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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

CVS Pharmacy, Inc. and Caremark Rx, LLC,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	1:17-cv-00190
	)	
Press America, Inc.,	)	
	)	
Defendant.	)	

MEMORANDUM IN SUPPORT OF PRESS AMERICA'S MOTION TO DISMISS PLAINTIFFS' AMENDED COMPLAINT

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INTRODUCTION

CVS Pharmacy, Inc./Caremark Rx, LLC (collectively, "CVS") hired Press America to perform printing and mailing work that involved sending letters to patients regarding prescription medications. CVS later solicited business from IBM whereunder CVS would send letters to IBM employees regarding their prescription medication. CVS won IBM's business, entered into a "series of agreements" with IBM, and ultimately executed a confidential final contract, that, among other things, provided that CVS would pay IBM significant monetary penalties if CVS inadvertently disclosed private health information regarding IBM employees. Thereafter, CVS subcontracted a portion of its IBM-related work to Press America via its preexisting contract with Press America. CVS claims Press America incorrectly mailed protected health information pertaining to certain IBM employees, and as such, CVS paid IBM a penalty of $1,845,000.00. Absent the confidential contract's penalty provisions, there would be no damages at all as CVS does not contend that it or IBM suffered any actual damages. CVS's Amended Complaint is an effort to impose the consequences of the secret terms of a contract, to which Press America was not a party, upon Press America under various indemnification-related theories.

In order to comprehend CVS's impermissible demands, an analogy to a construction project is useful. For purposes of this illustration, CVS is equivalent to a general contractor, Press America a subcontractor, and IBM the property owner. Imagine that the general contractor and subcontractor have a standing agreement whereby the general contractor may hire the subcontractor to work on various construction projects. The agreement contains a general indemnification by the subcontractor of the general contractor for claims arising out of defects in the subcontractor's work. Subsequently, the general contractor decides to bid on a construction

project. In negotiations with the property owner, in order to induce the owner to hire the general contractor, the general contractor promises flawless performance of the work, and indicates that he will agree to a confidential penalty of $45,000.00 for each instance in which a construction defect occurs, in addition to the actual cost to repair any of the defects. The general contractor then engages the subcontractor, pursuant to their pre-existing standing contract, to perform certain work on the project. After the work is performed, the general contractor discovers what he believes to be 41 defects in the subcontractor's work and calculates that he owes the owner a penalty payment of $1,845,000.00. The general contractor unilaterally pays the penalty and then, in turn, advises the subcontractor that he must reimburse the general contractor pursuant to the indemnification provision in their standing agreement, despite (1) the standing agreement pre-dated the contract between the general contractor and the owner, and (2) the general contractor's promise to pay the owner penalties was confidential between the general contractor and the owner.

Common sense indicates that the general contractor cannot recover under such a scenario. Certainly the subcontractor can be expected to pay for repairs for defects in its own work. However, it would be both unfair and absurd to allow a general contractor to secretly broker a deal with the owner wherein the owner is entitled not only to the cost to remedy the defects, but also to a windfall lump-sum penalty payment which the general contractor intends to pass along to the subcontractor via the pre-existing general indemnification provision.

In addition to common sense, New York law precludes recovery under the facts alleged in Plaintiffs' Amended Complaint. Indeed, Plaintiffs' Amended Complaint suffers from the same defects identified by Press America with respect to the original Complaint; namely (1) the penalty provision pursuant to which Plaintiffs seek indemnification is unenforceable as a matter of law, making any payment tendered to IBM voluntary in nature and not subject to indemnification in

this action; (2) as a matter of law, Press America could not have contemplated the *ex post facto* penalty provision agreed to between Plaintiffs and IBM at the time it entered into its own agreement with Plaintiffs, rendering the indemnity unenforceable; and (3) the Complaint fails to identify what contractual terms were in effect at the time of the incident in question.

In addition to the issues previously identified in Press America's two pre-motion submissions, the indemnification claims fail because the nature of the claim at issue is not provided for in the indemnification clauses. Further, all of Plaintiffs' claims fail as Press America was not the proximate cause of CVS's damages. Count IV fails because the facts alleged by CVS demonstrate that the implied indemnity claim is not a viable theory of recovery and merely duplicates its contract-based claims. Last, CVS has failed to plead any allegations identifying the source of its obligation to issue payment to IBM, which is an essential issue upon which each count of its Amended Complaint depends.

PLAINTIFFS' ALLEGATIONS

Plaintiffs and Press America entered into two contracts pursuant to which Plaintiffs seek indemnification, the Master Service Agreement and Business Associate Agreement (collectively, the "Press America Agreements"), both of which were effective on October 1, 2011. (ECF #28, ¶¶ 13-14). On August 2, 2012, Plaintiffs allege that Press America disclosed private health information in performing its duties under the Press America Agreements (the "Incident"). (ECF #28, ¶ 23). On March 28, 2013, Plaintiffs and IBM entered into a contract pursuant to which Plaintiffs agreed to pay a calculated penalty to IBM in the event improper disclosures of private health information occurred the ("IBM Agreement"), meaning the IBM Agreement did not exist on the date of the Incident. (ECF #28, ¶¶ 26-31 & Ex. 5). The IBM Agreement, though executed on March 28, 2013, bears an effective date of January 1, 2012. (ECF #28, ¶ 15 & Ex. 5). Plaintiffs

allege that the IBM Agreement "memorialized" a preceding "series of agreements." (ECF #28, ¶ 15). Other than a reference in a footnote to a "Letter of Understanding" Plaintiffs do not include any specific allegations as to what other agreements constituted this "series," or what contractual landscape existed on the date of the Incident. (ECF #28, fn. 1, p. 9).

