COURT OF APPEALS
STATE OF NEW YORK

ABAX LOTUS LTD. and ABAX NAI XIN A LTD.,	:	
	:	
Plaintiffs-Appellants,	:	
	:	
– against –	:	Index No. Below:
	:	650047/2013
CHINA MOBILE MEDIA TECHNOLOGY INC. and MAGICAL INSIGHT INVESTMENTS LIMITED,	:	
	:	
Defendants,	:	
– and –	:	
	:	
ZHANG ZHENGYU, Individually and as Chairman & Founder of China Mobile Media Technology, Inc.,	:	
	:	
Defendant-Respondent.	:	

MEMORANDUM OF LAW OF PLAINTIFFS-APPELLANTS IN OPPOSITION TO MOTION FOR LEAVE TO APPEAL TO THE NEW YORK STATE COURT OF APPEALS

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PRELIMINARY STATEMENT

Plaintiffs-Appellants Abax Lotus Ltd. and Abax Nai Xin A Ltd. ("plaintiffs" or "Abax") submit this memorandum of law in opposition to the motion of defendant-respondent Zhang Zhengyu ("defendant" or "Zhang") for leave to appeal to the Court of Appeals.

The Court should deny the motion for two main reasons. First, the requested appeal raises no novel or important legal issues. Zhang does not even try to suggest that it does. No reason exists for this Court to accept a further appeal of the First Department's unanimous decision construing established contract law. *See Abax Lotus Ltd. v. China Mobile Media Tech. Inc.*, 149 A.D.3d 535, 53 N.Y.S.3d 29 (1st Dep't 2017), reproduced as Exhibit E to Affirmation in Support of Jenice L. Malecki ["Malecki Aff."]. Further review is especially inappropriate since Zhang moved for reargument and leave to further appeal in the Appellate Division and lost (via a unanimous Decision and Order).

This Court should also deny the instant motion because the Appellate Division properly decided the appeal. The First Department modified the Decision and Order of the trial court and granted summary judgment to Abax on its claim for liquidated damages in connection with Zhang's breaches of his promises in the Investor Rights Agreement ("IRA") (i) to cause China Mobile Media Technology Inc. ("CMM") and its subsidiary, Magical Insight Investments Limited

("Magical"), to hire a Qualified Accounting Firm approved by Abax; and (ii) individually to indemnify Abax for losses occasioned by any breach of an IRA covenant or agreement. *Abax Lotus Ltd.*, 149 A.D.3d at 535-36. There is no dispute that the IRA mandated that Zhang perform these functions. There is also no dispute that Zhang failed to do so. In the face of this clear contractual language and breach, Zhang attempts to avoid his obligations by asking this Court to rewrite, or simply ignore, the IRA's terms.

Zhang refers to an April 1, 2008 letter agreement (which he calls "the Waiver"), executed by Magical, CMM as guarantor, and Abax (Malecki Aff. Ex. C [R. 149-50]), and to another letter from the day before. (*Id.* Ex. D [R. 147]). These letters simply postponed the deadline by which Zhang's companies were required to hire the qualified accountant and provided for $1 million in liquidated damages if the new deadline was missed, while waiving any additional damages otherwise due. As shown in detail below, Abax manifestly did not intend such letters to waive or supersede Zhang's pre-existing promises in a separate document, the IRA. The Appellate Division's Decision correctly construed the law and the facts and should not be disturbed on Zhang's deficient motion.

ARGUMENT

I.

THIS CASE PRESENTS NO NOVEL OR IMPORTANT LEGAL ISSUES

A motion for permission to appeal to the Court of Appeals should be only granted upon a showing that the questions presented merit additional review — for example, when "the issues are novel or of public importance, present a conflict with prior decisions of [the Court of Appeals], or involve a conflict among the departments of the Appellate Division." 22 N.Y.C.R.R. § 500.22(4).

This matter, though, involves a dispute between private parties based upon well settled principles of contract law. As such, Zhang cannot not raise any justification for leave to appeal to this Court. Indeed, on this motion, he makes no attempt whatsoever to do so. Hence, further appeal of the Appellate Division's unanimous decision is unwarranted.

