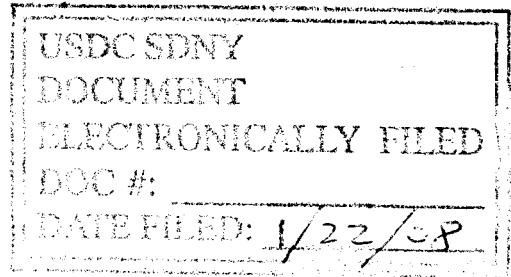


UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK



----- X
:
BRANDAID MARKETING CORP.,
:
Plaintiff,
:
-against-
:
STEVEN S. BISS and
CYBERIAN ENTERPRISES, LTD.,
:
Defendants.
:
----- X

03 Civ. 5088 (WHP)
MEMORANDUM AND ORDER

WILLIAM H. PAULEY III, District Judge:

Plaintiff BrandAid Marketing Corp. (“BrandAid”) brings this action against Defendants Cyberian Enterprises Ltd. (“Cyberian”) and Steven S. Biss (“Biss”), alleging breach of contract, as well as common law and securities fraud. Following a three-day bench trial, this Court concluded that both parties had committed fraud and dismissed their claims under the doctrine of in pari delicto. BrandAid Mktg. Corp. v. Biss, 418 F. Supp. 2d 329, 338 (S.D.N.Y. 2005) (“BrandAid I”).

The Court of Appeals disagreed, concluding that “as a matter of law [BrandAid] does not ‘bear at least substantially equal responsibility for the violations [it] seeks to redress.’” BrandAid Mktg. Corp. v. Biss, 462 F.3d 216, 219 n.4 (2d Cir. 2006) (“BrandAid II”). The Court of Appeals did not disturb this Court’s findings, but its analysis relied on certain facts this Court

deemed less pertinent.¹ See, e.g., BrandAid II, 426 F.3d at 218-219 (stating this Court “overlooked” disclosures in BrandAid’s SEC filings).

This Court reaffirms the extensive findings of fact it made in BrandAid I, and familiarity with that opinion is presumed.² Reviewing the trial record and the parties’ post-remand submissions, this Court makes the following additional findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure, and enters judgment in favor of BrandAid in the amount of \$21,000,001 against Cyberian, and in the amount of \$1 against Biss.

BACKGROUND

Cyberian approached BrandAid in November 2002 with an offer to invest \$21 million in exchange for 23.5 million BrandAid common shares. BrandAid I, 418 F. Supp. 2d at 331. At that time, BrandAid was in severe financial distress, with assets totaling \$304,000 and liabilities of \$5.335 million. (Trial Transcript (“Tr.”) at 24.) Cyberian assured BrandAid that the \$21 million it planned to invest was “currently placed in New York at one of the largest U.S.A. Banks.” (Tr. at 280.) Further, during due diligence, Cyberian represented that “the source of

¹ In doing so, the Court of Appeals seems not to have shared this Court’s previously noted concern that determining what evidence to credit was a daunting task because the parties’ deceptive conduct from the outset of the litigation “also permeated the trial.” BrandAid I, 418 F. Supp. 2d at 330.

² The Court of Appeals’ opinion implies this Court should have given the parties more time to conduct discovery, asserting that this Court “never decided” Defendants’ summary judgment motion and tried the case “[a]fter some discovery.” BrandAid II, 426 F.3d at 218. Yet the district court docket sheet shows that discovery was extended at the request of the parties and completed under the supervision of a magistrate judge. Defendants’ summary judgment motion, launched just before trial, was replete with material issues of disputed fact and entirely without merit. A trial was the only way to determine the facts.

[the \$21 million] is from investments.” (Tr. at 17-19.) In fact, Cyberian never had cash in New York to complete the transaction. BrandAid I, 418 F. Supp. 2d at 331.

