SHIRLEY WERNER KORNREICH
J.S.C

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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DAVID W. MAX, MICHAEL AMSPAUGH, KENT PERELMAN, SUSAN RUSSELL, CLAY FRANKLIN SCROGHAM, GARY SCROGHAM, LINDA SCROGHAM, HOWARD "NICK" CHANDLER, EDWARD T. HOLZHEIMER, as Trustee of the Edward T. Holzheimer Trust dated 2/15/99, DALLAS NEIL, CONWAY PRIVATE EQUITY GROUP LLC, MICHAEL SKINNER, LIFELINE PRODUCE, IAN O. MAUSNER, ERIC SCOTT, JENNY SCOTT, STEPHEN CHARTER, & AMAZING MILLING, LLC,

Plaintiffs,

-against-

GS AGRIFUELS CORPORATION, GREENSHIFT CORPORATION, KEVIN KREISLER, VIRIDIS CAPITAL, LLC, SUSTAINABLE SYSTEMS, INC, PAUL MILLER, THOMAS SCOZZAFAVA, MARK ANGELO, TROY RILLO, CARBONICS CAPITAL CORPORATION, YA GLOBAL INVESTMENTS, LP, YA GLOBAL INVESTMENTS (U.S.), LP, YA GLOBAL INVESTMENTS II (U.S.), LP, YA GLOBAL INVESTMENTS SPV, LLC, YORKVILLE ADVISORS LLC, & JOHN DOES 1-100,

Defendants.

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Index No.: 652233/2011
(Action No. 1)

DECISION & ORDER

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GS AGRIFUELS CORPORATION,

Plaintiff,

-against-

R. SCOTT CHAYKIN, DAVID MAX, MICHAEL SKINNER, MIKE MCGOWAN, DALLAS NEIL, KENT PERLMAN, JEANNE CARTER, LIFELINE PRODUCE, MICHAEL AMSPAUGH, FRANK SCROGHAM, GARY SCROGHAM, LINDA SCROGHAM, HOWARD CHANDLER, AMAZING MILLING, LLC, STEPHEN CHARTER, SUSAN RUSSELL, IAN O. MAUSNER, THE CONWAY

Index No.: 652080/2011
(Action No. 2)

PRIVATE EQUITY GROUP, LLC, EDWARD T. HOLZHEIMER, as Trustee of the EDWARD T. HOLZHEIMER TRUST, ERIC SCOTT, JENNY SCOTT, and GENE TRIPP,

Defendants.

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SHIRLEY WERNER KORNREICH, J.:

In Action No. 1, in an order dated March 19, 2013 (the 2013 Order),[1] the court dismissed all of plaintiffs' claims except breach of contract and several defendants. *See* Index No. 652233/2011, Dkt. 14; 2013 WL 1154937. Familiarity with the 2013 Order is presumed. The remaining Agrifuels Defendants (Agrifuels, Viridis, Greenshift, and Carbonics) now move, pursuant to CPLR 3212, for summary judgment and dismissal of plaintiffs' breach of contract claim. Seq. 002. Plaintiffs oppose and cross-move (1) for discovery pursuant to CPLR 3212(f); and (2) to strike portions of Kevin Kreisler's affidavit submitted in support of the Agrifuels Defendants' motion (Dkt. 27).

In Action No. 2, defendants move to dismiss the Complaint pursuant to CPLR 3211. Seq. 001. The motions are consolidated for disposition. For the reasons that follow, the Complaint in Action No. 2 is dismissed and the Agrifuels Defendants' summary judgment motion in Action No. 1 is denied. Plaintiffs' cross-motion in Action No. 1 is denied.

I. Factual Background & Procedural History

The court limits its recitation of the facts to matters not addressed in the 2013 Order – namely, the misrepresentations the Agrifuels Defendants contend excuse their failure to pay plaintiffs their unpaid SPA and going-private transaction compensation.[2] The relevant facts,

[1] Defined terms have the same meaning as in the 2013 Order.

[2] On the motion to dismiss, plaintiffs alleged they were the only Agrifuels shareholders that were not paid in the going-private transaction. *See* 2013 Order at 4. This allegation has not been

contained in the parties' summary judgment affidavits and the Complaint in Action No. 2, are undisputed.

