

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

DARIUS INTERNATIONAL, INC., : CIVIL ACTION
et al. :
 :
v. :
 :
ROBERT O. YOUNG, et al. : NO. 05-6184

MEMORANDUM AND ORDER

McLaughlin, J.

June 13, 2006

This case involves the deterioration of the business relationship between the plaintiffs, Darius International, Inc. ("Darius"), and Innerlight Inc. ("Innerlight"), and the defendants, Robert O. Young and Shelley R. Young ("the Youngs"). The Youngs are well-known developers of nutritional and dietary supplements. In 2001, they sold their business to the plaintiffs, and remained consultants to the business. They signed various non-competition provisions as part of the transaction.

Although the business relationship between the parties had never been without its problems, they came to a head in 2005. The plaintiffs learned that the defendants had been reselling large quantities of the products that they bought at a significantly discounted rate from the plaintiffs. Consequently, the plaintiffs limited the amount of product that the defendants would be allowed to purchase at the reduced rate. In late November of 2005, the defendants responded by launching their own

competing line of nutritional and dietary supplement products.

The plaintiffs sued the defendants, and moved for a preliminary injunction based upon their claims of breach of contract, breach of fiduciary duty, trademark infringement, unfair competition, tortious interference and appropriation of trade values. The Court granted the motion on the claims of breach of contract and unfair competition, and in part on the trademark infringement claim. The Court otherwise denied the motion. The plaintiffs posted bond in the amount of \$200,000.00 to secure against the wrongful entry of the preliminary injunction.

The Court decides here the defendants' motion for dissolution or reconsideration of the Court's Order granting in part the plaintiffs' motion for a preliminary injunction. The motion is based upon the plaintiffs' invocation of a set-off provision against the consulting fee payments to the defendants as of February 1, 2006.¹ The Court will deny the motion, and the preliminary injunction will stand.

I. Facts

The Court will not reiterate all of the factual

¹ Although the defendants informed the Court of this development shortly before the issuance of the preliminary injunction, the Court did not consider it in its decision on the preliminary injunction motion, as it had not been fully briefed at that time.

findings in its Memorandum on the motion for a preliminary injunction. The facts relevant to the motion to dissolve or for reconsideration are as follows:

A. The Agreements

The plaintiffs and the defendants entered into four written agreements: (1) the Non-Competition Agreement ("NCA"), on January 2, 2001; (2) the Asset Purchase Agreement ("APA"), on January 15, 2001; (3) the Consulting Agreement ("CA"), on January 15, 2001; and (4) the Post-Closing Agreement ("PCA"), on January 16, 2001. (Pl. Prelim. Inj. Hrg. Exs. ("Pl. Exs.") 4, 5, 6, 8).

As consideration for the NCA, the Youngs received 50,000 shares of Common Stock of The Quigley Corporation ("Quigley Corp."). As consideration for the CA, as modified by the PCA, the Youngs received a monthly consulting payment, "as reduced (if at all) pursuant to Section 3.6" of the CA. (Pl. Exs. 5, 6, 8).

Section 1.1 of the Non-Competition Agreement ("NCA") states that:

The Restricted Persons shall not, for so long as the Company pays the Restricted Persons a monthly payment pursuant to the terms of a Consulting Agreement between the Company and the Restricted Persons . . . engage in . . . a business that is competitive with the Business that is conducted by the Company.

(Pl. Ex. 6).

Similarly, § 2.1 of the Consulting Agreement ("CA")

states that:

The Consultants shall not, for so long as the Company pays the Consultants a monthly payment pursuant to the terms of this Agreement (reduced, as applicable, subject to Section 3.6)(the "Non-Competition Period") . . . engage in . . . a business that is competitive with the Business that is conducted by the Company.

(Pl. Ex. 5).

Section 3.6 of the CA, as referred to in § 2.1, states that "[t]he compensation payable to the [Youngs] hereunder shall be subject to reduction as provided in Section 6 of this Agreement." Id.

Section 6 of the CA reads as follows:

6.1 In the event either of the Consultants commits any material violation of the provisions of this Agreement, then, in addition to any other remedies which the Company might have at law or in equity, the Company shall have the right to set-off any actual and reasonable damages incurred by it against payments otherwise due hereunder. Nothing contained herein shall preclude the Company from seeking damages or injunctive relief against the Consultants as provided in Section 6.2.

6.2 In the event either of the Consultants commits any material violation of the provisions of Section 2 of this Agreement, as determined by the Company in good faith, the Company may, by injunctive action, compel the Consultants to comply with, or restrain the Consultants from violating, such provision, and, in addition, and not in the alternative, the Company shall be entitled to declare the Consultants in default hereunder and to terminate any further payments hereunder.

Id.

Under § 1.10 of the Asset Purchase Agreement ("APA"), the Youngs were permitted to purchase Innerlight products at a reduced rate. They were prohibited from reselling those products

to Innerlight's distributors and customers, or using them to compete with Innerlight. Id.