II.

THE FIRST DEPARTMENT CORRECTLY DECIDED THE APPEAL

The Appellate Division rightly held that Abax deserves summary judgment on the liquidated damages claim. Therefore, this Court should deny Zhang's present motion for permission to further appeal.

The IRA obliged Zhang "to cause each Group Company" to retain a qualified accounting firm to certify CMM's consolidated financial statements at

the end of each fiscal year. (IRA § 2.2(e), reproduced at Malecki Aff. Ex. A [R. 105-06]). Zhang does not contest that the IRA compelled him, individually, to indemnify Abax for any losses caused by violations of covenants in that Agreement. (*See* IRA § 8(a)(ii) [R. 113-14]). Instead, Zhang seeks leave to appeal on two related grounds — waiver and supersession (novation). However, Zhang's obligation in the IRA regarding retention of an accountant was not "superseded" by two subsequent letters dated March 31 and April 1, 2008. (Malecki Aff. Ex. D [R. 147]; *id.* Ex. C [R. 149-50]). Moreover, in those letters, Abax did not "waive" Zhang's liability in the IRA itself for failing to cause the hiring of a qualified accountant.

"Waiver is the intentional relinquishment of a right with both knowledge of its existence and the intent to relinquish that right." *England v. Nettesheim*, 222 A.D.2d 825, 827, 634 N.Y.S.2d 797 (3d Dep't 1995) (defendants did not establish a waiver defense because plaintiffs did not clearly manifest an intention to waive the clause at issue and plaintiffs did not affirmatively mislead defendants into believing the clause would not be enforced) (quoting *Werking v. Amity Estates*, 2 N.Y.2d 43, 52, 155 N.Y.S.2d 633 (1956)).

A purported waiver "should not be lightly presumed." *Gilbert Frank Corp. v. Fed. Ins. Co.*, 70 N.Y.2d 966, 968, 525 N.Y.S.2d 793 (1988). Instead, the parties must unmistakably exhibit an intention to waive. In other words, a court should not

infer such intent from an equivocal act. *In re Anglin*, 270 A.D.2d 853, 854, 705 N.Y.S.2d 769 (4th Dep't 2000); *see also Indep. Wireless One Corp. v. City of Syracuse*, 309 A.D.2d 1291, 1292, 765 N.Y.S.2d 567 (4th Dep't 2003); *Elite Gold, Inc. v. TT Jewelry Outlet Corp.*, 31 A.D.3d 338, 340, 819 N.Y.S.2d 516 (1st Dep't 2006).

Beyond seeking to manufacture a waiver where none exists, Zhang also essentially requests a "novation." Under that doctrine, the parties substitute a new contract for a prior one. Novation requires: (i) a previously valid obligation; (ii) agreement of the parties to the new obligation; (iii) extinguishment of the old contract; and (iv) a valid new contract. *Warberg Opportunistic Trading Fund L.P. v. GeoResources, Inc.*, 2017 NY slip op. 4537, *5 (1st Dep't 2017). Yet the party attempting to show novation must meet a stringent standard, similar to the one for proving waiver:

> In order to prove a novation, there must be a clear and definite intention on the part of all concerned that such is the purpose of the agreement. Not only must the intention to effect a novation be clearly shown, but a novation must never be presumed.

Beck v. Mfrs. Hanover Trust Co., 125 Misc. 2d 771, 779, 481 N.Y.S.2d 211 (Sup. Ct. N.Y. Cty. 1984); *see also Heth v. Van Riet*, 2014 N.Y. slip op. 30254(U), *10-11 (Sup. Ct. N.Y. Cty. 2014) (citing *Beck*).

