

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re

Chapter 11

GENUITY INC., et al.,

Case No. 02-43558 (PCB)

Debtor.

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GENUITY SOLUTIONS, Inc.

Plaintiff,

Adversary No. 03-93469

v.

METROPOLITAN TRANSPORTATION
AUTHORITY,

Defendant.

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APPEARANCES:

Law Offices of Thomas M. Mullaney
Attorney for Debtor
708 Third Avenue, Suite 2500
New York, NY 10017
By: Thomas M. Mullaney, Esq.

Lester G. Freundlich, Esq
Attorney for Defendant
347 Madison Avenue
New York, New York 10017

MEMORANDUM DECISION

BEATTY, Prudence Carter, U.S.B.J.

Before the Court are cross motions for summary judgment. Genuity Solutions, Inc. (“Genuity”) has moved for summary judgment to recover payments in the amount of \$103,464.00 arising from telecommunications service it contracted to provide to the

Metropolitan Transit Authority (the “MTA”). The MTA defends the action and cross moves for summary judgment on the grounds that the MTA paid all monies due Genuity for services rendered. It further asserts that Genuity breached their service contract (the “MTA-Genuity Contract”) and as such the MTA is entitled to recover damages. For the reasons stated below, the Court grants that portion of Genuity’s motion with respect to the monies owed for post-petition services performed by Genuity. The balance of the motions for summary judgment are otherwise denied.

BACKGROUND

On November 27, 2002, (the “Petition Date”) Genuity, Inc. and its fourteen domestic subsidiaries (the “Debtors”) filed voluntary petitions pursuant to Chapter 11 of the Bankruptcy Code (the “Code”) for the purpose of liquidating their assets.¹ They were among the world leading providers of internet services to business enterprises and telecommunications service providers. More specifically, their communication infrastructure included (1) a global fiber optic network consisting of broadband fiber optic network consisting of broadband fiber optic cable in the United States, (2) point of presence locations where they provided internet access to end users, (3) secure back up fiber optic connections and power sources in the United States and Europe and (4) undersea and international fiber optic cable compatibility. On February 4, 2003, Level 3 Communications, LLC (“Level 3”) acquired most of the Debtors network assets and operations. The Court confirmed a liquidating Chapter 11 plan on November 21, 2003.

¹The prior Bankruptcy Code is applicable to this case.

Pre-petition, on June 29, 2001, the MTA² and Genuity entered into the MTA-Genuity Contract, pursuant to which Genuity agreed to provide the MTA with various telecommunication services including Internet Service Provider (ISP) services, managed security services, firewall services, and installation and service of hardware and software. In May 2002, Genuity and the MTA amended the MTA-Genuity Contract with Supplemental Agreement 1. Under Supplemental Agreement 1, Genuity agreed to design and install a backup site for the MTA website (a “Hotsite”) that could operate if the MTA’s regular website was not functioning properly. Additionally, Genuity agreed to test the Hotsite (known as a “Stress Test”) to determine whether the backup site was capable of operating notwithstanding a high volume of persons attempting to contact the site simultaneously. The MTA-Genuity Contract provided that:

“The Contractor and the Authority shall jointly conduct this test * * * [to] demonstrate the Contractor’s ability to meet the Authority’s requirements. * * * There shall be a 90-work day test period commencing with successful installation of the Services * * * to ensure the complete operability of the Services. * * * During this period of time, the Authority may conduct any reasonable tests deemed necessary to assure that the Services meets all requirements. * * * At the conclusion of the test period, the Authority shall accept the Services provided that the Services fulfills all the requirements according to pre-arranged contractual standards.”

Bankruptcy Code § 365(a) provides for the assumption or rejection of executory contracts. The MTA-Genuity Contract was rejected by order of the Court on February 4, 2003. The MTA has a claim for breach of contract pursuant to Code § 365(g)(1)³.

