Precision Process, Inc. v Smith
2014 NY Slip Op 33460(U)
December 22, 2014
Supreme Court, Erie County
Docket Number: 2011-4844
Judge: Timothy J. Walker
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STATE OF NEW YORK
SUPREME COURT : COUNTY OF ERIE

PRECISION PROCESS, INC.,

Plaintiff,

v.

KENNETH E. SMITH, MICHAEL MOL, CK PRECISION INC., CRAFT LEASING, LLC, and CK PRECISION OF WNY, LLC,

Defendants.

Commercial Division
Decision and Order
Index No. 2011-4844

BEFORE: **HON. TIMOTHY J. WALKER, Presiding Justice**

APPEARANCES: **HODGSON RUSS LLP**
Stephen W. Kelkenberg, Esq.
Steven W. Wells, Esq.
Attorneys for Plaintiff

LAW OFFICE OF RALPH C. LORIGO
Ralph C. Lorigo, Esq.
Frank J. Jacobson, Esq.
Attorneys for Defendants

WALKER, J.

Plaintiff Precision Process, Inc. has moved for partial summary judgment on its eleventh (11th) cause of action. Plaintiff seeks a declaration that defendants Craft Leasing, LLC (Craft) and CK Precision of WNY, Inc. (CKPW) (collectively, "Defendants") are successors in interest to CK Precision, Inc. (CKP), and are therefore liable for its debts and obligations. For the reasons that follow, the motion is granted.

Background

The following facts are uncontested, unless otherwise stated. In late 2011, Plaintiff sued

CKP, Kenneth E. Smith and Michael Mol on several causes of action, alleging that Defendants Smith and Mol (Plaintiff's former employees) misappropriated confidential and trade secret information, and were disloyal. These individuals started a metal fabrication business in 2009 under the name of CKP, a corporation owned by their wives, Cynthia Smith and Karen Mol.

On August 27, 2013, this Court granted Plaintiff partial summary judgment against Defendants Mol and CKP on the first, second and third causes of action for breach of the duty of loyalty, and aiding and abetting that breach, awarding Plaintiff damages in the amount of $232,859.86, together with interest.[1] In May 2014, Defendants Smith and Mol filed for protection under Chapter 7 of the United States Bankruptcy Code, and subsequently received discharges for, *inter alia*, the judgments entered in this matter.

During post-judgment discovery, Plaintiff learned that CKP had transferred virtually all of its assets to Craft and CKPW, and ceased doing business at the end of July 2013. Craft had been formed in February 2013, and shares a common address with Defendant Smith. CKPW was formed on the same date and assumed the leased premises which CKP previously occupied.

Craft and CKPW are also owned by Mrs. Smith and Mrs. Mol. On July 2, 2013, after Plaintiff's motion for summary judgment had been filed as against Defendants Smith and Mol, and CKP, Mrs. Smith and Mrs. Mol held a shareholders' meeting (along with their officers, Defendants Smith and Mol), during which they resolved to sell all of CKP's manufacturing

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[1] An amended statement of judgment including interest, for a total of $276,199.54, was filed on August 28, 2013. At the time partial summary judgment was granted, Defendant Smith had a pending bankruptcy petition and the action was stayed as against him. Thereafter, the petition dismissed by the bankruptcy Court, Plaintiff renewed its motion as against Defendant Smith, and a statement of judgment was entered against him on October 10, 2013 in the amount of $278,668.60.

equipment to Craft (the "Equipment"). Craft executed a promissory note to CKP in the amount of $115,000. Pursuant to that note, Craft agreed to remit payments to First Niagara Bank, N.A. ("First Niagara"), CKP's secured creditor as to the Equipment. CKPW remits lease payments to Craft for use of the Equipment, from which Craft remits the equivalent of CKP's loan payments to First Niagara.

