

Francis N. Ruiz (JD 0308)
169-26 Hillsdale Avenue, 2nd Floor
Jamaica, NY 11432
Tel.: (718) 535-7925
Fax: (718) 228-6564

Of Counsel
Pro Hac Admission Pending

Laurence Singer (LS 4250)
Attorney at Law
1629 K Street NW, Suite 300
Washington D.C. 20006
646 327-8772

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

-----X
PASSLOGIX
Plaintiff

v.

Civ. Action No. 08-CV-10986

2FA TECHNOLOGY, LLC
2FA, INC.

ANSWER AND COUNTERCLAIM

GREG SALYARDS
AND
SHAUN CUTILL

Defendants

-----X

ANSWER

COMES NOW Defendants, and as and for its Answer to the Amended Complaint brought by Plaintiff Passlogix, states and alleges as follows:

FIRST AFFIRMATIVE DEFENSE

1. Plaintiff's Amended Complaint fails to state a claim upon which relief can be granted.

SECOND AFFIRMATIVE DEFENSE

2. The Amended Complaint is barred by the Defendants' complete performance under the terms of the License Agreement, as amended, and its compliance with all of its contractual obligations.

THIRD AFFIRMATIVE DEFENSE

3. Plaintiff's claims are barred in whole or in part by the doctrine of unclean hands.

FOURTH AFFIRMATIVE DEFENSE

4. This case does not fall within the scope of cases for which the Declaratory Judgment Act was intended, as among other things, it does not present circumstances sufficiently compelling to warrant exercise of the Court's discretion to grant or deny the relief requested, and the resolution of the issues requires the presentation of evidence and witnesses that would not be available to the Court pursuant to the Court's consideration of a declaratory ruling.

FIFTH AFFIRMATIVE DEFENSE

5. The Defendants are not presently able to determine all of the affirmative defenses to which they are entitled to assert, and may later determine that there are additional affirmative defenses that are applicable in this case. The Defendants reserve the right to supplement this Answer and to add any additional affirmative defenses to the Plaintiff's Amended Complaint.

SIXTH AFFIRMATIVE DEFENSE

6. Defendants deny each and every allegation contained in the Amended Complaint except as hereinafter may be expressly admitted. In response to the numbered paragraphs of the Amended Complaint, Defendants admit or otherwise respond as follows:

THE PARTIES

1. Upon information and belief, the Defendants admit the allegations set forth.
2. Defendants admit the allegations set forth.
3. Defendants admit the allegations set forth.

NATURE OF ACTION

4. To the extent the allegations state a legal conclusion no response is required.

JURISDICTION AND VENUE

5. Defendants admit the allegations set forth.
6. Defendants admit the allegations set forth.
7. Defendants admit the allegations set forth.

BACKGROUND

8. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that 2FA Technology LLC was a new venture, that the parties executed a License Agreement, and that the License Agreement has been amended on four occasions.
9. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that the original License Agreement was exclusive, that some of the obligations of the Defendants were subject to defined standards and deadlines, that the Plaintiff was licensed to provide the Defendants' offering with other of the Plaintiff's product offerings, and that the Plaintiff agreed to certain payments under the License Agreement.
10. To the extent the allegations state a legal conclusion no response is required.
11. To the extent the allegations state a legal conclusion no response is required. The

Defendants admit that the Plaintiff made certain monthly payments, and the Defendants admit that 2FA received a letter from Passlogix dated March 5, 2007.

12. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that they had received monetary payments from the Plaintiff, and the Defendants admit that 2FA claimed that it transmitted on November 2, 2007 a facsimile notice contending Passlogix was in breach of the License Agreement.

13. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that they sent a January 4, 2008 termination letter to the Plaintiff and that it was rescinded.

14. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that the Plaintiff lost its exclusivity. The Defendants admit that the parties entered into Amendment B. The terms of Amendment B speak for themselves.

15. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that the parties entered into Amendments C and D. The terms of Amendments C and D speak for themselves.

16. To the extent the allegations state a legal conclusion no response is required.

17. To the extent the allegations state a legal conclusion no response is required. The Defendants admit that on December 15, 2008 they sent a Termination Letter to the Plaintiff, that the Termination Letter contained multiple claims of material breaches, and that the Defendants demanded a payment from the Plaintiff of \$150,878.48.