On November 14, 2002, the parties signed a Subscription Agreement (the “Subscription Agreement”) requiring BrandAid to issue 23.5 million shares in exchange for Cyberian tendering the entire \$21 million in a single payment within thirty days. (Affidavit and Declaration of Steven S. Biss dated July 23, 2003 (“Biss Decl.”) Ex. A: Subscription Documents at 20; Joint Pre-Trial Order dated June 28, 2004 (“JPTO”) ¶ 7.9.) In anticipation of the December 13, 2002 closing, BrandAid issued 23.5 million shares on December 9 and delivered them to Biss to hold in escrow pending payment. (JPTO ¶ 7.15.) The shares were issued pursuant to Rule 144 of the Securities Act of 1933, and therefore could not be resold for two years. (JPTO ¶ 7.11; see generally 17 C.F.R. § 230.144.)

On the closing date, Cyberian failed to pay, and the parties began negotiations to amend the Subscription Agreement. (Direct Testimony of Paul Sloan dated July 20, 2004 (“Sloan Direct”) ¶¶ 128, 149-154, 185.) On March 24, 2003, the parties signed an addendum to the Subscription Agreement (the “Addendum”), under which Cyberian agreed to pay for the shares in thirty-six monthly installments beginning May 23, 2003. (JPTO ¶ 7.19; Biss Decl. Ex. A at A1-A2.) The 23.5 million shares BrandAid had issued would continue to be held in escrow by Biss, who would release a proportional number of shares with each monthly payment. (Biss Decl. Ex. A at A1-A2.)

Incredibly, in early April 2003—just two weeks after agreeing to the monthly installment payment plan—Cyberian proposed that instead of paying cash for the shares, it would transfer real estate in China to BrandAid. (JPTO ¶ 7.21; Sloan Direct ¶ 320; see also BrandAid I, 418 F. Supp. 2d at 334.) On April 16, 2003, Biss stated that Cyberian, as a

BrandAid shareholder, consented to the proposal. Biss demanded that BrandAid accept Cyberian's proposal immediately, despite the fact that Cyberian never paid for BrandAid's shares. (Biss Decl. at 5; JPTO ¶ 7.22.)

Cyberian failed to make the first payment under the Addendum when it came due on May 23, 2003. (Sloan Direct ¶ 376.) In a letter the same day, Biss, claiming to be a BrandAid shareholder and to "represent the holders of outstanding stock" by proxy, informed BrandAid he was replacing BrandAid's management with associates of Cyberian. (Biss Decl. Ex. D: letter from Steven S. Biss to Paul Sloan dated May 23, 2003 at 1-2.) Also on May 23, 2003, an agent of Cyberian, purporting to be the newly installed president of BrandAid, accepted the Chinese real estate in lieu of cash as consideration for the shares issued to Cyberian. (Biss Decl. ¶ 33, Ex. E: Amendment to Subscription Agreement dated May 23, 2003.) Biss, as the escrow agent, then released the 23.5 million BrandAid shares to Cyberian on May 30. (Biss Decl. at 10, 13.)

When BrandAid's prior management demanded the return of the escrowed shares, Biss refused. (JPTO ¶¶ 7.30-7.32.) Defaulting on its debts and lacking funding, BrandAid ceased operations on June 17, 2003. (JPTO ¶ 7.38; Sloan Direct ¶ 472.) BrandAid then filed suit against Cyberian and Biss on July 9, 2003, claiming Cyberian never intended to pay BrandAid for its 23.5 million shares, and alleging that Cyberian and Biss executed a fraudulent takeover of the company. (JPTO ¶ 7.40; Amended Complaint dated October 14, 2003 ("Compl.") ¶¶ 61, 64.)

BrandAid made several misrepresentations in the Subscription Agreement, most notably that it was "...licensed and in good standing under the laws of the State of Delaware." BrandAid I, 418 F. Supp. 2d at 332-333. In fact, at the time, BrandAid's corporate charter had

been voided because the company had failed to pay corporate franchise taxes for the past three years. (Tr. at 12-13.)

