Lester v Capo
2016 NY Slip Op 30214(U)
February 5, 2016
Supreme Court, New York County
Docket Number: 651134/2014
Judge: Eileen Bransten
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[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK PART 3

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MARC LESTER, MARC LESTER ANTIQUES & BROCANTE, LLC, and BEAUX-ARTS AUCTION, LLC,

Plaintiffs,

- against -

MICHAEL CAPO, KENNETH ROSENBLUM, JEROME MAZZEO, and BEAUX-ARTS AUCTION, LLC

Defendants.

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Index No.: 651134/2014
Motion Date: 10/21/2015
Motion Seq. Nos.: 001, 002, 003

MICHAEL CAPO, KENNETH ROSENBLUM, JEROME MAZZEO, and BEAUX-ARTS AUCTION, LLC,

Counterclaim-Plaintiffs
and Third Party Plaintiffs,

- against -

MARC LESTER, MARC LESTER ANTIQUES & BROCANTE, LLC, BEAUX-ARTS AUCTION, LLC, JOSEPH J. ASTERITA, and PATRICIA LEE

Counterclaim-Defendants
and Third Party Defendants.

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BRANSTEN, J.:

Motion Sequence Numbers 001, 002, and 003 are consolidated for disposition.

Plaintiffs Marc Lester, Marc Lester Antiques & Brocante, LLC ("MLAB"), and Beaux-Arts Auction, LLC (collectively, "Plaintiffs") brought this action asserting various direct and derivative claims against Lester's business partners: Michael Capo, Kenneth Rosenblum, Jerome Mazzeo, and, nominally, Beaux-Arts Auction, LLC (collectively, "Defendants" or the "Capo Parties"). Defendants filed a Verified Answer, Counterclaims and Third Party Complaint[1] asserting 19 counterclaims and third party claims against the Plaintiffs and two additional individuals: Patricia Lee, Marc Lester's wife, and Joseph J. Asterita, the attorney who represented the Company during the relevant time-period (collectively, "Third Party Defendants"). Joseph J. Asterita brings a motion to dismiss the claims against him in the Third Party Complaint (Motion Sequence No. 001). Marc Lester and his wife, Patricia Lee, bring a separate motion to dismiss the claims against them in the Third Party Complaint (Motion Sequence No. 002). Finally, Defendants Rosenblum and Mazzeo bring a third motion to dismiss the claims against them in the Complaint (Motion Sequence No. 003).

The Court will address each motion in turn.

[1] "Third Party Compl.," Docket No. 8.

I. BACKGROUND[2]

On May 7, 2013, Plaintiff Marc Lester and Defendant Michael Capo formed Beaux-Arts Auction, LLC, a New York Limited Liability Company ("Beaux-Arts," or the "Company"). Lester and Capo were the original members of the Company, which operated as an auction house for luxury items such as furniture, paintings, and antiques. Plaintiff Lester caused MLAB – an entity which Lester controlled – to invest $150,000 in Beaux-Arts. Initially, Lester and Capo agreed that they would be the sole managing members of Beaux-Arts. The Company's tumultuous existence culminated in this litigation involving, as it does, over two dozen claims and counterclaims.

A. The Initial Investments in the Company

The Capo Parties allege that throughout 2013, Lee and Lester made oral and written misrepresentations regarding the Company's financial prospects to mislead prospective investors. In April or May of 2013, prior to the Company's formation, Lee and Lester hosted investors at their home to attract capital for the Company. They allegedly stated that they would raise $1 million in capital, and that the Company's expected gross revenues would grow from $3 million in 2013 to $7 million in 2017. Moreover, Lee and Lester stated that they had extensive experience and connections in the finance world, and that they would tap their connections to accelerate the Company's

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[2] Unless otherwise noted, the facts in this section are taken from Plaintiffs' Complaint (Docket No. 1), and Defendants' Third Party Complaint, Docket No. 8.

growth. Specifically, they told investors they had relationships with executives at Sotheby's and Sherry Lehmann, which could lead to millions of dollars in annual sales for the Company. (Third Party Compl. ¶ 27.)