18. To the extent the allegations state a legal conclusion no response is required.

19. To the extent the allegations state a legal conclusion no response is required.

COUNTERCLAIM

Defendants and Counterclaimants 2FA Technology LLC and 2FA, Inc., by and through counsel, hereby counterclaim against Plaintiff and Counter-Defendant Passlogix, Inc. (“Passlogix”), as follows:

PARTIES

1. 2FA Technology LLC and 2FA, Inc (“2FA”) are a limited liability company and a corporation, respectively, organized and existing under the laws of the State of Texas with their principal place of business located at 930 S. Bell Boulevard, Suite 402, Cedar Park, Texas 78613.
2. Passlogix, Inc. is a Delaware corporation that maintains its principal place of business at 75 Broad Street, Suite 815, New York, New York 10004.

JURISDICTION AND VENUE

3. Jurisdiction in this action is based on 28 U.S.C. § 1332 because the matter is between citizens of different States and exceeds the sum of \$75,000, exclusive of interests and costs. Jurisdiction is also based on §§ 1331, 1338, 1367 and 2201.
4. Venue is proper in this action under § 28 U.S.C. 1391(a) and/or (b).
5. This Court has personal jurisdiction over the Counterdefendant because, among other things, Counterdefendant does business in this jurisdiction, and because Counter-Defendant has committed acts that caused injury within this jurisdiction.

NATURE OF ACTION

6. This counterclaim is brought by 2FA against Passlogix on the basis of Passlogix’s failure to comply with its contractual obligations and its unlawful use of 2FA’s technology. When the parties executed the License Agreement, 2FA was a new

company, with Passlogix as its sole customer. Passlogix was unwilling to dedicate sufficient resources to comply with its contractual obligations, used its leverage in the relationship to undertake activities to create an environment that caused significant operational and financial difficulties for 2FA, violated the non-competition and confidentiality provisions of the License Agreement, as amended, and illegally misappropriated 2FA's intellectual property for its own commercial purposes.

FACTS

7. On April 24, 2006 the parties entered into a License Agreement, which subsequently was amended four times.

8. The essence of the License Agreement was, as referred to in the information technology industry, an Original Equipment Manufacturer Agreement ("OEM" Agreement). In such an agreement, a company, in this case Passlogix, acquires a license to use the software of a second company, 2FA, and to rebrand or include that software as component of its own software offerings.

9. Passlogix was established in 1996 with its primary software offering of the "... first usable enterprise single sign-on ("ESSO") solution ...", which allowed users in large companies to use a single sign-on for multiple tasks.

10. To enable the company to sell a more complete and comprehensive software package, Passlogix became interested in bundling strong authentication software with ESSO so that its software offering also could include the capability to manage the authentication of each user on a large network.

11. 2FA was established in April 2006 as a "... security software company committed to delivering strong authentication solutions that simplify deployment and operational

processes ...”. Its first product was 2FA CM.

12. 2FA was not interested in marketing its software directly to the end user. Rather, its business was established as an original equipment manufacturer; consequently, it sought companies that could take on the marketing and sales efforts, allowing bundling its software with complimentary products or allowing third parties to rebrand its software.

13. The principals of Passlogix knew 2FA’s founders, Greg Salyards and Shaun Cuttill, before they established 2FA. In light of the two founders’ strong background and knowledge of strong authentication software, Passlogix was interested in both coming to work at Passlogix.

14. However, the two founders chose to start their own company, and based upon past relationships and knowledge of each other, Passlogix and 2FA entered into an exclusive License Agreement. Passlogix became 2FA’s first and only customer.

15. The License Agreement was to serve as the basis of a Passlogix collaboration with 2FA to grow a strong authentication business within Passlogix – an aspect of Passlogix’s business that was non-existent before its relationship with 2FA. 2FA’s CM software was then rebranded to become Passlogix’s v-GO CM software package.

16. Among the provisions of the License Agreement, Passlogix had “... the right to terminate the License Agreement at any time, without cause, upon sixty (60) days prior written notice to 2FA” (Paragraph 11.3), and Passlogix had the exclusive right to purchase “... all 2FA intellectual property relating to the Software owned by 2FA ...” according to agreed upon calculations. (Paragraph 16.0).

17. 2FA fully complied with its contractual obligations pursuant to the License

Agreement, and provided Passlogix with activities and services beyond its contractual obligations.

18. However, from the beginning of the new relationship, among other things, Passlogix unilaterally expanded the statement of work, was uncooperative, difficult to engage in management and technical matters, failed to respond to marketing and sales leads provided by 2FA, undertook actions that effectively competed against 2FA's technology, failed to comply with contractual confidentiality and non-competition provisions, misappropriated 2FA's trade secrets and proprietary information, and was consistently late in making the required contractual payments. Further, on July 7, 2006, Passlogix informed 2FA that it was halting all discussions with Passlogix's OEM customers – such as Oracle and IBM – about selling the v-GO CM software package, thus severely limiting 2FA's revenue potential.

