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Back to Decision

Arabesque Recordings, LLC v. Capacity, LLC, 650277/06

Supreme Court, New York County, IAS Part 3

650277/06

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Cite as: Arabesque Recordings, LLC v. Capacity, LLC, 650277/06, NYLJ 1202566215167, at *1 (Sup., NY, Decided July, 2012)

Justice Eileen Bransten

Decided: July, 2012

*1

Defendant Capacity, LLC ("Capacity") moves, pursuant to 22 NYCRR 130-1.1 (a), for an order awarding it costs and sanctions against plaintiff Arabesque Recordings, LLC ("Arabesque") and its attorneys, Richard E. Hahn, Esq. and Llorca & Hahn, LLP (both, "Hahn") on the ground that plaintiff and its attorneys knew this action was frivolous when they commenced it. Capacity seeks to recover $295,188.77, an amount equal to its litigation costs and expenses in defending this action over the course of four years.

Prior to oral argument of this motion, Capacity voluntarily settled and discontinued with prejudice the branch of the motion asserted against Hahn, and elected to proceed with the branch asserted against Arabesque, pursuant to a stipulation of discontinuance dated January 3, 2012.

Background

Arabesque is in the business of distributing and selling classical music and jazz recorded on compact discs ("CDs"). Arabesque is owned by nonparty Marvin M. Reiss,

*2

who is also its sole managing member.

By third-party order warehousing and order fulfillment agreement (the "warehousing agreement") dated July 7, 2003, Arabesque hired Capacity to receive, inventory, warehouse, and distribute music CDs for a two-year period. Pursuant to the warehousing agreement, Capacity was required once a month to forward to Arabesque a detailed invoice summarizing the services that it performed the previous month. See Warehousing Agr., Billing, at 5. The warehousing agreement required Arabesque to prepay Capacity on the first day of each month an amount equal to the previous month's charges, and to pay Capacity the difference between the prepayment amount and the actual monthly invoice amount within seven days after the invoice date. See id., Payment, at 5.

Subsequently, payment disputes arose between the parties. Following settlement negotiations at which both sides were represented by attorneys, the parties entered into a settlement letter agreement dated October 20, 2005. The settlement agreement required Capacity to

return, at Arabesque's expense, all of Arabesque's product in its possession, and to accept Arabesque's payment of $25,000 in full settlement of the outstanding balance owed by Arabesque to Capacity. The parties also executed a unilateral release releasing any and all claims Capacity might have against Arabesque.

On December 27, 2006, Arabesque commenced this action and, on January 3, 2007, effected service of process on Capacity through the secretary of state, pursuant to Limited Liability Company Law §303. In the complaint, verified by Reiss, Arabesque

*3

alleged that Capacity breached the warehousing agreement by failing to provide accurate and timely order fulfillment, inventory control and distribution services. Arabesque further alleged that, as a result of Capacity's alleged misconduct, it was unable to timely fill orders, and, therefore, lost business and clients and suffered damage to its reputation and goodwill. On these allegations, Arabesque sought to recover compensatory and consequential damages in an amount in excess of $2,750,000.

In the verified answer, Capacity denied all allegations of wrongdoing and alleged affirmative defenses. Capacity also sought to recover $150,000 in compensatory damages on a breach of contract counterclaim. In the counterclaim, Capacity alleged that Arabesque repeatedly failed to make the contractually required monthly payments, failed to have the warehoused inventory timely picked, packed and shipped, and repeatedly ignored Capacity's demands to cure.

By bench order issued September 27, 2007, the Honorable Karla Moskowitz granted Arabesque's motion to dismiss the counterclaim. Justice Moskowitz found that the counterclaim was barred by the settlement agreement and release.

Following the completion of discovery and significant motion practice, a bench trial was held before this court on March 21, 2012. After approximately one hour of testimony by Reiss, Arabesque voluntarily moved to dismiss its own case with prejudice

*4

on the ground that it was unable to produce any evidence in support of its legal claims and damages allegations asserted against Capacity. The court granted the motion.

