SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

- X

VXI LUX HOLDCO, S.À.R.L.,

Plaintiff,

-against-

SIC HOLDINGS, LLC, SYMBIO INVESTMENT CORP., FLANDERIT HOLDING AB, CAPMAN EQUITY VII A L.P., CAPMAN EQUITY VII C L.P., MANEQ 2005 AB, FINANCIAL TECHNOLOGY VENTURES II (Q), L.P., FINANCIAL TECHNOLOGY VENTURES II, L.P., ACTUA HOLDINGS, INC. (f/k/a ICG HOLDINGS, INC.), CAPMAN EQUITY SWEDEN KB, LANDTEK CORPORATION, TREASURE HIGH HOLDINGS, WATERTON RESOURCES LIMITED, UNIVERSITY VENTURES INC., RANDY LEE, ETHOS TECHNOLOGIES HOLDING LTD., JONING TA, SOUTH CHINA (JERSEY) HOLDINGS LIMITED, GRAHAM BOLTON, MICHAEL KEATING, JEAN CHOLKA, JAMES REESING, PAUL MACHLE, BO HUANG, GAGANDEEP SINGH, JOHN WAGSTER, BIG BEND XI INVESTMENTS, L.P., ANTHONY MASSA, DEBORAH BALDINI, SUSAN KIRCHHOFF, and JACOB HSU,

Defendants.

- X

DECISION AND ORDER
Index No.: 652064/2017

Motion Seq. No.: 005

O. PETER SHERWOOD, J.:

I. BACKGROUND

In a prior motion to dismiss, claims in the First Amended Complaint (FAC) for breach of contract and declaratory judgment were dismissed with prejudice and a claim alleging fraud was dismissed without prejudice. Plaintiff appealed dismissal of the first two causes of action only and obtained reversals. VXI did not seek review of dismissal of the fraud claims (*see* Doc. No. 93, n. 3). Plaintiff filed a Second Amended Complaint (SAC) to assert claims of breach of contract, declaratory relief, and various frauds (NYSCEF Doc. No. 103). The fraud cause of action, which is the subject of this motion, is asserted against defendants Jacob Hsu, Qing Lu, Sic Holdings, LLC, and Symbio Investment Corp. Movants seek dismissal of this claim on grounds of documentary evidence and failure to state a claim for which relief can be granted.

II. FACTS

As this is a motion to dismiss, the facts are taken from the SAC and assumed to be true.

Plaintiff VXI Lux Holdco S.a.r.l. (VXI) purchased Symbio S. A. (Symbio), a technology and software engineering company for about $110 million in 2014 pursuant to a Share Purchase Agreement (the SPA). VXI claims defendants, the sellers and their agents, misrepresented and omitted material facts, which caused VXI to overpay for the for the company. The defendants are "Selling Shareholders", except for SIC Holdings, LLC, the "Rollover Selling Shareholder" according to the SPA, and Jacob Hsu, the "Managing Shareholder" according to the SPA (SAC, paras 41-43).

VXI alleges Symbio misrepresented its pre-closing financial performance, specifically, its historical and projected earnings before interest, taxes, depreciation and amortization (its EBITDA) by concealing the true extent of its liability for China's social insurance and housing taxes (SAC ¶ 150, Doc. No. 103). This misrepresentation caused Symbio to appear more valuable and VXI to overpay for the company. VXI asserts breach of contract for violation of the SPA's representations and warranties, for which the remedy is dictated by the SPA. VXI also asserts claims for declaratory relief and fraud, fraudulent inducement, fraudulent misrepresentation, and fraudulent concealment. The fraud claims are asserted against the Managing Shareholder, the Rollover Selling Shareholder, Qing Lu, and SIC Holdings and allege that the principals of Symbio deliberately misrepresented the company's finances, including that it had made all of the tax payments and mandatory contributions required by the Chinese government. VXI asserts Symbio underpaid for taxes and social insurance by bribing the government auditors. VXI has not alleged any prosecution or tax enforcement action by government.