² The MTA, through its operating agencies, operates the subway and public bus systems within New York City, the commuter railroad systems of the Long Island Railroad and Metro-North Railroad, the public bus system within Nassau County, and the bridges and tunnels of the Triborough Bridge and Tunnel Authority.

³ 11 USC § 365(g)(1) states that:

“* * * the rejection of an executory contract * * * of the debtor constitutes a breach of such contract or lease if such contract * * * has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition.”

Immediately following the termination of the MTA-Genuity Contract, a new agreement between the MTA and Level 3 (“MTA-Level 3 Contract”) commenced. Unlike the MTA-Genuity Contract, the MTA-Level 3 Contract did not include a provision regarding a Stress Test of the Hotsite. It also did not include a “Service Level Agreement” to mandate that the ISP and Hotsite services be in operation for a specific minimum percentage of time during each month, or that Level 3 be available to respond to problems during specific time periods. The MTA amended an existing contract with Internet Security Systems, Inc. (“ISS”) to provide firewall services similar to those under the MTA-Genuity Contract, as well as a Service Level Agreement (the “MTA-ISS Contract”).

On March 13, 2003, Genuity sent the MTA a bill on account number C2901A (the “Account”) issued under invoice number 24005191, for \$103,464.42 for services provided from June 15, 2002 to March 12, 2003. The Account included a pre-petition debt owed by the MTA of \$52,544.31 and a post-petition debt of \$50,950.11.⁴ Subsequent to the March 13 bill, Genuity sent the MTA another invoice for \$155,590.86 for services rendered from August 2002 through March 2003. This subsequent bill reiterated the monies owed on the Account and further included the amounts owed on Account Numbers C2901D and 2901. On May 14, 2003, in response to the invoice for \$155,590.86, the MTA made three deductions totaling \$99,894.11 and sent Genuity a check for the remaining \$55,696.75 (the “Check”).⁵ The MTA deducted \$63,313.11 from the Account for charges related to the Hotsite, which at that time had not been

⁴ The post-petition claim comprises the payments due on the following invoice numbers: Invoice No. 23995814 due on 1/15/2002 in the amount \$12,522.40, Invoice No. 23998002 due on 2/12/2003, Invoice No. 24005191 due on 3/12/2003 in the amount of \$15,779.51 as listed on Genuity’s. Statement of Account (No. C2901A) and originally billed on March 12, 2003.

⁵ Genuity alleges that the deductions were made solely against Account Numbers C2901D and 2901, thus failing to satisfy any payments on the Account.

tested or accepted as a finished product. The MTA also deducted \$26,581⁶ for costs associated with the MTA-ISS contract and provision of firewall hardware and software, which the MTA claimed as damages resulting from Genuity's rejection of the MTA-Genuity Contract. Lastly, the MTA deducted \$10,000 for unspecified general overhead or "administrative" costs to obtain ISS as a replacement contractor. Enclosed with the Check was a letter from the MTA dated May 14, 2003, (the "MTA Letter") stating that the specific deductions were intended to "cover payments on invoices issued between the period of August 2002 and March 2003." Upon receiving the MTA Letter, Genuity deposited the Check. In June 2003, Genuity tendered a Statement of Account to MTA for \$103,464.00, the remaining balance Genuity claims to be due on the Account.

On November 25, 2003, Genuity commenced this adversary proceeding seeking the \$103,464 due on the Account. In response, the MTA states that the \$55,656.75 it paid to Genuity on May 14 constitutes an accord and satisfaction as payment in full for all monies owed for services rendered. The MTA further asserts that because Genuity rejected the MTA-Genuity Contract and failed to provide Hotsite testing, the MTA incurred damages, duly exercised its right of setoff and therefore does not owe anything to Genuity.