At the conclusion of the trial, the court also granted Capacity's request for leave to file this motion for costs, disbursements, and sanctions.

Capacity now seeks sanctions equal to Capacity's legal costs and disbursements incurred in defending this action since December 2006. Capacity contends that Arabesque knew, or should have known, that there was absolutely no valid basis upon which to commence this action, that Arabesque prolonged the action by taking frivolous and unsupported positions in opposition to Capacity's summary judgment motions and discovery demands, that Arabesque continued the action long after it became clear that its claims were not supported by the facts and the law, and that Arabesque permitted Reiss, its sole witness, to repeatedly perjure himself on the witness stand during trial.

Arabesque contends that the imposition of sanctions is not justified. Arabesque argues that the action was commenced in good faith, is predicated on a colorable claim and is based upon the evidence admitted at trial. Arabesque further argues that the mere fact that the court did not find Reiss's trial testimony to be credible does not constitute proof that the action was completely without merit ab. initio, and does not entitle Capacity to an award of sanctions.

Analysis

Pursuant to 22 NYCRR 130-1.1,

[t]he court, in its discretion, may award to any party or attorney in any civil action or proceeding before the court...costs in the form of reimbursement for actual expenses

*5

reasonably incurred and reasonable attorney's fees, resulting from frivolous conduct as defined in this Part. In addition to or in lieu of awarding costs, the court, in its discretion may impose financial sanctions upon any party or attorney in a civil action or proceeding who engages in frivolous conduct as defined in this Part

22 NYCRR 130-1.1 (a); see Matter of 155 W. 21st St., LLC v. McMullan, 61 A.D.3d 497, 501 (1st Dep't 2009); Klin Constr. Group, Inc. v. Blue Diamond Group Corp., 25 Misc. 3d 1230(A), 2009 NY Slip Op 52344(U), *20-21 (Sup. Ct. Kings County 2009). The legislative intent behind the rule "is to prevent the waste of judicial resources and to deter vexatious litigation and dilatory or malicious litigation tactics." Matter of Kernisan v. Taylor, 171 A.D.2d 869, 870 (2d Dep't 1991).

Conduct is considered frivolous for purposes of the statute when:

(1) it is completely without merit in law and cannot be supported by a reasonable argument for an extension, modification or reversal of existing law;

(2) it is undertaken primarily to delay or prolong the resolution of the litigation, or to harass or maliciously injure another; or

(3) it asserts material factual statements that are false

...

In determining whether the conduct undertaken was frivolous, the court shall consider, among other issues the circumstances under which the conduct took place, including the time available for investigating the legal or factual basis of the conduct, and whether or not the conduct was continued when its lack of legal or factual basis was apparent, should have been apparent, or was brought to the attention of counsel or the party

*6

22 NYCRR 130-1.1 (c).

Sanctions have been awarded where the sanctioned party maintained positions that have no basis in law or fact, thus, prolonging the litigation, or where the party makes false assertions of material fact. See, e.g., Stein v. McDowell, 74 A.D.3d 1323, 1325-1326 (2d Dep't 2010); Intercontinental Bank Ltd. v. Micale & Rivera, 300 A.D.2d 207, 208 (1st Dep't 2002); Klin Constr. Group v. Blue Diamond Group, 25 Misc. 3d 1230(A), 2009 NY Slip Op. 52344(U), at *22-23. Sanctions are appropriate where the conduct is continued after it became apparent, or should have been apparent, that the conduct was frivolous, or where the lack of merit of a claim had been brought to the attention of the party or its counsel. See Levy v. Carol Mgt. Corp., 260 A.D.2d 27, 33 (1st Dep't 1999).

A careful review of the record reveals that Arabesque should have been aware that its claims were without merit no later than Capacity's first motion for summary judgment, filed on September 24, 2008. In support of the motion, Capacity argued that Arabesque's failure to pay Capacity was a material breach of the warehousing agreement that excused any alleged non-performance by Capacity, and that Arabesque had no factual or legal support for the damages that it was seeking. In opposition, Arabesque contended that genuine triable issues of material fact existed, that Arabesque had paid Capacity in full throughout the warehousing agreement term and that Arabesque would present evidence at trial that Capacity had waived its contractual right to seek payment.