III. ARGUMENTS

Defendants argue this case is a breach of contract case for failure to provide accurate financial information, not a fraud case (Memo, NYSCEF Doc. No. 112, at 1). Justice Bransten dismissed the fraud claim on multiple grounds, including "failure to allege an actionable affirmative misrepresentation, failure to allege the special facts doctrine to create a duty to disclose, and failure to sufficiently allege scienter," and none of the deficiencies in the FAC have been remedied in the SAC (*id.*). Further, defendants disclosed how much Symbio had

paid in taxes, and plaintiff did not inquire further. The SPA states that all taxes have been paid and the tax returns provided are true and complete. The disclosure schedule to the SPA specified social insurance shortfalls for Beijing and Chengdu for several years and how the shortfalls were handled. The SPA also provided the procedures for seeking indemnification for breaches of representations and warranties (*id.* citing SPA section 8.09[a]).

Shortly before expiration of the representations and warranties in the SPA, VXI emailed a notice of claim (the Notice of Claim), which prevented release of the funds held in escrow. The Notice of Claim alleged the breach of representations and warranties, but no fraud (*id.* at 6). A fraud claim was alleged in the FAC and was dismissed by Justice Bransten, who found "statements allegedly made by Hsu and Lu concerning anticipated Q4 EBITDA were non-actionable projections", "VXI did not allege scienter, as it made no allegations that Hsu or Lu knowingly made misrepresentations or omissions", "that Zhou's email to Hsu, stating that he knew there had been no intentional misleading by Hsu, negated scienter" and "Hsu's and Lu's statements that Symbio had passed audits were not actionable, because the statements were true, and there was no allegation that Hsu and Lu had actual knowledge of the alleged scheme to underpay taxes", nor was there "special facts" creating a duty to disclose (*id.* at 8).

Defendants ask that the fraud claim be dismissed with prejudice as VXI has merely added "vague, conclusory, unsupported or irrelevant allegations to the fraud claim (*id.* at 11, citing SAC ¶¶ 145-180). VXI has not remedied the pleading deficiencies, and the fraud claim is still too vague. The alleged misrepresentations are not stated with specificity (*id.* at 11, citing SAC ¶ 150). Nor can predictions, such as the projected EBITDA, support fraud (*id.* at 12). VXI cannot argue reasonable reliance, since the projected EBITDA was not bourne out by facts, even before the deal closed. In addition, the fraud claim is duplicative of the breach of contract claim, as the statements at issue are the same as those in the representations and warranties and the remedies sought are the same (*id.* at 19-21). As far as plaintiff seeks rescission, that remedy is not available where there is an adequate legal remedy, and money damages would be sufficient here (*id*. at 21).

VXI argues it has provided detailed allegations of fraud and that Symbio paid less than half the required "social insurance and housing tax payments that were required", bribing government auditors, and that defendants Jake Hsu and Qing Lu were aware of and directed these activities (Opp, NYSCEF Doc. No. 137 at 1). Plaintiff claims Symbio's actions constitute

tax fraud, and are no mere disagreement. Plaintiff also alleges defendants stated Symbio had passed its audits and was operated to US standards. Plaintiff explains "[t]he Chinese government requires employers to pay social insurance and housing fund taxes based on number and type of employee [and in] 2016 VXI learned . . . Symbio had been significantly underpaying those taxes prior to VXI's acquisition of the company" (Opp at 5, citing SAC ¶¶ 76-104).

VXI contends it sufficiently pled material misrepresentation and omissions of material fact, based on the allegations regarding defendants' misrepresentations of Symbio's EBITDA prior to 2014, it's then-current EBITDA, and its projected 2014 year-end EBITDA (Opp at 11). The first-half EBITDA for 2014 was overstated by almost $1 million because of the liability for social insurance and housing taxes, and, since the valuation of Symbio was calculated as a multiple of the EBITDA, it resulted in an over-valuation of the company. Defendants similarly misrepresented the projected EBITDA for the latter half of 2014 (*id.* at 12). Defendants Hsu and Lu similarly misrepresented Symbio's earlier EBITDAs, assuring VXI that Symbio was in compliance with its obligations, including the tax payments and operating to US standards, meaning it "met its ethical and government-imposed obligations, unlike many other companies in China" *(id*. at 19). This was not true.

