Rosenthal & Rosenthal of California, Inc. v Malka
2020 NY Slip Op 32165(U)
June 30, 2020
Supreme Court, New York County
Docket Number: 656465/2019
Judge: Joel M. Cohen
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. JOEL M. COHEN **PART** **IAS MOTION 3EFM**

Justice

---X

ROSENTHAL & ROSENTHAL OF CALIFORNIA, INC.,

Plaintiff,

- v -

BENJAMIN MALKA,

Defendant.

---X

INDEX NO. 656465/2019

MOTION DATE 02/21/2020

MOTION SEQ. NO. 001

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 001) 11, 12, 13, 14, 15, 16, 17, 19, 20, 21, 22

were read on this motion to DISMISS.

This action arises from a Factoring Agreement (the "Agreement") between Plaintiff and nonparty Halston Operating Company, LLC ("HOC") by which HOC assigned its receivables to Plaintiff in exchange for cash (NYSCEF 14 [Agreement]; *see generally* NYSCEF 13 [Complaint]). Plaintiff alleges that Defendant, HOC's chief executive officer, caused HOC to change HOC's business structure to permit its customers to claim "deductions" for goods purchased from HOC *after* the receivables had been assigned to Plaintiff in contravention of the Agreement. Plaintiff further asserts that Defendant made various fraudulent misrepresentations to it as to the value of the receivables, among other things. Specifically, Plaintiff asserts causes of action against Defendant for: (1) tortious interference with the Agreement; and (2) fraud.[1]

[1] Plaintiff's complaint also contains a claim to recover under the personal guarantee executed by Defendant and attorneys' fees in its third and fourth causes of action, neither of which are at issue on this motion.

Defendant now moves to dismiss the complaint pursuant to CPLR 3211 (a) (7) and, in the alternative, to stay this proceeding. For the reasons set forth below, the motion is granted in part and denied in part.

Background

Plaintiff's factual allegations, which are assumed to be true solely for purposes of the motion, boil down to the following:

HOC is part of a family of entities and subsidiaries which collectively own and operate the fashion brand, "Halston." Specifically, nonparty House of Halston, LLC ("HOH") is the sole owner of both HOC and nonparty The H Company IP, LLC ("HIP"). HIP holds the "Halston" brand's licenses and trademarks while HOC operates the fashion inventory/goods business by, for instance, creating purchase orders, planning merchandise flow, and marketing the products on behalf of retailers. Defendant was the CEO of both HOC and HIP, a Manager of HOH, and a director and shareholder of nonparty Xcel Brands, Inc. ("Xcel"), a "brand development company" which, itself, owns two related "derivative" brands" ("H by Halston" and "H Halston") (NYSCEF 13, ¶¶ 5-9). A parent entity which indirectly owns 50% of HOH, nonparty Hilco Brands, LLC ("Hillco"), has an ownership interest in Xcel. Defendant was "hired by Hillco to run the Halston business" in 2011 (*id.* ¶ 10).

Under the Agreement, HOC was to assign its receivables (from sales or services relating to its fashion manufacturing and operations) to Plaintiff in exchange for cash advancements. HOC promised in the Agreement that the assigned receivables are "bona fide, existing and enforceable obligations of Customers arising out of sales or services . . . , free and clear of all security interests, liens, claims and Disputes whatsoever other than Permitted Liens" (NYSCEF 13, § 5.3 [Agreement]). It further warranted that, prior to assigning the receivables, it would

make an "inquiry and after such to [its] knowledge the Customer will accept the Inventory and/or such services without any offset or counterclaim" (*id.* § 5.4).

To induce Plaintiff to enter the Agreement, Defendant signed a personal guarantee by which he took personal liability for HOC's obligations to Plaintiff under the Agreement with his liability capped at $250,000 plus costs and expenses (NYSCEF 4 [Guarantee, Ex. 4 to Compl.]).