19. The difficulties in working with Passlogix resulted in the necessity of executing four amendments to the License Agreement. The first, Amendment A, was entered into on March 1, 2007 in order to allow a means for joint development of a feature set called Active Directory as a Data Repository, and to bring the teams together and ease points of friction. At the time of signing Amendment A Passlogix owed 2FA more than \$125,000.00.

20. On June 14, 2007, 2FA informed Passlogix that it was infringing 2FA's intellectual property rights and was in violation of the non-compete provision in the License Agreement. The infringement of 2FA's intellectual property, Passlogix's misappropriation of 2FA's confidential information for its own purposes, and violations of the non-compete and confidentiality provisions of the License Agreement continued,

despite 2FA's notification.

21. On December 27, 2007 Passlogix demanded that 2FA meet to discuss alternatives to the License Agreement.

22. The parties met on January 3, 2008, on which date Passlogix proposed terms that were unacceptable to 2FA, including an offer to purchase 2FA's intellectual property at a price far below the contractually agreed upon calculation.

23. Amendment B was signed on August 8, 2008, and represents the winding down of the OEM relationship between the parties, and the transition into a reseller relationship. In Amendment B, among other items, the parties agreed to make good faith efforts to enter into a Reseller Agreement whereby Passlogix would resell the 2FA software as a stand-alone product rather than as its own branded offering, and whereby Passlogix would suggest to existing customers that they transition to 2FA for maintenance and support. Amendments C and D, executed October 7, 2008 and October 24, 2008 respectively, detailed procedural aspects of the transition.

24. In accordance with the License Agreement, as amended, a draft Reseller Agreement was prepared by 2FA and submitted to Passlogix. However, Passlogix failed to make a reasonable good faith effort to enter into the Reseller Agreement, and the proposed Reseller Agreement was never executed, although Passlogix continues to represent itself to third parties that it is a reseller of 2FA's software.

25. Contrary to its obligation as set forth in Amendment B, Passlogix interfered with 2FA's opportunities to obtain maintenance and support contracts, and otherwise interfered with 2FA's business relations with third parties.

26. Passlogix engaged in unethical accounting practices in violation of the License

Agreement, its own policy and accounting regulations by improperly allocating discounts and modifying pricing schedules, and failed to comply in a timely manner to 2FA's request to exercise its right to an audit of Passlogix's accounting practices in accordance with the License Agreement.

27. In 2008 Passlogix presented to existing customers alternative technology to replace CM and compete against v-GO CM in direct violation of the License Agreement as amended.

28. Passlogix developed enhancements to its own software that included features taken from 2FA without 2FA's permission, leveraging 2FA's intellectual property while having complete, unobstructed access to 2FA's source code.

29. Although required by the License Agreement, as amended, Passlogix was contractually obligated to return all intellectual property to 2FA prior to the termination of the Transition Period, yet Passlogix did not satisfy its contractual obligation and failed to return 2FA's intellectual property to 2FA.

30. In light of Passlogix's consistent failures in complying with its contractual obligations, and its intentional actions undertaken to harm 2FA, Passlogix was notified that 2FA would issue a termination letter.

31. On December 15, 2008, 2FA sent the Letter of Termination to Passlogix.

FIRST CAUSE OF ACTION
(Breach of Contract)

32. Counterclaimants repeat and incorporate herein by reference the allegations in the preceding paragraphs of this Counterclaim.

33. Passlogix breached its obligations under the License Agreement, as amended, by

withholding timely payments.

34. Passlogix breached its obligations under the License Agreement, as amended, by manipulating its financial records.

35. Passlogix breached its obligations under the License Agreement by violating the non-compete and confidentiality provisions of the License Agreement, as amended.

36. Passlogix breached its obligations under the License Agreement, as amended, by requiring services from 2FA that were not part of 2FA's legal obligations under the License Agreement.

37. Passlogix breached its obligations under the License Agreement, as amended, by failing to provide the appropriate technical, marketing, and sales efforts and resources required by the Agreement.

38. By reason of the foregoing, 2FA has been damaged as a result of Passlogix's illegal actions in amounts that will be determined at trial, but believed not to be less than \$5,000,000 plus interest.