According to Defendants, shortly after the Company's formation, Lee and Lester caused the Company to hire Third Party Defendant Joseph J. Asterita as its attorney. Asterita allegedly drafted Offering Memoranda and other documents that were distributed to several individuals in order to solicit their investments. Defendants allege that Asterita assisted Lee and Lester's fraudulent scheme by knowingly preparing and presenting various documents that contained material misrepresentations. A presentation entitled "Investment Opportunity," dated June 2013, was distributed to prospective investors. (Docket No. 36.) An Offering Memorandum dated September 30, 2013 set forth the terms of a private offering (the "September Memorandum"). (Docket No. 37.) On December 11, 2013, the Company issued a second Offering Memorandum, attaching an exhibit entitled "Operating Agreement" to be executed by the Company's members (the "December Memorandum"). (Docket No. 38.)

The Capo Parties allege that Asterita knew or should have known, as early as October 2013, that the Company was underfunded. Despite this knowledge, Asterita assisted Lester and Lee's allegedly fraudulent scheme by continuing to act as the Company's attorney and drafting the offering documents. In addition, the Third Party Complaint alleges that Rosenblum initially deposited his investment with Asterita, who released it to the Company in December 2013 (with Rosenblum's consent), despite

knowing that the Company would be unable to generate future profits. The Capo Parties generally contend that Asterita included material misrepresentations in the documents he drafted, and that he failed to make any additional disclosures about the Company's finances to the individual investors who reviewed the documents.

Several investors acquired minority membership interests in the Company. Plaintiffs allege that MLAB made a capital contribution to the Company in the amount of $150,000 for its 15% membership interest. Defendant Rosenblum invested $50,000 for a 5% membership interest. Defendant Mazzeo also invested $50,000 for a 5% membership interest. Non-parties Martin Lane and Judith Chessman Beraka invested $100,000 and $50,000, for 10% and 5% membership interests, respectively.

As co-Managing Members, Lester was awarded a 35% membership interest and Capo was awarded a 25% membership interest. The December 2013 Offering Memorandum also provided that for their role as Managing Members, Lester and Capo would be entitled to guaranteed payments of $150,000 per year beginning in 2014.

B. Operations in 2013

According to Defendants, after forming the Company, Lester designated Patricia Lee as his contact for the company's business and delegated his responsibilities to her. (Third Party Compl. ¶ 11.) Defendants contend that Lee and Lester immediately engaged in a pattern of waste and mismanagement that threatened the Company's financial stability. On September 23, 2013, Lester and Lee allegedly caused the Company to enter

into a seven-year lease for commercial space, depositing $112,678.12 and committing to a monthly rent of $13,287.81. (Third Party Compl. ¶ 23.) Defendants allege that this Lease was excessive, particularly because Capo had identified an alternate property for $8,500 per month. On October 2013, Lester and Lee caused the Company to enter into a second lease for additional space, at an annual base rent of approximately $14,966.55 (the "Second Lease"). *Id.* Defendants allege that the second rental space has never been used for the Company's business, and is exclusively employed by Lester and Lee to store their personal effects. *Id.*

In addition to the rental space, Lester and Lee allegedly hired several employees at excessive rates, and caused the Company to spend $4,000 on a safe and $20,000 on a website. They also spent exorbitant amounts courting business prospects, which have not generated any revenue for the Company.

The Company's first auction took place in October 2013, with subsequent monthly auctions being held at least through February 2014. According to Plaintiffs, these auctions generated average monthly sales of $130,000, far below the parties' expectations of $250,000. (Compl. ¶¶ 13-17.)

C. *The January 24, 2014 Members' Meeting*

Plaintiffs allege that at a January 24, 2014 meeting, Capo requested to increase his membership percentage to 40%, and asked to reduce Lester's percentage to 20%. Plaintiff Lester agreed to reduce his membership interest to 20% in exchange for $68,750, and a guarantee that he would receive future payments equal to those made to Capo. (Compl. ¶ 39.)

Meanwhile, Defendants deny agreeing to pay Lester $68,750 at the meeting. (Answer, ¶¶ 39-40.) Instead, they allege that after months of mismanagement and deception, Lester and Lee finally revealed that the Company was "technically bankrupt."[3] Five days after the Company meeting, on January 29, 2014, Lester surreptitiously wrote himself check number 154 from the Company's JP Morgan Chase bank account for $45,319.43, and authorized the Company's payroll service, Paychex, to pay himself $23,430.57, totaling $68,750.

