

<b>135 E. 57th St., LLC v 57th St. Day Spa, LLC</b>
2014 NY Slip Op 31802(U)
July 7, 2014
Supreme Court, New York County
Docket Number: 602167/09
Judge: Charles E. Ramos
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SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: COMMERCIAL DIVISION

-----X  
135 EAST 57<sup>TH</sup> STREET, LLC,

Plaintiff,

Index No.  
602167/09

- against -

57<sup>TH</sup> STREET DAY SPA, LLC, GH DAY SPA 57<sup>TH</sup>  
STREET, LLC, GH DAY SPAS, INC., LATHER, INC.,  
LATHER SPA, INC., GERALD KATZOFF,  
RAE PINCHUK, and ROBERT HOYT,

Defendants.

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**Hon. Charles E. Ramos, J.S.C.:**

Motion sequence numbers 010 and 011 are consolidated for  
disposition.

Plaintiff 135 East 57<sup>th</sup> Street, LLC, owner and landlord of a  
building in Manhattan, obtained a judgment for rent against its  
former tenant, defendant 57<sup>th</sup> Street Day Spa, LLC (the Tenant).  
Plaintiff brings this action to collect the judgment from the  
owners of the Tenant on theories of piercing the corporate veil,  
successor liability, civil conspiracy, and pursuant to Debtor and  
Creditor Law (DCL) § 270, et seq.

Two sets of defendants move for summary judgment to dismiss  
the first corrected second amended complaint: in motion sequence  
number 010, Lather Inc., Lather Spa, Inc., and Robert Hoyt (the  
Lather defendants), and in motion sequence number 011, Gerald  
Katzoff and Rae Pinchuk. The Lather defendants also move for  
expenses and attorneys' fees, pursuant to 22 NYCRR 130-1.1 (a).

The Tenant provided spa services, personal care products, and conducted other related retail business activities in the leased premises. The lease term was from November 1, 1999 through September 30, 2010. Beginning in 2005, the base rent was \$45,000 a month.

Katzoff and his wife were principals and owners of defendant GH Day Spas, Inc. (GH Company), a Pennsylvania holding company, owner, and managing member of the Tenant. Katzoff controls the family trust that owns GH Company. Defendant GH Day Spa 57<sup>th</sup> Street, LLC (GH Day Spa) is a managing member of both the Tenant and GH Company. Katzoff and Pinchuk were managers and principals of the Tenant, managing members of GH Day Spa, and shareholders/officers/directors of GH Company.

Defendant Lather, Inc., a California company, provides day spa services and sells soaps and skin care products to hotels and spas throughout the country. Emilie Hoyt, the wife of defendant Robert Hoyt, founded defendant Lather, Inc. in 1999. While Emilie Hoyt alone owns Lather, Inc., both Hoyts are its presidents. The Hoyts own equal parts of defendant Lather Spa, which they formed to purchase 49% of the membership interest in the Tenant. Emilie Hoyt, originally a defendant, was previously dismissed from this action.

Katzoff managed the Tenant's spa through one or more of the GH entities. At some point, the spa was losing money and Katzoff

wanted to sell it. Under the lease, a sale of 50% or more of the ownership interest in the Tenant could be accomplished only with the landlord's approval. Katzoff unsuccessfully attempted to obtain plaintiff's consent to sell the spa. Katzoff alleges that plaintiff's owner conditioned consent on receiving a significant sum of money, which Katzoff refused to pay.

**The 2005 Transaction and the Agreements.**

Hoyt and Katzoff met while the former was looking for retail outlets in New York City for Lather, Inc. products. Hoyt thought that he could make a go of the spa. Hoyt and Katzoff decided on the following transaction, finalized in September 2005 via four agreements. The Hoyts formed Lather Spa, which purchased 49% of the membership interest in the Tenant from GH Company, the Tenant's owner.

Katzoff states that he settled on 49% because that was as much as he could sell without the landlord's consent. Lather Spa became the spa's manager and operated a retail store on the premises, selling only Lather, Inc. products. Out of the spa's revenue, Lather Spa would pay the monthly rent to the Tenant, which would then pay the landlord.

**The Membership Interest Purchase and Sale Agreement (PSA).**

The PSA provides that GH Company would sell Lather Spa 49% of the membership interests in the Tenant for \$150,000 and \$45,000 (PSA ¶ 2.1). The \$45,000 was to constitute rent for

September 2005. Lather Spa agreed to make a \$200,000 capital contribution to the Tenant, "as a material consideration for the sale of the Membership Interests" (*id.*, ¶ 2.2). Lather Spa had the option of buying the remaining 51% membership interest in the Tenant at the end of the lease term for \$250,000.

The PSA names GH Company as the Tenant's president, Lather Spa and GH Company as its managing members, and Lather, Inc. as its chief operating member. The first paragraph, which names the parties to the contract, identifies Lather, Inc. as "Lather Guarantor." Hoyt asserts that Lather, Inc.'s inclusion as chief operating member is an error and that Lather Spa was supposed to occupy that position. He says that Lather, Inc. is not even a member of Lather Spa and that it makes no sense for it to be named as the chief operating member.

