounts receivables, the Companies represented to Milberg that the amounts reflected a "recent change" in their accounting practices where they "used Moda as an intermediary between Guess Europe and factories in China to address concerns regarding European VAT taxes." *Id.* The Companies further assured Milberg that "Moda recorded no net income from these transactions and that it simply facilitated the pass through of the same factory charges and commissions related to Guess Europe that were previously recorded in another affiliate, Fisher International." *Id.* at 6. Milberg also points out that, in August 2013, Moda entered into a contract with JCP for the sale of goods without disclosing same to Milberg, and it was not until 2017 when Milberg noticed a sharp increase in Moda's 2014-2016 sales (over $40 million when compared with the $2 million sale in 2013), which indicated that the Companies used Moda to record sales to JCP to circumvent factoring charges on such sales. *Id.* Milberg further points to the February 2017 memorandum (NYSCEF Doc. No. 367) prepared by the Companies' auditor, BDO, which stated that "Moda has ownership of the goods at the time the goods leave the factory and before [they] reach the ship and bears the risk of loss during that

time;" "Moda assumes the risk of collection, allowance and returns;" "Moda earns revenue based on the goods which are shipped, and revenue is not earned on a commission or fee basis;" and BDO agreed with the Companies' conclusion that "the transactions handled by Moda LLC should be presented as gross sales on the income statement." In light of the above, Milberg alleges the Companies fraudulently misrepresented Moda's business activity, when they told Milberg Moda was "mainly used as a servicing company" and "any payments over cost that reside in Moda are the results of commission." *Id.* at 7.

In reply, plaintiffs contend the financial statements of the Companies and Moda "accurately reported" that Moda generated revenues and receivables from the sale of goods, even though they did not use certain words (such as "inventory" or "change"), and that the Companies did not conceal the "change" to Moda's business because they repeatedly told Milberg through emails and financial statements that Moda changed its business to do "first cost services"[7] and generated $262 million of revenue and receivables from the sale of goods. Plf. Reply at 8-9. They also contend Milberg was informed Moda sold custom-ordered, private label goods to JCP and Guess Europe, and as such "Moda did not have any inventory, as reflected in its financial statements, since it never took physical possession of any inventory." *Id.* They further contend that, regardless of what label Milberg uses to characterize Moda's business (whether its revenues were based on commissions or sale of goods), the financial statements accurately reported those revenues, and BDO's memorandum "does not change the fact that the Company accurately reported the nature of Moda's sales transactions, which is effectively the same as Fisher International's commission-based business except for the payment to the factories for its customers." *Id.*, at 9, n 17. Moreover, they contend Moda was not mandated by the Side Letter to enter a factoring agreement, "Milberg had no contractual right to do so when Milberg already had a Guaranty Agreement [with Moda]," and "Moda's business could not be subject to a factoring agreement because it could not grant a security interest in inventory [due to the nature of Moda's business with its customers]." *Id.* at 10-11.

[7] Plaintiffs explain that "first cost services" means the factory bills Moda, Moda bills the customer (Guess Europe or JCP), the customer pays Moda, and Moda pays the factory.

The foregoing shows the parties have conflicting views regarding whether Moda's change in business was fully and accurately disclosed by the Companies, as required by the Side Letter. The fraudulent misrepresentation affirmative defence, is reinforced by the BDO memorandum, which stated Moda's revenue is "not earned on a commission or fee basis" and its transactions "should be presented as gross sales," as well as Moda's contracts with Guess Europe and JCP, which show Moda's revenues are not purely commission-based, but involve the sale and purchase of footwear. Thus, for the sole purpose of this CPLR 3211 (b) motion to dismiss defenses, Milberg has adequately pleaded the fraud defense in connection with the Moda Receivables, because it alleges plaintiffs misrepresented Moda's business as only administrative and commission-based, that Milberg justifiably relied upon such representations and refrained from requiring Moda to enter into a factoring agreement (as permitted under the Side Letter), and that it suffered monetary losses (i.e. factoring commissions) as a result. Whether such allegations can be proven at trial is irrelevant at this pleading stage, particularly when the parties have not completed discovery.