The agreements are to be read together pursuant to § 10.2 of the NCA and CA, and the multiple references in the NCA and CA to each other. (Pl. Exs. 5, 6).

Section 7.02(g) of the APA allowed the Youngs to terminate if the plaintiffs materially breached the APA. (Pl. Ex. 4).

B. Set-Off and Purported Termination

On March 13, 2006, Innerlight sent a letter to the Youngs stating that it had calculated that the consulting fee for February of 2006 was \$56,653.42. Instead of sending a wire transfer in that amount, however, Innerlight invoked § 6.1 of the CA and set off damages incurred against it against payments otherwise due to the Youngs under the CA. Innerlight described two bases for the invocation of the set-off provision: (1) that Dr. Young resold more than \$800,000 of Innerlight products in contravention of § 1.10 of the APA; and (2) that the Innerlight Board of Directors had been paying commissions of more than \$900,000 to the Youngs on products to which they had no title, yet represented they owned, or products that were sold by Innerlight and acquired by Innerlight after the date of the APA and the CA for which there was no independent commission

agreement. Innerlight stated that the set-offs would continue until Innerlight recouped its funds. (Mot. to Dissolve or Reconsider ("Mot.") Ex. A).²

On March 27, 2006, the Youngs sent a letter to Innerlight. The letter indicated that Innerlight's failure to pay the February monthly payment to the Youngs constituted a material breach of the agreements. It stated that the Youngs were therefore electing to terminate the agreements because they lacked consideration and for other legal reasons. The letter gave Innerlight the opportunity to cure its alleged breach. (Mot. Ex. C).

On March 31, 2006, Innerlight sent another letter to the Youngs. It acknowledged the receipt of the Youngs' March 27, 2006 letter, which it stated wrongfully accused Innerlight of material breach. It stated that Innerlight was not in breach; rather, Innerlight had invoked § 6.1 of the CA and NCA.³ It stated that because Innerlight had not materially breached the agreements, the Youngs were not entitled to terminate them. (Mot. Ex. D).

² Innerlight sent a similar letter to the Youngs on April 12, 2006. This letter stated that Innerlight had calculated the consulting fee for March of 2006 at \$62,826.64. (Mot. Ex. B).

³ In fact, section 6.1 of the NCA only allows for set-off "against any Quigley Stock in the Company's possession." It does not allow for set-off against consulting fee payments, like § 6.1 of the CA. Thus, only the CA set-off provision is applicable to the instant situation.

II. Standard of Review

"The standard that the district court must apply when considering a motion to dissolve an injunction is whether the movant has made a showing that changed circumstances warrant the discontinuation of the order." Twp. of Franklin Sewerage Auth. v. Middlesex County Utils. Auth., 787 F.2d 117, 121 (3d Cir. 1986). A party seeking reconsideration must show (1) an intervening change in controlling law; (2) the availability of new evidence; or (3) the need to correct a clear error of law or prevent manifest injustice. North River Ins. Co. v. CIGNA Reinsurance Co., 52 F.3d 1194, 1218 (3d Cir. 1995).

"The standard for evaluating a motion for preliminary injunction is a four-part inquiry as to: (1) whether the movant has shown a reasonable probability of success on the merits; (2) whether the movant will be irreparably injured by denial of the relief; (3) whether granting preliminary relief will result in even greater harm to the nonmoving party; and (4) whether granting the preliminary relief will be in the public interest." United States v. Bell, 414 F.3d 474, 478 n.4 (3d Cir. 2005). The Court must now consider whether the plaintiffs' invocation of the set-off provision constitutes a changed circumstance or new evidence that shifts the balance of these factors out of the plaintiffs' favor.

III. Analysis

A. Reasonable Probability of Success on the Merits

The defendants argue that the preliminary injunction should be dissolved or reconsidered due to the plaintiffs' invocation of the set-off provision. They argue that the plaintiffs can no longer show a reasonable probability of success on the merits of their claims because the setting-off gave the defendants the right to terminate the agreements, which they exercised, and rendered the agreements without consideration. The Court disagrees.

1. Plaintiffs' Right to Set-Off; Defendants' Right to Terminate

The defendants argue that the plaintiffs no longer have a reasonable probability of success on the merits of their claims because the plaintiffs' invocation of the set-off provision constituted a material breach and gave the defendants the right to terminate the agreements. The Court is not persuaded by this argument.

It is true that the non-competition provisions of the NCA and CA apply only so long as "the Company pays the Consultants a monthly payment." (Pl. Exs. 5&6). However, in the NCA, this sentence defines "payment" as subject to the terms of the CA. (Pl. Ex. 6). In the CA, the sentence specifically

defines "payment" as "reduced, as applicable, subject to Section 3.6" of the CA. (Pl. Ex. 5). Section 3.6, in turn, references Section 6 of the CA, which is the set-off provision. Id. Thus, any required "payment," by definition, is subject to the set-off provision.