Though pursuant to Plaintiffs' own allegations the penalty provision contained in Section 3.13 of the IBM Agreement would not have existed at the time of the Incident, it forms the basis of Plaintiffs' claim for damages. That provision provides, in pertinent part:

> **3.13 Performance Standards**
> CVS Caremark shall comply with the performance standards described in Exhibit D (Performance Standards)…Performance standards and any related fee adjustments are intended to ensure a certain level of service by CVS Caremark. The parties expressly agree that such performance standards and any related fee adjustments are not intended to operate as liquidated damages, a penalty, or as an exclusive remedy but rather to correspond with the level of service being provided. Performance standards are intended to permit the parties to monitor the quality of service so as to confirm services are being performed promptly and properly. Notwithstanding any provision in this Agreement to the contrary, any adjustment to CVS Caremark's fees by reason of the operation of one or more of the performance standard provisions is in addition to, and not in lieu of, any other indemnification rights or remedies provided by the parties under this Agreement or by applicable law by reason of any breach in whole or in part of the terms and conditions of this Agreement. If CVS Caremark fails to satisfy the performance standards in Exhibit D, CVS Caremark's fees shall be adjusted as described in Exhibit D…In the event a quarterly performance standard is not met in any subsequent quarter, the adjustment to fees shall be doubled up to an annual maximum of 50% of the annual fee adjustment limit described in Exhibit D (Performance Standards)…

(ECF #28, Ex. 5, p. 18).

The performance standard at issue is titled "Protection of Information Failure" and establishes a penalty of 3% of the annual at-risk fees IBM was to pay CVS for each disclosure at issue. (ECF #28, Ex. 5, p. D8). CVS contends that its at-risk fees were $1,500,000.00, 3% of which is $45,000.00, and that the alleged 41 disclosures at issue therefore resulted in a total penalty of $1,845,000.00. (ECF #28, Ex. 5, ¶¶ 32-34).

ARGUMENT

A. Counts I, II, III, and IV Should Be Dismissed Because the Penalty Provision is Unenforceable as a Matter of Law.

1. Because it sets damages for a fixed sum, the penalty provision must be assessed as either liquidated damages or an unenforceable penalty.

Liquidated damages constitute the compensation which the parties have agreed must be paid in satisfaction of the loss or injury which will follow from a breach of contract. *Frankel's Carpet Fashions, Inc. v. Abraham*, 228 N.Y.S.2d 123, 126 (Nassau Cnty. Ct. 1962). "Provisions for liquidated damage have value in those situations where it would be difficult, if not actually impossible, to calculate the amount of actual damage." *Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 424, 393 N.Y.S.2d 365, 369, 361 N.E.2d 1015, 1018 (N.Y. 1977). "In such cases, the contracting parties may agree between themselves as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury." *Id.*

Here, Section 3.13 of the IBM Agreement, along with the formula set forth in Exhibit D thereto, must either be considered liquidated damages or an unenforceable penalty, as they consist of fixed fees separate from actual damages. The provision sets fixed compensation, $45,000.00 per incident, to be paid by CVS in the event it breaches the privacy requirements at issue. The IBM Agreement, however, contains curious language disclaiming the self-evident nature of the contemplated payment, stating "[t]he parties expressly agree that such performance standards and any related fee adjustments are not intended to operate as liquidated damages, a penalty, or as an exclusive remedy but rather to correspond with the level of service being provided." (ECF #28, Ex. 5, p. 18). Nevertheless, the provision indicates IBM may separately and additionally recover actual damages. (ECF #28, Ex. 5, p. 18). In essence, this language purports to create a contractual

no-man's land wherein the $45,000.00 payment is styled as none of the only possible creatures recognized by law: actual damages, liquidated damages, or a penalty.

Under New York law, what the parties choose to call a damages provision is "not material," because "such an approach would put too much faith in form and too little in substance." *Truck Rent-A-Ctr., Inc*., 41 N.Y.2d at 425. Indeed, the Southern District of New York has previously recognized that whether a provision is "styled" as liquidated damages "makes little difference," because "courts look to the substance of such a provision in interpreting it. *Agerbrink v. Model Serv. LLC*, 196 F. Supp. 3d 412, 418 (S.D.N.Y. 2016). Here, there is no question that the provision in question must be either an enforceable liquidated damages clause or an unenforceable penalty. It does not seek to recover actual, provable, direct damages. Rather, it sets a sum certain that must be paid in the event of a breach. Colloquially speaking, if it looks like a duck and quacks like a duck, it is a duck. Because it is not actual damages, which the contract separately allows, the provision must be either enforceable liquidated damages or an unenforceable penalty.

2. The Court should look to the substance, and not the form, of the provision.

As noted above, it is immaterial whether a contract provision declares itself not to be what it in fact is. Indeed, the comments to the Restatement (Second) of Contracts § 356 contain a section entitled "Disguised penalties" noting that contracting parties may go to great lengths to conceal that a damages provision in a contract is truly a penalty in nature:

> Under the rule stated in this Section, the validity of a term providing for damages depends on the effect of that term as interpreted according to the rules stated in Chapter 9. Neither the parties' actual intention as to its validity nor their characterization of the term as one for liquidated damages or a penalty is significant in determining whether the term is valid. Sometimes parties attempt to disguise a provision for a penalty by using language that purports to make payment of the amount an alternative performance under the contract, that purports to offer a discount for prompt performance, or that purports to place a valuation on property to be delivered. Although the parties may in good faith contract for alternative performances and fix discounts or valuations, a court will look to the substance of

> the agreement to determine whether this is the case or whether the parties have attempted to disguise a provision for a penalty that is unenforceable under this Section.

Restatement (Second) of Contracts § 356 (1981). Accordingly, in examining the penalty provision at issue, the Court should set aside whether the provision is *styled* as a penalty provision and instead determine whether, as a matter of law, it *functions* as a penalty.[1]

3. The liquidated damages provision is an unenforceable penalty because the contract also allows for the recovery of actual damages.