*7

By order dated September 9, 2009, this court denied Capacity's first motion for summary judgment. The court found that Arabesque had raised triable issues sufficient to preclude summary judgment regarding whether Arabesque had made timely payments to Capacity throughout the term of the warehousing agreement, whether Capacity had caused Arabesque to lose sales and whether Capacity had waived its right to seek payment.

Reiss's anticipated and actual trial testimony and the documentary record demonstrate that Arabesque's opposition to the motion was based on falsehoods.

At the court's direction, in January 2010, prior to the initial February 1, 2010 trial date, the parties exchanged affidavits in lieu of direct examination of their witnesses and filed documentary exhibits that they intended to move into evidence during the trial.

A bench trial of this matter was held on March 21, 2011. After opening statements, Reiss took the stand as Arabesque's sole witness. The trial transcript demonstrates that much of Reiss's testimony was belied by the undisputed documentary evidence or his own deposition testimony.

For example, Reiss testified at trial, in support of Arabesque's claim that Capacity breached the warehousing agreement and caused Arabesque to lose business by not timely packaging the CDs and paper product together, that the paper product was located in a warehouse in Troy, NY in July 2003, when the warehousing agreement was executed. Trial Tr., at 83:9 to 85:2. Reiss later admitted that most of the paper product was located in an Arabesque storage facility in Hastings, NY until mid-November 2003. Id. at 90:8 to

*8

91:3. He also admitted that Arabesque had not identified any specific paper product order that was not fulfilled completely and timely by Capacity (id. at 100:7-11), and had not identified a single sale lost by Arabesque from 2003 through 2005, as the result of Capacity's conduct. Id. at 103:3-6. Reiss admitted that Arabesque received a complaint notice from only one of its recording artists, but that their business relationship had continued and that it was currently selling that artist's CDs. Id. at 110:14-26.

Reiss testified at trial that Arabesque was current in paying its invoices from July 2003 through November 2003, but he also testified that Arabesque paid only actual expenses, and did not make the prepayment required by the warehousing agreement. Trial Tr., at 94:5-17. The undisputed documentary evidence demonstrated that Reiss's testimony was false. See Capacity by Jeffrey Kaiden to Arabesque by Reiss Nov. 2003 E-Mails; Arabesque Invoice/Capacity Payment List. Moreover, the undisputed documentary evidence established that, while the warehousing agreement remained in effect until October 2005, Arabesque's last payment was a partial payment of $2,500 made on October 5, 2004. Documentary evidence demonstrated that Capacity never relinquished its right to timely prepayments and payments, and repeatedly informed Arabesque that it would stop providing service until receipt of payment in full. Trial Tr., at 94:5 to 95:14; Capacity by Jeffrey Kaiden to Arabesque by Reiss Nov. 2003 E-Mails.

Reiss testified at trial that Arabesque was never in financial distress (see Trial Tr., at 95:22-26), although he also testified that Arabesque's 2002 and 2003 income tax returns accurately demonstrated that Arabesque's revenues fell from $831,282 in 2002 to

*9

$108,710 in 2003. See id. at 97:3-18.

Reiss denied at trial that Arabesque's business had changed gradually, beginning in the 1990s, and that it had stopped producing most of the CDs in its catalog. See id. at 119:11 to 121:17. However, at deposition, Reiss testified that Arabesque had changed from a full service record company to a company that did only post production and sales. Reiss Dep. Tr., at 21:18 to 22:5.

During the trial, Arabesque presented no credible evidence in support of its claims of breach of contract and for compensatory damages or its arguments previously made in opposition to Capacity's first summary judgment motion.

Following Reiss's contradictory testimony regarding Arabesque's business, this court made the following statements on the record: "I am more than perturbed. I have written down in my comments on the testimony of your client [Arabesque] 'unbelievable, caught in another lie, inconsistent testimony, unbelievable'...[Arabesque] has not produced an iota of evidence in support of [its] claim." Trial Tr., at 122:10-23.