DISCUSSION

Summary Judgment Standards

Both parties have cross-moved for summary judgment pursuant to Fed. R. Civ. P. 56(c) ("Federal Rule 56(c)"), as made applicable by Bankruptcy Rule 7056. Summary judgment is appropriate where the "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Federal Rule 56(c); *see*

⁶ MTA later amended this amount to a total of \$20,754.

also *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23. The party moving for summary judgment has the initial burden to establish that no genuine issue of material fact exists. *Alvarez v. Prospect Hospital*, 501 N.E.2d 572, 574 (N.Y. 1986). Failure to meet this burden requires the court to deny the motion. *Id.* If the burden is met by the moving party, however, the burden then shifts to the non-moving party to produce admissible evidentiary material to demonstrate that there is a genuine issue of material fact. *Id.* A genuine issue of material fact exists “if the evidence is such that a reasonable jury could return a verdict for the non-moving party.” *Anderson v. Liberty Lobby Inc.*, 477 U.S. 242, 248 (1986). In deciding a summary judgment motion, the evidence must be “viewed in the light most favorable to the party opposing the motion.” *Addickes v. S.H. Kress & Co.*, 398 U.S. 144, 158-59 (1970). Furthermore, “only when reasonable minds could not differ as to the import of evidence is summary judgment proper.” *Bryant v. Maffucci*. 923 F.2d 979, 982 (2d Cir. 1991). As such, the purpose of the court is not “to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial.” *Anderson*, 477 U.S. at 249.

Accord and Satisfaction

The MTA’s first affirmative defense is that the \$55,696.75 check constituted an accord and satisfaction of all debts owed to Genuity. An accord and satisfaction is the resolution of a disputed unliquidated claim through a new agreement that settles all or part of the parties’ obligations under the original contract through a stipulated payment. *See Carnrite v. Granada Hospital*, 175 F.R.D. 439, 449 (W.D.N.Y. 1997); *see also Merrill Lynch Realty/Carll Burr Inc. v. Skinner*, 473 N.E.2d 229, 232 (N.Y. 1984). A defendant has the burden to plead and prove accord and satisfaction as an affirmative defense to a claim for breach of contract. *See Ramrup v. 131 Starr Realty Corp.*, 2004 WL 1191038, at *7 (N.Y. Sup. May 25, 2004). To establish the

defense of accord and satisfaction, the elements of a complete agreement must be present. These include a lawful subject matter, a sufficient consideration and the mutual assent of the parties.

IBM World Trade Corporation v. Granite State Insurance Company, 455 N.Y.S.2d 914, 916 (N.Y. Sup.1982); *see also Sorrye v. Kennedy*, 699 N.Y.S.2d 214, 216 (N.Y. App. Div. 1999).

In the instant case, the most relevant issue is the third element: whether there was mutual assent of the parties to constitute an accord and satisfaction.⁷ Accord and satisfaction is a valid defense “only when the person receiving the [payment] has been clearly informed that acceptance of the amount offered will settle or discharge a legitimately disputed unliquidated claim.” *Merrill Lynch Realty/Carll Burr Inc. v. Skinner*, 473 N.E.2d at 232; *See also Manley v. Pandick Press, Inc.*, 424 N.Y.S.2d 902, 905 (N.Y. App. Div. 1980); *Caldwell v. Unger*, 578 N.Y.S.2d 3, 4 (N.Y. App. Div. 1991) (“An essential element of accord and satisfaction is a clear manifestation of intent by one tendering less than full payment of an unliquidated claim that the payment has been sent in full satisfaction of the disputed claim”); *Altamuro v. Capocetta*, 622 N.Y.S.2d 155, 157 (N.Y. App. Div. 1995) (terms of new contract must be “reasonably certain” to be binding); *Goldbard v. Empire State Mut. Life Ins. Co.*, 171 N.Y.S.2d 194, 200 (N.Y. App. Div. 1958) (explaining that some factors such as unequivocal language are more indicative of intent to substitute and discharge a superseding agreement than others).