HOC's Restructuring and Alleged Breach

In early 2017, "HOC and HIP were in default on [a] loan" and owed $23 million to nonparty Bank Hapoalim, B.M. (the "Bank"). Plaintiff alleges that, "[t]o restructure the debt and arrange a payment stream, Xcel, with [Defendant's] active participation and assent, structured a new supply arrangement of product to retailers that generated royalty streams within HOC and HIP" to be pledged in satisfaction of that debt (*id.* ¶ 37). Under the restructuring arrangement, HOC assumed risks originally borne by the retailers by guaranteeing "minimum gross margins" for the sales of its products (*id.*). Apart from giving retailers "guaranteed minimum margins and return rights," the restructuring also increased royalty payments to HIP which were "timed to the [Bank] payments" in connection with repaying the debt (*id.* ¶ 38). Nonetheless, Plaintiff alleges that the new structure was "driven solely by a desire for [Defendant] to enhance his financial interests in Hilco and Xcel by agree [sic] to do their bidding" by satisfying the Bank debt and "Xcel's royalty goals" (*id.* ¶ 40).

Plaintiff alleges that the new structure breached the Agreement because customers could claim deductions if its minimum profit margins were not met even after the receivables had been assigned to Plaintiff. Plaintiff also asserts that HOC's financial outlook declined after the new structure was instituted and that Defendant concealed that information from Plaintiff (*see id.* ¶¶ 48-50 [asserting Defendant falsely informed Plaintiff that the "dilution on the product was

improving" when the "estimated dilutions . . . from returns and markdowns were almost $3.4 million" and growing]).

HOC's finances continued to decline and "Hilco intervened" in HOC's business by "develop[ing] a new secret plan" under which HOC would keep borrowing from Plaintiff by falsely representing there were no claims or offsets on the receivables (*id.* ¶¶ 54-55). Defendant colluded in that "scheme" by "arrang[ing] for customers to defer their chargebacks" to ensure that Plaintiff would remain "in the dark about the extent of the margin guarantees" and customer claims while advancing further funds for the misleadingly valued receivables (*id.* ¶ 56). Defendant falsely told Plaintiff that there were no deductions on the receivables and Plaintiff asserts that Defendant directed a nonparty, Hudson's Bay ("Hudson's"), to defer a claim for a $2 million deduction to perpetuate the "scheme" against Plaintiff (*id.* ¶ 59).

In late 2018, Defendant advised Plaintiff he had resigned from HOC and that HOC had entered into an assignment for the benefit of creditors. Plaintiff attempted to liquidate the collateral but faced "disaster[ous]" "customer dilutions in the range of 75% from one . . . major" customer (Hudson's) and other offsets resulting in "millions of dollars" (*id.* ¶ 30). In sum, Plaintiff alleges it incurred more than $10 million in damages as a result of HOC's breaches.

DISCUSSION

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. [The Court] accept[s] the facts as alleged in the complaint as true, [and] accord[s] plaintiff[] the benefit of every possible favorable inference" (*Leon v Martinez*, 84 NY2d 83, 87–88 [1994] [citation omitted]). However, bare legal conclusions and "factual claims which are . . . inherently incredible" are not "accorded their most favorable intendment" (*Summit Solomon & Feldesman v Lacher*, 212 AD2d 487, 487 [1st Dept 1995]).

1. Tortious Interference with the Agreement

A claim for tortious interference with a contract requires "a valid contract between the plaintiff and a third party, defendant's knowledge of that contract, defendant's intentional procurement of the third-party's breach of the contract without justification, actual breach of the contract, and damages resulting therefrom" (*Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413, 424 [1996]). "To establish a corporate officer's liability for inducing a breach of a contract between the corporation and a third party, the complaint 'must allege that the officers' . . . 'acts were taken outside the scope of their employment or that they personally profited from their acts' " (*Hoag v Chancellor, Inc.*, 246 AD2d 224, 228 [1st Dept 1998], quoting *Courageous Syndicate v People–to–People Sports Comm.*, 141 AD2d 599, 600 [2nd Dept 1988]).

