15882 Canada, Inc. v Money.Net, Inc.
2021 NY Slip Op 30516(U)
February 23, 2021
Supreme Court, New York County
Docket Number: 653604/2014
Judge: Andrew Borrok
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. ANDREW BORROK** **PART** **IAS MOTION 53EFM**

Justice

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15882 CANADA, INC.

Plaintiff,

- v -

MONEY.NET, INC.

Defendant.

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INDEX NO. 653604/2014

MOTION DATE 02/03/2020, 02/14/2020, 02/05/2020

MOTION SEQ. NO. 008 009 010

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 008) 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 371, 372, 373, 374, 375, 376, 377, 441

were read on this motion to/for STRIKE JURY DEMAND.

The following e-filed documents, listed by NYSCEF document number (Motion 009) 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 332, 333, 334, 335, 336, 337, 338, 339, 340, 341, 342, 343, 344, 345, 346, 347, 348, 349, 350, 369, 386, 387, 388, 389, 390, 391, 392, 393, 394, 395, 396, 397, 398, 399, 400, 401, 402, 403, 404, 405, 406, 407, 408, 409, 410, 411, 412, 413, 414, 415, 416, 417, 418, 419, 420, 421, 422, 423, 424, 425, 426, 427, 428, 429, 430, 431, 432, 433, 434, 435, 437, 438

were read on this motion to/for SUMMARY JUDGMENT (AFTER JOINDER).

The following e-filed documents, listed by NYSCEF document number (Motion 010) 351, 352, 353, 354, 355, 356, 357, 358, 359, 360, 361, 362, 363, 364, 365, 366, 367, 368, 370, 378, 379, 380, 381, 382, 383, 384, 385, 439, 440

were read on this motion to/for AMEND CAPTION/PLEADINGS.

Upon the foregoing documents, 158852 Canada, Inc., Ronald Black, Canadian Asset Based Lending Enterprise (CABLE), Inc., David Cytrynbaum and Daniel Elituv, the Estate of Leo Schwartz, Jeffrey Schwartz, Martin Schwartz, Alan Schwartz and Jeff Segal's (collectively, the **Plaintiffs**) motion (Mtn. Seq. No. 009) for summary judgment is granted because the Recapitalization (hereinafter defined) was not approved by a disinterested board. As such, Money.net Inc. and Janet Christofano (collectively, the **Company Defendants**) are not entitled to protection under the business judgment rule and they have failed to prove the entire fairness of

the transaction. The Plaintiffs' motion (Mtn. Seq. No. 010) for leave to amend their complaint is denied because it is utterly devoid of merit and the Plaintiffs have failed to demonstrate in this derivative action how they could recover against HVA LP (hereinafter defined). Finally, the Company Defendants' motion (Mtn. Seq. No. 008) to strike the jury demand is denied as moot.

The Relevant Facts and Circumstances

This action concerns the Plaintiffs' attempt to rescind the 2012 recapitalization of Money.net, Inc. (the **Company**) due to the allegedly improper manner in which the Company's officers and directors conducted the transaction. The Plaintiffs were early-stage investors in the Company, which is a Delaware corporation that provides an online platform for the delivery of real time financial market data to investors (NYSCEF Doc. No. 153, ¶¶ 16, 21).

At the time of the recapitalization, the Company's officers were Harold Van Arnem IV, the Chairman and Chief Executive Officer, and Janet Christofano, the Chief Financial Officer. The Company's board of directors consisted solely of Mr. Van Arnem and his mother, Karen Schram (NYSCEF Doc. No. 419 at 39:24-40:8). Both Mr. Van Arnem and Ms. Schram passed away during the course of this litigation (NYSCEF Doc. No. 337).