Plaintiff responds to this assertion that drafts of the PSA, drawn up and circulated before it was finalized, also listed Lather, Inc. as chief operating member.

**Amended Operating Agreement.**

GH Company and Lather Spa amended the Tenant's operating agreement by adding Lather Spa as a new member, and Lather Spa and GH Company as managing members. Both managing members' votes were required for all spa business and both were required signatories for all bank business. All profits, gains, and losses from the spa business are required to be divided according

to ownership of membership interests, 49% for Lather Spa and 51% for GH Company.

The Amended Operating Agreement states that the Tenant is required to post a \$200,000 security deposit with the landlord, and that Lather Spa will make capital contributions in the same amount to the Tenant, which will "be posted under the Lease via either a letter of credit or a cash deposit" (Amended Operating Agreement, ¶ 14).

Upon the expiration of the lease term, the Tenant will return to Lather Spa as much of the security deposit as the landlord releases. The return of any of part of the security deposit to Lather Spa would not be considered a distribution or dividend and would not decrease its membership interest in the Tenant.

#### **The Management Agreement.**

The Tenant and Lather Spa entered into the Management Agreement, providing that, from that time, Lather Spa was the Tenant's manager with responsibility for buying all supplies, supplying all services, hiring and supervising personnel, administering the payroll, paying for utilities, and everything else concerned with the day-to-day business of the spa.

The Tenant granted Lather Spa a license to market Lather products and services at the premises. As compensation, Lather Spa was entitled to keep 90% of the profits from the spa. If

Lather Spa defaulted on any obligations or caused a default under the lease, the Tenant had the right to cancel the Management Agreement.

**The Product Exclusivity Agreement.**

Under this agreement between the Tenant and Lather Spa, Lather Spa could operate a store at the premises selling only Lather, Inc. products and services. "To defray the cost and expense to the [Tenant] of the Premises for Lather Products and Lather Services to be provided at the Premises," Lather Spa was obligated to pay the Tenant the sum equal to the rent every month (Product Exclusivity Agreement, ¶ 6 [a]). This sum, termed the facilities fee, "shall be deemed expenses of Lather for purposes of determining profits under the Management Agreement" (*id.*). To induce the Tenant not to operate another spa, Lather Spa was required to pay the Tenant \$50,000.

**The Lease Amendment.**

The Lease Amendment, between plaintiff and the Tenant, is dated April 2006. In it, plaintiff consented to the Tenant changing its name from Greenhouse Day Spa to Lather Spa. The signature page bears the printed name of the Tenant and, next to that, in handwriting, "By [GH Company]" (Lease Amendment). Pinchuk signed her name on the printed line under the Tenant's name. Under her signature, it states in handwriting, "Trustee Managing Member" (*id.*).

**How this action came about.**

Under Hoyt's direction, Lather Spa operated the spa from September 2005 to August 1 or 3, 2009, when the spa closed its doors. As of January 2009, Lather Spa stopped paying rent to the Tenant, and the Tenant stopped paying rent to the landlord.

According to Hoyt, the spa went out of business because it did not earn any profit during the entire time of Lather Spa's management.

The landlord brought a nonpayment proceeding (135 E. 57<sup>th</sup> St., LLC v 57<sup>th</sup> Street Day Spa, LLC d/b/a Lather Spa and Lather Spa, Inc., Civ Ct, New York County, index No. 72039/09). On June 7, 2010, one day before the nonpayment proceeding was scheduled for trial, the Tenant filed for bankruptcy in the United States District Court for the Southern District, listing plaintiff as its sole creditor. On October 27, 2010, the bankruptcy petition was dismissed and the stay was lifted. On the next trial date in the non-payment proceeding, the Tenant did not appear. On March 7, 2011, plaintiff was awarded a judgment for \$902,621.15 in rent and \$99,213.80 in interest.

This action was commenced on July 14, 2009. The second amended complaint was filed on December 30, 2010, and thereafter corrected on July 2011. The Court dismissed the claims for fraud, fraudulent inducement, and breach of fiduciary duty, and denied plaintiff leave to amend to add a claim against the Tenant



for breach of the lease.

GH Company, GH Day Spa, Katzoff, and Pinchuk failed to produce responses to discovery demands. The Court determined that an adverse inference on the topics covered by the withheld documents would be entered at trial against those defendants, and that plaintiff was entitled to attorneys' fees incurred by reason of the discovery difficulties. A special referee assessed \$69,106.25 in such fees against the GH defendants. Due to overlapping demands, Lather Spa and Lather, Inc. produced some of the evidence that plaintiff sought from the sanctioned defendants.

Plaintiff alleges that the Lather defendants operated a business on the Tenant's premises, in effect, taking over the lease from the Tenant, that all defendants dominated the Tenant to such an extent that it ceased to have any independent existence, and that transfers that should have been made to the Tenant to enable it to pay rent were made instead to Katzoff, one or more of the GH entities, and Lather, Inc.