Besides alleging the Companies misrepresented or failed to disclose Moda's change in business, Milberg alleges "their lies about Moda were exposed" in connection with the ES acquisition and how they financed the acquisition. Milberg Opp. at 9-11. In effect, Milberg asserts that while performing field examination of the Companies in April 2017 (after the acquisition was concluded in December 2016), it discovered that, in late 2016, "more than $21 million was stripped from the Fisher Enterprise [which includes Moda] to provide the financing that Mr. Fisher needed for the acquisition, including a purported $16 million 'loan' to himself and a $5.5 million 'advance' to Easy Spirit - both supposed repayable 'on demand.'" *Id.* at 10. Milberg further alleges these transfers "covertly leverage[d] Milberg's credit to finance the acquisition - rendering false Plaintiffs' representation that they arranged financing from outside sources - [and] the amounts vastly exceed the $6 million that Plaintiffs represented were distributed out of the Fisher Enterprise for the acquisition." *Id.* at 10 (noting it was Burris who misrepresented the source of financing in his January 2017 email). Moreover, Milberg alleges that, despite its repeated requests to see documentation for these transactions and the accounting treatment of the purported loans and advances, the Companies refused and "simply

asserted that their accounting was proper because the 'loans' and 'advances' were intended to be repaid;" but yet, the balance sheet as of June 30, 2017, for the Companies showed "the so-called demand loan was still outstanding in the amount of $12.1 million and that Easy Spirit owed the Fisher Enterprise over $4 million." *Id.* at 10-11.

In reply, plaintiffs contend ES is a business entity which is not a party to the Agreements, and thus "owed no duty to Milberg to disclose" the source of financing for the acquisition of the ES brand. Plf. Reply at 25. They further contend the statements by Burris in his January 2017 email were only made in his capacity as the CFO of ES (not of the Companies), and that the statements were not actionable as they "express[ed] future intent because they were predicated upon the anticipation that ES would be able to take an IP secured loan, and it was anticipated that the $6 million would be accounted for as a distribution, not a loan, but subsequent events changed the terms of ES's financing." *Id.*

The parties hold divergent views as to whether there was misrepresentation in connection with the source of the ES financing. Nonetheless, Milberg points out that, instead of addressing the dispute regarding the source of financing, plaintiffs repeat their "ridiculous contention" that Burris made those misrepresentations only in his capacity as the CFO for ES and not as the CFO for the Companies, and that "it strains credulity" that Burris "was unaware of the sources of financing," because the ES acquisition was already completed in December 2016, and that his statements (made in January 2017) did not express a "future intent." *Id.* at 24-25. This dispute and the dispute regarding the accounting treatment of the purported loans and advances, as well as discovery-related discussion regarding the identification of experts and reports (as reflected in the parties' stipulations), renders premature any decision as to whether there was fraudulent misrepresentation in connection with the ES acquisition financing. Thus, plaintiffs' motion to dismiss the second affirmative defense is denied.

2. Third Affirmative Defense (Alter Ego)

As an initial matter, the parties dispute which state's law applies to the alter ego defense. Plaintiffs assert that because New York choice of law principles provide the state of incorporation has the greater interest in determining corporate veil piercing or alter ego disputes, Delaware law applies here because Moda is a Delaware company. Milberg argues that because

Moda is not a party to this action, its citizenship is not dispositive, and the parties chose New York to govern disputes arising from the Agreements and the Moda security agreement. Notably, the parties have not identified any significant difference in the applicable laws of Delaware and New York, and, as plaintiffs acknowledge, the issue at hand is whether Milberg has pled a viable alter ego defense "regardless of whether New York or Delaware law applies." Plf. Reply at 11. Based on the parties' pleadings, there appears to be substantial similarity in the laws of Delaware and New York in the context of determining alter ego claims or defenses.

Milberg asserts the Companies exercise complete domination over Moda because, among other things: Marc Fisher owns 99% of Moda and funds were stripped from Moda for his personal purposes; Moda and the Companies share common ownership and management; Moda is used as a conduit to circumvent the Companies' obligations under the Agreements, including diverting sales to Moda to avoid factoring commissions; and Moda guarantees the Companies' debt and they do not deal with each other at arms' length. Milberg Opp. at 16-19; citing *Matter of Morris v New York State Dept of Taxation and Fin.*, 82 NY2d 135, 141 (1993) (alter ego involves a showing of "the owners exercised complete domination of the corporation in respect of the transaction attacked" and that such domination was "used to commit a fraud or wrong against [a party] which resulted in injury [to the party]").

