SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

ALAN ADES, Plaintiff,	:	Index No. 656471/2021
	:	Mot. Seq. No. 001
-vs-	:	
VAN DALE INDUSTRIES, INC., MAURICE SETTON, ALBERT ADES, JIMMIE ADES and GABRIEL ADES, Defendants.	:	

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE COMPLAINT

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Defendants Van Dale Industries, Inc., Maurice Setton, Albert Ades, Jimmie Ades, and Gabriel Ades (collectively, "**Defendants**"), by their attorneys Herrick, Feinstein LLP, submit the following Memorandum of Law in support of Defendants' Motion to Dismiss the Complaint filed in this action by Plaintiff Alan Ades pursuant to CPLR 3211(a)(7), and for such other and further relief as the Court deems just and proper.

PRELIMINARY STATEMENT

The Complaint in this action seeks to rescind a merger, approved by the majority of the shareholders of Van Dale Industries, Inc. ("**Van Dale**") and effectuated on September 2, 2021, that offered a cash payment for the fair value of Alan's[1] shares. According to Alan, the merger should be set aside because it lacked a legitimate business purpose.

But the Complaint acknowledges, as it must, that the Notice of Shareholders' Meeting to approve the merger explicitly stated the merger's legitimate business purpose:

> In connection with its determination to approve the Merger Agreement, the Board deliberated and concluded that the business of the Company would be best served with management of the Company and ownership being fully aligned, thereby avoiding all potential conflicts of interest based upon the current organizational structure, consisting of three employee-management shareholders and one non-employee non-management shareholder. (*See* Affidavit of Joshua M. Herman, Esq. ["**Herman Aff.**"], Ex. A, ¶ 17).

The bar to show a legitimate business purpose for a merger is not high under New York law, and avoiding "potential conflicts of interest" has long been recognized as a valid purpose. Unsurprisingly, the Complaint does not address in any way what Alan is surely aware of—that prior to the merger Alan's business ventures outside of Van Dale caused conflicts of interest in which Alan sided against Van Dale and his former partners and in favor of his own pocketbook. As a result of Alan's conduct, the individual defendants, all of whom were employee-management

[1] For ease of reference, the plaintiff and individual defendants are referred to by their first names throughout this brief.

shareholders of pre-merger Van Dale, lost all trust and confidence in Alan and determined, in their good faith business judgment, that Alan's continued involvement as an owner of Van Dale posed significant conflicts.

Those conflicts are best demonstrated by Alan's 50% ownership of A&E Stores, Inc. ("**A&E**"), a company that had a history of purchasing goods from Van Dale. In 2018, Van Dale continued its business relationship selling goods to A&E even though A&E had allowed nearly $200,000 in open invoices to accumulate. Van Dale did so based on assurances from Alan's partner that all invoices would be paid. At the same time, unbeknownst to Van Dale, public filings now reveal that Alan and his partner had been taking out millions of dollars in personal "loans" from A&E, rendering it insolvent and ultimately forcing A&E into dissolution. In fact, nearly $90,000 remains outstanding and due and owing to Van Dale today, and A&E has largely gone out of business. Given Alan's involvement and ownership in both Van Dale and A&E, aggressive collection efforts on Van Dale's behalf would have run the risk of negatively impacting Van Dale's own creditworthiness with its bank, its suppliers, and with potential business partners. Meanwhile, Alan's response to the debt when confronted directly by Maurice was that it was Van Dale's own fault for trusting Alan's business partner.

Accordingly, the Defendants determined it was in Van Dale's business interest to avoid future similar scenarios, realizing that Alan would put his personal interests above those of Van Dale and his partners. Removing these conflicts of interest provides more than enough benefit to Van Dale to justify the merger. Accordingly, the Complaint must be dismissed in its entirety.

FACTUAL BACKGROUND

A. The Company and its Shareholders

Van Dale manages and licenses ladies intimate apparel brands (*see* Herman Aff., Ex. A, ¶ 10). As of September 1, 2021, its shareholders were Alan, Maurice, Jimmie, and Gabriel (*id*. ¶ 9).