The plaintiffs were only entitled to invoke the set-off provision if the Youngs committed a material breach of the agreements. The Court has already determined that the plaintiffs have a reasonable probability of success on their claim that the defendants violated § 1.10 of the APA by reselling Innerlight products in competition with Innerlight. (Prelim. Inj. Mem. at 62-63). Therefore, there is a reasonable probability that the defendants committed a material breach of their agreements with the plaintiffs.

The plaintiffs, then, have a reasonable probability of success on the merits of the claim that they were entitled to invoke the set-off provision, and that their doing so did not constitute a material breach of the agreements, which would have entitled the Youngs to terminate under § 7.02(g) of the APA. Rather, set-off was a right contemplated by the agreements, and was appropriate to the extent that it compensated for the breach of the APA.⁴ The Youngs' purported termination of the agreements

⁴ The plaintiffs also set-off damages against the overpayment of commissions to the Youngs over the years. The set-off provision allows for the setting-off of damages in the

in their letter to Innerlight dated March 27, 2005, was ineffective.

2. Lack of Consideration

The defendants also argue that the plaintiffs no longer have a reasonable probability of success on the merits of their claims because the plaintiffs' invocation of the set-off provision renders the agreements lacking in consideration. This argument fails for two reasons.

First, the Youngs are still being "paid," as contemplated by the agreements. The definitions of "payment" in the NCA and the CA include potential set-off by referencing the CA and the set-off provision, respectively. By invoking the set-

event that the Youngs commit a material breach of the agreements. To date, the plaintiffs have never argued to the Court that the acceptance of these commissions constituted a breach of contract. At this stage, they are not entitled to set-off damages for something that they never argued constituted a breach. The violation of § 1.10 is an independent and sufficient basis for the set-off, so the fact that the Court will not uphold the second basis for the set-off does not give the defendants the right to terminate. The damages already set-off shall be considered to be against the amount resold in violation of § 1.10 of the APA, and the plaintiffs shall not, at this stage, set-off damages against the overpayment of commissions.

The plaintiffs stated that the amount of the set-off corresponding to the breach of § 1.10 of the APA was more than \$800,000. The defendants have not disputed the amount of the set-off; rather, they have argued only that the plaintiffs no longer have the right to injunctive relief because of their setting-off of damages. The Court need not decide here whether \$800,000 is the correct set-off amount because the amount set-off thus far is well below \$800,000.

off provision, the plaintiffs were simply indicating that the Youngs had wrongfully received large amounts of money in breach of the agreements, and that future payments would be deducted to offset that amount.

Second, the consulting fee was not the only consideration that the Youngs received under the agreements. They also received 50,000 shares of the Quigley Corp.'s Common Stock under the NCA. Thus, at least the NCA is supported by additional consideration. There is a reasonable probability of success on the merits of the argument that consideration is not lacking; rather, it has already been paid.

The plaintiffs have a reasonable probability of success on the merits of their claims despite their invocation of the set-off provision.

B. Adequate Remedy at Law

The defendants also argue that the setting-off illustrated that the plaintiffs have an adequate remedy at law. The set-off does not constitute an adequate remedy at law. First, the set-off provision specifically states that nothing within it "shall preclude the Company from seeking damages or injunctive relief against the Consultants as provided in Section 6.2." (Pl. Ex. 5, emphasis added).

Even without that provision, however, the Court

concludes that the set-off is not an adequate remedy at law rendering the entry of the preliminary injunction inappropriate. First, the set-off was based solely on the breach of § 1.10 of the APA, whereas the grant of the preliminary injunction was based upon the breach of that and other terms, as well as unfair competition and trademark infringement.

As the Court discussed in its decision on the preliminary injunction, there is potential for significant irreparable harm to Innerlight. (Prelim. Inj. Mem. at 74-76). The set-off provision only compensates for past wrongful payments, but the potential irreparable harm would continue into the future. The set-off provision does not constitute an adequate remedy at law.

C. Bond

If the defendants believe that amount of the bond posted by the plaintiffs should be increased to account for the set-off, they should inform the Court of their views on that issue.

An appropriate Order follows.

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ORDER

AND NOW, this 13th day of June, 2006, upon consideration of the defendants' Motion to Dissolve, or, in the Alternative, Motion for Reconsideration, Under Fed. R. Civ. P. 59(e), of This Court's April 20, 2006 Order Granting in Part Plaintiffs' Motion for Preliminary Injunction (Docket No. 50), and the response thereto, IT IS HEREBY ORDERED that the motion is DENIED.

IT IS FURTHER ORDERED that if the defendants believe that the bond should be increased to account for the set-off, they should inform the Court of their views on that issue on or before June 30, 2006.

BY THE COURT:

/s/ Mary A. McLaughlin
MARY A. McLAUGHLIN, J.