Here, the MTA did not explicitly inform Genuity that the Check was to satisfy all pre-existing debts arising from the MTA-Genuity Contract. Rather, the MTA Letter merely stated that the payment “covered” particular invoices issued to the MTA. While the MTA specifically listed the deductions from the Account, the Court finds that the MTA Letter does not constitute an express statement from which Genuity could realize that the deposit of the Check would be considered payment in full for the original claim or that the Check constituted anything

⁷The first two elements of accord and satisfaction are not at issue.

more than payment for services previously rendered. *See Merrill Lynch Realty*, 473 N.E.2d at 232.

Where the parties' intent can be determined from the "face of the agreement," the court may interpret the agreement as a matter of law and summary judgment is appropriate. *Towne Gardens, LTD v. McDonalds Corp.*, 2005 WL 2406004, at *5 (W.D.N.Y. Sept. 29, 2005); *see also Loblaw, Inc. v. Wylie*, 375 N.Y.S.2d 706, 710 (N.Y. App. Div. 1975). For the reasons set forth above, the Court finds that the MTA Letter did not provide "unequivocal language" which expressly informed Genuity that the deposit of the Check would discharge all prior outstanding claims and the MTA's affirmative defense fails as a matter of law.

The MTA's Post-Petition Claims

Since there was no accord and satisfaction, the Court must next resolve whether the MTA is entitled to any right of setoff pursuant to Code § 553(a).⁸ This Court previously rendered a decision in this case regarding the issue of whether post-petition claims may be setoff against pre-petition claims. *See In re Genuity*, 323 B.R. 79 (Bankr. S.D.N.Y. 2005). The Court denied the crossover of pre- and post-petition claims because "pre-petition dollars and post-petition dollars are considered differently under the Code." *Id.* at 84. While pre-petition claims are usually paid through fractional dividends, or percentages on the dollar, post-petition administrative expenses are paid in "full," 100 cent dollars. *Id.* For these reasons, this Court held that "it is [neither] fair, nor * * * equitable, to allow the satisfaction of post-petition obligations with fractional dollars, rather than whole ones." *Id.* The Court further stated that

⁸ 11 U.S.C. § 553(a) states that:

"* * * this title does not affect nay right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor to the debtor that arose before the commencement of the case * * *."

pre-petition obligations may not be setoff against post-petition obligations since the debtor and the debtor-in-possession are two separate and distinct entities, which act in different capacities pre-and post-petition. Therefore, pre-petition claims may only be setoff against pre-petition claims, and post-petition claims may only be setoff against post-petition claims. *Id.* at 82; *see also In re Shoppers Paradise*, 8 BR 271, 277 (Bankr. S.D.N.Y. 1980).

Setoff enables “entities that owe each other money to apply their mutual debts against each other, thereby avoiding the ‘absurdity of making A pay B when B owes A.’” *In re Genuity*, 323 B.R. at 82; *see also Citizens Bank v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat’l Bank*, 229 U.S. 523, 528 (1913)). It is a remedy rooted in equity, the allowance or disallowance of which rests within the sound discretion of the bankruptcy court. *Id.*; *See also In re Adelpia Communications Corp.*, 2006 WL 1559437, at *4 (S.D.N.Y. June 7, 2006). To establish a valid claim for setoff: (1) the amount owed by the debtor must be a pre-petition debt; (2) the debtor’s claim against the creditor must also be pre-petition; and (3) the debtor’s claim against the creditor and the debt owed the creditor must be mutual. *In re Genuity*, 323 B.R. at 82; *In re Bousa Inc.*, 2006 WL 2864964, at *3 (Bankr. S.D.N.Y. Sept. 29, 2006). To demonstrate mutuality, each party must maintain both a debt and a claim against the other party. *In re Whimsy*, 221 B.R. 69, 72 (Bankr. S.D.N.Y. 1998).