Maurice serves as Van Dale's President and Chairman of the Board of Directors, Albert Ades is CEO, Gabriel is Vice President and Secretary, and Jimmie is Treasurer (*id*. ¶¶ 11-12; Affidavit of Maurice Setton, dated January 21, 2022 ["**Setton Aff.**"], ¶ 3).

B. The Merger

On August 23, 2021, Van Dale's shareholders met and voted, among other things, to elect Jimmie, Gabriel, and Albert Ades to join Maurice on Board of Directors (Herman Aff., Ex. A, ¶ 19). Also on August 23, 2021, a Notice of Meeting was delivered to the shareholders notifying all shareholders that a Special Meeting would be held on September 2, 2021 (*id*. ¶ 15). The Notice of Meeting stated that the purpose of the meeting was to consider and vote on a proposal to approve an Agreement and Plan of Merger between Van Dale and Van Dale Industries, Corp., an entity owned by Maurice, Jimmie, and Gabriel (*id*. ¶ 16). Alan would no longer be a shareholder in the newly-merged entity (*id*.), but would be entitled to a cash payment for his shares in Van Dale that was supported by two independent valuations (Setton Aff., ¶ 3).

The Notice of Meeting provided the following purpose for the merger:

> In connection with its determination to approve the Merger Agreement, the Board deliberated and concluded that the business of the Company would be best served with management of the Company and ownership being fully aligned, thereby avoiding all potential conflicts of interest based upon the current organizational structure, consisting of three employee-management shareholders and one non-employee non-management shareholder. (Herman Aff., Ex. A, ¶ 17.)

On August 31, 2021, Alan allegedly sent Van Dale a Notice of Election pursuant to BCL § 623(a) exercising his dissenter's rights and demanding payment of fair value for his shares (*id*. ¶ 23). On September 2, 2021, the Special Meeting was held and the Agreement and Plan of Merger was voted on and approved by a 3-1 vote of the shareholders, with Alan the lone dissenter (id. ¶ 24). A Certificate of Merger was filed with the Secretary of State of the State of New York, and Alan thereafter ceased to be a shareholder of Van Dale (*id*. ¶¶ 25-26).

C. The Merger's Legitimate Business Purpose

The accompanying Affidavit of Maurice Setton provides additional context behind the Board's deliberation and conclusion, as stated in the August 23, 2021 Notice of Meeting, that Van Dale's business would be best served by aligning management and ownership, thereby avoiding potential conflicts of interest.

Those conflicts of interest are best demonstrated by Alan's role in Van Dale's dealings with A&E. In addition to his involvement with Van Dale, since the early 1970's Alan has been 50% owner of A&E, which developed and operated retail clothing chains Bolton's, Strawberry, and Pay Half (Setton Aff. ¶¶ 6-7). Brothers Albert Erani and Dennis Erani own the remaining 50% (*id.* ¶ 6). Alan serves as A&E's CEO (*id.* ¶ 15).

Based on familial connections among the owners, Van Dale historically had a longstanding business relationship supplying merchandise to A&E's stores (*id.* ¶ 8). However, by 2016, market changes and competition led A&E to close its struggling Strawberry and Pay Half stores, leaving only the Bolton's division (*id.* ¶ 9). In addition to the closures of Strawberry and Pay Half, public records indicate that A&E's finances were further burdened by Alan and the Erani Brothers' large cash withdrawals from A&E, totaling approximately $7,097,000 by the end of 2016, which were booked as "loans" (*id.* ¶ 9). Public records further show that A&E did not renew a $4,000,000 line of credit for working capital which expired on December 31, 2016 (*id.*).

Because of these precarious finances, A&E soon found itself with few suppliers willing to ship merchandise on credit. Consequently, A&E leaned on Van Dale (*id.* ¶ 10). In 2015 and 2016, Bolton's generally ordered no more than $1,500 per month of goods from Van Dale, and paid most invoices in full within 30 days of the due date (*id.* ¶ 11). But in 2017, Bolton's began increasing the amounts of its orders and the length of its open invoices. In eight separate months during 2017, Bolton's orders exceeded $3,000, and Bolton's carried unpaid invoices for longer than 30 days from the due date (*id.* ¶ 12). Then, beginning January 2018, Bolton's began to leave invoices unpaid for longer than 60 days while it ran up large bills. Between February 2018 and November 2018, Bolton's outstanding balance ballooned from $9,993.00 to $196,007.00 (*id.* ¶ 13).