Plaintiffs maintain that Lester drafted the check from the Company's account in reliance on the parties' agreement, but claim "Capo apparently changed his mind" and contacted JP Morgan Chase Bank to place a "fraud alert" on the Check. Lester alleges that Capo and Rosenblum lied to the bank's employees by stating that Lester had stolen cash from the Company's premises and defrauded the Company. Capo and Rosenblum

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[3] The Court has not been notified of any bankruptcy filing by any party to this action.

are also alleged to have made false statements regarding Lester to the other members of the Company. (Compl. ¶ 183.)

Upon receipt of the fraud alert, JP Morgan Chase Bank prevented Lester from withdrawing the funds and closed the Company's bank account. Thus, neither party disputes that Defendants successfully prevented Lester from withdrawing the funds. (Third Party Compl. ¶ 32.)

D. Defamatory Statements

It is also alleged that several acrimonious verbal exchanges took place during this time period. Lester asserts that Capo's statements to JP Morgan Chase Bank's employees, including that Lester stole cash from the Company's premises and that he committed fraud, amounted to defamation. Meanwhile, Defendants allege that Lee made false statements about Capo, telling other members that he was a "slow player" who made the Company look "stupid" in the media. (Third Party Compl. ¶ 36.) On January 28, 2014, Lee also told the Company's staff that Capo was "dishonest" and perpetrated "tax fraud." (Third Party Compl. ¶ 37.) Finally, on April 21, 2014, Lester allegedly disparaged Capo to executives at Sotheby's.

E. The February 14, 2014 Members' Meeting

Following the dispute about Lester's withdrawal of funds, the Company's members met on February 14, 2014 and proposed certain resolutions. These included removing Lester as Managing Member, removing Lester from the Company's bank accounts, and prohibiting Lester from taking unilateral action on behalf of the Company. Plaintiffs allege that Defendants changed the locks to the Company's premises, removed Lester from the company's website, and prevented him from being involved in the Company's business. Plaintiffs challenge the validity of these resolutions. Despite Plaintiffs' objections, Defendants acted as if the resolutions had passed. Two months after being ousted, Lester brought this action on April 11, 2014. On June 3, 2014, Defendants filed their Answer and Counterclaims, asserting 19 causes of action against Plaintiffs and Third Party Defendants.

Against this backdrop, the Court proceeds to examine the numerous claims.

II. LEGAL STANDARD

Motion Sequence No. 001 is Third Party Defendant Joseph J. Asterita's motion to dismiss the Third Party Complaint pursuant to CPLR 3211(a)(1) and (a)(7). Motion Sequence No. 002 is Marc Lester, MLAB, and Patricia Lee's motion to dismiss the Third Party Complaint pursuant to CPLR 3211(a)(1) and (a)(7). Finally, Motion Sequence No. 003 is Defendants Rosenblum and Mazzeo's motion to dismiss the First and Seventh Causes of action asserted against them in the Complaint pursuant to CPLR 3211(a)(7).

A motion to dismiss for failure to state a claim pursuant to CPLR 3211(a)(7) must be denied if the factual allegations contained "within the pleadings' four corners . . . manifest any cause of action cognizable at law." *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 152 (2002). The facts alleged in the complaint must be accepted as true, and the plaintiffs accorded the benefit of every possible favorable inference. *Leon v. Martinez*, 84 N.Y.2d 83, 87 (1994). Conversely, "allegations consisting of bare legal conclusions as well as factual claims flatly contradicted by documentary evidence are not entitled to any such consideration." *David v. Hack*, 97 A.D.3d 437, 438 (1st Dep't 2012). Whether a plaintiff can ultimately establish its allegations may not be considered when deciding a motion to dismiss. *EBC I, Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 19 (2005).