VXI also alleges Symbio's chairperson, David Lee, acting as a representative of defendant SIC Holdings, LLC, met with VXI representatives in July of 2014 and assured them the company operated at US standards, rather than being run like other Chinese companies (*id.* at 14). Further, in a meeting on June 5, 2014, Hsu and Lu told VXI's CEOs Zhou and Wang that the company had passed all audits but did not reveal the company had given bribes and falsified information. Defendants had a duty to reveal these "special facts" because defendants had superior knowledge which made the transaction unfair (*id.* at 14). Plaintiff could not have discovered this information by due diligence. Plaintiff alleges it inquired specifically about tax practices and was told, falsely, the company operated to US standards. These allegations are sufficient to support the claim for fraud, showing Hsu, Lu, and Lee had knowledge of the underpayments and misrepresented the facts to induce VXI to close the deal. VXI has alleged Lu personally participated in directing the tax fraud on the government and paying a bribe, and Hsu's personal participation in the fraud (*id.* at 17-18).

VXI claims to have sufficiently pled reliance (*id.* at 19). The SPA was signed and became binding on November 26, 2014, and the fact that year-end EBITDA was lower than

predicted in November would not have changed the situation (*id.*). Further, even the year-end EBITDA was inflated by the failure to pay taxes. VXI claims to have properly pled damages, because, had EBITDA been properly reported, the price, calculated as a multiple of EBITDA, would have been lower.

As far as defendants maintain the fraud claim is contradicted by an email from David Zhou (who said plaintiff did not believe defendants had intentionally misled plaintiff), the post-closing employment of certain defendants or other conduct, these allegations are irrelevant to the fraud claim (*id.* at 20). They do not definitively disprove plaintiff's allegations here.

Plaintiff also contends the fraud claim is not duplicative of the breach of contract claim because the claim is based on pre-contractual misrepresentation of then-present facts, such as the EBITDA and the audit status of Symbio, and how that company did business. Nor are the damages the same, as the SPA limits contract damages to the amount of the escrow account, which now holds about $11M, but the SPA does not impose limitations on fraud damages. Further, plaintiff seeks rescission, and defendants' argument that damages provide an adequate remedy is conclusory and should be ignored (*id.* at 22).

Defendants reply that the plaintiff's attempt to fill in gaps in the SAC by adding new allegations through an additional affirmation and affidavit should be unavailing because these allegations have never been made before. Notably, one of the affiants, Baoguo Zhou (BZ), is an employee who has been available to plaintiffs all the while. Further "BZ's affirmation … that it was a 'common practice in China … to pay far less for social insurance … [and] bribe tax authorities …' (BZ aff. ¶ 4) … means that VXI should have been on 'high alert' for Social Insurance Tax issues as the owner of other Chinese businesses and aware of this allegedly 'common practice' such that it would have carefully scrutinized the Symbio Social Insurance Taxes paid by Symbio" rather than merely asking if Symbio paid their taxes (Reply, NYSCEF Doc. No. 145, at 1-2). Defendants argue the David Zhou (DZ) affidavit should also be ignored because it provides little detail of alleged misrepresentations (*id.* at 4).

Defendants argue the plaintiff still has not specifically alleged who made what misrepresentation on what day, and so the claim must fail (*id.* at 5). Further, "there is no contention that Symbio failed to calculate its EBITDA based on its actual payment of such taxes" (*id.* at 6). Defendants also note plaintiff concedes the Chinese government has not challenged the sufficiency of the tax payments made (*id.* at 6, see also Memo, at 2 and 12).

Defendants also contend they did not have a duty to disclose, as plaintiff had the ability to inquire and seek information if it wanted it, and it failed to exercise ordinary intelligence and perform its due diligence to uncover that information, which it had the ability to do. Further, VXI has only managed to allege scienter with the meager affidavit of BZ five years after taking control and having unfettered access to Symbio's records (*id.* at 10). Any allegations that representatives of Symbio said that company was run like US companies, or "not run like other Chinese companies" is mere puffery and non-actionable (*id.* at 10-11). VXI has admitted in an email that it knew Hsu had no knowledge of falsity or intent to deceive, contradicting its current position (*id*. at 11). VXI has continued to pay Hsu and Lu, and employ Hsu and BZ, after learning of this alleged fraud (*id.*).

Finally, the fraud claim is duplicative of the breach of contract claim as the subjects of the alleged fraud are covered by the representations and warranties of the SPA. The damages sought are actually the same, and rescission is not available 5 years after the transaction closed and where only one selling shareholder is accused of fraud (*id.* at 12).