**Hoyt and the Lather Entities' Allegations.**

The spa was no more successful under Lather Spa's management and Hoyt's direction than it had been under GH Company's management and Katzoff's direction. Hoyt did not receive any salary or income from Lather Spa, nor did his wife. The Hoyts and the Lather entities received no benefit from Lather Spa's

purchasing 49% of the Tenant or from managing the spa. The Tenant never transferred any money to any of them. Lather Spa's tax returns, which were produced to plaintiff during discovery, show that it lost money every year of its management. Hoyt met with the landlord to discuss whether the spa could continue with a lower rent but they could not come to any agreement.

By allowing the spa to be closed before the lease expired, Hoyt sacrificed the \$200,000 security deposit. Hoyt claims that Lather Spa managed to pay off most of the Tenant's creditors out of funds on hand, however, the rent was too large to pay off, as was Lather Spa's debt to Lather, Inc., which totals over \$3 million. That debt derives from loans that Lather, Inc. made to Lather Spa, when the latter's revenue was too small to meet its expenses, and from Lather Spa's failure to pay for products purchased from Lather, Inc.

Hoyt alleges that, before and after the 2005 transaction, the Tenant's corporate records were kept at Katzoff's office in Pennsylvania and/or in New York City at the GH Company address across the street from the leased premises. No reason existed to alter that arrangement, because GH Company continued to be the Tenant's majority owner. Katzoff, through GH Company, continued to pay the rent, deal with the landlord, and file tax returns for the Tenant. Lather Spa's sole responsibility was to manage the business and make payments to the Tenant consistent with the

agreements.

Hoyt asserts that the Lather Spa's and Lather, Inc.'s records show that Lather Spa acted the same as any other Lather, Inc. customer, by ordering goods and receiving invoices. The sales were recorded on Lather Spa's accounting records as accounts payable and on Lather, Inc.'s accounting records as accounts receivable. Lather, Inc. banked in California and Lather Spa in New York City. Each entity maintained a separate general ledger, books, and records. Hoyt testified that Lather, Inc. made a profit from 2006 through 2009.

**Katzoff's and Pinchuk's Allegations.**

According to Katzoff, he had no involvement in the spa after the 2005 transaction. He states that plaintiff cannot show that the Tenant or Lather Spa transferred any monies, property, or items of value to him.

Pinchuk alleges that her only connection to this action is that she signed the Tenant's lease and the amended lease as a trustee of the trust which owns GH Company. By agreement dated October 19, 1999, Pinchuk turned over all management and control of GH Day Spa to Katzoff. Her only other connection to the spa is that, before September 2005, she was an employee there. Pinchuk represents that she received nothing of value from the Lather defendants and that she did not exercise any management or control of the Tenant or any other entity relevant to this

action.

**Plaintiff's Opposition to the Motions.**

Plaintiff argues that the following evidence, derived from deposition transcripts, emails, bank statements, and other financial and corporate records, demonstrates that defendants are liable for the Tenant's rent.

1. Lack of corporate formalities, intermingling of funds.

Lather, Inc. sent products to Lather Spa for sale at the leased premises. Lather Spa purportedly never paid for the products and never paid back any of the money that it borrowed from Lather, Inc. The loans from Lather, Inc. to Lather Spa were not made pursuant to any writings, lacked terms of repayment or interest rates, and were actually capital contributions to Lather Spa, rather than loans.

The exceptions are four promissory notes showing loans that Lather, Inc. made to Lather Spa: July 21, 2009 - \$35,000; September 16, 2009 - \$25,000; December 14, 2009 - \$30,000; and April 14, 2009 - \$12,000. Lather Spa used these monies, the only genuine loans from Lather, Inc., to pay for litigation costs in the nonpayment proceeding.

Five times, in October, November, December 2005, January 2006, and December 2007, Lather, Inc. paid the rent directly, although according to the agreements, Lather Spa was supposed to pay the rent to the Tenant who then was to pay it to the

landlord.

Lather Spa continued to occupy the premises after the January 2009 rent default. Lather, Inc. invoiced Lather Spa through June 2009. This indicates that Lather Spa continued to sell Lather, Inc. products on the leased premises after the rent default.

Expenses for Lather Spa and Lather, Inc. were pooled. Lather, Inc. capitalized Lather Spa, which had no money when it started. The monies that Lather Spa was to pay the Tenant under the agreements came from the personal account of Emilie Hoyt.

Lather Spa did not hold regular business meetings and did not keep minutes of any meetings. From 2005 onward, GH Company and the Tenant filed no tax returns. Katzoff permitted the Tenant to forgive payment of the rent from January 2009 through August 2009, even though during that time Lather Spa occupied the premises and operated the spa.

2. Inadequate capitalization, wrongful transfers, siphoning off the Tenant's money.

Defendants purportedly caused the Tenant to transfer substantially all of its assets to the Lather entities. The 2005 transaction left the Tenant without any assets. Under the agreements, Lather Spa was to pay the Tenant \$150,000 (purchase price), \$200,000 (capital contribution), and \$50,000 (non-compete). These sums were paid to Katzoff. Evidence that

Katzoff received the money is documented in a comment in the margin of a draft of the Amendment to the Operating Agreement which states, "how to handle distribution of \$200,000 and \$50,000 to [Katzoff]." Hoyt testified that the purpose of Lather Spa paying the \$200,000 was to release Katzoff from his obligations under the security deposit.