The recapitalization was formally set in motion pursuant to a Unanimous Written Consent of Directors (the **Directors Consent**; NYSCEF Doc. No. 338), dated April 19, 2012, wherein the Company's board approved of: (i) a 3% Convertible Promissory Note (the **Note**; NYSCEF Doc. No. 331), dated April 3, 2012, by and between the Company and Morgan Downey, whereby the Company promised to pay Mr. Downey the principal of $100,000 before December 31, 2012 or

convert the Note to shares in the Company and (ii) the Company's recapitalization (the **Recapitalization**), which consisted of the following:

(i) an exchange offer to warrant holders offering one share of the Corporation's Common Stock for each ten warrants held;

(ii) the modification of the terms of each class of Preferred Stock that will result in the exchange of all outstanding shares of Preferred Stock for a like number of shares of Common Stock;

(iii) the termination of the Corporation's Incentive Stock Option Plan and of all outstanding stock options under the Plan or otherwise;

(iv) a reverse stock split on a 1 for 5 basis to be effective following shareholder approval at such date and time as the CEO shall determine;

(v) after the reverse split is effected, issue new shares to the Chief Executive Officer and Chief Financial Officer equal to 50% and 20% respectively of the new outstanding shares for such consideration as the Board shall determine;

(vi) after the reverse split is effected, creation of a reserve equal to 5% of the Corporation's stock for the issuance of options or other equity incentives;

(vii) the settlement and/or forgiveness of certain of the Corporations outstanding indebtedness on such terms as the CEO shall determine.

(NYSCEF Doc. No. 338).

Next, the Company secured approval for the Recapitalization from preferred stockholders to exchange Series A, B, and C Preferred Stock for shares of the Company's common stock, equal to 20% of the number of shares of preferred stock, after giving effect to a 1 for 5 reverse stock split of the Company. Pursuant to a Written Consent of Holders of Not Less than a Majority of Series A Preferred Stock (NYSCEF Doc. No. 339), dated April 24, 2012, Ms. Christofano and Mr. Van Arnem were two out of three preferred stockholders who approved the conversion of Series A Preferred Stock. Pursuant to a Written Consent of Holders of Not Less than a Majority

of Series B Preferred Stock (NYSCEF Doc. No. 340), dated April 24, 2012, Ms. Christofano and Mr. Van Arnem were two out of seven preferred stockholders who approved of the conversion of Series B Preferred Stock. Pursuant to a Written Consent of Holders of Not Less than a Majority of Series C Preferred Stock (NYSCEF Doc. No. 342), dated April 30, 2012, Ms. Christofano and Ms. Schram were two out of three preferred stockholders who approved of the conversion of Series C Preferred Stock.

Pursuant to a Majority Written Consent of Stockholders (the **Shareholders Consent**; NYSCEF Doc. No. 341), dated April 30, 2012, by Mr. Van Arnem, Ms. Schram, HVA Limited Partnership (hereinafter, **HVA LP**; executed by Mr. Arnem on behalf of HVA LP), Andre Meyer Group, Morgan Downey and David Kopstain, consisting of holders not less than a majority of the outstanding shares of common stock of the Company, ratified the Recapitalization with notice of the same terms that were outlined in the Directors Consent.

The Company then notified its shareholders and warrant holders of the Recapitalization pursuant to a Notice of Action (the **Notice**; NYSCEF Doc. No. 343), dated May 16, 2012, which provided that the Recapitalization was undertaken to "(i) encourage management and employees to remain with the Company; and (ii) entice new investment to revitalize the Company's product platform by simplifying the Company's capital structure and strengthening its balance sheet," given that the Company at the time was "insolvent" (*id.*). The Notice also explained that the Recapitalization was "duly authorized by the holders of not less than a majority of the … Preferred Stock … and the Common Stock of the Company" as follows:

(i) exchange each share of Preferred Stock for the same number of shares of Common Stock;
(ii) effect a 1:5 reverse stock split for the Common Shares and use Common Shares to secure initial new capital, retain employees and settle indebtedness to employees;
(iii) offer an exchange of 1 common share for each 10 warrants held in the Company;
(iv) terminate the Company's Incentive Stock Option Plan and all outstanding stock options under the Plan or otherwise;
(v) create of a reserve equal to 5% of the Company's stock for the issuance of options or other equity incentives; and
(vi) settle or forgive certain of the Company's outstanding indebtedness on such terms as management shall determine including indebtedness to employees and out-of-pocket expenses incurred on behalf of the Company.