The liquidated damages provision at issue indicates it is not an "exclusive remedy" and that recovery of the fixed sum damages "is in addition to, and not in lieu of, any other indemnification rights or remedies provided by the parties under this Agreement or by applicable law by reason of any breach." (ECF #28, Ex. 5, p. 18). This is impermissible. It is well established, under New York law, that liquidated damages and actual damages are mutually exclusive remedies. *U.S. Fid. & Guar. Co. v. Braspetro Oil Servs. Co*., 369 F.3d 34, 71 (2d Cir. 2004) ("Under no circumstances…will liquidated damages be allowed where the contractual language and attendant circumstances show that the contract provides for the full recovery of actual damages, *because liquidated and actual damages are mutually exclusive remedies under New York law."*) (emphasis added); *See also Agerbrink*, 196 F. Supp. 3d at 417–18 (*quoting Trilegiant Corp. v. Sitel Corp.,* No. 09 CIV. 6492 KBF, 2013 WL 2181193, at *7 (S.D.N.Y. May 20, 2013)) ("The general, common-sense rule underlying this determination is that 'liquidated damages and actual damages are mutually exclusive remedies under New York law.'"); *Agerbrink,* 196 F. Supp. 3d at

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[1] Tellingly, the Letter of Understanding referenced in Plaintiffs' Amended Complaint, though not attached thereto, describes the funds at risk to be the "penalty pool" and notes that all breaches other than security breaches shall be subject to a "maximum penalty" of $1,500,000.00. (Letter of Understanding, attached hereto as Ex. A, p. 18). The penalty provision was apparently subsequently re-styled to disguise its true nature in the IBM Agreement. The Letter of Understanding may be considered by the Court for purposes of this motion to the extent the Court finds it is a document integral to the Complaint. *Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 48 (2d Cir. 1991).

418 (When a liquidated damages provision in a contract guarantees a party "a 'minimum recovery' regardless of actual damages, while preserving their right to pursue actual damages if they so desire, the [provision] is unenforceable."). Under New York law, when a contract allows for both liquidated and actual damages, the liquidated damages provisions are "rejected as unenforceable penalties." *Id.* at 417. If a party "could recover both liquidated damages and actual damages, there would be no question that the 'liquidated damages' provision was a penalty." *Jarro Bldg. Indus. Corp. v. Schwartz*, 54 Misc. 2d 13, 15, 281 N.Y.S.2d 420, 422 (N.Y. App. Term 1967).

Further, New York courts have observed that even when a contract provides the *option* between liquidated damages and actual damages, rather than allowing the two to be pursued in the aggregate, the liquidated damages provision is nevertheless an unenforceable penalty. In *Jarro Bldg. Industries Corp. v. Schwartz*, the Supreme Court of New York explained why such a situation is impermissible:

> The theory which underlies the distinction between an enforceable liquidated damages provision and an unenforcible penalty is that where damages will be difficult to ascertain, the parties to a contract may estimate them in advance (either by dollars or by percentage) and the court will enforce the agreement where the estimated damages are not disproportionate to the probable loss. The parties thereby avoid the difficulties of requirements of certainty of proof of unliquidated damages. Moreover, a liquidated damages provision to be valid must fix the damages in advance and be for an amount certain. 'If court action is necessary in order to fix the amount, the stipulation is meaningless, as it fails to achieve the only valid purpose of liquidated damages'.

54 Misc. 2d 13, 18–19, 281 N.Y.S.2d 420, 426 (N.Y. App. Term 1967) (internal citations omitted). The court further observed that when a contract leaves open the potential recovery of actual damages in spite of a liquidated damages provision, the liquidated damages provision is an unenforceable penalty. *Id.*

The District Court of Nassau County made a similar observation in *Dalston Const. Corp. v. Wallace*:

> A liquidated damage clause must always be examined rather closely. The policy of the law is to approve such clauses where they are reasonable. The underlying purpose is to permit parties to look to the future, anticipate that there may be a breach and make a settlement in advance. This implies two things; (1) that the amount specified be a fixed amount and (2) that both parties be bound to that amount. The clause here does not disclose a fixed amount. In essence it fixes a minimum which must be paid by the home owner to the contractor, but leaves the door wide open to him to prove actual damage in addition to the so-called liquidated damage. This is no settlement at all and it permits the contractor to have his cake and eat it too.

Dalston Const. Corp. v. Wallace, 26 Misc. 2d 698, 699–700, 214 N.Y.S.2d 191, 193 (N.Y. Dist. Ct. 1960). Here, the contract at issue does exactly what the court in *Dalston* observed is impermissible: it leaves the door open to recovery of actual damages in addition to the liquidated damage penalty payment at issue. As such, the provision is an unenforceable penalty.

4. The liquidated damages provision is additionally unenforceable because it is intended to compel performance.

Under New York law, if a liquidated damages clause is "intended to operate in lieu of performance," then it may be enforced by the courts. *N. Shipping Funds I, L.L.C. v. Icon Capital Corp.*, 998 F. Supp. 2d 301, 334 (S.D.N.Y. 2014). If, however, a liquidated damage clause is included as "a means to compel performance, it will be deemed a penalty and will not be enforced." *Id.* Whether a liquidated damage clause is enforceable or a penalty is a question of law for determination by the Court. *Id.* Moreover, liquidated damage clauses are strictly construed, and "any reasonable doubt as to whether a provision constitutes an unenforceable penalty or a legitimate liquidated damages clause should be resolved in favor of a construction which holds the provision to be a penalty." *NCSPlus Inc. v. WBR Mgmt. Corp.*, 37 Misc. 3d 227, 235, 949 N.Y.S.2d 317, 323–24 (Sup. Ct. N.Y. Cnty. 2012). Here, it is self-evident that the provision at issue is a penalty, as the provision itself states that the payments are "intended to ensure a certain level of service," which is simply another way of saying it is intended to compel performance. (ECF #28,

Ex. 5, p. 18). As such, it is apparent on the face of the contract that the provision is an unenforceable penalty under New York law.

5. Because the provision at issue is an unenforceable penalty, indemnification is prohibited under the voluntary payment doctrine.