IV. DISCUSSION

A. Standards

On a motion to dismiss a plaintiff's claim pursuant to CPLR § 3211 (a) (7) for failure to state a cause of action, the court is not called upon to determine the truth of the allegations (*see, Campaign for Fiscal Equity v State,* 86 NY2d 307, 317 [1995]; *219 Broadway Corp. v Alexander's, Inc.,* 46 NY2d 506, 509 [1979]). Rather, the court is required to "afford the pleadings a liberal construction, take the allegations of the complaint as true and provide plaintiff the benefit of every possible inference [citation omitted]. Whether a plaintiff can ultimately establish its allegations is not part of the calculus in determining a motion to dismiss" (*EBC I v Goldman, Sachs & Co.*, 5 NY3d 11, 19 [2005]). The court's role is limited to determining whether the pleading states a cause of action, not whether there is evidentiary support to establish a meritorious cause of action (*see Guggenheimer v Ginzburg,* 43 NY2d 268, 275 [1977]; *Sokol v Leader,* 74 AD3d 1180 [2d Dept 2010]).

To succeed on a motion to dismiss pursuant to CPLR § 3211 (a) (1), the documentary evidence submitted that forms the basis of a defense must resolve all factual issues and definitively dispose of the plaintiff's claims (*see 511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 152 [2002]; *Blonder & Co., Inc. v Citibank, N.A.*, 28 AD3d 180, 182 [1st Dept

2006]). A motion to dismiss pursuant to CPLR § 3211 (a) (1) "may be appropriately granted only where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law" (*McCully v. Jersey Partners, Inc.*, 60 AD3d 562, 562 [1st Dept. 2009]). The facts as alleged in the complaint are regarded as true, and the plaintiff is afforded the benefit of every favorable inference (*see Leon v Martinez*, 84 NY2d 83, 87-88 [1994]). Allegations consisting of bare legal conclusions as well as factual claims flatly contradicted by documentary evidence are not entitled to any such consideration (*see e.g. Nisari v Ramjohn*, 85 AD3d 987, 989 [2nd Dept 2011]).

CPLR § 3211 (a) (1) does not explicitly define "documentary evidence." As used in this statutory provision, "'documentary evidence' is a 'fuzzy term', and what is documentary evidence for one purpose, might not be documentary evidence for another" (*Fontanetta v John Doe 1*, 73 AD3d 78, 84 [2nd Dept 2010]). "[T]o be considered 'documentary,' evidence must be unambiguous and of undisputed authenticity" (*id.* at 86, citing Siegel, Practice Commentaries, McKinney's Cons. Laws of N.Y., Book 7B, CPLR 3211:10, at 21-22). Typically that means "judicial records, as well as documents reflecting out-of-court transactions such as mortgages, deeds, contracts, and any other papers, the contents of which are 'essentially undeniable,' " (*id.* at 84-85). Here, the documentary evidence is the SPA and the email from VXI to Hsu acknowledging Hsu had not known about the falsity of the representations about Symbio's finances.

B. Elements of the Claim

"To state a cause of action for fraud, a plaintiff must allege a representation of material fact, the falsity of the representation, knowledge by the party making the representation that it was false when made, justifiable reliance by the plaintiff and resulting injury" (*Kaufman v Cohen*, 307 AD2d 113, 119 [1st Dept 2003] citing *Monaco v New York Univ. Med. Ctr.*, 213 AD2d 167, 169 [1st Dept 1995], lv. denied 86 NY2d 882 [1995]; *Callas v Eisenberg*, 192 AD2d 349, 350 [1st Dept 1993]).

"In a fraudulent inducement claim, the alleged misrepresentation should be one of then-present fact, which would be extraneous to the contract and involve a duty separate from or in addition to that imposed by the contract . . . and not merely a misrepresented intent to perform" (*Hawthorne Group v RRE Ventures*, 7 AD3d 320, 323-24 [1st Dept 2004] [citations omitted]; *see also J.M. Bldrs. & Assoc., Inc. v Lindner*, 67 AD3d 738, 741 [2d Dept 2007] ["[a] present intent

to deceive must be alleged and a mere misrepresentation of an intention to perform under the contract is insufficient to allege fraud"]). Representations of opinion, even as to matters of fact, are not representations and are not actionable unless guaranteed (*see Lanzi v Brooks*, 54 AD2d 1057 [1976], *affd* 43 NY2d 778 [1977]; *Mun. Metallic Bed Mfg. Corp. v Dobbs*, 253 NY 313 [1930]).