**SECOND CAUSE OF ACTION
(Breach of the Covenant of Good Faith and Fair Dealing)**

39. Counterclaimants repeat and incorporate herein by reference the allegations in the preceding paragraphs of this Counterclaim.

40. Passlogix had a legal obligation to undertake its activities pursuant to the License Agreement in a manner consistent with good faith and fair dealing. In undertaking actions throughout the contractual relationship to harm 2FA, Passlogix breached the covenant of good faith and fair dealing.

41. By reason of the foregoing, 2FA has been damaged as a result of Passlogix's

illegal actions in amounts that will be determined at trial, but believed not to be less than \$5,000,000 plus interest.

**THIRD CAUSE OF ACTION
(Unfair Competition)**

42. Counterclaimants repeat and incorporate herein by reference the allegations in the preceding paragraphs of this Counterclaim.

43. Passlogix used its leverage in the relationship in an attempt to obtain 2FA's intellectual property at a price far below the market value, and engaged in deceptive and wrongful business practices to the commercial detriment of 2FA. Passlogix's conduct was intentional, willful, wanton and malicious.

44. By reason of the foregoing, 2FA has been damaged as a result of Passlogix's illegal actions in amounts that will be determined at trial, but believed not to be less than \$5,000,000 plus interest. In addition, 2FA requests an award of punitive damages to be determined at trial.

**FOURTH CAUSE OF ACTION
(Misappropriation)**

41. Counterclaimants repeat and incorporate herein by reference the allegations in the preceding paragraphs of this Counterclaim.

42. Passlogix unlawfully appropriated the intellectual property of 2FA for its own commercial advantage, and such conduct was intentional, willful, wanton and malicious.

43. By reason of the foregoing, 2FA has been damaged as a result of Passlogix's illegal actions in amounts that will be determined at trial, but believed not to be less than \$10,000,000 plus interest. In addition, 2FA requests an award of punitive damages to be determined at trial.

**FIFTH CAUSE OF ACTION
(Interference with Business Relations)**

44. Counterclaimants repeat and incorporate herein by reference the allegations in the preceding paragraphs of this Counterclaim.

45. Passlogix has unlawfully interfered with 2FA's contractual and business relationship with third parties, and such conduct was intentional, willful, wanton and malicious.

46. By reason of the foregoing, 2FA has been damaged as a result of Passlogix's illegal actions in amounts that will be determined at trial, but believed not to be less than \$5,000,000 plus interest. In addition, 2FA requests an award of punitive damages to be determined at trial.

PRAYER FOR RELIEF

WHEREFORE, the Defendants respectfully request the Court to:

- A. Dismiss the Plaintiff's Amended Complaint with prejudice.
- B. Deny the Plaintiff's request for a Declaratory Judgment.
- C. On Counterclaimants' First Cause of Action, award the Counterclaimant damages to be proven at trial, but believed to be not less than \$5,000,000.
- D. On Counterclaimants' Second Cause of Action, award the Counterclaimant damages to be proven at trial, but believed to be not less than \$5,000,000.
- E. On Counterclaimants' Third Cause of Action, award the Counterclaimant damages to be proven at trial, but believed to be not less than \$5,000,000.
- F. On Counterclaimants' Fourth Cause of Action, award the Counterclaimant damages to be proven at trial, but believed to be not less than \$10,000,000.

- G. On Counterclaimants' Fifth Cause of Action, award the Counterclaimant damages to be proven at trial, but believed to be not less than \$5,000,000.
- H. Award the Defendants and Counterclaimants reasonable costs and attorney's fees incurred in defending Plaintiff's Amended Complaint and pursuing its Counterclaim.
- I. Award punitive damages in the amount of \$10,000,00.00 to Counterclaimants for the intentional, willful, wanton, and malicious conduct undertaken by Passlogix.
- J. Award equitable relief in the form of preliminary and permanent injunctions, including but not limited to enjoining Passlogix from the use of any of 2FA's intellectual property; and
- K. Award the Defendants and Counterclaimants such other and further relief as the Court shall find just and proper.

Dated: January 30, 2009

FRANCIS N. RUIZ

By: 

Francis N. Ruiz (JD 0308)
169-26 Hillsdale Avenue, 2nd Floor
New York, NY 11432
Tele: (718) 535-7925
Fax: (718) 228-6564

Of Counsel
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Laurence Singer (LS 4250)
Attorney at Law
1629 K Street NW, Suite 300
Washington D.C., 20006
646 327-8772

TO: Hal S. Shaftel, Esq.
1585 Broadway, New York, New York 10036-8299