Plaintiffs contend Milberg's allegations are "conclusory" because, among other things, Moda is a profitable business and made loans to Fisher and ES in 2016 that were "largely repaid in 2017 so that no funds were stripped;" the Companies did not circumvent any obligations under the Agreements because Moda does not have a factoring agreement with Milberg; Milberg cannot show Moda was undercapitalized because the "issuance of loans and inter-company transfers" are permitted under the Agreements; and Moda did not borrow from Milberg, the Companies paid Milberg in full upon contract termination and Milberg suffered no injury. Plf. Reply at 12.

Milberg's alter ego defense has no application here as that defense seeks to persuade the court to impose corporate obligations of non-party Moda on plaintiffs (*see Morris v NYS Dept of Taxation and Finance*, 82 NY 2d 135, 141 [1993]). Milberg admits it does not seek to hold "Plaintiffs liable for Moda's actions" (Def. Mem 19, n. 16, Doc 360). Moda, the entity Milberg

alleges was inadequately capitalized and served as plaintiffs' "alter ego" had no obligation to Milberg except as a guarantor of loans made by Milberg to the admittedly adequately capitalized debtors. As such, any alleged domination of Moda resulting in its undercapitalization could not be a vehicle for any fraud allegedly suffered by Milberg. In any event, the alter ego defense is duplicative of the breach of contract defense and as such is not a wrong that would warrant piercing the corporate veil (*see Skanska USA Bldg. Inc. v Atlantic Yards B2 Owner, LLC,* 146 AD 3d 1, 12 [] 1st Dept 2016]).

IV. CONCLUSION

Based on the foregoing, the court concludes as set forth below.

The motion of Milberg to dismiss the first cause of action alleging breach of contract or for partial summary judgment (motion sequence number 002) shall be granted insofar as it relates to (1) the $3 million DSW reserve, (2) the Reduced Funding issue which is claimed to have resulted in reputational harm to the Companies, (3) liability only regarding the Other Legal Fees, (4) the $33,731 in consulting and auditing charges and (5) default interest. The motion is denied as to (1) the additional $8 million reserve, the court having held that Milberg has not shown its action with respect thereto was reasonable; (2) the $500,000 Legal Reserve and (3) the ES Transaction Charges.

The second (implied covenant) and third (conversion) causes of action shall be dismissed as they are duplicative of the breach of contract claim. The branch of Milberg's motion that seeks dismissal of the fourth cause of action will be denied.

The motion of plaintiffs for partial summary judgment (motion sequence number 003), must be denied in part as there are material issues of fact as to (1) the Moda Receivables, (2) the ES Transaction Charges, (3) the Legal Reserve and (4) Post-termination legal fees. The branch of the motion relating to $52,763 in legal fees is also denied as premature. The motion is granted as to the fourth cause of action (specific performance).

The motion of plaintiffs to dismiss the affirmative defenses of alter ego and fraud (motion sequence number 004) shall be granted as to the alter ego defense and otherwise denied.

It is hereby,

ORDERED, that defendant's motion to dismiss or for partial summary judgment (sequence number 002) is granted with respect to (1) the first cause of action (breach of contract), only to the extent set forth in Section III.A.1 of this decision, and to (2) the second (breach of the implied covenant) and the third (conversion) causes of action, as set forth in Section III.A.2 and Section III.A.3 of this decision, respectively; and is denied with respect to the fourth cause of action (specific performance), as set forth in Section III.A.4 of this decision; and it is further

ORDERED, that plaintiffs' motion for partial summary judgment (sequence number 003) is denied with respect to the first cause of action (breach of contract), to the extent set forth in Section III.B.1 of this decision; and is granted with respect to the fourth cause of action (specific performance), as set forth in Section III.B.2 of this decision; and it is further

ORDERED, that plaintiffs' motion to dismiss defendant's second (fraud) and third (alter ego) affirmative defenses (sequence number 004) is granted as to the alter ego defense and is otherwise denied, as set forth in Section III.C of this decision; and it is further

ORDERED, that counsel for the parties are directed to appear for a status conference at Part 49, Room 252, 60 Centre Street, New York, New York 10007 on November 12, 2019 at 10:30 am to fix a date for filing the Note of Issue, schedule further proceedings in this case, and any other matters in furtherance of a final resolution of the case.

This constitutes the decision and order of the court.

DATED: **October 17, 2019**

ENTER,

O. PETER SHERWOOD J.S.C.