DISCUSSION

BrandAid asserts claims for breach of contract, common law fraud and securities fraud. Cyberian lodged counterclaims against BrandAid and also filed a third-party complaint. This Court dismissed those counterclaims and the third-party claims after trial. (BrandAid I, 418 F. Supp. 2d 338.) Because Cyberian did not appeal this Court’s dismissal of its counterclaims and third-party claims in BrandAid I, those claims are not before this Court on remand. Accordingly, this Court limits its analysis to Plaintiff’s claims, and considers them seriatim.

I. Breach of Contract

According to the Subscription Agreement, the contract “shall be construed in accordance with and governed by the laws of the State of Florida.” (Biss Decl. Ex. A at 17.) To establish breach of contract under Florida law, the plaintiff must prove (1) an enforceable contract, (2) adequate performance by the plaintiff, (3) breach by the defendant, and (4) damages resulting from the breach. Rollins, Inc. v. Butland, 951 So. 2d 860, 876 (Fla. Dist. Ct. App. 2006). BrandAid has satisfied each of these elements.

Defendants argue that the Subscription Agreement was unenforceable because of BrandAid’s misrepresentations. A material misrepresentation, whether intentional or not, does not render the contract unenforceable, but only makes it voidable and subject to rescission by the other party. Mazzoni Farms, Inc. v. E.I. DuPont De Nemours and Co., 761 So. 2d 306, 313 (Fla. 2000). A party that continues to accept the benefits of a contract even after learning of a

misrepresentation is deemed to have ratified the contract and to have rendered it enforceable. Mazzoni Farms, 761 So. 2d at 313. A defrauded party must disgorge any benefits received under the contract, or the contract is ratified. Jackson v. BellSouth Telecomm., 372 F.3d 1250, 1278 (11th Cir. 2004).

As noted in BrandAid I, 418 F. Supp. 2d at 333, BrandAid misrepresented, inter alia, its corporate status in Delaware and its financial condition to procure Cyberian's investment. These misrepresentations rendered the contract voidable and subject to rescission by Cyberian. See Mazzoni Farms, 761, So. 2d at 313. However, Cyberian made no effort to rescind the Subscription Agreement or the Addendum once it learned BrandAid's corporate status in May 2003.³ (Biss Decl. at 7-8.) On the contrary, Cyberian ratified the contract by accepting the shares held in escrow by Biss on May 30, 2003. (Biss Decl. at 10.) Therefore, the contract was enforceable.

Defendants contend that Cyberian did not breach the Subscription Agreement or the Addendum by failing to pay because under Florida law, "[shares are] paid for at the time the promise is made." (Tr. at 229.) This mischaracterizes Florida law, which allows corporations to issue shares in exchange for the promise to pay, if that is the corporation's intent. Fla. Stat. § 607.0621 (1989). Biss ignores the plain language of the contract, explicitly requiring that "the shares will be held in escrow until paid for." (Biss Decl. Ex A at A2.) "It is well settled that the actual language used in the contract is the best evidence of the intent of the parties and, thus, the plain meaning of that language controls." Rose v. M/V "Gulf Stream Falcon", 186 F.3d 1345,

³ Moreover, as the Court of Appeals observed, while BrandAid may not have adequately disclosed its financial and legal difficulties during its negotiations with Cyberian, it "largely disclose[d] them in its contemporaneous SEC filings, which Cyberian could easily have checked." BrandAid II, 462 F.3d at 218-19.

1350 (11th Cir. 1999). Therefore, on the plain language of the contract, Cyberian breached its contractual obligations by not paying for the shares.

“Damages in a breach of contract action are intended to place the injured party in the same position he or she would have been in had the breach not occurred.” Telemundo Network, Inc. v. Spanish Television Servs., Inc., 812 So. 2d 461, 464 (Fla. Dist. Ct. App. 2002). Had Cyberian not breached, it would have paid \$21 million for the shares it received. Accordingly, BrandAid is entitled to receive from Cyberian the full \$21 million due under the contract.⁴