Similarly, on a motion to dismiss based upon documentary evidence pursuant to CPLR 3211(a)(1), the Court must accept as true the facts alleged in the complaint and afford plaintiff the benefit of every favorable inference. *Chapman, Spira & Carson, LLC v. Helix BioPharma Corp.*, 115 A.D.3d 526, 527 (1st Dep't 2014) (citing *Leon v. Martinez*, 84 N.Y.2d 83, 87 (1994)). Such motion "may be appropriately granted only where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Rubinstein v. Salomon*, 46 A.D.3d 536, 539 (2d Dep't 2007).

III. DISCUSSION

A. *Third Party Defendant Asterita's Motion to Dismiss (Motion Seq. 001)*

Third Party Defendant Joseph J. Asterita moves to dismiss the three causes of action asserted against him by the Capo Parties in the Third Party Complaint: aiding and abetting breach of fiduciary duty (Count Five); aiding and abetting fraud (Count Eight); and negligent misrepresentation (Count Eleven). The Court will address each cause of action in turn.

1. Aiding and Abetting Fraud (Count Eight)

The Capo Parties generally allege that the Offering Memoranda prepared by Asterita in his role as the Company's attorney contained misrepresentations and omissions, and that Asterita was aware – or should have been – that the documents misrepresented the Company's financials. (Third Party Compl. ¶ 83.) Specifically, the Capo Parties allege that Asterita knew the Company was grossly underfunded and headed towards insolvency as early as October 2013, but failed to disclose that to investors. (Third Party Compl. ¶ 15); (Br. Opp'n at 8.)

Asterita argues that the Third Party Complaint fails to allege that he provided substantial assistance to fraud. First, Asterita contends that the documents he drafted as the Company's attorney do not contain any misrepresentations that could support a fraud claim. Second, he argues that as the Company's attorney, he had no independent relationship with the investors giving rise to a duty to make additional disclosures. For

the following reasons, the Court concludes that Count Eight of the Third Party Complaint fails to state a claim.

In order to properly plead a claim for aiding and abetting fraud, a complaint must allege: (1) the underlying fraud; (2) knowledge of the fraud; and (3) "substantial assistance" by the defendant in achievement of the fraud. *Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, 64 A.D.3d 472, 476 (1st Dep't 2009). "Substantial assistance" exists where (1) a defendant affirmatively assists, helps conceal, or fails to act when required to do so, enabling the fraud to proceed, and (2) the aider and abettor's actions proximately cause plaintiff's harm. *Id.* (citing *UniCredito Italiano SPA v. JPMorgan Chase Bank*, 288 F. Supp. 2d 485, 502 (S.D.N.Y. 2003)). While, "a plaintiff need not produce absolute proof of fraud . . . [and] there may be cases in which particular facts are within a defendant's possession, it is also true that the strength of the requisite inference of fraud will vary based on the facts and context of each case." *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 560 (2009).

The Court concludes that the Capo Parties have failed to allege that Asterita provided substantial assistance to fraud. First, Asterita correctly points out that the Third Party Complaint fails to specifically allege that he prepared any document besides the Offering Memoranda. (Third Party Compl. ¶ 83.)[4] To the extent the aiding and abetting

[4] The Third Party Complaint asserts that "Asterita provided substantial assistance ... by jointly drafting and distributing ... the Offering Memoranda *and other materials* that contained misrepresentations..." (Third Party Complaint ¶ 83) (emphasis added).

fraud claim is based on the Offering Memoranda, the Complaint fails to identify any omissions or misrepresentations in those documents. *See generally* Third Party Compl. ¶¶ 81-84. While the Capo Parties allege that Lee and Lester made oral misrepresentations that the Company would raise $1,000,000, (Third Party Compl. ¶ 82), the Offering Memoranda indicate that the net proceeds from the sale of Membership Interests are estimated at "approximately $400,000" and neither document represents that $1,000,000 would be raised. (Lester Aff., Ex. B, at 10; Lester Aff., Ex. C, at 10.)