During depositions, Defendant and Mrs. Smith, and Defendant Mol each testified that Craft and CKPW are owned by Mrs. Smith and Mrs. Mol, who are also CKP's shareholders. Each testified further that CKP is no longer operating; Mrs. Smith testified that CKPW began operations on August 1, 2013 in the same leased space as CKP, serving most of the same customers and using the same equipment as CKP; and the other deponents testified similarly.[2] CKPW paid nothing to CKP for that transfer.

As a result, Plaintiff sought leave to amend its Complaint to assert causes of action against CKPW and Craft for successor liability and fraudulent conveyance. This Court denied the motion as to the fraudulent conveyance claim, but granted Plaintiff leave to file and serve a supplemental complaint asserting the successor liability claim.

SUMMARY JUDGMENT STANDARD

On a motion for summary judgment, the moving party bears the initial burden of making

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[2] The affidavit of Defendant Smith submitted in opposition to the motion contradicts, in many respects, his sworn deposition testimony. However, "an affidavit submitted in opposition to a motion for summary judgment does not raise a triable issue of fact where the affidavit 'can only be considered to have been tailored to avoid the consequences of ... earlier testimony' (*Phillips v Bronx Lebanon Hosp.*, 268 AD2d 318, 320 [1st Dept 2000])" (*Fields v Lambert Houses Redevelopment Corp.*, 105 AD3d 668, 671 [1st Dept 2013]).

a *prima facie* showing of entitlement to judgment as a matter of law, after tendering sufficient evidence to eliminate any material issues of fact from the case (*see Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 [1985]). The movant must demonstrate the merits of its claims or defenses, and cannot satisfy its burden merely by identifying gaps in its opponent's proof (*Edwards v Arlington Mall Assocs.*, 6 AD3d 1136, 1137 [4th Dept 2004]). Unless the movant establishes entitlement to judgment as matter of law, the burden does not shift to the opposing party to raise an issue of fact, and the motion must be denied without consideration of the opposing papers (*see Loveless v Am. Ref-fuel Co. of Niagara, LP*, 299 AD2d 819, 820 [4th Dept 2002]). Equally important, the court must view the evidence in the light most favorable to the non-moving party (*see Evans v Mendola*, 32 AD3d 1231, 1233 [4th Dept 2006]). Once the moving party establishes entitlement to judgment as a matter of law, the burden then shifts to the non-moving party to raise a triable issue of fact (*see Gern v Basta*, 26 AD3d 807, 808 [4th Dept], *lv denied* 6 NY3d 715 [2006]).

Discussion

As a general principle of New York law, a corporation that acquires the assets of another corporation is not liable for the latter's torts (*see Schumacher v. Richards Shear Co.*, 59 NY2d 239, 245 [1983]). However, four (4) recognized exceptions exist - rendering the acquiring corporation liable - where (1) it expressly or impliedly assumed the predecessor's tort liability (which did not occur here); (2) there was a consolidation, actual, or "de facto" merger of the two entities; (3) the purchasing entity was a "mere continuation" of the selling entity; or, (4) the

transaction is entered into fraudulently to escape such selling entity's obligations (*id.*).[3]

The Court of Appeals held, in *Schumacher* (later affirmed in *Grant-Howard Assoc. v General Housewares Corp.*, 63 N.Y.2d 291, 296 [1984]), that "allowing recovery in a tort against a successor corporation" was merely an extension of products liability; and both *Schumacher* and *Grant-Howard* were products liability cases. However, subsequent case law applies the successor liability criterion developed in *Schumacher* with respect to **all** torts.

For example, the Appellate Division, Fourth Department, has applied *Schumacher* to "torts" claims (*see Sweatland v Park Corp*, 181 AD2d 243 [4th Dept 1992]). Although that case dealt with a products liability issue, (then) Presiding Justice Denman determined that there were issues of fact as to whether the predecessor and successor corporations had engaged in a "de facto" merger, stating:

> The corporate law doctrine of "de facto" merger was developed for several reasons: **to protect the seller's creditors**, to assess taxes, and to protect tax interests of the buyer's dissenting shareholders ....