"[A] cause of action seeking to hold corporate officials personally responsible for the corporation's breach of contract is governed by an enhanced pleading standard" and, generally, "such a standard [] require[s] a particularized pleading of allegations that the acts of the defendant corporate officers which resulted in the tortious interference with contract either were beyond the scope of their employment or . . . were motivated by their personal gain, as distinguished from gain for the corporation" (*Petkanas v Kooyman*, 303 AD2d 303, 305 [1st Dept 2003] [construing "personal gain in terms that the challenged acts were undertaken 'with malice and were calculated to impair the plaintiff's business for the personal profit of the [individual] defendant' "] quoting *Joan Hansen & Co. v Everlast World's Boxing Headquarters Corp.*, 296 AD2d 103, 110 [1st Dept 2002]).

While such officers may avoid liability if "their actions were taken to protect an economic interest" of the corporation (*Foster v Churchill*, 87 NY2d 744, 751 [1996]), that protection is unavailable if the officer used "fraudulent or illegal means" to procure the breach

(*id.* at 750; *see also Buckley v 112 Cent. Park South*, 285 AD 331, 334 [1st Dept 1954] ["(A) corporate officer who is charged with inducing the breach of a contract between the corporation and a third party is immune from liability if it appears that he is acting in good faith as an officer . . . (and did not commit) independent torts or predatory acts directed at another."]).

Defendant argues that Plaintiff's cause of action for tortious interference must be dismissed because (a) HOC did not breach the Agreement and (b) Plaintiff has neither sufficiently stated facts to showing that Defendant intentionally induced HOC to breach the Agreement nor acted with malice or for personal gain. The Court disagrees.

Plaintiff alleges that HOC breached the Agreement by assigning receivables that were subject to customer claims arising from missed guaranteed profit margins. The Agreement states that the "Receivables are, to [HOC's] knowledge (after due inquiry), bona fide, existing and enforceable obligations of Customers arising out of sales made or services rendered by [HOC], free and clear of all security interests, liens, claims and Disputes[2] whatsoever . . . ." (NYSCEF 14, §§ 5.3-5.4 [requiring HOC to conduct a pre-assignment inquiry as to each Receivable and represent/warrant to Plaintiff that the customer accepted the inventory/service "without any offset or counterclaim" and "no known Dispute will exist in any respect"]).

Defendant's argument that the customer chargebacks/deductions that resulted from the guaranteed profit margins constitute permissible "discounts" under § 7.1 of the Agreement is not dispositive and does not warrant dismissing Plaintiff's claim as a matter of law at this juncture (*see id.* § 7.1 [stating that that "(t)he purchase price for each Receivable shall be the invoice

[2] "Dispute" is defined as "any dispute, claim, offset, defense, counterclaim or any other reason (including, merchandise returns) or no reason for nonpayment of or any refusal to pay all or a portion of any receivable other than a customer's financial inability to pay . . . ." (NYSCEF 14 at 15). Risk relating to customers' ability to pay are typically afforded to HOC under the Agreement (*see e.g.* §§ 2-4; *cf. also id.* at 16 [defining "Eligible Receivables" and "Net Amounts" for Receivables both eligible and otherwise]).

amount of the Receivable, less . . . any selling discounts, credits or deductions of any kind allowed, granted or taken by the Customer at any time"]). Crediting this argument would, at most, create an ambiguity not ripe for resolution on this motion.

Affording the complaint its most liberal construction and according Plaintiff all favorable inferences, Plaintiff has adequately alleged a claim for tortious interference with the Agreement: the Agreement is undisputedly valid; Defendant was aware of the Agreement and procured HOC's breach its warranties/covenants by causing HOC to assign receivables subject to customer claims to Plaintiff in contravention of the Agreement without justification; and Defendant procured the breach to benefit himself through his interest in Xcel, which reaped the benefits of royalty payments from HOC's continued operation which was made possible by Plaintiff's cash advances (*see* NYCEF 13, ¶¶ 35-59 [permitting an inference that Defendant, aware of HOC's impending insolvency, induced the breach to convert HOC's remaining value for his own benefit through increased royalties to Xcel]).