Van Dale agreed to ship these orders on credit to Bolton's after receiving assurances from Albert Erani, who told Maurice during a phone call in 2018, in sum and substance, "don't worry, of course you are going to get paid. You have my word" (*id.* ¶ 14).

But A&E did not pay. By November 2018, nearly $100,000 in invoices had been left unpaid for over 120 days from the due date. Consequently, Van Dale ceased accepting orders from Boltons—which by that time had begun closing stores—and began repeatedly calling A&E for payment (*id.* ¶ 18). Although Bolton's has since made several modest payments, an unpaid balance of $88,557.25 remains open (*id.* ¶ 20).

Alan has made no effort to assist Van Dale in obtaining payment on its open invoices from A&E. To the contrary, when Maurice told Alan that Albert Erani had given his word that Van Dale would be paid, Alan responded, in sum and substance, that it was Maurice's own fault for trusting A&E and Albert Erani, and that Van Dale should have sued A&E (*id.* ¶ 21). Alan's unscrupulous refusal to take any personal responsibility for the goods his 50%-owned company ordered from Van Dale or for his business partner's assurances have been particularly demoralizing and troubling to Van Dale's employees and managers (*id.*).

Throughout these dealing with A&E, Alan's status as a non-employee shareholder of Van Dale posed significant conflicts of interest that both caused and exacerbated the harm to Van Dale, which continues unabated. *First*, notwithstanding Alan's involvement in and knowledge of A&E's business (indeed, *because of* this involvement), at no time did Alan advise Van Dale that (i) the reason for A&E's increased orders on credit was A&E's inability to obtain credit elsewhere, and

(ii) A&E's finances were precarious and it was unlikely that A&E would generate sufficient revenue to pay its open invoices (*id*. ¶ 16). Had Alan advised Van Dale of these facts, then Van Dale's management likely would have engaged in a deliberate discussion resulting in an informed, strategic decision whether (and on what terms) to continue extending credit to A&E (*id*. ¶ 17). ***Second***, Alan's involvement in Van Dale limited Van Dale's collection efforts against A&E. Although Van Dale was insured and could have submitted a claim to recover the unpaid balance, or alternatively could have commenced litigation (*id*. ¶ 19), this may have damaged A&E's and Alan's creditworthiness, and by extension Van Dale's. Van Dale was thus limited to making repeated, futile phone calls to A&E throughout 2019 requesting payment (*id*. ¶ 20). ***Third***, Van Dale's continued association with Alan posed a plausible risk to Van Dale's ability to secure bank financing and favorable terms from suppliers (*id*. ¶ 22). A&E's treatment of Van Dale and its other creditors left many in the industry viewing Alan as unscrupulous, which reflected poorly on Van Dale and may have plausibly caused potential business partners to hesitate to transact business with Van Dale (*id*. ¶ 23). Van Dale's bank might also take Alan's involvement in A&E and its open invoices into consideration when reviewing applications for additional financing (*id*. ¶ 22).

The Van Dale merger was thus intended to address these concerns, and thereby enhance the profitability and stability of Van Dale.

ARGUMENT

A. The Court May Consider Supplemental Affidavits on a Motion to Dismiss.

In determining a motion for failure to state a cause of action, the court must "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*Leon v Martinez*, 84 NY2d 83, 87–88 [1994]). The court may consider defendants' evidentiary material to determine whether plaintiff has a cause of action, though not to consider whether complaint states a cause of action (*see Ladera Partners, LLC v Goldberg, Scudieri & Lindenberg, P.C.*, 157 AD3d 467, 467 [1st Dept 2018] [dismissing legal malpractice claim where evidentiary material negated conclusory allegations in complaint]).

B. The First Cause of Action for "Breach of Fiduciary Duty / Rescission of Merger" Should be Dismissed for Failure to State a Claim.