(*Sweatland v Park Corp.*, 181 A.D.2d 243, 246 [4th Dept 1992] [Denman, J.] [emphasis supplied]).

Defendants contend that successor liability is wholly inapplicable here, because it is solely a strict products liability doctrine that does not apply to business torts such as those at issue here. This Court disagrees. Defendants rely upon the decision in *Greenlee v Sherman*, a negligence action against the estate of a deceased sole proprietor who had installed a furnace that allegedly caused a fire. Plaintiffs sought to impose liability upon the company that purchased the

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[3] The judgment in this action is based upon tortious conduct by Defendants Smith and Mol (i.e., that they breached duties of loyalty to Plaintiff).

deceased plumber's assets (142 AD2d 472, 475 [3rd Dept. 1989]). The court stated (in dicta) that "it appears" that the successor liability doctrine does not apply outside of the products liability area. However, the court also found that plaintiffs had failed to establish a "de facto" merger, or that the successor defendant was a "mere continuation" of the decedent's business (*Id.*) - implying that the doctrine may apply in a non-products liability case.

Additionally, the First Department has consistently noted that the successor liability doctrine concerns "products liability **and torts law**" but is not applicable, for example, in an action to collect on a promissory note (*Symbax, Inc. v Bingaman*, 219 AD2d 552, 552-553 [1st Dept 1995] [emphasis added]); and that a plaintiff **could** state claim of "mere continuation" or "de facto" merger where a sale to a new business was in an effort to avoid liability under a lease (*see Teachers Ins. Annuity Assn of Am. v Cohen's Fashion Optical of 485 Lexington Ave., Inc.*, 24 AD3d 317 [1st Dept 2007]).

Indeed, the Southern District Court, interpreting New York law, has concluded that *Schumacher* created a broad, common-law rule of successor liability, applicable to cases other than those premised upon products liability (*see, Cargo Partners AG v Albatrans Inc.*, 207 FSupp2d 86, 110 [SDNY 2002] [applying New York law] *affirmed,* 352 F3d 41 [2nd Cir 2003]). As The Second Circuit stated:

> A "de facto" merger occurs when a transaction, although not in form a merger, is in substance "a consolidation or merger of seller and purchaser." Schumacher, 59 N.Y.2d at 245. Applying New York law, we have observed that: "[T]o find that a "de facto" merger has occurred there must be [1] a continuity of the selling corporation, evidenced by the same management, personnel, assets and physical location; [2] a continuity of stockholders, accomplished by paying for the acquired corporation with shares of stock; [3] a dissolution of the selling corporation[;] and [4] the assumption of liabilities by the purchaser...." [cits. om.])

(*Cargo Partner AG v Albatrans, Inc.*, 352 F3d at 45-46). Further, "continuity of ownership is the essence of a merger" (*Id.* at 47),[4] and there is no reference to a "fifth criterion" namely, that it applies solely to a products liability action.

"De facto" Merger

The testimony of Defendant Smith, Mrs. Smith, and Defendant Mol establishes the following: CKPW and Craft share common ownership with CKP (*see generally Cargo Partner AG*, 352 F3d at 46 [continuity of ownership is essential for determination of "de facto" merger]). Further, CKP retained virtually no assets, with the exception of a promissory note that requires Craft to pay CKP's prior debt to First Niagara relating to the equipment, which is now "owned" by Craft. The fact that CKP has not been dissolved "is not dispositive, since it has been left an empty shell" (*Teacher's Insurance Annuity Assoc. Of America v Cohen's Fashion Optical of 485 Lexington Avenue, Inc.*, 45 AD3d 317, 319 [1st Dept 2007]). Contrary to Defendants' contention, a "de facto" merger can be found even if the successor did not engage in a stock swap with the predecessor (*see Matter of New York City Asbestos Lit.*, 15 AD3d 254, 256 [1st Dept 2005] [predecessor's shareholders must become direct or indirect shareholders of successor as a result of the latter's purchase of the predecessor's assets "as occurs in a stock-for-assets transaction"]).