Additionally, the court rejects the Capo Parties' contention that Asterita owed them some independent duty requiring him to make additional disclosures about the Company. In *Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, the First Department rejected an aiding and abetting fraud claim based on similar allegations that "[defendants who distributed investment presentation materials] assisted in the alleged fraud by failing to disclose [the company's] insolvency." 64 A.D.3d 472, 476 (1st Dep't 2009). The *Stanfield Offshore* court reasoned that such allegations were "insufficient to support a claim of aiding and abetting fraud absent a fiduciary duty or some other independent duty owed by [defendants] to the plaintiffs." *Id.*; *see also Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 562 (2009) ("In the absence of a

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Notably, Third Party Plaintiffs do not identify other documents or "materials" that were drafted by Asterita. The Court concludes that the allegations regarding "other materials" fail to meet the pleading standards of CPLR 3016(b), which require that causes of action based on fraud "be pleaded with sufficient detail to give adequate notice" of the claim. *Houbigant, Inc. v Deloitte & Touche LLP*, 303 A.D.2d 92, 97 (1st Dep't 2003).

fiduciary relationship, we perceive no legal duty obligating [law firm defendants] to make affirmative disclosures to plaintiffs under the circumstances of this case."). Here, the Offering Memoranda explicitly provide that Asterita was acting solely as counsel for the Company. *See* Lester Aff., Ex. B, at 3 ("Prospective investors are not to construe the contents of this offering memorandum as legal or tax advice. Each investor should consult his own counsel . . . ."). There are no other allegations that support the contention that Asterita was acting as counsel for the individuals or owed them any independent duty.

Accordingly, the Court concludes that Count Eight of the Third Party Complaint fails to state a claim for aiding and abetting fraud, and must be dismissed.

2. Aiding and Abetting Breach of Fiduciary Duty (Count Five)

Third Party Plaintiffs also allege that Asterita aided and abetted Lester and Lee's breaches of their fiduciary duties based on the same allegations of failure to disclose financials. (Third Party Compl. ¶¶ 65-68.) Specifically, Third Party Plaintiffs assert that Asterita aided and abetted Lester's breach of fiduciary duty by failing to disclose that the Company had failed to raise $1,000,000 and was on the brink of bankruptcy. *Id.*

To state a claim for aiding and abetting a breach of fiduciary duty, a plaintiff must allege "(1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damage as a result of the breach." *Kaufman v. Cohen*, 307 A.D.2d 113, 125 (1st Dep't 2003). A

defendant knowingly participates in the breach of fiduciary duty when they provide "substantial assistance" to the primary violators by helping to conceal or failing to act when required to do so, thereby enabling the underlying breach. *Art Capital Group, LLC v. Neuhaus*, 70 A.D.3d 605, 610 (1st Dep't 2010).

The Third Party Complaint fails to allege that Asterita provided "substantial assistance." As stated above, Asterita had no independent fiduciary relationship with the Capo Parties and otherwise had no duty to disclose details regarding the company's solvency. *See*, supra, Part III.A.1; *Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, 64 A.D.3d 472, 476 (1st Dep't 2009). For those same reasons, the aiding and abetting breach of fiduciary duty claim must be dismissed.

In addition, "public policy demands that attorneys, in the exercise of their proper functions as such, shall not be civilly liable for their acts when performed in good faith." *Compare Art Capital Group, LLC v. Neuhaus*, 70 A.D.3d 605, 606 (1st Dep't 2010); *Oster v. Kirschner*, 77 A.D.3d 51, 55 (1st Dep't 2010) (denying motion to dismiss several aiding and abetting claims against an attorney who acted in bad faith when, despite knowing that underlying tortfeasors had previously been convicted of securities fraud and been barred from the industry, he drafted private placement memoranda soliciting investments in an admitted Ponzi scheme). In *Art Capital Group*, the court dismissed a similar claim against a lawyer after finding that his alleged conduct fell "completely within the scope of [his] duties as an attorney." *Id.* Here, similarly, the Complaint does not assert that Asterita "acted in any capacity other than as an attorney," and there are no

allegations that he acted in bad faith. *Id.* Accordingly, the Capo Parties have failed to properly claim a cause of action against Asterita for aiding and abetting Lester's breach of fiduciary duty. Count Five of the Third Party Complaint must also be dismissed.

3. Negligent Misrepresentation (Count Eleven)

The Capo Parties assert a negligent misrepresentation claim against Asterita based on the same facts described above. They allege that Asterita knowingly failed to disclose material facts about the Company's finances to the prospective investors. For the following reasons, this claim is also dismissed.