After the 2005 transaction, the Tenant's bank statements show no balance or revenue, other than the monthly rent deposits from Lather, Inc. or Lather Spa. The Tenant's account dwindled to zero in January 2009, when it defaulted on its rent. Around that time, Lather Spa made the following transfers to Lather, Inc., rendering Lather Spa insolvent and unable to pay the rent to the Tenant, which then could not pay the landlord: November 2008 - \$100,000, January 2009 - \$35,000, \$30,000, and \$40,000; April 2009 - \$20,000.

3. Overlap in corporate owners, officers, directors and personnel.

Lather Spa operated the Tenant, and Hoyt and his wife own Lather Spa. Emilie Hoyt is the sole shareholder of Lather, Inc., which is the chief operating member of Lather Spa, which owns 49% of the Tenant. Hoyt is president of both Lather entities, while Emilie Hoyt is president of Lather, Inc.

Lather Spa hired nearly all of the same employees employed by the Tenant. Lather, Inc.'s accounting manager, Shelly Levitt,

along with other Lather, Inc. employees, performed all of Lather Spa's bookkeeping, bill paying, and payroll functions. For Lather Spa, Levitt obtained insurance, set up a merchant credit card account, recorded sales receipts and, as directed by Hoyt, effected the transfers from Lather, Inc. to Lather Spa. Lather Spa's invoices and bills were sent to the California address, where Levitt maintained Lather Spa's records. Levitt and the other Lather, Inc. personnel had offices in California. Levitt reported to Hoyt, who signed each authorization for a bank wire or transfer from a Lather, Inc. account to a Lather Spa account. During his deposition, Levitt was not able to explain the method by which transactions in Lather, Inc.'s ledger marked were transferred (rather than wired) to Lather Spa were accomplished if not by linked accounts with Lather Spa.

The PSA, all of Lather Spa's corporate documents, and its checkbooks were kept in California. Levitt mailed the Tenant's rent checks to the GH office across the street from the leased premises or to Pennsylvania, but not to the leased premises.

#### 4. Common addresses and phone numbers.

The Lather entities and Hoyt shared office space in Pasadena, California, and had a common phone number and web presence. Lather, Inc.'s website indicates that Lather, Inc. operated a store out of the leased premises. Lather Spa's tax returns listed the Lather, Inc. address in California as its

address. Hoyt signed his emails conducting Lather Spa business as president of Lather, Inc.

Katzoff and the GH entities stored tenancy documents in Pennsylvania, not on the leased premises. After the 2005 transaction, Katzoff and other GH personnel no longer had offices on the premises. They had offices across the street and in Pennsylvania.

5. Degree of discretion by the dominated corporation.

After the 2005 transaction, the Tenant had no more management functions or activity. Its only activity was paying rent to the landlord and, in reality, Lather Spa was paying the rent. Hoyt, as spa manager, owner of the Tenant, and president of the Lather entities, completely controlled all aspects of the business, and had absolute and sole discretion as to the payment of bills, including rent. Katzoff had to get Hoyt's consent before agreeing to amend the lease.

6. Payment of the corporation's debts by the dominating corporation/person.

Lather Spa and Lather, Inc. assumed responsibility for all of the spa's expenses, including payroll, rent, and employee health insurance. At times, Lather, Inc. paid the spa's expenses directly to the Tenant or its vendors. Hoyt personally paid the Tenant's bankruptcy attorney.

Lastly, plaintiff contends that the adverse inference charge



is sufficient to deny Katzoff's and Pinchuk's motion.

**Hoyt's Reply.**

Hoyt replies that Lather Spa and GH Company shared control of the Tenant. Decisions about the business required the approval of both. Lather Spa's input was necessary because it was the Tenant's manager and it had the option to purchase the entire business when the lease expired.

Several times, when Lather Spa was just starting to operate and did not have funds, Hoyt arranged for Lather, Inc. to pay the rent directly to the Tenant. Lather Spa, not Lather Inc., paid the rent and capital contribution to the Tenant. The fact that Lather, Inc. had to give the money to Lather Spa does not alter that fact. Lather, Inc. had no control or role whatsoever in the spa business. Its only relationship with the Tenant was as a vendor of products. Each transfer from Lather, Inc. to Lather Spa was recorded in both their records as a loan.

No wrong attaches to the five transfers from Lather Spa to Lather Inc. Lather, Inc. transferred over \$3 million to Lather Spa, while Lather Spa transferred only \$295,000 to Lather, Inc. The bulk of Lather Spa's transfers, totaling \$225,000, took place from November 2008 through April 2009, during the holiday period. According to Hoyt, holiday sales were traditionally the strongest of the year. He hoped that the revenue from those sales would allow Lather Spa to pay down its debt to Lather, Inc., which did

not happen. As a result of lower than expected holiday revenue, Lather, Inc. had to transfer \$285,000 to Lather Spa during that period.