(*id.*).

In other words, in contrast to the Directors Consent, the Notice failed to disclose that Mr. Van Arnem and Ms. Christofano would receive 70% of the newly issued shares, or that Mr. Downey could receive 5% of the common stock after the Recapitalization pursuant to the Note.

By a Notice of Action (NYSCEF Doc. No. 344), dated May 16, 2012, the Company offered to exchange warrants subject to a 1:5 reverse stock split unless an election was made to exchange one share of the Company's common stock for ten warrants. The plaintiffs, David Cytrynbaum, Jeffrey Schwartz, Alan Schwartz, Martin Schwartz and Jeffrey Segal executed the exchange offer for warrants in July 2012 (NYSCEF Doc. Nos. 345, 346) without notice of the dilution caused by the Recapitalization.

On June 1, 2012, Matthew Press, emailed the Company's counsel, Jack Halperin, on behalf of the plaintiff Canadian Asset Based Lending Enterprise (CABLE), Inc. (**CABLE**), advising that the Company appeared to be in breach of its fiduciary obligations due to the redistribution of the Company's equity to Mr. Van Arnem and Ms. Christofano (NYSCEF Doc. No. 347). Mr.

Halperin responded by letter, dated June 10, 2012, stating that all actions constituting part of the Recapitalization were authorized and approved by the Company's board and shareholders in accordance with Delaware law (NYSCEF Doc. No. 348).

Approximately two years after the Recapitalization, on June 11, 2014, Mr. Press served the Company with a demand, under Delaware Corporation Code § 220(b), for full disclosure of its books and records, to which the Company refused to provide any disclosure (NYSCEF Doc. No. 349; NYSCEF Doc. No. 153, ¶ 87). On November 21, 2014, the Plaintiffs commenced this action solely against the Company, alleging claims for (1) books and records pursuant to Delaware Corporation Code § 220(b), (2) a declaratory judgment that the Recapitalization was invalid, (3) breach of fiduciary duty, and (4) an accounting (the **Complaint;** NYSCEF Doc. No. 1).

On January 19, 2017, the Plaintiffs filed a motion to amend the Complaint (*see* Mtn. Seq. 003), which motion was granted on the record after oral argument and by order dated June 29, 2017 (Ramos J., 6/8/2017 Tr., NYSCEF Doc. No. 361; NYSCEF Doc. No. 155). The Plaintiffs' First Amended Complaint asserts derivative claims against the Company, Mr. Van Arnem, and Ms. Christofano, alleging claims for (1) books and records pursuant to Delaware Corporation Code § 220(b), (2) a declaratory judgment that the Recapitalization was invalid and rescission appropriate to unwind the unlawful transaction, (3) fraud, (4) breach of fiduciary duty, and (5) an accounting (the **First Amended Complaint**; NYSCEF Doc. No. 153). The Amended Answer asserts one counterclaim for costs and attorneys' fees pursuant to the New York Rules of Court 130-1.1 (NYSCEF Doc. No. 156).

On October 6, 2018, Mr. Van Arnem passed away unexpectedly. Pursuant to an order, dated April 5, 2019, Mr. Van Arnem was dismissed from the action and his father, Harold L. Van Arnem III (**Mr. Van Arnem III**) was substituted in solely in his capacity as the administrator of Mr. Van Arnem's estate (the **Estate**) (NYSCEF Doc. No. 269). The Estate is represented by counsel that is separate from counsel for the Company Defendants (NYSCEF Doc. No. 270).

On December 31, 2019, the Plaintiffs filed note of issue with a jury demand (NYSCEF Doc. No. 310).