"The rule is well settled in this State that a party who voluntarily settles a lawsuit, *i.e.*, to pay an agreed amount of money, without waiting for judgment, assumes the risk of being able to prove that he was legally obligated to make such payment, when he…seeks indemnity from the party ultimately determined to be liable." *Trojcak v. Wrynn*, 45 A.D.2d 770, 770, 357 N.Y.S.2d 32, 34 (2d Dept. 1974). Rather than disputing any claim made by IBM (and CVS does not even allege IBM made one), and rather than tendering defense of the matter to Press America as contemplated in the Press America Agreements, CVS unilaterally issued its purported payment to IBM on December 31, 2012. Thereafter, CVS sought reimbursement from Press America via demands made in 2014 and 2015. (ECF #28, ¶¶ 34, 38 and Ex. 3, 4). In such a case "[the plaintiff] must establish that he would have been liable and that there was not a good defense to the liability." *Feuer v. Menkes Feuer, Inc.*, 8 A.D.2d 294, 299, 187 N.Y.S.2d 116, 122 (1st Dept. 1959). "[T]he indemnitee 'assumes the risk of being able to prove the actionable facts upon which his liability depends *as well* as the reasonableness of the amount which he pays.'" *Id.* (Citation omitted) (emphasis original). "This means, in effect, that the indemnitee must establish his case against the indemnitor in the same way that the claimant against him would have been obligated to establish its case, namely, by a preponderance of the evidence or other appropriate level of proof required to sustain recovery in favor of the claimant." *Id.* In essence, it is CVS's responsibility to plead and prove a case within a case – that IBM possessed a valid and enforceable breach of contract claim against CVS.

> The explanation for the higher requirement that an indemnitee, who has not given notice, or who has rejected defense by the indemnitor, establish that he had been liable to the claimant stems from the fact that his action with regard to the claim is completely free of control by the indemnitor. Since, under such circumstances, the indemnitee knows or believes that any financial responsibility he undertakes is likely to fall ultimately on the indemnitor, he is not inhibited, except by the barest self-restraint. This is an insufficient protection for an indemnitor; and, as a consequence, the indemnitee acts at his own risk that later he will be able to establish that the payment he made was one he had to make. Needless to say, even this is not an absolute test. He meets his burden if he shows, by satisfying the finder of the facts by the preponderance of the evidence or other appropriate level of proof, that he would have been liable.

Id. at 300. Here, CVS made a business decision to voluntarily pay IBM rather than seek to avoid the payment due to the unenforceability of the penalty provision. Perhaps paying $1,845,000.00 was a good business decision for CVS given the revenues it derives from working with IBM. However, CVS cannot seek indemnification from Press America just because CVS has business interests that motivated it to pay claims that are unenforceable under the law. CVS can only seek indemnification with respect to payments it was legally required to make. In the case at bar, CVS can never satisfy its duty to prove it was obligated under the IBM Agreement to make the penalty payment of $1,845,000.00 because, as a threshold matter, the penalty provision itself is unenforceable as a matter of law. The Court and parties need not burden themselves with any evidentiary inquiry. The IBM Agreement, attached to Plaintiff's Amended Complaint, is all that is necessary to establish that CVS can never recover.

A similar situation to the case at bar arose recently in *Hedley's, Inc. v. Airwaves Global Logistics, LLC*, wherein the court applied the voluntary payment doctrine to bar recovery. *Hedley's, Inc. v. Airwaves Glob. Logistics, LLC*, 130 A.D.3d 872, 873, 15 N.Y.S.3d 84, 85 (2d Dept. 2015), *leave to appeal denied*, 26 N.Y.3d 911, 43 N.E.3d 374 (N.Y. 2015). In *Hedley's*, the plaintiff, a New York art exporter, contracted with a consignee in London to ship a collection of fine art from New York to London. *Id*. The shipping contract between the exporter and the

consignee contained a limitation of liability clause in the amount of $40,000.00. *Id*. The exporter hired a shipping company that failed to provide adequate documentation when it shipped the artwork, which was subsequently seized by United Kingdom Customs. *Id*. In response, the exporter paid the consignee the full value of the lost artwork: $239,189.00, rather than the sum of $40,000.00 as specified in the limitation of liability clause. *Id*. The exporter then sought indemnification from the shipping company in the amount of $239,189.00, plus interest and punitive damages. *Id*. The Supreme Court found that no payment beyond $40,000.00 was required under the contract between the plaintiff exporter and third-party consignee, and therefore the claim of $239,189.00 against the defendant shipping company was invalid pursuant to the voluntary payment doctrine. *Id*. Here, the situation is the same. The IBM Agreement did not vest IBM with a valid and enforceable claim for $1,845,000.00 because, *inter alia*, IBM retained the right to pursue actual damages from CVS, which rendered the penalty provision unenforceable. Because IBM could not have recovered that sum from CVS, CVS cannot recover it from Press America.

6. <u>This issue is ripe for adjudication via the instant motion</u>.

Frequently, the voluntary payment doctrine is raised as an affirmative defense. However, it may also be raised by motion to dismiss. *See Dillon v. U-A Columbia Cablevision of Westchester, Inc.,* 292 A.D.2d 25, 27, 740 N.Y.S.2d 396, 397 (2d Dept. 2002), *aff'd,* 100 N.Y.2d 525, 760 N.Y.S.2d 726, 790 N.E.2d 1155 (N.Y. 2003) (plaintiff's allegations insufficient to survive application of voluntary payment doctrine); *see also Morales v. Copy Right, Inc*., 28 A.D.3d 440, 441, 813 N.Y.S.2d 731, 733 (2d Dept. 2006) (complaint dismissed upon application of the voluntary payment doctrine when no fraud or mistake of material fact or law alleged). Moreover, affirmative defenses are properly raised via a Rule 12(b)(6) motion if the defense appears on the face of the complaint, as it does here. *Pani v. Empire Blue Cross Blue Shield*, 152