As for the allegation that the Tenant's assets were stripped away, Hoyt states that plaintiff does not identify what those were. The spa's only assets were its phone number, customer list, and equipment, which never stopped belonging to the Tenant. Otherwise, the spa had only liabilities, such as payroll and bills. In regard to the spa's address being on Lather, Inc.'s website, the spa was just one of the retailers at which Lather, Inc. sold its products. All of the retailers were listed on Lather, Inc.'s website.

**Katzoff's reply.**

In regard to the claimed disregard of corporate formalities, intermingling of funds, and common office space and personnel, plaintiff attacks the relationship between the Lather entities. The Tenant's corporate offices remained unchanged after the 2005 transaction. Lather Spa agreed to manage the spa and to pay day-to-day expenses out of revenue. Unfortunately, there was not enough revenue to pay all those expenses, and the Hoyts lost over \$3 million that was owed to Lather, Inc.

The Tenant received fair consideration for the 49% of membership interest that Lather spa bought. The 2005 transaction did not render the Tenant insolvent. The spa was already

operating at a loss. No assets were stripped from the spa.

### **Discussion**

The proponent of a motion for summary judgment must make a prima facie showing of entitlement to judgment as a matter of law eliminating all material issues of fact (CPLR 3212; *Tompa v 767 Fifth Partners, LLC*, 113 AD3d 466, 470 [1<sup>st</sup> Dept 2014]). A defendant must establish that the plaintiff's "cause of action ... has no merit" (CPLR 3212 [b]). Once this burden is met, the opposing party must then demonstrate the existence of a triable issue of fact in order to defeat the motion (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]).

On a motion for summary judgment the court does not determine credibility, only whether there exists a genuine issue of fact (*Falk v Goodman*, 7 NY2d 87, 91 [1959]). The court "must view the evidence in the light most favorable to the nonmoving party" (*Haseley v Abels*, 84 AD3d 480, 482 [1<sup>st</sup> Dept 2011]).

The motions for summary judgment are granted, in part. Defendants demonstrate, and plaintiff fails to raise a triable issue in opposition, that punitive damages are not warranted, that they were not involved in a conspiracy, and that Pinchuk has no involvement in this action.

In regard to other claims, defendants either do not demonstrate entitlement to summary judgment or plaintiff raises issues of fact.

**Debtor and Creditor Law.**

DCL §§ 276 and 276-a.

Plaintiff's claims for actual fraud were dismissed, leaving DCL claims based upon constructive fraud. Constructive fraud occurs when a conveyance is made without fair consideration by one who: 1) is insolvent or who is rendered insolvent by the conveyance; 2) is engaged or is about to engage in a business or transaction for which the property remaining after the conveyance is unreasonably small; or 3) intends or believes that it will incur debts beyond its ability to pay as they mature (DCL §§ 273, 274, 275; *In re Vargas Realty Enters., Inc.*, 440 BR 224, 240 [SD NY 2010]; *In re Jacobs*, 394 BR 646, 660-661 [ED NY 2008]).

A creditor attempting to set aside a fraudulent conveyance is limited to setting aside the conveyance of the property which would have been available to satisfy the debt had there been no conveyance (*Marine Midland Bank v Murkoff*, 120 AD2d 122, 133 [2d Dept 1986]). The creditor can recover from the party who made the transfer or the party who received the transfer (*Sullivan v Kodsi*, 373 F Supp 2d 302, 309 [SD NY 2005]). A claim of fraudulent conveyance cannot be sustained against a non-transferee on the ground that it assisted in the transfer (*Cahen-Vorburger v Vorburger*, 41 AD3d 281, 282 [1<sup>st</sup> Dept 2007]).

Plaintiff contends that one fraudulent conveyance occurred when Katzoff received the \$150,000 purchase price for the

membership interest in the Tenant. Plaintiff, as creditor, can attack only conveyances made by its debtor, which is the Tenant. The PSA identifies GH Company as the Tenant's owner and seller, but does not state that GH Company should receive the purchase price. However, the only reasonable construction of the PSA is that the seller will take the purchase funds, and thus, the seller, GH Company, owned the funds. If the seller conveyed the funds to another party, there could not be a fraudulent conveyance that plaintiff could put aside.

The second allegedly fraudulent conveyance occurred when \$200,000 (the capital contribution) and \$50,000 (non-compete payment) were paid to Katzoff or to one of the GH defendants, instead of to the Tenant. The PSA and the Product Exclusivity Agreement provide that the Tenant will receive those sums. Although plaintiff does not allege that the Tenant conveyed those monies but, rather, that the Tenant did not receive them, that does not mean that a fraudulent conveyance did not take place. Because the monies belonged to and should have been paid to the Tenant, if the Tenant was bypassed and the monies paid directly to the transferees, the transferees could have received a fraudulent conveyance.