To state a claim for negligent misrepresentation a plaintiff must allege: (1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information defendant relayed was incorrect; and (3) reasonable reliance on the information. *J.A.O. Acquisition Corp. v. Stavitsky*, 8 N.Y.3d 144, 148 (2007). Professionals, such as attorneys, "by virtue of their training and expertise, may have special relationships of confidence and trust with their clients." *Kimmell v. Schaefer*, 89 N.Y.2d 257, 263 (1996). The inquiry requires considering (1) whether a special relationship of trust or confidence existed, and (2) whether the speaker was aware of the use to which the information would be put and supplied it for that purpose." *MatlinPatterson ATA Holdings LLC v. Federal Express Corp.*, 87 A.D.3d 836, 840 (1st Dep't 2011) (citing *Kimmell*, 89 N.Y.2d at 264).

Although the Court has already concluded that no special relationship existed between Asterita and the individuals, the Capo Parties argue that in the context of negligent misrepresentation the existence of such relationship is a question of fact that cannot be resolved on a motion to dismiss. (Br. Opp'n at 11) (citing *Hutchins v. Utica Mut. Ins. Co.*, 107 A.D.2d 871, 873 (3d Dep't 1985)). However, in *MatlinPatterson ATA Holdings LLC*, the First Department affirmed the dismissal of a negligent misrepresentation claim because there was "no support for the conclusion that there was 'a special relationship of trust and confidence' between [defendants and plaintiffs]." 87 A.D.3d at 841. Here, the absence of allegations that such relationship existed similarly warrants dismissal of the claim. *Eurycleia Partners, LP*, 12 N.Y.3d at 561-62 ("It is well settled that a corporation's attorney represents the corporate entity, not its shareholders or employees."). Accordingly, the Court concludes that Count Eleven must also be dismissed.

4. Conclusion

For the foregoing reasons, Motion Sequence No. 001, Third Party Defendant Joseph J. Asterita's motion to dismiss the Third Party Complaint's claims against him, is granted in its entirety. Accordingly, Counts Five, Eight and Eleven of the Third Party Complaint are dismissed with prejudice.

B. The Lester-Lee Parties' Motion to Dismiss the Counterclaims[5] (Motion Seq. 002)

Plaintiffs Marc Lester and MLAB, together with Patricia Lee (collectively, the "Lester-Lee Parties"), move to dismiss the remaining claims and counterclaims in the Third Party Complaint pursuant to CPLR 3211(a)(1) and (a)(7). The Lester-Lee Parties argue that the allegations made by the Capo Parties fail to state claims cognizable at law. Because this motion involves over a dozen causes of action asserted by the Capo Parties, the Court will address each argument in turn. For the reasons that follow, the motion is granted in part and denied in part.

1. Derivative Claims – Demand Futility

At the outset, the Lester-Lee Parties argue that the derivative counterclaims, which are asserted on behalf of the Company against Lester and Lee, must be dismissed because the Capo Parties failed to make a demand, or plead demand futility with sufficient particularity.[6] (Br. Supp. at 6.) The Capo Parties do not argue that they made a demand on the Company, but contend that making such demand would have been futile. (Br.

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[5] When referenced in this section, "Br. Supp." refers to the Lester-Lee Parties' Memorandum of Law in Support of Motion to Dismiss Counterclaims (Docket No. 34), and "Br. Opp'n" refers to the Capo Parties' Memorandum of Law in Opposition (Docket No. 54).

[6] The Third Party Complaint asserts six derivative claims against the Lester-Lee Parties: 2nd Counterclaim – breach of fiduciary duty; 4th Counterclaim – aiding and abetting breach of fiduciary duty; 14th Counterclaim – accounting; 17th Counterclaim – breach of N.Y. LLC Law §409; and 18th Counterclaim – judicial dissolution pursuant to N.Y. LLC Law §702; and 19th Counterclaim – declaratory judgment.

Opp'n at 7.) For the following reasons, the Court determines that the Third Party Complaint sufficiently alleges demand futility.