Briefly, this action involves Share Purchase Agreements (SPAs) for the sale of stock in Sustainable Systems, Inc. (SSI), which had been owned by the plaintiffs in Action No. 1 and sold to Agrifuels. Sustainable Systems, LLC (SSL, collectively with SSI, Sustainable) was a wholly owned subsidiary of SSI and operated a renewable energy company in Montana. Due diligence began in May 2006, the SPAs were executed in March 2007, and a going-private transaction, wherein Greenshift Corporation (Greenshift) intended to take Agrifuels private, was announced in February 2008.[3] During the due diligence period, on May 8, 2006, SSI sent Agrifuels a Private Placement Memorandum (the PPM) that indicated it owned SSL's refining plant (the Plant). The PPM makes consistent use of the term "our" when referring to its ownership of the plant. *See, e.g.*, Dkt. 26 at 5 ("Our initial plan outlines our financing the expansion of *our oilseed processing plant*") (emphasis added). It is undisputed that when Agrifuels agreed to acquire Sustainable, the purpose of the transaction was to own the Plant.

During the due diligence period, Agrifuels was provided with all of Sustainable's financial records, which were produced by Miller, who ran the companies. These financial records disclosed that the Plant was encumbered by a mortgage loan with a maturity date in September 2013. However, Agrifuels was not provided with a separate refinancing agreement

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refuted by the Agrifuels Defendants. *See* Index No. 652233/2011, Dkt. 79 (5/29/14 Tr. at 30) (The Agrifuels Defendants' counsel is still unsure if Miller, who was responsible for the alleged fraudulent statements, received his going-private payment).

[3] The going-private transaction closed on February 29, 2008 and payment to Agrifuels' shareholders was due on March 31, 2008. *See* Dkt. 46 at 19.

that required a $1.5 million payment on the mortgage by October 31, 2007, in order to avoid foreclosure.

The Agrifuels Defendants allege they first became aware of the refinancing deadline in December 2007 (9 months after the SPA, but 2 months before the going-private transaction was announced). However, Agrifuels clearly knew about the deadline earlier. For instance, on September 23, 2007, Sustainable – which, at the time, was controlled by Agrifuels – executed an agreement with the lender to extend the refinancing deadline to December 31, 2007. *See* Dkt. 46 at 13. In fact, Agrifuels obtained further extensions and bridge financing until February 2010, when it was evicted by the lender for defaulting. The Agrifuels Defendants have invoked the non-disclosure of the October 31, 2007 refinancing deadline as a defense in not paying plaintiffs their going-private buyout payments. However, Agrifuels knew about the refinancing obligations before it agreed to pay all of its shareholders, including plaintiffs, in the going-private transaction.

Plaintiffs raise several additional issues. First, plaintiffs aver that Agrifuels' failure to inquire of the lender about any modifications to the mortgage should preclude a fraud claim. They argue that a review of Sustainable's mortgage payments would have made clear (or, at a minimum, triggered inquiry notice duties about) that the mortgage payments were being made on terms different than originally disclosed. Second, the entity that lied to, and hence allegedly defrauded, Agrifuels, Sustainable, is the very company Agrifuels acquired. Moreover, the individual that failed to adequately disclose the refinancing deadline, Miller, is a defendant in Action No. 1. It was Miller who ran the company, not plaintiffs. Plaintiffs had no authority to act on behalf of the company under Sustainable's operating agreement. *See* Dkt. 46 at 2-4. Third, even after the Agrifuels Defendants learned of the refinancing on February 14, 2008, and

thus understood that Sustainable's title to the Plant was encumbered by the mortgage, it stated in an SEC filing that Sustainable owned the Plant. *See* Dkt. 53 at 2. Nevertheless, the Agrifuels Defendants contend that as a result of the mortgage, Sustainable's pre-SPA representations that it owned the Plant were false.

In addition, Plaintiffs note that the fraud claims asserted against them were previously dismissed by Justice Lowe in a prior action between the parties, styled *GS Agrifuels Corp. v Chaykin*, Index No. 101401/2009 (the Prior Action). *See* Index No. 101401/2009, Dkt. 31. The dismissal of the Prior Action was never appealed. Instead, on July 29, 2011, Agrifuels commenced Action No. 2, asserting fraud allegations arising from the very same transaction at issue in the Prior Action.

II. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such

consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

Summary judgment may be granted only when it is clear that no triable issue of fact exists. *Alvarez v Prospect Hosp.*, 68 NY2d 320, 325 (1986). The burden is upon the moving party to make a *prima facie* showing of entitlement to summary judgment as a matter of law. *Zuckerman v City of New York*, 49 NY2d 557, 562 (1980); *Friends of Animals, Inc. v Associated Fur Mfrs., Inc.*, 46 NY2d 1065, 1067 (1979). A failure to make such a *prima facie* showing requires a denial of the motion, regardless of the sufficiency of the opposing papers. *Ayotte v Gervasio*, 81 NY2d 1062, 1063 (1993). If a *prima facie* showing has been made, the burden shifts to the opposing party to produce evidence sufficient to establish the existence of material issues of fact. *Alvarez,* 68 NY2d at 324; *Zuckerman,* 49 NY2d at 562. The papers submitted in support of and in opposition to a summary judgment motion are examined in the light most favorable to the party opposing the motion. *Martin v Briggs*, 235 AD2d 192, 196 (1st Dept 1997). Mere conclusions, unsubstantiated allegations, or expressions of hope are insufficient to defeat a summary judgment motion. *Zuckerman,* 49 NY2d at 562. Upon the completion of the court's examination of all the documents submitted in connection with a summary judgment motion, the motion must be denied if there is any doubt as to the existence of a triable issue of fact. *Rotuba Extruders, Inc. v Ceppos*, 46 NY2d 223, 231 (1978).

III. Discussion

The Agrifuels Defendants seek to use their fraud claims for two purposes: (1) to excuse their failure to perform their contractual buy-out obligation (i.e., paying plaintiffs their $0.50 per share); and (2) to rescind the SPAs. As set forth above, the standards on dismissal and summary judgment motions are, of course, different. However, where, as here, no material questions of fact exist, the Agrifuels Defendants' fraud claims are ripe for dismissal.

"The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009); *Perrotti v Becker, Glynn, Melamed & Muffly LLP*, 82 AD3d 495, 498 (1st Dept 2011). Pursuant to CPLR 3016(b), "the circumstances constituting the wrong shall be stated in detail." *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491 (2008). However, "[w]here a party has the means to discover the true nature of the transaction by the exercise of ordinary intelligence, and fails to make use of those means, he cannot claim justifiable reliance on defendant's misrepresentations." *Stuart Silver Assocs., Inc. v Baco Dev. Corp.*, 245 AD2d 96, 99 (1st Dept 1997); *see also HSH Nordbank AG v UBS AG*, 95 AD3d 185, 194-95 (1st Dept 2012) (collecting cases).

The fraud claims warrant dismissal for the same reasons Justice Lowe dismissed the Prior Action. Justice Lowe held that Agrifuels' fraud claims – the very fraud claims at issue in the instant action – "are deficient."[4] *See id.* at 8; *see also id.* at 2-3 (setting forth the same refinancing fraud allegations at issue in the instant action). Justice Lowe recognized that Miller,

[4] In the Prior action, Justice Lowe held that the alleged fraud was not a breach of contract (*see* Index No. 101401/2009, Dkt. 31 at 4-6), the fraud claim failed as a matter of law (*id.* at 6-9), and, in any event, the fraud claim was duplicative as an improper attempt at maintaining a non-viable breach of contract claim (*id.* at 8-9).

not plaintiffs, acted on behalf on Sustainable and that Miller, who would go on to work for Agrifuels, had allegiances to the Agrifuels Defendants, not plaintiffs. Hence, he concluded, the notion that Miller defrauded Agrifuels was not tenable, especially since Agrifuels paid Miller his buy-out amount. In other words, the very individual who Agrifuels blames for the fraud got paid and went on to work for Agrifuels, while plaintiffs, who had nothing to do with the active operation of the business and were innocent, passive bystanders,[5] were the only Agrifuels shareholders who did not get paid.

To be sure, the failure to appeal the dismissal of the Prior Action or to move to amend collaterally estopps the Agrifuels Defendants' fraud claims asserted in the instant actions.[6] *See Lot 1555 Corp. v Nahzi*, 79 AD3d 580 (1st Dept 2010) ("judgment in one action is conclusive in a later one, not only as to any matters actually litigated therein, but also as to any that might have been so litigated"); *Marinelli Assocs. v Helmsley-Noyes Co.*, 265 AD2d 1, 5 (1st Dept 2000) (*res judicata* "bars not only claims that were actually litigated but also claims that could have been litigated, if they arose from the same transaction or series of transactions."). On the merits, the fraud claims asserted here fare no better.