Zhang contends that Abax bears the burden of establishing a binding contract with him. (Memorandum of Law in Support of Zhang's Motion for Leave to Appeal to the Court of Appeals ["Opening Memo."] at 11, 12). Yet he conveniently ignores that he must shoulder the burden of proving waiver of an existing contract. *Rosenthal v. City of N.Y.*, 283 A.D.2d 156, 160, 725 N.Y.S.2d 20 (1st Dep't 2001) (the burden of proving a defense of waiver rests on the party asserting the defense). Analogously, "[t]he party claiming a novation has the burden of proof of establishing that it was the intent of the parties to effect a novation." *Warberg Opportunistic Trading Fund L.P.*, 2017 NY slip op. 4537, at *5. Zhang cannot satisfy his burden of proof under these theories.

A later agreement cannot be held to replace or supersede an earlier agreement without evidence of an express understanding between the parties that the subsequent agreement was meant to replace the earlier one. This rule applies to guaranties. *Republic Nat'l Bank of N.Y. v. Haddad*, 121 A.D.2d 986, 988, 504 N.Y.S.2d 669 (1st Dep't 1986) (successive guaranties did not "terminate, supersede or cancel any prior guaranties because there was no express provision therein to that effect") (citations & internal quotation marks omitted); *see also Raico v. Concorde Funding Grp.*, 60 A.D.3d 834, 836, 875 N.Y.S.2d 251 (2d Dep't 2009) (no waiver where there was no "evidence of an express agreement with the plaintiff that the 'superseding notes' were to replace the original notes or that they

would discharge the debt evidenced by the original notes"); *Fourth Branch Assocs. Mechanicville v. Niagara Mohawk Power Corp.*, 302 A.D.2d 780, 783, 754 N.Y.S.2d 783 (3d Dep't 2003) (viability of an earlier agreement remained "unaffected" by subsequent agreements that contained "no explicit directive that they were intended to replace or supersede the earlier agreement").

In the case at bar, Zhang wrongly asserts waiver and novation. First, Abax did not waive any of its rights under the IRA. The March 31 and April 1, 2008 letters refer to the Indenture and Notes, not the IRA. The letters merely provide that Abax agreed to postpone the date by which CMM and Magical had to appoint a Qualified Accounting Firm until October 31, 2008, in exchange for those companies agreeing to a payment of $1 million in liquidated damages if Magical failed to appoint a qualified firm by that date. The letters explicitly reference the "Additional Amounts" that Magical would otherwise owe Abax, per the Indenture, if Magical failed to timely designate an appropriate accountant. (Indenture § 1.01 "Additional Amounts," reproduced at Malecki Aff. Ex. B at 1 [R. 313]; *cf. id*. Ex. D [R. 147]; *id.* Ex. C at 1 [R. 149]. During the relevant time frame, the "Additional Amounts" always exceeded $1 million.[1] Consequently, when the letter agreements

[1] The "Additional Amounts" owed, if the liquidated damages provision had not been implemented, were 5% of the principal amount of the "RMB Notional Amount," or RMB7,500,000. (*See* Malecki Aff. Ex. B at 1 [R. 313] (defining "Additional Amounts"), *id.* at 21 [R. 333] (defining "RMB Notional Amount")). But, RMB7,500,000 has always exceeded $1,000,000 since October 2007. This may be verified using any publicly-available historical currency conversion chart, e.g., https://www.xe.com/currencycharts/?from=CNY&to=USD

were executed, and continuing to the present day, Abax was conferring a benefit to the counterparties by reducing their liability.

The letters waived rights under the Indenture and Notes. The letters do not purport to alter Zhang's duties under the IRA and, in fact, do not speak to the IRA at all. Rather, as just explicated, the letters amend the terms of the Indenture (Malecki Aff. Ex. B [R. 312-435]), to which Zhang was not a party. Zhang's responsibilities under the IRA continued: He still had to cause Magical to appoint a Qualified Accounting Firm and still had to indemnify Abax's losses if Magical failed to do so.

Furthermore, Abax never evinced an intention to have the letter agreements "supersede" Zhang's underlying IRA obligation (to cause Magical to hire a qualified firm). Indeed, the letters make clear this obligation remained in full force and effect, albeit to be fulfilled at a later date and for limited damages. Zhang received the benefit of a reprieve on his obligations with respect to the hiring of the Qualified Accounting Firm when Abax agreed to give Magical more time. He cannot shirk his responsibility to otherwise fulfill his part of the bargain.