II. Common Law Fraud

BrandAid’s common-law fraud claim is governed by New York law. “While [the choice-of-law] provision is effective as to breach of contract claims, it does not apply to fraud claims, which sound in tort.” Rosenberg v. Pillsbury Co., 718 F. Supp. 1146, 1150 (S.D.N.Y. 1989). Under New York’s “interest analysis,” the important factors determining the proper law to apply are “the parties’ domiciles and the locus of the tort.” GlobalNet Financial.com, Inc. v. Frank Crystal & Co., Inc., 449 F.3d 377, 384 (2d Cir. 2006). BrandAid was a citizen of New York, with its principal place of business in New York; Cyberian was domiciled in Hong Kong, and Biss was domiciled in Virginia. (JPTO ¶¶ 1-3.) Moreover, the fraud specifically concerned money purportedly on deposit at a New York bank. (Sloan Direct ¶ 112.) New York law therefore governs the analysis of BrandAid’s fraud claim.

⁴ This Court notes that BrandAid only sought \$5 million in compensatory damages in its Amended Complaint. (Compl. ¶ 89.) However, a determination of damages must be based on “the relief to which the party is entitled, even if the party has not demanded that relief in its pleadings.” Fed. R. Civ. P. 54(c).

A. Liability

A plaintiff generally cannot assert separate claims for breach of contract and fraud when the fraudulent act arises out of the same failure to perform the contract. Telecom Int'l. Am., Ltd. v. AT&T Corp., 280 F.3d 175, 196 (2d Cir. 2001). However, a separate claim of fraud exists where a defendant allegedly made a fraudulent misrepresentation collateral to, or extraneous to, the contract. Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc., 98 F.3d 13, 20 (2d Cir. 1996). A defendant's intentional misstatement prior to the formation of the contract, which induces the plaintiff to enter the contract, constitutes such a collateral misrepresentation. Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 747 (2d Cir. 1979). BrandAid claims that it was induced to enter the Subscription Agreement because of Cyberian's representation that it had \$21 million on deposit in New York. (Compl. ¶¶ 46-47; Sloan Direct ¶¶ 103-106.) BrandAid is therefore entitled to bring a fraud claim.

To establish fraud, a plaintiff must prove: (1) a material misstatement or omission (2) made knowingly by the defendant (3) to induce the plaintiff's reliance, (4) justifiably relied on by the plaintiff, (5) causing the plaintiff injury. Lama Holding Co. v. Smith Barney Inc., 88 N.Y.2d 413, 421 (1996); Wurtsbaugh v. Banc of Am. Sec. LLC, No. 05 Civ. 6220 (DLC), 2006 WL 1683416, at *6 (S.D.N.Y. June 20, 2006). The plaintiff must prove each of these elements by clear and convincing evidence. Dallas Aerospace, Inc. v. CIS Air Corp., 352 F.3d 775, 784-85 (2d Cir. 2003).

As previously noted by this Court, the Defendants' insistence that it had \$21 million in cash "was false," and "when Biss forwarded Cyberian's letter [claiming the existence of the \$21 million] to BrandAid, he was facilitating Cyberian's deception, or consciously avoiding the truth." BrandAid I, 418 F. Supp. 2d at 331-32. Thus, the first two elements of a

fraud claim are satisfied. BrandAid has also proved by clear and convincing evidence that Cyberian’s false promise was made to induce it to part with 23.5 million shares. For example, BrandAid’s chairman first authorized his counsel to negotiate with Cyberian after Cyberian’s agent said that “BrandAid could overcome its substantial liabilities and become extremely successful far faster with a large cash infusion.” (Sloan Decl. ¶ 97) (emphasis added). BrandAid’s reliance on Defendants’ assertions was also justifiable; BrandAid only negotiated the Subscription Agreement after conducting due diligence into the source of Cyberian’s cash. (Sloan Decl. ¶¶ 108-112.) Thus, the fourth element of a fraud claim has been established.

Finally, BrandAid has proven that it suffered an injury as a result of the Defendants’ fraud—namely, the loss of 23.5 million shares and control of the company. “Under New York law, damages for fraud must be the direct, immediate, and proximate result of the fraudulent misrepresentations.” Goldberg v. Mallinckrodt, Inc., 792 F.2d 305, 307 (2d Cir. 1986). According to the “out of pocket rule,” the plaintiff must demonstrate actual pecuniary loss to prove injury, with damages “calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained.” Lama Holding, 88 N.Y.2d at 421. Because BrandAid transferred 23.5 million shares on December 9, 2002 without receiving any compensation, and those shares represented a certain value, their loss constituted cognizable injury.