Arabesque then moved for permission to voluntarily discontinue this action with prejudice. The court granted the motion. Id. at 124:5 to 125:14. The court also stated that it would entertain Capacity's motion for costs and sanctions. See id. at 124:18-21.

Arabesque presented no evidence at trial that it was entitled to consequential damages. A party seeking consequential damages, or, lost profits, "must establish that such damages were actually caused by the breach, that the particular damages were fairly within the contemplation of the parties to the contract at the time it was made and that the

*10

alleged loss is capable of proof with reasonable certainty." Awards.com v. Kinko's, Inc., 42 A.D.3d 178, 183 (1st Dep't 2007), aff'd 14 N.Y.3d 791 (2010) (internal quotation marks and citation omitted). Consequential damages are not mentioned in the warehousing agreement, Reiss's testimony does not suggest that such damages were considered by the parties when they drafted the warehousing agreement, and, as discussed above, Reiss denied the existence of any evidence of such damages.

Contrary to Arabesque's contention, Reiss's competency as Arabesque's owner to testify as a lay witness to the value of the company's damages does not relieve Arabesque of the necessity of presenting admissible objective documentary evidence supporting Arabesque's claims against Capacity. Arabesque has never identified a single instance when a CD replicator could not produce CDs as needed, has never identified a single lost sale, has never demonstrated that it lost recording artists and has never cited any evidence demonstrating that Arabesque was forced to sell its CD distribution rights at a deep discount, as a result of Capacity's alleged misconduct.

In sum, Arabesque's continuation of this action after September 24, 2008 was frivolous. There comes a point when the court can no longer permit a litigant to engage in frivolous conduct; such conduct comes at a tremendous cost to other parties and is a drain upon the resources of the court. Sanctions are appropriate where, as here, a litigant continues to prosecute the same patently meritless claims in a protracted and highly litigious manner, long after it knew, or should have known, that its position was tenable. See Tsabbar v. Auld, 26 A.D.3d 233, 234 (1st Dep't 2006); Gassab v. R.T.R.L.L.C., 22

*11

Misc. 3d 1140(A), 2009 NY Slip Op. 50519[U], *4 (Sup. Ct. NY County 2009), aff'd 69 A.D.3d 511 (1st Dep't 2010).

For these reasons, Capacity's motion for the imposition of sanctions equal to its costs, disbursements, and legal fees incurred in defending this action is granted, to the extent that Capacity seeks costs, disbursements and legal fees incurred since the filing and service of its first motion for summary judgment, the date that Arabesque should have been aware that its claims were frivolous.

The branch of the motion in which Capacity seeks sanctions prior to that date is denied.

Pursuant to the doctrine of law of the case, sanctions cannot be assessed against Arabesque for the method of service of process that it chose to employ. By bench order issued on May 19, 2007, Judge Moskowitz held that Arabesque properly served Capacity through the New York secretary of state pursuant to Limited Liability Company Law §303, using Capacity's Hauppauge, NY address. Justice Moskowitz further held that Arabesque properly moved for a default judgment.

The imposition of sanctions is also not warranted prior to the filing of Capacity's first summary judgment motion on the ground that Arabesque allegedly "stonewalled" discovery, including document exchange and depositions, by failing and refusing to state the ways in which Capacity allegedly breached the warehousing agreement, and by failing and refusing to provide documentation in support of its allegations of breach of contract and demands for compensatory and consequential damages. A review of the

*12

documentary record demonstrates that Arabesque acted within the bounds of the rules of discovery in responding to Capacity's discovery demands.