The letters give no inkling that Abax wished to waive its right to recover from Zhang in the event no such firm was hired within the extended period agreed upon, or to relieve him of the mandate to "cause" Magical to do so under the IRA.

&view=10Y. A conversion rate of 0.1333 represents the point at which RMB 7.5 million equals USD 1 million.

As analyzed above, Zhang bears the burden of demonstrating Abax's clear and express intention to repudiate the IRA's dictates. But, Abax certainly did not plainly indicate that it wanted to relinquish its right to recover merely because it allowed an exception in one instance to give Magical more time to appoint a qualified auditor in exchange for liquidated damages. Furthermore, as the IRA proclaims, "All indemnification rights hereunder shall survive indefinitely, regardless of… any knowledge of any Investor and/or any of the other Indemnified Parties." (IRA § 8(c) [R. 114]).

Even *if* Abax had waived its right enshrined in the IRA itself to an earlier appointment of an eligible accountant, that waiver would not have committed Abax to permitting a further or continuing waiver. The IRA declares:

> No waivers of or exceptions to any term, condition, or provision of this Agreement, *in any one or more instances*, shall be deemed to be, or construed as, *a further or continuing waiver* of any such term, condition or provision.

(IRA § 9.4 [R. 115-16]) (emphasis added).

In other words, after Zhang breached the IRA by failing to cause CMM or Magical to appoint an appropriate accountant in the time frame allotted, Abax indirectly gave him a reprieve. To the extent this reprieve operates as a waiver or "exception," it represents a limited waiver of the kind contemplated in the portion of IRA § 9.4 quoted above. Abax thereby could be said to forgo an immediate

remedy against Zhang, as indemnitor, so long as a qualified accountant is appointed by the new deadline. But, again as IRA § 9.4 anticipates and instructs, Abax did not thereby also agree to rescind all of its future remedies against Zhang if the new deadline were disregarded.[2] As soon as the new deadline passed, Zhang violated his continuing responsibilities under the IRA. Abax never waived (or materially amended) the continuing obligations.

In its present motion, Zhang chiefly relies upon *Mallad Constr. Corp. v. Cty. Fed. Sav. & Loan Assoc.*, 32 N.Y.2d 285, 292, 344 N.Y.S.2d 925 (1973), to support its contention that the current litigants deliberately canceled provisions of the IRA. In that decision, the Court found that the parties therein expressed an intention to supplant their original commitments and to discharge the obligations arising under them. Crucially, the new agreement in *Mallad* explicitly stated that "its acceptance shall constitute a revocation and cancellation of the prior agreement between the parties." *Mallad Constr.*, 32 N.Y.2d at 289-90. Of course, no such express revocation occurred in the matter *sub judice*. Indeed, a close reading of the relevant documents reveals that Abax gave no sign that it wanted to cancel Zhang's commitments in the IRA, nor did Abax have any incentive to do so.

[2] While IRA § 9.4 [R. 115-16] requires "written consent" for certain amendments to the Agreement, that section permits oral "waivers of or exceptions to any term, condition or provision."

Zhang does not and cannot claim that he provided any additional consideration to Abax sufficient to modify his underlying obligations to hire a Qualified Accounting Firm and to indemnify Abax for the non-fulfillment of that obligation. *See Tierney v. Capricorn Inv'rs, L.P.*, 189 A.D.2d 629, 631, 592 N.Y.S.2d 700 (1st Dep't 1993) (rejecting a modification because "[n]either a promise to do that which the promisor is already bound to do, nor the performance of an existing legal obligation constitutes valid consideration"); *In re Anglin*, 270 A.D.2d at 855 ("any change in an existing contract must have a new consideration to support it").