As Justice Lowe recognized in the Prior Action, the fraud claims fail because (1) they are duplicative of a non-viable claim for breach of the SPAs; (2) they lack the requisite

[5] The argument that the Shareholder Consents somehow create liability is wholly without merit. The consents were merely ministerial documents required to be signed by the minority shareholders to effectuate the transaction. Aside from the dangerous precedent the Agrifuels Defendants seek to create by imputing personal liability to individual shareholders for the actions of a company's management, the claim here is, as Justice Lowe observed, nonsensical given the circumstances. Plaintiffs, unlike Miller and the Agrifuels Defendants, were the only parties to this litigation who had no role in actually vetting the transaction.

[6] Though Justice Lowe only dismissed the fraud claim against the individual defendants without prejudice and with leave to replead with the requisite specificity (*see* Index No. 101401/2009, Dkt. 31 at 9), an amended complaint was never filed. The Prior Action has been disposed since 2010.

specificity against the individual defendants;[7] (3) the failure to properly conduct due diligence on the mortgage loan bars the fraud claims;[8] and (4) the notion that Miller's action should be imputed to the passive shareholders – the only basis for liability – simply makes no sense given the parties respective roles in the merger. The claim for fraudulent inducement of the SPA is legally deficient and, regardless, is *res judicata*.

In any event, the alleged fraud (i.e. the failure to disclose the refinancing agreement), which occurred before the March 2007 merger, was discovered by the Agrifuels Defendants before the end of 2007. Nonetheless, the Agrifuels Defendants chose to go through with the going-private transaction in February 2008. They contractually bound themselves to buy-out all of Agrifuels' shareholders while knowing that they had these alleged grievances against some of them. Hence, such grievances cannot excuse non-performance of the contract. Moreover, the going-private transaction had nothing to do with the SPAs and alleged breaches of the SPAs cannot excuse the buy-out. Accordingly, it is

ORDERED that the motion to dismiss Action No. 2 (Index No. 652080/2011) is granted and the Clerk is directed to enter judgment dismissing the Complaint with prejudice; and it is further

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[7] For instance, scienter has not been pled since the Agrifuels Defendants do not plead facts giving rise to a reasonable inference that plaintiffs knew about the refinancing. Again, as plaintiffs were passive shareholders that did not run the company, there is no reason to believe (nor do the Agrifuels Defendants plead non-conclusory facts suggesting) that plaintiffs were even in a position to ascertain the truth about the PPM's representations.

[8] On the motion to dismiss, the Agrifuels Defendants argued and the court held that plaintiffs' insufficient due diligence barred plaintiffs' fraud claim. *See* 2013 Order at 12-13. It is somewhat hypocritical for the Agrifuels Defendants to rely on plaintiffs' lack of due diligence to excuse their fraud while asking the court to excuse their own negligent due diligence on the mortgage. Indeed, given that the Agrifuels Defendants are far more sophisticated than plaintiffs and engage in other similar transactions, the court cannot apply a lower due diligence standard to them than was applied to plaintiffs. To wit, on this record, it appears that the absence of robust due diligence was the hallmark of the subject transactions.

ORDERED that the Agrifuels Defendants' summary judgment motion in Action No. 1 (Index No. 652233/2011) is denied and their counterclaims are dismissed with prejudice; and it is further

ORDERED that plaintiffs' cross-motion is denied as moot; and it is further

ORDERED that the completion of fact discovery and the filing of the Note of Issue in Action No. 1 must occur by October 31, 2014, and such deadline shall not be extended for any reason;[9] and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, for a status conference on August 19, 2014 at 11:00 in the forenoon; and it is further

ORDERED that the parties must meet and confer about the remaining discovery needed and shall bring a proposed discovery schedule to the conference.

Dated: August 6, 2014

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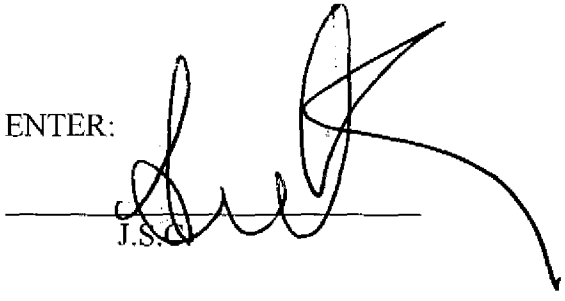

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[9] Expert discovery, if it is required, must be completed by December 12, 2014.