F.3d 67, 74 (2d Cir. 1998). Further, the voluntary payment doctrine operates not as an affirmative defense, but rather within the plaintiff's *prima facie* case, when the plaintiff's reimbursement depends on whether the underlying "payment was legally compelled." *Millennium Holdings LLC v. Glidden Co*., 146 A.D.3d 539, 547, 46 N.Y.S.3d 528, 535 (1st Dept. 2017). All of counts I-IV of the Amended Complaint seek the same thing: indemnification for the sum CVS contends it paid IBM. (ECF #28, ¶¶ 46, 60, 73, 77). Claims for common law indemnification only arise if the plaintiff seeking indemnification was "compelled to pay" the sum sought. *Perkins Eastman Architects, P.C. v. Thor Engineers, P.A.*, 769 F. Supp. 2d 322, 329 (S.D.N.Y. 2011). Similarly, for claims arising under an indemnification agreement, a plaintiff must establish that it was legally compelled to make the underlying payment. *Feuer v. Menkes Feuer, Inc*., 8 A.D.2d 294, 299, 187 N.Y.S.2d 116, 122 (1st Dept. 1959). Because CVS is required to demonstrate it was legally obligated to pay IBM, the voluntary payment doctrine may be raised for purposes of a Rule 12(b)(6) motion.

Furthermore, Press America has standing to assert challenges to enforceability of the purported payment made by CVS to IBM. *Broadway Houston Mack Dev. LLC v. Kohl*, 22 Misc. 3d 1001, 1008, 870 N.Y.S.2d 748, 754 (Sup. Ct. Suffolk Cnty. 2008), *aff'd*, 71 A.D.3d 937, 897 N.Y.S.2d 505 (2d Dept. 2010) (general contractor defendant successfully asserted invalidity of third-party subcontractors' liens and lack of plaintiff property owner's contractual duty to pay third-party subcontractors in a subrogation action brought by the property owner after paying subcontractors directly, because it was the plaintiff property owner's duty to establish its "legal compulsion to pay"); *see also Fed. Nat. Mortg. Ass'n v. Bridgeport Portfolio, LLC,* 150 Conn. App. 610, 617, 92 A.3d 966, 972 (Conn. App. 2014) (personal guarantor of mortgage had standing to challenge whether fees and charges in an agreement between the lender and the property owner

constituted unenforceable penalties). Indeed, the very essence of the voluntary payment doctrine is to provide a mechanism for the potential indemnitor to challenge the indemnitee's legal obligation to make the underlying payment. Accordingly, counts I-IV should be dismissed.

B. <u>Because the IBM Agreement's Penalty Provision Did Not Exist When Press America Contracted with CVS, CVS Cannot Recover</u>.

An indemnification agreement will not be read to impose obligations upon the indemnitor which are neither disclosed <u>at the time of its execution</u> nor reasonably within the scope of its terms and the over-all intendment of the parties <u>at the time of its making</u>." *Tokyo Tanker Co. v. Etra Shipping Corp.*, 142 A.D.2d 377, 378, 536 N.Y.S.2d 75 (1st Dept. 1989) (emphasis added). In *Tokyo Tanker*, the plaintiff agreed to act as an agent for Globtik Companies ("Globtik") with respect to the sale of tanker ships, and agreed to indemnify Globtik with respect to any claims and expenses "resulting from, caused by or as a consequence of" the sale of the tanker ships. *Id.* Separately, Globtik entered into an agreement with its bank to refinance debt related to the tanker ships pursuant to which Globtik agreed to pay fees and commissions to the bank in connection with the future sale of the tanker ships. *Id.* Ultimately, Globtik was assessed more than $1 million in fees and commissions by its bank in connection with the sale. *Id.* Globtik then sought reimbursement of the fees and commissions via Tokyo Tanker, its agent, pursuant to its indemnity agreement. *Id.* Tokyo Tanker refused to pay the indemnity claim and instead sought a declaration that the fees and commissions were not subject to indemnification. *Id.* Importantly, the court noted that the indemnity agreement between Globtik and its bank "was not made known to Tokyo Tanker at the time it executed" the indemnity agreement and that "Tokyo Tanker was neither aware of, nor involved in, [Globtik's] debt to the bank or the fee obligation." *Id.* The court further found it notable that the Globtik-bank agreement had been treated as confidential and that Tokyo Tanker "was never shown a copy." *Id.* The court held that Globtik was not entitled to indemnification

because the provision in question "should be construed so as to encompass only that loss and damage which reasonably appear to have been within the intent of the parties." *Id*. The loss in question could not have reasonably been with Tokyo Tanker's intent because Tokyo Tanker was unaware of the separate obligation Globtik created between itself and its bank. *Id*.

The case at bar is virtually the same as *Tokyo Tanker*, except here there could never be a question of fact as to whether Press America knew of the penalty provision in the IBM Contract when it entered into its indemnity agreement with CVS, *because the IBM Contract did not exist*. CVS has pled itself out of Court by admitting in its Amended Complaint that the IBM Contract was executed months after the incident in question, and even its backdated "effective" date of January 1, 2012 was after the date of the Press America Agreements. CVS can never recover with respect to its *ex post facto* dealings with IBM.

Importantly, just as in *Tokyo Tanker*, the liability CVS seeks to impose in this case is one that it created in secret. Not only was the IBM Agreement entered into after the Press America Agreements, but the IBM Agreement contains a confidentiality provision that expressly disallowed disclosure of the "terms and conditions of [the IBM Agreement]." (Am. Compl., Ex. 5, p. 45, § 8.16(a)). As such, by the express terms of the IBM Agreement, CVS was restricted from telling Press America about the financial terms of the penalty provision. Of course, Press America would have reasonably contemplated that mailing information protected under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") could give rise to liability. But that liability would be via claims asserted by the individuals subject to potential disclosures of protected information. The relevant inquiry is what Press America could have understood its exposure to be <u>at the time it executed the contract</u>.