In order for a conveyance not to be fraudulent, good faith is required of both the transferor and the transferee (*Sardis v Frankel*, 113 AD3d 135, 143 [1<sup>st</sup> Dept 2014]; *American Panel Tec v*

*Hyrise, Inc.*, 31 AD3d 586, 587 [2d Dept 2006])). A transfer without good faith is deemed to lack fair consideration (*id.*). Transfers to controlling shareholders, officers, or directors of an insolvent corporation are deemed to be lacking in good faith and are presumptively fraudulent (*Matter of CIT Group/Commercial Servs., Inc. v 160-09 Jamaica Ave. Ltd. Partnership*, 25 AD3d 301, 303 [1<sup>st</sup> Dept 2006]; *Matter of P.A. Bldg. Co. v Silverman*, 298 AD2d 327, 328 [1<sup>st</sup> Dept 2002])). Insolvency is presumed if fair consideration is lacking (*First Keystone Consultants, Inc. v Schlesinger Elec. Contrs.*, 871 F Supp 2d 103, 120 [ED NY 2012]; *United States v Alfano*, 34 F Supp 2d 827, 845 [ED NY 1999])).

Since Katzoff was an insider, if money was transferred to him, the presumption arises that these transfers lacked good faith and fair consideration, and that the Tenant was thereby rendered insolvent. However, these matters raise questions of fact. For example, the fact-finder must determine if, at the time of the alleged conveyances, the Tenant's property was unreasonably small or it believed that it would incur debts that it could not pay.

The third allegedly fraudulent conveyance was the sale of 49% of the interest in the Tenant. Plaintiff alleges that the purchase price was not fair consideration for what was conveyed. Fair consideration is "a fair equivalent" for the conveyance or an "amount not disproportionately small as compared with the

value of the" conveyance (DCL § 272). As nothing in the record indicates that the purchase price was not fair consideration, and plaintiff does not point to any such evidence, that part of the claim is dismissed.

A fourth alleged fraudulent conveyance consists of the series of conveyances that took place from November 2008 through April 2009, when Lather Spa transferred money to Lather, Inc. on five occasions. Lather Spa was supposed to pay the Tenant so that the Tenant could pay plaintiff. If the transferred funds should have been paid to the Tenant for rent, those transfers could be fraudulent conveyances to Lather Spa, as an insider.

However, whether these transfers were fraudulent is a question of fact. Hoyt alleges that the money was intended to repay Lather, Inc., but transfers to satisfy antecedent debts can be fraudulent conveyances if made to an insider (*American Panel*, 31 AD3d at 587).

The fifth alleged fraudulent conveyance consists of the Tenant's failure to insist on payment of the rent starting in January 2009, thereby benefitting the Lather companies and leaving the Tenant without any money. The Tenant did not demand the rent or sue the Lather entities, according to plaintiff. A waiver or release of an obligation can be a conveyance under DCL (see *Palestine Monetary Auth. v Strachman*, 62 AD3d 213, 224 [1<sup>st</sup> Dept 2009]; *NPR, LLC v Met Fin Mgt., Inc.*, 63 AD3d 1128, 1129 [2d

Dept 2009])).

**Piercing the Corporate/Limited Liability Company Veil.**

A member of a limited liability company cannot be held liable for the company's obligations by virtue of being a member alone (*Retropolis, Inc. v 14th St. Dev. LLC*, 17 AD3d 209, 210 [1<sup>st</sup> Dept 2005]; see also *Matter of Morris v New York State Dept. of Taxation & Fin.*, 82 NY2d 135, 140 [1993] [discussing the limited liability of corporate shareholders])). An exception arises whereby owners may become liable for their company's or corporation's debts if: "(1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury" (*Morris*, 82 NY2d at 141). Courts will pierce the corporate veil between a company and its owners if that is the only way to prevent fraud or achieve equity (*id.* at 140).

Some of the elements that justify piercing the corporate veil include:

"(1) the absence of the formalities ... that are part and parcel of the corporate existence, i.e., issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the allegedly dominated corporation, (7) whether the related corporations deal with the dominated



corporation at arms length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own" (*Shisgal v Brown*, 21 AD3d 845, 848 [1<sup>st</sup> Dept 2005]).

Paying the debts on behalf of a company can be evidence of an alter ego relationship because it evidences control and a lack of regard for corporate formalities (*Classic Maritime Inc. v Limbungan Makmur SDN BHD*, 646 F Supp 2d 364, 371 [SD NY 2009]).

Lather Spa allegedly caused money to be transferred in and out of Tenant without formalities, and used Lather, Inc. funds to pay the Tenant's bills. Lather Spa and Lather, Inc. had the same personnel/offices, and the latter's employees handled the Tenant's business. Dealings among the three were not at arm's length. The Tenant showed little business discretion and was dominated by Lather Spa. The Tenant and Lather Spa acted as an integrated entity. The Tenant's property was used as if it belonged to Lather Spa. After the Tenant stopped paying rent, Lather Spa remained in occupancy and continued to sell Lather, Inc. products on the premises. These allegations present issues of fact as to piercing the corporate veil to make the Lather entities liable for the Tenant's rent.

The corporate veil can be pierced to place liability for the corporations' obligations on individual owners, when the company

is so dominated by an individual that it primarily conducts the individual's business rather than its own and, through this domination, a wrong is committed against a third party (*Walkovszky v Carlton*, 18 NY2d 414, 420 [1966]; *Retropolis*, 17 AD3d at 211).