Discussion

I. The Plaintiffs' Motion for Summary Judgment (Mtn. Seq. No. 009) is Granted

A. Applicable Standard for Summary Judgment

On a motion for summary judgment, the movant "must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact" (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986], citing *Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 [1985]). The opposing party must then "produce evidentiary proof in admissible form sufficient to require a trial of material questions of fact" that its claim rests upon (*Zuckerman v New York*, 49 NY2d 557, 562 [1980]).

Although the Plaintiffs rely on *CILP Assoc., L.P. v Pricewaterhouse Coopers LLP*, 735 F3d 114 [2d Cir 2013] to argue that a movant may point to a lack of evidence on an essential element of the nonmovant's claim where the burden of proof at trial would fall on the non-moving party and thus oblige the non-moving party to raise a material issue of fact for trial (*id.* at 123), this

standard is limited to application in federal courts. This is not the law in the First Department. In state court, "a party [in state court] does not carry its burden in moving for summary judgment by pointing to gaps in its opponent's proof, but must affirmatively demonstrate the merit of its claim or defense" (*see Yun Tung Chow v Reckitt & Colman, Inc.*, 17 NY3d 29, 36 [2011] [distinguishing between the federal and state court standard for summary judgment]; *Torres v Indus. Container*, 305 AD2d 136, 136 [1st Dept 2003] ["[movant] cannot obtain summary judgment by pointing to gaps in [non-movant's] proof"]).

B. Applicable Standard of Review for the Recapitalization

Delaware law applies to govern the substantive summary judgment motion because the Company was incorporated in Delaware and the issues at *nisi prius* involve corporate governance (*see Hart v Gen. Motors Corp.*, 129 AD2d 179, 182-183 [1st Dept 1987] [law of the state of incorporation should govern the duties and obligations of directors and officers]).[1]

1. The Entire Fairness Standard Applies

The parties dispute whether the Company Defendants are entitled to the application of the business judgment rule or whether the Company Defendants bear the burden of proving entire fairness. Recently, the First Department addressed when the burden falls upon interested directors to prove the entire fairness of the transaction under Delaware law (*Matter of Cadus Corp. Stockholders Litig.*, 2020 NY Slip Op 07279 [1st Dept 2020]).

[1] The parties also rely on Delaware law in their summary judgment papers and do not dispute that Delaware law should apply to adjudicate their claims.

In *Matter of Cadus*, the plaintiffs alleged that a Special Committee, consisting of certain director defendants, helped the controlling shareholder acquire a company at an unfair price to its minority shareholders. The First Department held that the motion court correctly applied the business judgment rule instead of the entire fairness test when granting the defendants' motion to dismiss the complaint. Upon a review of the allegations, the plaintiff failed to allege facts permitting a reasonable inference that the majority of the Special Committee members were "sufficiently loyal to, beholden to, or otherwise influenced by an interested party so as to undermine [their] ability to judge the matter on its merits" (*id.* at *2 [citations omitted]). In particular, allegations about the directors' friendships with the interested party were "not sufficient to suggest the sort of personal relationship (one in which the parties are 'as thick as blood relations') that would circumvent the [business judgment rule]" (*id.*, citing *In re MFW Shareholders Litig.*, 67 A3d 496, 509 [Del Ch 2013], *affd sub nom M & F Worldwide*, 88 A3d 635 [2014]).

The facts of this case are materially different than those in the *Matter of Cadus Corp*. Here, the informed approvals were essentially by interested parties. To wit, the Recapitalization was primarily approved by Ms. Christofano and Mr. Van Arnem who used their position as preferred stockholders to provide consent for the conversion of the Company's Series A, B, and C Preferred Stock to common stock (NYSCEF Doc. No. 339). In fact, during her deposition, Ms. Christofano testified that prior to the Recapitalization, the Company had declining revenue and a stale product, such that one purpose of the Recapitalization was to consolidate the Company's shares to "clean up" its capital structure (NYSCEF Doc. No. 419 at 186-187). Ms. Christofano also testified that (i) another purpose of the Recapitalization was to incentivize herself and Mr.