B. Damages

BrandAid has not offered any viable method for quantifying its loss due to Defendants’ fraud. Where the shares of stock are restricted, “[t]he general rule is that the market price of a security should be discounted to reflect the decrease in value, if any, due to a

restriction on its transferability.” Waxman v. Envipco Pickup & Processing Servs., Inc., No. 02 Civ. 10132 (GEL), 2006 WL 1788964, at *3 (S.D.N.Y. June 28, 2006). While a discount of thirty to thirty-five percent from their publicly traded value has been treated as a starting point in several cases that valued restricted shares, “the precise discount . . . depends on the facts of [the] case, including expert testimony.” Waxman, 2006 WL 1788964, at *4 (citing cases).

When BrandAid issued shares to Biss as escrowee on December 9, 2002, BrandAid’s publicly traded share price closed at \$2.32. (Affidavit of Paul Sloan dated Oct. 8, 2007 (“Second Sloan Aff.”) ¶¶ 5-6, Ex. A: BrandAid stock price historical table.) Thus, the newly issued shares clearly had value; the question is how to determine the amount. The shares were restricted and in escrow. (JPTO ¶¶ 11, 15.) Further, the issuance of 23.5 million shares more than quadrupled the number of outstanding shares, see BrandAid I, 418 F. Supp. 2d at 331, presumably diluting the market value of each share. Moreover, the historical prices for BrandAid in the over-the-counter market reveal that the shares were thinly traded and subject to substantial price fluctuations. (Second Sloan Aff. Ex A.)

While the Court of Appeals was technically correct to observe that BrandAid was “a publicly traded corporation at the time it commenced this action” on July 9, 2003, BrandAid II, 426 F.3d at 217, the larger reality is that by that time—barely six months after Cyberian was supposed to make its investment—BrandAid had already ceased operations and was defunct. (JPTO ¶ 7.38; Sloan Direct ¶ 472.) Moreover, it is clear that BrandAid was insolvent long before that, with liabilities far exceeding its assets by the time it began negotiating with Cyberian. (Tr. at 24.) BrandAid’s abrupt demise raises questions about whether BrandAid shares were worth anything substantial when BrandAid transferred them, a suspicion reinforced by BrandAid’s failure to present any evidence of their actual value at trial.

Because liability and damages were not bifurcated, BrandAid was obliged to present evidence of damages at the August 2004 trial. BrandAid did not offer any credible evidence or viable method for measuring the loss of value of the 23.5 million shares. Indeed, BrandAid's complaint woodenly sought damages of \$5 million on each claim, a figure BrandAid's own counsel recognized was inappropriate. (Compl. at 21; Plaintiff's Memorandum in Support of Damages ("Plaintiff's Damages Mem.") dated January 12, 2007 at 9.) Even post-remand, BrandAid's calculation of its damages was no more precise than "in the millions of dollars in stock market valuation." (Plaintiff's Damages Mem. at 9.)

"[W]hen a party to a contract is guilty of fraud . . . [it] is liable to the defrauded party, to pay, at least, nominal damages." Northrop v. Hill, 57 N.Y. 351 (1874). However, it would be imprudent to award damages greater than a nominal amount on the fraud claim in the absence of evidence on the value of the loss. This Court's determination of contract damages against Cyberian confers on BrandAid the benefit of its bargain. Since the trial record is bereft of any evidence of damages arising from the fraud that are independent of the contract claim, the appropriate result is to award BrandAid nominal damages of \$1 on its fraud claim. See Imaging Int'l v. Hell Graphic Sys. Inc., 2007 WL 3227245, at *13 (N.Y. Sup. Oct. 29, 2007) (where plaintiff failed meet its "burden to provide a non-speculative method [to] quantify its recoverable damages as a result of the fraud" other than by "pure guesswork . . . plaintiff is entitled to only nominal damages").