"The language of an indemnity provision should be construed so as to encompass only that loss and damage which reasonably appear to have been within the intent of the parties." *Niagara Frontier Transp. Auth. v. Tri-Delta Const. Corp*., 107 A.D.2d 450, 453, 487 N.Y.S.2d 428, 431 (4th Dept. 1985), *aff'd*, 65 N.Y.2d 1038, 494 N.Y.S.2d 695, 484 N.E.2d 1047 (N.Y. 1985). "It should not be extended to include damages which are neither expressly within its terms nor of such character that it is reasonable to infer that they were intended to be covered under the contract." *Id*. "[A] contract assuming a duty to indemnify 'must be strictly construed to avoid reading into it a duty which the parties did not intend to be assumed.'" *McCoy v. Goldberg*, No. 89 CIV. 8151 (WCC), 1992 WL 237327, at *3 (S.D.N.Y. Sept. 15, 1992) (citation omitted). "[T]he contractual language must evince an 'unmistakable intention' to indemnify'" the loss in question. *Sparta Commercial Servs., Inc. v. DZ Bank AG Deutsche Zentral-Genossenschaftsbank*, 160 F. Supp. 3d 580, 585 (S.D.N.Y. 2015), *aff'd sub nom. Sparta Commercial Servs., Inc. v. DZ Bank*, No. 16-432 (L), 2017 WL 710131 (2d Cir. Feb. 22, 2017) (citation omitted). "[W]hen the terms of a written contract are clear and unambiguous, the intent of the parties must be found within the four corners of the contract, giving practical interpretation to the language employed and the parties' reasonable expectations." *Hall v. Paez*, 77 A.D.3d 620, 621, 909 N.Y.S.2d 105, 107 (2d Dept. 2010).

Crucially, neither of the Press America Agreements contains even the slightest reference to the penalty provisions CVS would later agree to with IBM. Press America could not have known that CVS would later manufacture liabilities that otherwise would not exist by agreeing to an exorbitant penalty provision with IBM that bore no relation to actual damages. Indeed, what CVS is attempting to achieve in this case is absurd. It seeks to pass the buck to Press America to recover an arbitrary, secret sum it agreed to with IBM in order to obtain IBM's business. This $45,000.00 per-person penalty was not and could not have been disclosed to Press America. What

if the sum had been $450,000.00 or $450,000,000.00? Taken to its logical conclusion, CVS's Amended Complaint assumes that any penalty it set between itself and IBM would be indemnified by Press America. Under New York law, however, CVS cannot recover for losses it created out of whole cloth in a confidential agreement with a third party. Accordingly, Counts I-IV of the Amended Complaint should be dismissed.

C. Counts I, II, and III Fail Because the Claim at Issue Falls Outside the Scope of the Indemnification Clauses.

In the Master Agreement, the relevant indemnification clause reads as follows:

> Vendor agrees (i) to indemnify and hold harmless CVS from and against claims, liabilities, and damages *to the extent same are due to Vendor's negligence, willful misconduct, or breach of this Agreement* or Vendor's failure to comply with or abide by any applicable law (*other than by reason or an act* or omission *of CVS*)…

(Am. Compl., Ex. 1, p. 4, § 8.1) (emphasis added).

The indemnification clause in the Business Associate Agreement states:

> Vendor will indemnify and hold harmless CVS and any of its officers, directors, employees, or agents from and against any claim, cause of action, liability, damage, cost, or expense, including reasonable attorneys' fees and court or proceeding costs, *arising out of or in connection with any breach* of the terms of this Agreement, any Breach of Private Information under the control of Vendor or its agents or subcontractors that requires notification under the HIPAA Rules or state law, or any failure to perform its obligations with respect to Private Information by Vendor, its officers, employees, agents, or any person or entity under Vendor's direction or control.

(Am. Comp., Ex. 2, p. 7, § 6.0) (emphasis added).

In plain terms, both indemnification provisions provide that Press America will reimburse CVS for damages Press America causes in performing its work. That, however, is not the scenario in the case at bar. While Press America's conduct could theoretically have caused some damage to CVS through potential HIPAA liability, the cause of CVS's purported liability to IBM of $1,845,000.00 is not Press America's conduct, but CVS's separate confidential promises made to

IBM. Nothing in either indemnification clause applies to such a claim. Therefore, Counts I, II, and III, which all rely on these clauses, should be dismissed.

D. <u>All Counts of Plaintiffs' Amended Complaint Should Be Dismissed as No Act or Omission of Press America Was the Proximate Cause of Any Damage</u>.

While Press America's conduct may have been a cause in fact of CVS's purported liability to IBM, it was not the proximate cause pursuant to which recovery is legally available.

> Causation incorporates at least two separate but related concepts: cause-in-fact and proximate cause. Cause-in-fact refers to those antecedent events, acts or omissions which have so far contributed to the result that without them it would not have occurred.... Proximate cause serves to limit, for legal or policy reason, the responsibility of an actor for the consequences of his conduct.

Aegis Ins. Servs., Inc. v. 7 World Trade Co., L.P., 737 F.3d 166, 178 (2d Cir. 2013). "The *term* "proximate cause" is shorthand for a concept: Injuries have countless causes, and not all should give rise to legal liability." *CSX Transp., Inc. v. McBride*, 564 U.S. 685, 692, 131 S. Ct. 2630, 2637, 180 L. Ed. 2d 637 (2011) (emphasis original). Proximate cause is "that which in a natural and continuous sequence, unbroken by any new cause, produces the event, and without which that event would not have occurred." *Hassanein v. Avianca Airlines*, 872 F. Supp. 1183, 1189 (E.D.N.Y. 1995). Furthermore, in order to establish proximate cause, the injury in question:

> must have been the natural and probable consequence of the defendant's negligent act or omission and, further, that the act of a party sought to be charged will not be regarded as a proximate cause unless it is in clear sequence with the result and unless it could have been reasonably anticipated that the consequences complained of would result from the alleged wrongful act.