A minority shareholder seeking to rescind a freeze-out merger must overcome the general rule that "[c]ourts will not interfere with the proper business judgment of directors in the absence of a showing of fraud, illegality, or self-dealing … so long as there is some proper corporate purpose for the merger other than the forced buy-out of the minority shares" (*Alpert v 28 Williams St. Corp.*, 63 NY2d 557, 573 [1984]). Although a forced buy-out for its own sake may not qualify as a proper purpose, the removal of minority shareholders may qualify when such removal "furthers the objective of conferring some general gain upon the corporation" (*id.*). The Court of Appeals has further noted in the context of freeze-out mergers "that a finding that there was an independent corporate purpose for the action taken by the majority will not be defeated merely by the fact that the corporate objective could have been accomplished in another way, or by the fact that the action chosen was not the best way to achieve the bona fide business objective" (*id.*).

Demonstrating a "proper purpose" for a merger is not an onerous standard to meet (*id.* ["The benefit need not be great, but it must be for the corporation"]).[2] Eliminating conflicts of

[2] Relatively few cases have interpreted the "proper purpose" standard. This is likely because, unlike corporations, the more-recently enacted statutes governing limited partnerships and limited liability companies provide for appraisal as the exclusive remedy for dissenting minority partners/members in freeze-out mergers (*see, e.g.*, *Appleton Acquisition, LLC v National Hous. Partnership*, 10 NY3d 250, 255-256 [2008] [noting that B.C.L. § 623(k)'s "fraud or illegality exception to the exclusivity of the appraisal remedy" was intentionally omitted from Partnership Law § 121-1102(d)]; L.L.C. L. § 1002[g] [providing that a member of a merged company who has a right to demand payment for his membership interest "shall not have any right at law or in equity … to attack the validity of the merger … or to have the merger … set aside or rescinded."]). In Delaware, courts have long recognized that frozen-out shareholders are adequately protected by fair value appraisal rights (*see Cede & Co. v Technicolor, Inc.*, 684 A2d 289, 297 [Del 1996] ["the majority may now cash-out the minority by a merger without a business purpose, but must pay the dissenters fair value for "whatever their loss may be, subject only to the narrow limitation that one can not take speculative effects of the merger into account."]). In light of this weight of authority finding the "proper business purpose"

interest among owners, improving employee morale, and incentivizing further investment and creditworthiness have all been held sufficient corporate purposes to justify removal of minority owners through a merger. For example, in *Alpert v 28 Williams St. Corp.*, the Court of Appeals found it sufficient that the merger was intended to bring in additional capital from outside investors to repair the corporation's building (*id*. at 574). In *Glosser v Ketchum & Co., Inc.* (1991 WL 11763951 [Sup Ct, New York County 1991]), the court found it sufficient that the merger was intended to make the resulting entity more credit worthy, thereby able to receive better terms from creditors and suppliers, and that employee morale would improve. And in *Tanzer Economic Assoc., Inc. Profit Sharing Plan v Universal Food Specialties, Inc.* (87 Misc 2d 167, 181-82) [Sup Ct 1976]), a freeze-out merger between Nestle and U.S.-based food processor and distributor Libby, McNeil & Libby was intended to enhance operational efficiency, " without being inhibited by potential claims of conflict of interest by shareholders of Nestle or Libby for the necessary reallocation of business opportunities, tax benefits and managerial, administrative and financial support and services among Libby and other Nestle affiliates in the United States and elsewhere." (*See also Schulwolf v Cerro Corp.*, 86 Misc 2d 292, 297 [Sup Ct, NY County 1976] [merger would eliminate possible conflicts of interest posed by inter-company transactions between merged entities]).

Courts in New York have also found it a "proper" corporate purpose where a freeze-out merger was intended to remove a minority owner whose outside business activities were detrimental to and/or in conflict with the company's interests. In *Stulman v John Dory LLC* (2010 WL 10078475 [Sup Ct, NY County 2010]), the court found it properly within the company's

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unnecessary to protect frozen-out minority owners, it is not surprising that courts have imposed a low bar to satisfy the "proper business purpose" standard.

interests for a freeze-out merger to remove a member who had breached fiduciary duties by opening a competing restaurant.