That branch of the motion for the imposition of sanctions equal to costs, disbursements, and legal fees in the amount of $295,188.77 is held in abeyance, pending a hearing on the amount of reasonable attorneys' fees that Capacity may recover. "[T]he courts possess the traditional authority 'to supervise the charging of fees for legal services under the courts' inherent and statutory power to regulate the practice of law.'" Collier, Cohen, Crystal & Bock v. MacNamara, 237 A.D.2d 152, 152 (1st Dep't 1997), quoting Matter of First Natl. Bank of E. Islip v. Brower, 42 N.Y.2d 471, 474 (1977). "It is well settled that an award of attorney's fees should be 'reasonable in light of the skill, experience and background of...counsel, the nature of the services rendered, the difficulty and complexity of the issues of fact and law involved in the case, as well as the time actually spent on [the case].'" Willis v. Willis, 149 A.D.2d 584, 584 (2d Dep't 1989), quoting Silver v. Silver, 63 A.D.2d 1017, 1018 (2d Dep't 1978). Here, the record contains insufficient evidence to justify the more than the $295,000 demanded by Capacity. A hearing is required regarding the legal services actually rendered in order to determine the amount of reasonable litigation costs to be awarded.

Thus, Arabesque must pay all of Capacity's legal costs, including reasonable attorneys' fee, as determined by the Special Referee, incurred in defending this action since September 24, 2008. Capacity must prepare affirmations detailing such costs and provide them to Arabesque's counsel within 14 days of service of a copy of this decision

*13

and order with notice of entry. Within 30 days after such service, Arabesque's counsel must serve a copy of this decision and order with notice of entry on the Clerk of the Office of Special Referees (Room 119), who shall set this matter down for a hearing in accordance with this order.

Failure by Arabesque to timely serve a copy of this decision and order on the Office of the Special Referees shall result in a judgment in favor of Capacity in the amount set forth in its affirmations related to costs and attorneys' fee. Failure by Capacity to serve a costs/fees affirmation on Arabesque's counsel within 14 days after service of a copy of this decision and order with notice of entry shall result in Capacity's waiver of its right to recover costs and attorneys' fee from Arabesque.

Order

Accordingly,

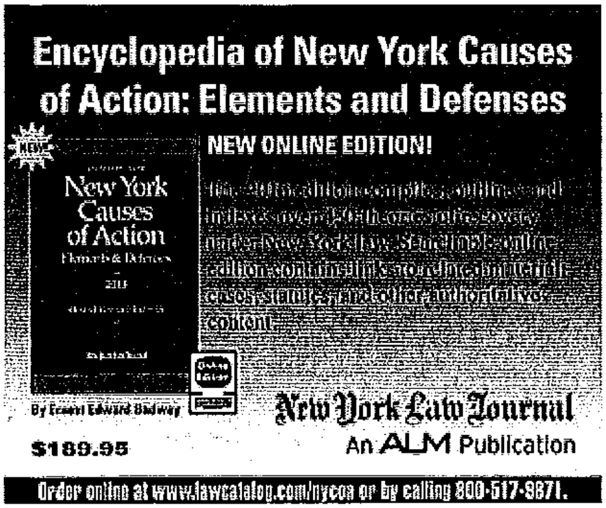
the court having determined as set forth above that plaintiff Arabesque Recordings, LLC has engaged in frivolous conduct as defined by Section 130-1.1 (c) of the Rules of the Chief Administrator, and that as a result defendant Capacity, LLC has incurred unnecessary attorneys' fees, costs, and disbursements in defending this action since September 24, 2008, it is now, therefore,

ORDERED that defendant's motion for sanctions and costs is granted to the extent that plaintiff is sanctioned by this court in an amount equal to the reasonable attorneys' fees, costs, and disbursements incurred by defendant in defending this action since September 24, 2008; and it is further

*14

ORDERED that defendant must prepare affirmations detailing such costs and provide them to plaintiff's counsel within 14 days after service of a copy of this decision and order with notice of entry. Within 30 days after such service, plaintiff's counsel must serve a copy of this decision and order with notice of entry on the Clerk of the Office of Special Referees (Room 119), who shall set this matter down for a hearing in accordance with this order. Failure by plaintiff to timely serve a copy of this decision and order on the Office of the Special Referees shall result in a judgment in favor of defendant in the amount set forth in its affirmations related to costs and attorneys' fees. Failure by defendant to serve costs/fees affirmations on plaintiff's counsel within 14 days after service of a copy of this decision and order with notice of entry shall result in defendant's waiver of its right to recover costs and attorneys' fee from plaintiff.

This constitutes the decision and order of the court.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