In his present motion, Zhang advances various textual interpretations, but none of them are convincing. Firstly, Zhang points to a clause in the IRA § 9.4 [R. 115] requiring that he consent to the "amend[ment]" of any term of that Agreement to be enforced against him. However, as explained above, the letters did not "amend" Zhang's obligations to cause Magical to appoint a qualified auditor, or his agreement to indemnify Abax. In the letters, Abax conditionally promised CMM and Magical that Abax would decline "Additional Amounts" to which it may have been entitled under a different contract, the Indenture. (Malecki Aff. Exs. C at 1 [R. 149], D [R. 147], B at 1 [R. 313]). To the extent that the extra time and liquidated damages affected Zhang's duties under the IRA — which Abax disputes — the reprieve acted, at most, as a limited "waiver or exception,"

which did not require Zhang's consent and did not "amend" the IRA. (*See* IRA § 9.4 [R. 115-16]).

Secondly, Zhang muses that, in the letters, Abax "could have" mentioned Zhang's indemnification commitment, but instead the letters do not allude to the IRA at all. (Opening Memo. at 12). Yet such references were unnecessary, since the parties undoubtedly understood that the IRA's provisions, including Zhang's pledge to indemnify Abax, continued unabated. To repel summary judgment against him, Zhang must establish an "explicit directive," and "a clear and definite" or "unmistakable" intention on the part of all concerned, that they wanted to obliterate his pre-existing responsibilities. *See, e.g.*, *Beck*, 125 Misc. 2d at 779; *In re Anglin*, 270 A.D.2d at 854; *Fourth Branch Assocs.*, 302 A.D.2d at 783. Zhang has failed to marshal such evidence. In contrast, to merit summary judgment in Abax's favor, Abax need not justify why it did not include "foolproof" language in the letters.

Thirdly, Zhang notes that CMM served as the sole guarantor of both the Indenture (Malecki Aff. Ex. B at 80 [R. 392]) and the April 1, 2008 letter agreement (*id.* Ex. C at 2 [R. 150]). Part of Zhang's argument on this issue merely reiterates his larger contention that he should not be bound by letter agreements he did not execute. Abax attacked that larger point earlier in this Memorandum, demonstrating that the IRA itself (and not the letters) contained Zhang's continuing

obligations and that nothing in the letters signified a desire to extinguish those obligations.

In this regard, Zhang erroneously complains that the April 1, 2008 letter's liquidated damages clause has "no connection to" the IRA's indemnity clause. (Opening Memo. at 16; *cf. id.* at 13). However, the two clauses work in tandem: In the letter, Abax permitted Magical both more time and a lesser penalty if it could not meet the new, extended deadline. This amnesty also reduced Zhang's exposure under the IRA. But, Abax still expected Zhang to cause Magical to comply and still expected Zhang to make Abax whole if he did not effect such compliance.

Abax lost one million dollars when Magical refused to pay that sum as liquidated damages. Thus, as Zhang contracted to do all along, he is liable for Abax's loss. In fact, Zhang agreed to reimburse Abax for "any loss" which Abax "may suffer, sustain or become subject to… by virtue of" CMM or Magical's "nonfulfillment or breach" of any covenant or agreement in the IRA, even if the loss is merely "incidental to" the breach. (IRA § 8 [R. 113-14]). The indemnity is very broad and encompasses the loss of the liquidated damages.

To the extent Zhang focuses on the CMM guaranty and the Zhang indemnity, he mainly depends on a 114-year-old case that discharged a guarantor when "the first contract was superseded by the new one" and "the burdens imposed" on the guarantor were "increased" in the new contract. *N.Y. v. Clark*, 84

A.D. 383, 387-88, 82 N.Y.S. 855 (1st Dep't 1903). Yet, in the instant matter, the letters did *not* supersede the IRA, and Zhang received a benefit from them. *See also Haddad*, 121 A.D.2d at 988 (successive guaranties did not "terminate, supersede or cancel" any prior ones without an express provision to that effect).

Zhang also states that contracts of guaranty must conform to the Statute of Frauds. (Opening Memo. at 12-13). Of course, in Section 8(a)(ii) of the IRA [R. 113-14], he agreed in a signed writing to indemnify Abax for any breach of the IRA by himself, CMM or Magical. Also, as examined below, Zhang undertook an indemnity, not a guaranty. In contrast, CMM promised a guaranty.