"The elements of fraudulent misrepresentation are (1) the defendant made a material false representation, (2) the defendant intended to defraud the Plaintiffs thereby, (3) the Plaintiffs reasonably relied upon the representation, and (4) the Plaintiffs suffered damage as a result of their reliance" (*J.A.O. Acquisition Corp. v Stavitsk*y, 18 AD3d 389, 390 [1st Dept 2005]).

"The elements of a fraudulent concealment claim [are] concealment of a material fact which defendant was duty-bound to disclose, scienter, justifiable reliance, and injury" (*Mitschele v Schultz*, 36 AD3d 249, 254-55 [1st Dept 2006]).

C. Justifiable Reliance

Justifiable reliance is an element of all of the fraud-related claims. Plaintiff has not alleged justifiable reliance. Plaintiff is a Luxembourg s.à r.l. with its principal place of business in Los Angeles, California. It is a sophisticated, well counseled business with businesses located in China. Its predecessor in interest, VXI Offshore Ltd., the purchaser under the SPA, is not alleged to be different. While plaintiff makes allegations of certain representations and failure to disclose certain alleged criminal conduct, it does not state it performed significant due diligence even though the alleged conduct was purportedly widely practiced by businesses operating in China. VXI does not allege what diligence it conducted other than to make a casual inquiry.

D. Injury

Plaintiff claims it paid more for Symbio than it was worth, since the company had underpaid its social insurance taxes thereby reducing its liabilities, and that VXI suffered injury as a result. However, plaintiff concedes Symbio's books were audited by the government and it paid all taxes and interest due. It also does not dispute that the Chinese government has not claimed that it is due any unpaid social insurance taxes. Any injury asserted is hypothetical.

A. **Duplicative**

It is well established that "a fraud claim that arises from the same facts as an accompanying contract claim, seeks identical damages and does not allege a breach of any duty collateral to or independent of the parties' agreements is subject to dismissal as redundant of the

contract claim" (*Cronos Group Ltd. v XComIP, LLC*, 156 AD3d 54, 62-63 [1st Dept 2017] quoting *Havell Capital Enhanced Mun. Income Fund, L.P. v Citibank, N.A.*, 84 AD3d 588, 589 [1st Dept 2011]). Plaintiff VXI does not allege the breach of a duty independent of the agreement. Further, the damages are identical.

While plaintiff seeks rescission as a remedy for the alleged fraud, and relies on that distinction in damages, rescission is not available here. "In order to justify the intervention of equity to rescind a contract, a party must allege fraud in the inducement of the contract; failure of consideration; an inability to perform the contract after it is made; or a breach in the contract which substantially defeats the purpose thereof" (*Babylon Assoc. v Suffolk County*, 101 AD2d 207, 215 [2d Dept 1984]). As "rescission is an equitable defense, [it is unavailable where] plaintiff had an adequate remedy at law for money damages" (*Yetnikoff v Mascardo*, 63 AD3d 473, 475 [1st Dept 2009]).

Here, the parties bargained for the measure of damages to be paid in the event of a breach of the SPA. VXI is merely claiming it paid too much for the company, indicating money damages would serve as a remedy. If, instead, the remedy of rescission were granted, ownership of Symbio would revert back to the defendants and plaintiff would still receive money. Accordingly, the claim for rescission fails.

For the reasons discussed above, the motion shall be granted and the fraud claim shall be dismissed. It is hereby

ORDERED that defendants' motion to dismiss the third cause of action (motion sequence number 005) is GRANTED and the fraud claims are hereby DISMISSED; and it is further

ORDERED that counsel shall appear at a status conference on Tuesday, July 21, 2020 at 10:30 AM at Part 49, Courtroom 252, 60 Centre Street, New York, New York.

This constitutes the decision and order of the court.

DATED: June 3, 2020

E N T E R,

O. P. Sherwood

O. PETER SHERWOOD, J.S.C.