Van Arnem to stay at the Company by issuing 50% and 20% of the new shares to themselves, (ii) no outside consultant was hired to negotiate the percentage of new shares that she and Mr. Van Arnem would receive, (iii) no independent director or committee of directors were consulted on the provision of new shares, (iv) Mr. Van Arnem and his mother, Ms. Schram, were the two sole directors of the Company who approved of the Recapitalization in the Directors Consent, and (v) that Ms. Christofano understood that the Company was on one side of the transaction while she was an officer on the other side of the transaction (*id.* at 186, 226:6-227:25, 229:22-230:6, 237:17-23).

Put another way, on the record before the court, the Plaintiffs have established that the Recapitalization involved clear director and officer self-interest because the Recapitalization was conceived largely by Mr. Van Arnem and Ms. Christofano, both of which were interested parties who stood on both sides of the Recapitalization and the transaction was approved by Mr. Van Arnem and his mother, Ms. Schram, who is beyond question an interested director (*see Matter of Cadus Corp., supra*). As such, the Company Defendants are not entitled to business judgment rule protection and must prove the entire fairness of the transaction (*see also Weinberger v Uop*, 457 A2d 701, 710 [Del 1983] [classic example of director self-interest involves director that appears on both sides of a transaction, or a director that receives a personal financial benefit from a transaction that is not shared by the shareholders]; *In re Trados Inc. Shareholder Litig.*, 2009 Del Ch LEXIS 128, at *22 [Ch July 24, 2009]), citing *Rales v Blasband*, 634 A2d 927, 936 [Del 1993]); *Cede & Co. v Technicolor*, 634 A2d 345, 361 [Del 1993]).

2. The Company Defendants Fail to Prove That the Recapitalization was Fair

The Company Defendants argue that summary judgment should be denied because there is a material issue of fact as to whether the Recapitalization was for a fair price based on the expert affidavit and report of Ronald G. Quintero, which indicates that the Company was insolvent at the time of the Recapitalization (NYSCEF Doc. Nos. 397-399). The argument fails. The fairness standard applies to both the duty of care and the duty of loyalty owed by directors of a Delaware corporation (*see Dohmen v Goodman,* 234 A3d 1161, 1168 [Del 2020]).

There are two aspects to a fairness analysis: fair dealing and fair price (*Weinberger*, 457 A2d at 711). Fair dealing involves when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how director and stockholder approval was obtained (*id.*). Fair price relates to the economic and financial consideration of the proposed transaction, including factors such as assets, market value, earnings, and other elements that affect the inherent value of a company's stock (*id.*).

With respect to fair dealing, the Company Defendants failed to meet their burden of proving that the sequence of events that set the Recapitalization into motion was fair. A key aspect of the Recapitalization was that 70% of the new shares would be issued to Mr. Van Arnem and Ms. Christofano. The Company Defendants did not explain how it decided on a 70% allocation of new shares to its officers and there was no advice from outside consultants in reaching this percentage allocation. Indeed, as discussed above, the record indicates that Mr. Van Arnem and Ms. Christofano decided to award themselves 70% of the Company stock and pursuant to the Director's Consent, Mr. Van Arnem and his mother "blessed" the transaction. Although the

Shareholders Consent disclosed the 70% equity transfer, three out of six of the shareholders who executed the Shareholders Consent were clearly not disinterested – i.e., Mr. Van Arnem, Ms. Schram, and HVA LP for which Mr. Van Arnem was the signatory (NYSCEF Doc. No. 341). The written consent to convert the Series A, B, and C Preferred Stock did not disclose the equity transfer in the Company to Mr. Van Arnem and Ms. Christofano. Finally, inasmuch as the Notice was issued after certain "consents" were obtained, the Notice did not notify the Company's general shareholders and warrant holders that 70% of the newly issued common stock would go to Mr. Van Arnem and Ms. Christofano. Instead, the Notice merely provided in general terms that the Company would "settle or forgive certain of the Company's outstanding indebtedness on such terms as management shall determine including indebtedness to employees" (NYSCEF Doc. No. 343). Thus, the Plaintiffs are entitled to summary judgment for breach of fiduciary duty and rescission of the Recapitalization as the Company Defendants have failed to prove that the Transaction was not fair (*see Oberly v Kirby*, 592 A2d 445, 466 [Del 1991] [stockholders may demand rescission of transaction if it is found to be unfair to the corporation]).