There is no evidence that Hoyt acted for his own personal ends, and plaintiff has failed to raise a triable issue that the veil should not be pierced against him as an individual. Levitt testified that Hoyt used an American Express card in Hoyt's name to pay the Lather companies' expenses, but also that Hoyt did not use the card for personal expenses. There is no other evidence in the record on that point.

As for Katzoff, because of the adverse inference previously rendered against him, coupled with the allegation that he personally received the \$200,000, the motion for summary judgment to dismiss him in his individual capacity is denied.

#### **Successor Liability.**

When two corporations merge to become a single entity, the successor corporation is automatically liable for the debts of both predecessors (*Cargo Partner AG v Albatrans, Inc.*, 352 F3d 41, 45 [2d Cir 2003]). The rule is that a purchase of a company's stock or assets does not by itself create a merger, so the purchaser does not become liable for the purchased company's/seller's debts (*id.* at 44-45). However, there are four

exceptions by which the purchaser can become liable for the seller's debts, of which one is the de facto merger doctrine (*Schumacher v Richards Shear Co.*, 59 NY2d 239, 244-45 [1983]).

Plaintiff relies on that doctrine, claiming that the 2005 transaction created a de facto merger between Lather Spa and the Tenant and Lather, Inc. and the Tenant, so the Lather companies are responsible for the Tenant's rent.

A de facto merger occurs when a transaction, although not in the form of a merger, is in substance "a consolidation or merger of seller and purchaser," and the successor absorbs and continues the operation of the predecessor (*Schumacher*, 59 NY2d at 245; *Tap Holdings, LLC v Orix Fin. Corp.*, 109 AD3d 167, 176 [1<sup>st</sup> Dept 2013]). The basis of the de facto merger doctrine is that "a successor that effectively takes over a company in its entirety should carry the predecessor's liabilities as a concomitant to the benefits it derives from the good will purchased" (*Fitzgerald v Fahnestock & Co.*, 286 AD2d 573, 575 [1<sup>st</sup> Dept 2001]).

Almost every de facto merger case is based on an asset purchase transaction. The plaintiff claims that the defendant is liable for the debts of the corporation whose assets the defendant purchased. However, Lather Spa did not purchase the Tenant's assets. It purchased 49% of the membership interests in the Tenant.

The few cases addressing whether there can be a de facto

merger where only ownership is purchased generally answer in the negative (see *Irving Bank Corp. v Bank of N.Y. Co.*, 140 Misc 2d 363, 367 [Sup Ct, NY County 1988] [where a corporation is acquired by the purchase of all of its outstanding stock, the corporate entity remains intact and retains its liabilities, despite the change of ownership]; see also *Abundance Partners LP v Quamtel, Inc.*, 840 F Supp 2d 758, 769 [SD NY 2012] [the de facto merger doctrine did not apply to an equity purchase situation, where all of a limited liability company's outstanding membership interests were purchased]; *Golub v Kidder, Peabody & Co.*, 2000 WL 1024688, \*4 [SD NY 2000] [purchaser of all of the stock, not the assets, of another company was not liable for the company's debts; the company remained an ongoing concern]; *Fireman's Fund Ins. Cos. v Meenan Oil Co.*, 755 F Supp 547, 553 [ED NY 1991] [ditto]; see also *Cargo*, 352 F3d at 45 [noting in dicta that stock buyers become liable for the debts of the sold company only if the corporate veil is pierced]).

The most common indications that a de facto merger has taken place include: "continuity of ownership; cessation of ordinary business and dissolution of the acquired corporation as soon as possible; assumption by the successor of the liabilities ordinarily necessary for the uninterrupted continuation of the business of the acquired corporation; and, continuity of management, personnel, physical location, assets and general

business operation" (*Fitzgerald*, 286 AD2d at 574).

As the above cited cases indicate, when ownership changes, the acquired company remains intact and is not dissolved. Thus, the elements of continuity of ownership and dissolution of the acquired company are not present. Although not sufficient by itself to warrant finding de facto merger, continuity of ownership has been described as "the essence of a merger" (*Cargo*, 352 F3d at 46-47). It "exists where the shareholders of the predecessor corporation become direct or indirect shareholders of the successor corporation" (*Matter of New York City Asbestos Litig.*, 15 AD3d 254, 256 [1<sup>st</sup> Dept 2005]).

A handful of cases find successor liability where first stock and then assets were acquired. Where the defendant took all the outstanding stock of another corporation and immediately took by assignment its only assets, the transaction amounted to a de facto merger so as to render the defendant liable for the other corporation's breach of contract (*Hoche Prods., S.A. v Jayark Films Corp.*, 256 F Supp 291, 295-296 [SD NY 1966]). De facto merger was also found where the purchaser acquired the stock of a company, the acquired company operated as a subsidiary for a year, and the purchaser then took its assets (*Arnold Graphics Indus., Inc. v Independent Agent Ctr., Inc.*, 775 F2d 38 [2d Cir 1985]). The possibility of a de facto merger was found where the defendant purchased the stock of another company and

then merged the assets of that company with its own (*Fitzgerald*, 286 AD2d at 575).