The MTA argues that a “fundamental principal” of contract law warrants that a party that breaches a contract must pay damages to the other party. However, as this Court has previously held, the primary tenets of setoff preclude the crossover of post-and pre-petition claims. *In re Genuity*, 323 B.R. at 84. Although Genuity’s rejection of the MTA-Genuity Contract resulted in a breach of the Contract pursuant to Bankruptcy Code § 365(g)(1), the breach is deemed immediately before the filing date and therefore, constitutes a pre-petition

claim. The MTA, however, offset pre-petition damages from the breach of the MTA-Genuity Contract against post-petition payments it owed to Genuity. Applicable precedent established by this Court in this case does not support this action. The MTA's offset of its post-petition obligations against its pre-petition breach of contract claims was, therefore, erroneous as a matter of law. *Id.* The complaint states that the Account billed to the MTA by Genuity for \$103,464.42 includes a post-petition obligation owed by the MTA to Genuity of \$50,950.11. Genuity is, therefore, entitled to a final judgment against the MTA in the amount of \$50,950.11. *See* Fed. R. Civ. P. 54(b).⁹

The MTA's Pre-Petition Setoff Claims

Turning to the MTA's pre-petition setoff claims, the MTA asserts that it is entitled to a setoff based on Genuity's rejection of the MTA-Genuity Contract, claiming damages it incurred when it obtained ISS as a replacement contractor as well as for costs associated with Genuity's failure to test the Hotsite. Genuity responds that the MTA is not entitled to any setoff of its pre-petition claims at all and disputes the various elements making up MTA's claim. Genuity urges that the MTA cannot offset its pre-petition claims because the MTA has only alleged a contingent pre-petition claim. Genuity cites *In re Drexel Burnham Lambert Group Inc.*, 148 B.R. 982, 986-87 (Bankr. S.D.N.Y. 1992) to support its proposition that the MTA's claim for damages is a contingent claim.¹⁰ Here the damages incurred by the MTA in finding the

⁹ Federal Rule of Civil Procedure 54(b), as made applicable by Bankruptcy Rule 7054(a), provides that:

“* * * the court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment * * *.”

¹⁰ A contingent claim is defined as a claim that is dependent on some future event that may never happen and has not yet accrued. Black's Law Dictionary 631 (8th ed. 2004). The MTA's claim against Genuity is not contingent. *See also In re Casado*, 187 B.R. 466, 449-50 (Bankr. E.D.N.Y. 1995); *In re Trojan Hardware Co., Inc.*, 534 N.Y.S.2d 789, 790-91 (N.Y. App. Div. 1988); *In re Westchester Structures, Inc.*, 181 B.R. 730, 740 (Bankr. S.D.N.Y. 1995).

replacement contractor, ISS, are the direct result of the rejection of the MTA-Genuity Contract.¹¹ They are not contingent upon any uncertain future event. This Court rejects Genuity's argument that the MTA does not have a right of setoff.

The MTA argues that it is entitled to set-off \$20,754.00 for damages it sustained following Genuity's rejection of the MTA-Genuity Contract. *See Deen v. New School University*, 2007 WL 1032295, *2 (S.D.N.Y. March 27, 2007); *see also Harsco Corp. v. Segui*, 91 F.3d 337, 348 (2d Cir.1996). In determining damages for a breach of contract, the court must limit such damages to the amount necessary to "put the plaintiff in the same economic position plaintiff would have occupied had the breaching party performed the contract." *3947 Austin Boulevard Associates, LLC v. M.K.D. Capital Corp.*, 2007 WL 1575265, at *2 (S.D.N.Y. May 30, 2007) (quoting *The Topps Company Inc. v. Cadbury Stani S.A.I.C.*, 380 F.Supp.2d 250, 261 (2d Cir. 2005); *See also Wallace Steel Inc. v. Ingersoll-Rand Co.*, 739 F.2d 112, 115 (2d Cir. 1984).