Hoggard v. Otis Elevator Co., 52 Misc. 2d 704, 707, 276 N.Y.S.2d 681, 686 (N.Y. Sup. Ct. 1966), *aff'd*, 28 A.D.2d 1207, 285 N.Y.S.2d 262 (1st Dept. 1967).

Though cause in fact and proximate cause are often discussed in the context of negligence cases, the United States Supreme Court has affirmed that the concept also applies as a minimum requirement to recovery in both tort and contract settings:

> We agree with the Ninth Circuit that where the injured party is the sole proximate cause of the damage complained of, that party cannot recover in contract from a party whose breach of warranty is found to be a mere cause in fact of the damage. Although the principles of legal causation sometimes receive labels in contract analysis different from the "proximate causation" label most frequently employed in tort analysis, these principles nevertheless exist to restrict liability in contract as well. Indeed, the requirement of foreseeability may be more stringent in the context of contract liability than it is in the context of tort liability.

Exxon Co., U.S.A. v. Sofec, Inc., 517 U.S. 830, 839–40, 116 S. Ct. 1813, 1819, 135 L. Ed. 2d 113 (1996). The Court noted this rule dates all the way back to *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854), and "impose[s] a more severe limitation on the recovery of damages of contract than that applicable to actions in tort…" *Id*.

The Second Circuit has similarly noted the important reasons underpinning the requirement of proximate causation.

> In everyday terms, the concept might be explained as follows: Because the consequences of an act go endlessly forward in time and its causes stretch back to the dawn of human history, proximate cause is used essentially as a legal tool for limiting a wrongdoer's liability only to those harms that have a reasonable connection to his actions. The law has wisely determined that it is futile to trace the consequences of a wrongdoer's actions to their ultimate end, if end there is.

Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc., 191 F.3d 229, 235 (2d Cir. 1999), as amended (Aug. 18, 1999). In addition to mere foreseeability, in order to satisfy proximate causation, an injury must be direct. "[O]ne notion traditionally included in the concept of proximate causation is the requirement that there be 'some direct relation between the injury asserted and the injurious conduct alleged.'" *Id*. (Citation omitted). "[A] plaintiff who complain[s] of harm flowing merely from the misfortunes visited upon a third person by the defendant's acts [is] generally said to stand at too remote a distance to recover." *Id.* The Court may properly determine as a "matter of law" whether the alleged damages are "too remote" to satisfy proximate cause on a motion to dismiss. *Id*. at 238, 243.

In the case at bar, while Press America's conduct is a cause in fact of CVS's alleged damages (assuming *arguendo* the allegations of the Amended Complaint to be true), it is not the proximate cause of the damage. The $1,845,000.00 penalty is not the natural and probable consequence of the printing and mailing error at issue. That sum, established in a confidential contract to which Press America was not a party, is not a consequence that could have been reasonably anticipated by Press America when it entered into the Press America Agreements. Moreover, the damages sought are indirect rather than direct, arising out of IBM's purported damages under its confidential contract with CVS and not in any way arising out of any damages provided for in the Press America Agreements. Accordingly, these purported damages are unrecoverable as a matter of longstanding law. Because all counts of the Amended Complaint sound in contract or tort, and because CVS's allegations fail as a matter of law to establish proximate causation, all counts should be dismissed.

E. <u>Count IV for Common Law Indemnification Fails Because No Duty Flowed Between Press America and IBM</u>.

Under New York law, a claim for common law indemnity is only available in an instance where the party from whom indemnity is sought violated a duty to the primary claimholder. Thus, a third party action for indemnity "does not lie against one who has not violated a duty owed to plaintiff in the primary action." *Perkins Eastman Architects, P.C. v. Thor Engineers, P.A.*, 769 F. Supp. 2d 322, 329–30 (S.D.N.Y. 2011) (*quoting Dora Homes, Inc. v. Epperson,* 344 F.Supp.2d 875, 894 (E.D.N.Y.2004)). "[A] cause of action for common-law indemnification can be sustained only if: (1) the party seeking indemnity and the party from whom indemnity is sought have breached a duty to a third person..." *Amguard Ins. Co. v. Getty Realty Corp.*, 147 F. Supp. 3d 212, 220 (S.D.N.Y. 2015). Here, CVS does not contend any duty flowed from Press America to IBM,

who were, in essence, strangers under the parties' dealings as set forth in the Amended Complaint and relevant agreements. As such, CVS's common law claim for indemnification fails.

F. <u>Count IV for Common Law Indemnification Also Fails Because Express Agreements Exist Between CVS and Press America</u>.

Claims for common law or implied indemnification are considered "quasi-contract claim[s] in which a contract is implied in law in order to avoid unjust enrichment.'" *Murray Bresky Consultants, Ltd. v. N.Y. Comp. Manager's Inc*., 106 A.D.3d 1255, 1258, 968 N.Y.S.2d 595, 600 (3d Dept. 2013). A plaintiff may not "recover in quasi contract where the parties have a valid, enforceable contract that governs the same subject matter" as the quasi contract claim." *4Kids Entm't, Inc. v. Upper Deck Co*., 797 F. Supp. 2d 236, 248–49 (S.D.N.Y. 2011). Here, due to the existence of the Press America Agreements, the common law indemnification claim is impermissibly duplicative and should be dismissed.

G. <u>The Amended Complaint as a Whole Fails to Meet Requisite Pleading Standards by Failing to Identify What Contractual Landscape Existed Between CVS and IBM on the Date of the Incident</u>.

Each and every count of Plaintiffs' Amended Complaint is predicated on the notion that CVS was required, under some sort of agreement with IBM, to pay the sum of $1,845,000.00. Press America noted in both of its pre-motion submissions to the Court that CVS has failed to identify any specific contractual requirements between it and IBM that purportedly gave rise to the payment made. Despite the fact that CVS has already been twice alerted to this issue and has once amended its complaint, it still has failed to correct this defect.