An indemnity imposes more comprehensive liability than a guaranty, since an indemnity may be enforced without first exhausting recourse against the primary obligor. BLACK'S LAW DICTIONARY *s.v.* "indemnity" and "guaranty" (10th ed. 2014); *Weissman v. Sinorm Deli*, 88 N.Y.2d 437, 446, 646 N.Y.S.2d 308 (1996).

> An indemnification is a primary obligation: if a loss or event occurs within its scope, the indemnitors are primarily liable. A guaranty, by contrast, is a contract of secondary liability. Thus, a guarantor will be required to make payment only when the primary obligor has first defaulted.

Id.

Zhang served not as a guarantor of the IRA but rather as an indemnitor therein. As such, he provided stronger protection to Abax than CMM's guaranty

furnished in the Indenture and letter agreement. Logically, Abax wanted both CMM's guaranties and the even greater protection of Zhang's indemnity. No good reason existed why Abax would sacrifice the latter. Abax signaled no such objective and indeed signaled the opposite. (*See, e.g.,* IRA § 8(c) [R. 114] ("All indemnification rights hereunder shall survive indefinitely…"); IRA § 8(d) [R. 114] ("The indemnity obligations that each Group Company and the Controlling Shareholders have under this Section shall be in addition to any liability that [they] may otherwise have.")).

This analysis brings us to Zhang's final, flawed argument, that Abax's holding him liable under the IRA "would amount to a blank check" since, *inter alia*, "[a] liquidated damages clause… changes the landscape for an indemnitor of a company that is not a going concern…." (Opening Memo. at 12, 15; *cf. id.* at 10). Contrary to Zhang's claim, however, the company *was* "a going concern" during the relevant time frame. [R. 689-90]. Moreover, whether the financial "landscape" had changed or not, the same legal rules apply.

More importantly, the Court should place in full context the parties' incentives to execute the various contracts. The Court's "aim should be a practical interpretation of the expressions of the parties to the end that there be a realization of [their] reasonable expectations." *Hudson-Port Ewen Assoc. L.P. v. Kuo*, 165 A.D.2d 301, 303-04, 566 N.Y.S.2d 774 (1st Dep't 1991) (internal citations

omitted). Obviously, Abax did not "sign a blank check," either. As an investor in a high-risk endeavor, Abax needed relatively strong incentives to induce CMM's and Magical's principals and shareholders to exercise appropriate controls, such as appointing a well-credentialed auditor. That appointment would have helped protect the investment.

Abax held such robust protections — e.g., the companies' pledges to obtain an appropriate accountant or face significant consequences; Zhang's agreement to cause the companies to complete that task; and Zhang's indemnity (not mere guaranty). It does not make sense that Abax would voluntarily toss aside Zhang's agreements, especially without consideration. It makes much more sense that Abax would grant Magical some forbearance (i.e., more time to find an accountant, and liquidated damages) while demanding the new guaranty from CMM. In short, Abax did not aim to gut the IRA, and this Court should not let Zhang circumvent his legal duties thereunder.

CONCLUSION

For the foregoing reasons, plaintiffs respectfully ask that the Court deny defendant's motion in its entirety, grant costs to plaintiffs, and confer such other or further relief as the Court deems just or proper.

Dated: Hawthorne, New York
November 29, 2017

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DISCLOSURE STATEMENT

In accordance with § 500.1(f) of the Court's Rules of Practice, plaintiffs-appellants provide the following information:

ABAX LOTUS LTD. and ABAX NAI XIN A LTD. are both wholly-owned subsidiaries of Abax Global Opportunities Fund, an investment fund registered with the Cayman Islands Monetary Authority. Abax Global Opportunities Fund is also the parent of Abax Emerald Ltd. and Abax Nai Xin B Ltd.

Abax Global Opportunities Fund, in turn, is owned by Abax Upland Fund, LLC (a Delaware limited liability company) and by Abax Arhat Fund (a Cayman Islands fund).