Here, the Tenant was not dissolved, but allegedly it ceased functioning. Successor liability analysis is flexible, and a finding of de facto merger does not "necessarily require" the presence of each factor (*Matter of New York City*, 15 AD3d at 256 [1<sup>st</sup> Dept 2005]). The requirement of dissolution can be satisfied, although the selling corporation continues to exist, if that entity is shorn of its assets and becomes a mere shell that is incapable of doing business except through the alleged successor (*Fitzgerald*, 286 AD2d at 575).

Notwithstanding the allowance of flexibility, the standards for determining the existence of a de facto merger should not be rendered meaningless. Continuity of ownership would mean that GH Company, the Tenant's owner and seller of 49% of it to Lather Spa, became also Lather Spa's owner. That did not happen. There is no evidence that Lather Spa purchased or otherwise took the Tenant's assets. Plaintiff claims that the assets were taken, but that is a conclusory allegation. It is not indicated what those assets were or if they had value. In addition, Lather Spa owned, not all, but only 49% of the Tenant. Based on Lather Spa's ownership of less than all of the Tenant and its non-ownership of the assets, the conclusion is that Lather Spa and the Tenant did not effectuate a de facto merger.

### **Civil conspiracy.**

A conspiracy to commit a tort is not a cause of action (*Alexander & Alexander of N.Y. v Fritzen*, 68 NY2d 968, 969 [1986])). "Allegations of conspiracy are permitted only to connect the actions of separate defendants with an otherwise actionable tort" (*id.*). Where the tort is already pled against the parties, as in this case, the conspiracy claim will be dismissed as duplicative (see *American Baptist Churches of Metro. N.Y. v Galloway*, 271 AD2d 92, 101 [1<sup>st</sup> Dept 2000]; *Gray & Assoc., LLC v Speltz & Weis LLC*, 22 Misc 3d 1124[A], 2009 NY Slip Op 50275[U], \*15-16 [Sup Ct, NY County 2009])).

Plaintiff has already pled a claim for fraudulent conveyance against defendants. Moreover, there is no evidence that the defendants had a plan to deprive plaintiff of the rent (*Abacus Fed. Sav. Bank v Lim*, 75 AD3d 472, 474 [1<sup>st</sup> Dept 2010] [listing elements of civil conspiracy])). Thus, the claim of civil conspiracy is dismissed.

### **Law of the case.**

A threshold question is presented as to whether the doctrine of law of the case bars the instant motions. Plaintiff states that defendants already moved once for summary judgment, that the Court denied that motion, that said denial establishes the law of the case, and that successive motions for the same relief are not allowed.

Plaintiff filed its second amended complaint in December 2010. Rather than filing an answer to that complaint, the attorney who was then representing all of the defendants moved by order to show cause on behalf of the individual defendants in February 2011. The order to show cause requested a protective order, pursuant to CPLR 3103, a dismissal based on summary judgment for Pinchuk, the Lather entities, and the Tenant, the striking or dismissal of plaintiff's third cause of action, and/or extension of time for defendants to answer.

On February 7, 2011, when signing the order to show cause, this Court crossed out the portion seeking summary judgment. On that day, both sides were before the Court, and the Court stated that the motion was being regarded as being made pursuant to CPLR 3211. During the hearing on the motion on March 3, 2011, the motion was treated as one for CPLR 3211 relief. Therefore, defendants did not make successive motions for summary judgment and the law of the case doctrine is inapplicable.

The claims against Hoyt in his individual capacity are dismissed. The second cause of action for successor liability against the Lather entities and the third cause of action for civil conspiracy are dismissed as against all the moving parties. The sixth, seventh, and eighth causes of action based on DCL § 276 (intentional fraud) are dismissed. The claims against Pinchuk are dismissed, as there is no evidence that she was



involved in any of these events. The demand for punitive damages is stricken, as the alleged misconduct was not so "gross and wanton" (NPR, 63 AD3d at 1130).

The first cause of action based on piercing the corporate veil is not dismissed. The fourth and fifth causes of action based on constructive fraud under DCL are not dismissed. The claims against Katzoff in his individual capacity are not dismissed.

Hoyt's and the Lather companies' motion for attorneys' fees and expenses is denied. Plaintiff has not acted frivolously pursuant to 22 NYCRR 130-1.1 (a).

In conclusion, it is

ORDERED that motion sequence number 010 by defendants Lather, Inc., Lather Spa, Inc., and Robert Hoyt for summary judgment is granted to the extent that the second, third, sixth, seventh, and eighth causes of action are dismissed as against said defendants, and all claims against Robert Hoyt in his individual capacity are severed and dismissed, and the motion is otherwise denied; and it is further

ORDERED that motion sequence number 011 by defendants Gerald Katzoff and Rae Pinchuk for summary judgment is granted to the extent that the second, third, sixth, seventh, and eighth causes of action are dismissed as against said defendants, all claims against Rae Pinchuk are severed and dismissed, and the motion is

otherwise denied; and it is further

ORDERED that the parties are directed to appear for a pre-trial conference in this matter on July 28 at 10:30 in Room 238.

No costs.

Dated: July 7, 2014

ENTER:

A handwritten signature in black ink, consisting of a large, stylized capital 'R' followed by a horizontal line extending to the right.

J.S.C.