The third criterion, that the successor assume liabilities necessary for uninterrupted continuation of the predecessor's business, is satisfied by Craft's assumption of CKP's debt to First Niagara, which debt is paid by CKPW by way of an alleged lease. Further, Defendant and Mrs. Smith, and Defendant Mol each testified that there was an uninterrupted continuation of

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[4] The Northern District recently held that the *Schumacher* general rule and the four (4) noted exceptions apply to both tort and contract cases (*see City of Syracuse v Loomis Armored US, LLC*, 900 FSupp2d 274, 288 [NDNY 2012]).

CKP's business operations by Craft and CKPW, using the same employees (to whom CKPW is now paying wages -previously liabilities of CKP). Finally, there is a continuation of CKP's management, physical location and assets in the two corporations: Defendant Smith testified that the officers of CKP are now managers of CKPW; CKPW employs CKP's former employees; CKPW operates at the same premises that CKP formerly used; and CKPW uses the same equipment and services the same customers previously serviced by CKP. Defendant Mol testified that CKPW was "substantially" the same company as its predecessor.

Defendants fail to raise any issues of fact for trial. Their claim that CKPW assumed no assets of CKP is belied by the record, as they are discounting (at a minimum) the customer lists and the "good will" the managers had established while operating CKP; assets which now enable CKPW to pay Craft for the use of the Equipment.

Mere Continuation

> Under New York law, the "mere continuation" exception "refers to corporate reorganization, ... where only one corporation survives the transaction; the predecessor corporation must be extinguished." *Schumacher*, 59 N.Y.2d at 245. The successor-buyer is not in existence prior to the purchase of the predecessor's assets, and the predecessor-seller does not survive the sale of the assets. *Greenlee v. Sherman*, 142 A.D.2d 472 (3rd Dept.1989). Other factors considered by New York courts to be indicative of the "mere continuation" exception are that the business of the successor is the same as the business of the predecessor, the business employs the same work force, and the predecessor's officers and directors become the officers and directors of the successor. *Mitchell v. Suburban Propane Gas Corp.*, 182 A.D.2d 934 (1992).

(*Alvarado v Dreis and Krump Mfg. Co.*, 1 Misc3d 912(A), *3 [Sup Ct Bronx County 2004]). Under *Schumacher,* this exception does not apply unless the predecessor corporation is "extinguished". This Court declines to apply this exception.

Fraudulent Transaction to Evade Liability

A fraud claim requires proof by clear and convincing evidence (*see Symbax Inc. v Bingaman*, 219 AD2d 552, 5534 [1st Dept 1995]). This Court previously determined, in a prior order, that Plaintiff failed to state a claim under these precise circumstances for a fraudulent conveyance under the Debtor and Creditor Law, a ruling that constitutes law of the case (*see Town of Angelica v Smith*, 89 AD3d 1547, 1550 [4th Dept 2011]). However, fraud is not a necessary element of this cause of action.

Accordingly, it is hereby

ORDERED, that Plaintiff's motion for partial summary judgment on its 11th cause of action against Craft and CKPW is granted; and it is further

ORDERED, that CKPW and Craft are hereby determined to be successors in interest to CKP and, as such, are liable for its debts and obligations including, but not limited to the judgment previously entered against CKP in this action; and it is further

ORDERED, that judgment is granted against Craft and CKPW in the amount of $232,859.86, together with interest, consistent with the judgment previously entered against CKP.[5]

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[5] Plaintiff fails to state either a contractual or statutory basis for its claim for attorneys' fees, which is therefore denied.

This constitutes the Decision and Order of this Court. Submission of an order by the Parties is not necessary. The mailing of a copy of this Decision and Order by this Court shall not constitute notice of entry.

Dated: December 22, 2014
Buffalo, New York

HON. TIMOTHY J. WALKER, J.C.C.
Acting Supreme Court Justice
Presiding Justice, Commercial Division
8th Judicial District

GRANTED

DEC 22 2014

BY _____
JOSEPH B. GALLO, JR.
COURT CLERK