While the MTA asserts that it was forced to contract with ISS to obtain the ISP and firewall services it would have otherwise received pursuant to the MTA-Genuity Contract, Genuity disputes the extent of damages that the MTA alleges it sustained. Specifically, Genuity argues that pursuant to the MTA-Genuity Contract, the MTA only borrowed the firewall and ISP equipment that it later contracted with the ISS to purchase. Genuity further asserts that the MTA could have purchased the equipment from Genuity rather than ISS, thereby mitigating and

¹¹ This is established pursuant to Code § 502(g)(1) which states that:

"a claim arising from the rejection, under § 365 of this title * * * of an executory contract * * * that has not been assume shall be determined and allowed under subsection (a), (b) or (c) of this section or disallowed under subsection (d) or (e) of this section * * *."

reducing its damages. Since a genuine dispute exists in regard to the amount of the MTA's claim for damages, summary judgment on this portion of the MTA's claim is denied.

The MTA also urges that it may setoff \$10,000 for unspecified costs, which it alleges it sustained when obtaining ISS as the replacement contractor. The Court finds that such damages constitute unrecoverable consequential damages. Consequential damages are allowable only if they are "within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting." *Ijemba v. Litchman*, 2007 WL 1705074, at *1 (S.D.N.Y. June 14, 2007); *see also Globecon Group, LLC v. Hartford Fire Insurance Co.*, 434 F.3d 165, 176 (2d Cir. 2006) (To impose consequential damages on a defaulting party in addition to damages that directly arise from a breach, "such unusual or extraordinary damages" must be contemplated by parties at the time of or prior to contracting). In determining the reasonable contemplation of the parties, the nature, purpose and specific circumstances surrounding the contract must be evaluated in addition to "what liability the defendant fairly may supposed to have assumed consciously * * *." *See Kenford Company, Inc. v. County of Erie*, 537 N.E.2d 176, 179 (N.Y. 1989).

In the present case, the MTA-Genuity Contract does not provide for the imposition of consequential damages by either party in the event of a breach of the Contract. Moreover, the MTA has failed to substantiate its claim for general overhead or "administrative" costs with records or other documentation to show how such alleged damages were ever computed. On the facts of this case, the MTA cannot recover consequential damages for these costs as a matter of law.

Finally, the MTA argues that it may setoff the damages it incurred as a result of Genuity's failure to test the Hotsite. The MTA fixes the amount of its Hotsite damages at

\$63,313.11¹² and asserts a pre-petition right of setoff in the total amount of \$84,067.11.¹³

Genuity's pre-petition claim is for only \$52,514.31. The MTA-Genuity Contract plainly required that there be a Stress Test of the Hotsite to test the operability of the equipment. There is no dispute that Genuity failed to do so. Genuity, however, asserts that such a test was not possible or practical.

This Court cannot determine the amount of damages incurred by the MTA, if any, on the present record. The Court finds that on the basis of the papers before it, there are genuine issues of material fact in dispute which preclude the granting of either cross-motion for summary judgment on the pre-petition cross-claims.

CONCLUSION

For the reasons set forth above, the Court holds: 1) that Genuity's deposit of the Check does not constitute an accord and satisfaction of all prior outstanding debts owed by the MTA to Genuity; 2) that the MTA was not entitled to setoff pre-petition claims against post-petition payments owed to Genuity and judgment is granted to Genuity in the amount of \$50,950.11; and 3) there are genuine issues of material fact in dispute as to the amount the MTA may setoff against Genuity's pre-petition claims.

Summary judgment is granted in part and denied in part.

Dated: New York, New York
 June 20, 2007

/s/ Prudence Carter Beatty
United States Bankruptcy Judge

¹² This amount is actually greater than the amount Genuity invoiced in the Account and pled in the complaint. The Court finds that this discrepancy arises from the MTA's failure to directly respond to Genuity's Complaint, which seeks to recover \$103,464.00 made up of \$52,544.31 in pre-petition claims and \$50,950.11 in post-petition claims. It appears that the MTA's claim is based on the second \$155,590.86 invoice.

¹³ This amount includes the \$20,754.00 that the MTA fixes as rejection damages.