The IBM Agreement was executed on March 28, 2013. (ECF #28, ¶ 15 & Ex. 5). Accordingly, irrespective of the fact it bears a backdated effective date of January 1, 2012, it was not the contract that governed the IBM-CVS relationship on the date of the Incident. Plaintiffs tacitly admit as much, noting that the IBM Agreement "memorialized" a preceding "series of

agreements." (ECF #28, ¶ 15). The fatal flaw in Plaintiffs' Amended Complaint is they do not identify 1) what comprises this "series of agreements"; 2) what the terms of those agreements are with respect to any penalties to be paid by CVS to IBM; and 3) which agreements of this series, if any, were in effect on the date of the Incident. The only indication CVS gives as to what pre-dated the IBM Agreement is reference in a footnote to a "Letter of Understanding between the parties." (ECF #28, fn. 1, p. 9). Though the Letter of Understanding was produced by CVS to Press America *after* the filing of the Amended Complaint, its terms are not identified in the Amended Complaint itself beyond the small quotation in the footnote. CVS does not allege that the Letter of Understanding was the operative document on the date of the Incident. Further, the Letter of Understanding is *per se* not a "series of agreements." It is a single agreement. Accordingly, Plaintiffs' Amended Complaint makes clear that there are other undisclosed agreements whose terms remain wholly unidentified in the Amended Complaint.

Under the Federal Rules of Civil Procedure, Press America is entitled to "fair notice of what the ... claim is and the grounds upon which it rests." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 1964, 167 L. Ed. 2d 929 (2007). CVS's obligation is to provide "more than labels and conclusions." *Id*. A complaint must contain more than "a statement of facts that merely creates a *suspicion* [of] a legally cognizable right of action." *Id*. (emphasis added). On a motion to dismiss, courts "are not bound to accept as true a legal conclusion couched as a factual allegation." *Id*. The United States Supreme Court has affirmed that "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions." *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 1949, 173 L. Ed. 2d 868 (2009).

Here, each and every count of Plaintiffs' Amended Complaint rests on a legal conclusion: that CVS had a legal obligation to pay IBM the sum of $1,845,000.00.[2] CVS alleges it issued payment in the form of a credit to IBM "[a]s required under the IBM Contract," "in accordance with its explicit obligations under the IBM Contract," and as "was specifically required under the IBM Contract." (ECF #28, ¶¶ 34-35). Plaintiffs allege "[a] true and correct copy of the IBM Contract is enclosed herewith as Exhibit 5." The contract attached as Exhibit 5, however, was not executed until the year following the Incident, and that fact controls over any conflicting conclusory allegations of the complaint. *Sterling Res. Int'l, LLC v. Leerink Swann, LLC*, 92 A.D.3d 538, 538, 939 N.Y.S.2d 349, 350 (1st Dept. 2012); *see also BNP Paribas Mortg. Corp. v. Bank of Am., N.A.*, 778 F. Supp. 2d 375, 394 (S.D.N.Y. 2011). Accordingly, the IBM Agreement itself demonstrates it was not the operative contract at the time of the Incident.

Because the IBM Agreement cannot have been the source of CVS's alleged obligation to pay IBM, CVS has not identified the necessary contractual framework at issue. CVS has created nothing more than a mere suspicion that it may be correct. The Court need not accept CVS's *implication* that something in the unidentified "series of agreements" that predated the IBM Agreement required CVS to pay IBM. Were CVS's Amended Complaint upheld, it would deny Press America its right to fair notice of the grounds upon which CVS's claims rest. If CVS contends it was legally obligated to issue payment to IBM, it bears the duty of identifying the factual basis of that legal conclusion.

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[2] CVS vaguely references potential additional categories of damages, including its "reputation and goodwill with *these clients*," whomever they may be, some sort of threat to its "Medicare star rating," without actually alleging that any change occurred, and costs and attorneys' fees, which are contingent upon the principal claim of $1,845,000.00. (*See e.g.* ECF #28, ¶¶ 81-82). These bald, conclusory allegations also fall short of the pleading requirements set forth in *Twombly* and *Iqbal* and are not included in the "CVS's Related Damages" section of the Amended Complaint. (ECF #28, ¶¶ 32-41).

Further, CVS should not be permitted leave to correct these previously disclosed defects. Under Fed. R. Civ. Pr. 15, a party is granted leave to amend its pleading as a matter of course only once. CVS has already amended its complaint in response to Press America's identification of the pleading deficiencies at issue via Press America's original pre-motion letter, which noted "CVS failed to plead facts demonstrating that it was legally obligated to make payment by failing to provide the IBM Agreement or even quoting the language set forth in the purported penalty provision." (ECF #17, p. 3). When the Amended Complaint did not remedy the error, Press America filed another letter indicating a Rule 12(b)(6) motion remained appropriate, reiterating its position with respect to the pleading deficiencies. (ECF #36). In response, CVS could have asked the Court for leave to file a second amendment. It did not. It elected to stand by its Amended Complaint. Given the foregoing, CVS's Amended Complaint should be dismissed with prejudice and leave to amend should be denied both as an equitable matter and pursuant to the Court's Individual Rule of Practice in Civil Cases 3(D).

CONCLUSION

CVS is attempting to obtain reimbursement for an unenforceable penalty payment it made to IBM. For the many reasons outlined herein, none of the legal theories asserted by CVS allows for recovery of any kind. Press America is not responsible for CVS's business decision to enter into a confidential contract with IBM that called for penalty payments, nor is it responsible for reimbursing unenforceable payments volunteered by CVS. These confidential payments were not a foreseeable result of any act or omission of Press America under its separate contracts with CVS. Further, CVS has failed to allege basic facts establishing that any contract between it and IBM requiring the payment existed on the date of the Incident. Accordingly, the Amended Complaint should be dismissed with prejudice.

Respectfully submitted,

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