III. Securities Fraud

To establish a violation of § 10b and Rule 10b-5, a plaintiff must prove by a preponderance of the evidence that the defendant purposely made, and the plaintiff relied on,

material misstatements or omissions in connection with the purchase or sale of a security, causing the plaintiff economic loss. Dura Pharm. v. Broudo, 544 U.S. 336, 341-42 (2005); In re GlaxoSmithkline PLC Sec. Litig., No. 05 Civ. 3751 (LAP), 2006 WL 2871968, at *5 (S.D.N.Y. Oct. 6, 2006). Here, BrandAid has failed to prove loss causation.

Proving loss causation in a 10b-5 claim requires a greater showing than merely pointing out a company's share price movements before and after the alleged misstatement or omission, because the share movements could have been caused by other factors. Dura, 544 U.S. at 342-43. Although Dura was decided after the trial in this action, the principle requiring more rigorous proof of loss causation to support securities fraud claims had previously been recognized in the Second Circuit. See, e.g., Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 95 (2d Cir. 2001) ("It is settled that causation under federal securities laws is two-pronged: a plaintiff must allege both transaction causation...and loss causation, i.e., that the subject of the fraudulent statement or omission was the cause of the actual loss suffered.") Such proof requires more than a simplistic showing that a drop in the company's share price followed the defendants' misrepresentations. ATSI Commc'ns Inc. v. Shaar Fund Ltd., 493 F.3d 87, 107 (2d Cir. 2007). To adequately prove loss causation, a plaintiff must "'eliminat[e] . . . that portion of the price decline that is the result of forces unrelated to the wrong.'" Gordon Partners v. Blumenthal, No. 02 Civ. 7377 (LAK), 2007 WL 1438753, at *1 (S.D.N.Y. May 16, 2007) (citation omitted).

BrandAid has failed to prove that the Defendants' false statements, or Biss's fraudulent attempt to exercise voting rights in shares held in escrow, actually caused the decline in BrandAid's share price. BrandAid's chairman testified that the company's share price declined from 76 cents per share to 24.5 cents per share between March 24, 2003 (the day the

Amended Subscription Agreement was executed) and June 17, 2003 (the day BrandAid announced it would cease operations). (Sloan Direct ¶¶ 536-537.) Yet BrandAid had been in desperate financial straits before the negotiations with Cyberian began. As the company's 2002 SEC filings demonstrated, the company had more than \$5 million in debt, and very little cash flow. (Tr. at 23-24.) BrandAid offered no evidence that the Defendants' misstatements, and not BrandAid's weak business prospects and poor cash flow, caused BrandAid's decline in market value and its failure to pay off creditors. Because BrandAid has not eliminated other factors as the root cause of its failure as a publicly traded company, it cannot prove loss causation, and therefore has failed to prove its 10b-5 claim.

CONCLUSION

Accordingly, judgment is granted for Plaintiff BrandAid in the amount of \$21 million on its breach of contract claim against Cyberian and nominal damages of \$1 on its fraud claim against Cyberian and Biss, jointly and severally. The foregoing constitutes this Court's additional findings of fact and conclusions of law as required by Rule 52 of the Federal Rules of Civil Procedure.

This case presents a cautionary tale about the potential for advocates to obscure the issues and impose needless burdens on busy courts. The action began with a groundless application for preliminary relief. Incessant pre-trial sparring, ad hominem attacks and a barrage of frivolous motions on the eve of trial impeded a resolution of this matter. The parties post-trial submissions only further clouded their unfocused trial presentations. Even on remand, the lawyers continued to obfuscate, leaving this Court to grope down a dimly lit corridor. Time will tell whether this Memorandum and Order finally puts an end to the madness.

The Clerk is directed to enter judgment pursuant to Rule 58 of the Federal Rules of Civil Procedure and once again mark this case closed.

Dated: January 22, 2008
New York, New York

SO ORDERED:


WILLIAM H. PAULEY III
U.S.D.J.

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