For the avoidance of doubt, the safe harbor provision under section 144(a) of the Delaware General Corporation Law does not apply to prevent this interested transaction from being void as Mr. Van Arnem and Ms. Christofano's self-interest was not disclosed to and approved by a majority of disinterested directors, a majority of disinterested shareholders, and the transaction was not fair to the Company (*Cede & Co. v Technicolor*, 634 A2d 345, 365 [Del 1993]; 8 Del C § 144 [a]).

II. Plaintiffs' Motion to Amend (Mtn. Seq. No. 010) is Denied

The Plaintiffs argue that they should be granted leave to add HVA LP as a defendant because there is no prejudice in doing so, HVA LP has complete unity of interest with the current defendants, and any purported delay is attributable to the defendants' evasive responses to discovery. In their opposition papers, the Company Defendants and the Estate argue that HVA LP should not be added to this action because there is no merit to this addition when HVA LP's only involvement was its execution of the Shareholders Consent.

Leave to amend under CPLR § 3025 (b) is committed to the sound discretion of the trial court (*Colon v Citicorp Inv. Servs.*, 283 AD2d 193, 193 [1st Dept 2001], citing *Edenwald Contr. Co. v New York*, 60 NY2d 957, 959 [1983]). Leave to amend pleadings should be freely given unless there is prejudice or surprise resulting from the delay to the opposing party or if the proposed amendment is "palpably improper or insufficient as a matter of law" (*McGhee v Odell*, 96 AD3d 449, 450 [1st Dept 2012]). Pursuant to CPLR § 1003, parties may be added during any stage of the action by leave of court.

On September 11, 2019, Mr. Van Arnem III was deposed as the representative of the Estate. Mr. Van Arnem III testified that HVA LP is owned 1% by the entity HVA Corp. and 99% by the family trust, and that his son had no role at HVA LP or authority to sign documents on behalf of HVA LP (NYSCEF Doc. No. 368 at 22:22-23:4, 24:23-25:5). When shown the Shareholders Consent, Mr. Van Arnem III acknowledged that his son's signature appeared above the signature block for HVA LP, but could not recall whether he was aware that Mr. Van Arnem was signing the document or whether Mr. Van Arnem asked for permission to do so (*id.* at 38:17-39:14).

On the basis of Mr. Van Arnem III's testimony, the Plaintiffs assert that HVA LP is distinct from Mr. Van Arnem and may be an independent source of recovery. This is not a basis to assert derivative claims against HVA LP. Thus, the motion for leave to amend is denied.

III. The Company Defendants' Motion (Mtn. Seq. No. 008) to Strike the Jury Demand is Denied

In light of the foregoing, the Company Defendants' motion to strike the jury demand is denied as moot.

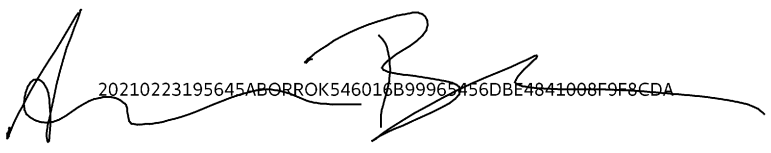
Accordingly, it is

ORDERED that the Plaintiffs' motion (Mtn. Seq. No. 009) for summary judgment is granted; and it is further

ORDERED that the Plaintiffs' motion (Mtn. Seq. No. 010) for leave to amend their complaint is denied; and it is further

ORDERED that the Company Defendants' motion (Mtn. Seq. No. 008) to strike the jury demand is denied as moot; and it is further

ORDERED that the Plaintiffs are directed to submit a proposed judgment on notice within 10 days of this decision and order.



2/23/2021

DATE

ANDREW BORROK, J.S.C.

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