Further, Defendant's intent is supported by Plaintiff's factual allegations that HOC became insolvent (leaving Plaintiff to collect the remains of HOC's receivables) and by Defendant's purported misrepresentations and omissions regarding HOC's financial outlook, the status of the receivables, and his instructions to at least one customer (Hudson's) to "defer" its claim to conceal the diminished value of the receivables from Plaintiff. Thus, at the pleading stage, Plaintiff sufficiently alleges that Defendant intentionally interfered with the Agreement and acted maliciously to harm Plaintiff for his own individual benefit, not for the benefit of HOC or its affiliates.

Defendant's reliance on the 'economic justification' doctrine set forth in *Felsen v Sol Cafe Mfg. Corp.* (24 NY2d 682 [1969]), *Foster v Churchill* (87 NY2d 744, 751 [1996]), and

their progeny is unavailing. While Plaintiff concedes that the restructuring also benefited HOC and its affiliated entities, an incidental benefit to those companies alone is insufficient to warrant dismissal on a CPLR 3211 motion (*see e.g. Pacific Carlton Dev. Corp. v 752 Pac., LLC*, 62 AD3d 677, 680 [2d Dept 2009] [allowing tortious interference claims against corporate officers where the officers were acting, in part, to benefit corporation]). Further, whether Defendant acted for his own benefit or for that of HOC or the Halston-family entities would involve resolution of factual issues not appropriate for this motion.

Accordingly, the motion to dismiss the first cause of action is denied.

2. Fraud

Plaintiff's fraud cause of action is a repackaged claim that HOC breached the Agreement. "A cause of action for fraud does not arise when the only fraud charged relates to a breach of contract" (*Krantz v Chateau Stores of Can. Ltd.*, 256 AD2d 186, 187 [1st Dept 1998] [citations omitted]). "To plead a viable cause of action for fraud arising out of a contractual relationship, the plaintiff must allege a breach of duty which is collateral or extraneous to the contract between the parties" (*id.* [citations and quotation marks omitted]). Here, Plaintiff does not allege facts suggesting that Defendant had an independent duty to provide information regarding HOC's financial position or to ensure HOC's performance under the Agreement.

Accordingly, the motion to dismiss the second cause of action is granted.

3. Stay Proceedings

Finally, Defendant's request for a stay of proceedings, pursuant to CPLR 2201, pending the resolution of HOC's assignment for the benefit of creditors proceedings, is denied. Although amounts recovered from HOC, if any, may impact Plaintiff's ultimate recovery from Defendant if it prevails in this case, issues relating to damages can be resolved at a later date. Moreover,

Plaintiff asserts that the HOC proceedings have substantially concluded. In the meantime, Plaintiff should be permitted to proceed with its case.

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The Court has considered the parties' remaining arguments and finds that they are without merit, unpersuasive, or otherwise do not require an alternate result.

Accordingly, it is

ORDERED that Motion Sequence Number 001 is **granted in part and denied in part**; it is further

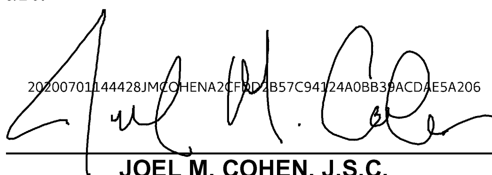
ORDERED that the motion is granted to the extent that Plaintiff's Second Cause of Action for Fraud is dismissed; it is further

ORDERED that the motion is denied with respect to Plaintiff's First Cause of Action (Tortious Interference) and Defendant's request to stay these proceedings; it is further

ORDERED that Defendant shall answer the complaint within 20 days of the Court's entry of this Decision and Order on NYSCEF; and it is further

ORDERED that the parties shall appear for a preliminary conference on August 25, 2020 at 11:00 AM.

This Constitutes the Decision and Order of the Court.



6/30/2020
DATE

JOEL M. COHEN, J.S.C.

CHECK ONE:	☐ **CASE DISPOSED**		X **NON-FINAL DISPOSITION**	
APPLICATION:	☐ **GRANTED**	☐ **DENIED**	X **GRANTED IN PART**	☐ **OTHER**
	☐ **SETTLE ORDER**		☐ **SUBMIT ORDER**	
CHECK IF APPROPRIATE:	☐ **INCLUDES TRANSFER/REASSIGN**		☐ **FIDUCIARY APPOINTMENT**	☐ **REFERENCE**