Even discord within a closely held, general business corporation can justify eliminating a dissonant minority's interest, particularly where matters of business judgment are the subject of controversy and the discord has impaired the corporation's ability to conduct business. For example, *Horizon House-Microwave, Inc. v Bazzy* (21 Mass App Ct 190, 199-200, 486 NE2d 70, 76-77 [Mass App Ct 1985]), involved a corporation having three shareholders, two of whom were brothers, whose relationship was characterized by hostility and deadlock. One brother, who held the majority of stock, diluted the stockholdings of the other brother, in order to alleviate complaints about compensation by the third shareholder, a key employee. The court dismissed a challenge to the transaction because it found that the resulting dilution enabled the corporation to operate effectively in the best interest of all concerned and the minority shareholder was adequately protected by appraisal rights.

The merger between Van Dale and Van Dale Industries, Corp. was in furtherance of a legitimate, independent corporate purpose, because it was intended to remove a minority owner with diverging, conflicted interests, thereby strengthening Van Dale's standing with creditors and improving employee morale (Setton Aff. ¶¶ 21-23). As discussed above, all of these purposes have been recognized as valid, independent, and legitimate business interests of the corporation (*see Glosser*, 1991 WL 11763951 [identifying improved creditworthiness and employee morale as valid purposes]; *Stulman*, 2010 WL 10078475 [removal of member who formed competing business venture was valid corporate purpose]; *Tanzer*, 87 Misc 2d at 181-82 [elimination of potential conflicts of interest was valid purpose]).

Alan's dual ownership of Van Dale and A&E posed conflicts of interest that adversely affected Van Dale. As 50% owner and manager of A&E, Alan owed a duty to A&E to obtain advantageous credit and repayment terms from suppliers, such as Van Dale. Yet at the same time, as a 20% owner of Van Dale, Alan should have been taking all possible measures within his control to ensure repayment of debts owed to Van Dale, such as A&E's open invoices. Alan thus stood on both sides of these dealings, ultimately siding with his 50%-owned company A&E by failing to pay its open invoices to Van Dale. Alan's conflicts of interest posed issues for Van Dale's managers, as well. Because Alan was a 20% owner of Van Dale, the owners and managers of Van Dale were reluctant to commence litigation or insurance claims against A&E because that could have negatively affected Alan's creditworthiness and, by extension, Van Dale's (Setton Aff. ¶¶ 19, 22).

Alan's betrayal of Van Dale's interests has also negatively impacted morale at Van Dale. Van Dale's managers had trusted that Alan would personally ensure that A&E honor its commitments to Van Dale. Since Alan told Van Dale's managers that it was their own fault for extending credit to A&E and that he would not try to help Van Dale, Van Dale's managers and employees have felt conflicted about expending efforts to benefit Alan (Setton Aff. ¶ 21).

Given Alan's negative impact on Van Dale's operations, it was a valid exercise of business judgment for the Board to approve the merger. Accordingly, the First Cause of Action must be dismissed.

C. The Second Cause of Action for an Accounting Should be Dismissed for Failure to State a Claim.

Alan's second cause of action seeks the equitable remedy of an accounting for corporate expenditures, distributions, and dividends since the effective date of the merger. However, because the merger extinguished Alan's rights as a shareholder of Van Dale, Alan cannot sustain a claim for an accounting (*see Farro v Schochet*, 190 AD3d 689 [2d Dept 2021] [holding that merger extinguished minority shareholders' interest sufficient to support a demand for an accounting]). Although BCL § 623(e) would entitle Alan to "the right to payment of any intervening dividend or other distribution" in the event that Alan is ultimately successful in rescinding the merger, this same provision states explicitly that upon consummation of a merger the dissenting shareholder "shall cease to have any of the rights of a shareholder except the right to be paid the fair value of his shares and any other rights under this section." Accordingly, Alan has no right to an accounting and the Second Cause of Action must be dismissed.

D. The Third Cause of Action for Damages Should be Dismissed for Failure to State a Claim.

The third cause of action for damages is premised on "rescission and nullification of the alleged merger," as set forth in the First Cause of Action. Because Alan has failed to state a claim for rescission of the merger (*see* Section B, *supra*), the Third Cause of Action must also be dismissed.

CONCLUSION

For the reasons cited herein, Defendants' Motion to Dismiss should be granted in its entirety together with such other and further relief as the Court deems just and proper.

Dated: January 21, 2022
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