Generally, a shareholder has no individual cause of action against a wrongdoer that harms only the corporation. *Serino v. Lipper*, 123 A.D.3d 34, 39 (1st Dep't 2014). When a wrong is directed solely at a corporation, the shareholder may bring a derivative suit on behalf of the entity to enforce its rights. N.Y. Bus. Corp. Law § 626(a); *Marx v. Akers*, 88 N.Y.2d 189, 193 (1996) (A derivative action is "brought in the right of a domestic or foreign corporation to procure a judgment in its favor."). The Court of Appeals has explicitly extended the right to bring derivative suits to members of limited liability companies ("LLCs"). *Tzolis v. Wolf*, 10 N.Y.3d 100, 103 (2008).

Before a derivative action is instituted against a corporation or LLC, the shareholder or member is required to make a demand upon the corporation to commence the action. *Marx v. Akers*, 88 N.Y.2d 189, 193 (1996); *see also Najjar Grp., LLC v. W. 56th Hotel LLC*, 110 A.D.3d 638, 639 (1st Dep't 2013) ("A pre-suit demand is similarly required in a derivative action involving a limited liability company."). This demand requirement is excused only when the complaint alleges with particularity that: "(1) a majority of the directors are interested in the transaction, or (2) the directors failed to inform themselves to a degree reasonably necessary about the transaction, or (3) the directors failed to exercise their business judgment in approving the transaction." *Wandel ex rel. Bed Bath & Beyond, Inc. v. Eisenberg*, 60 A.D.3d 77, 80 (1st Dep't 2009) (citing *Marx*, 88 N.Y.2d at 198). A director may be interested if they are self-interested in the

transaction, or if they lose independence due to the control of another interested director. *In re Comverse Tech., Inc.*, 56 A.D.3d 49, 54 (1st Dep't 2008). "Directors are self-interested in a challenged transaction where they will receive a direct financial benefit from the transaction which is different from the benefit to shareholders generally." *Id.* (citing *Marx*, 644 N.Y.S.2d at 202). In addition, courts may find that a director failed to exercise their business judgment when "the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment." *In re Omnicom Grp. Inc. S'holder Derivative Litig.*, 43 A.D.3d 766, 768 (1st Dep't 2007).

The Lester-Lee Parties argue that the Third Party Complaint fails to establish that Lester could have prevented the Company from instituting a lawsuit. Thus, they contend a demand would not have been futile. The Court disagrees. Viewing the Third Party Complaint's allegations in the light most favorable to the non-movants, it alleges that Lester and Lee controlled the company, took certain unilateral actions (including entering into leases), and moved the books and records of the company to their home. (Third Party Compl. ¶¶ 22, 25, 34.) Under these circumstances, Lester had the authority to take unilateral action to prevent the Company from instituting a lawsuit against himself. Moreover, Plaintiffs' Complaint and Defendants' Third Party Complaint both allege that Lester and Capo agreed to be the sole co-Managing Members of the Company. (Compl. ¶ 12; Third Party Compl. ¶ 11.) While Lester and Capo did not each own an equal 50% membership interest in the Company, both complaints assume that they were "intended to have equal interest in and control over" the Company. *See Executive Leasing Co. v.*

Leder, 191 A.D.2d 199, 200 (1993) (where two stockholders are intended to have equal control over a company, "an action cannot be maintained in the name of the corporation by one stockholder against another with an equal interest and degree of control over corporate affairs; the proper remedy is a stockholder's derivative action.") *Id.* 200. Accordingly, the Court concludes that a derivative suit is the appropriate action in this case.

Next, the Lester-Lee parties argue that Capo Parties' actions at the February 14, 2014 meeting refute the contention that demand should be excused. Specifically, the Lester-Lee parties contend that Third Party Plaintiffs took sweeping resolutions that exemplified their ability to get the Company to institute a lawsuit, including (i) removing Lester as co-Managing Members, (ii) removing him as signatory on Company accounts, and (iii) prohibiting Lester from acting on behalf of the Company without prior written authorization. (Br. Supp. at 7.) However, to the extent these allegations are contained in the Complaint, they have been denied by the Capo Parties. (Answer ¶¶ 49-59.) At this juncture, the Court cannot resolve this factual dispute in favor of the movants.

For the foregoing reasons, the Third Party Complaint properly alleges demand futility. Accordingly, the Court declines to dismiss the derivative claims in the Third Party Complaint for failure to make a demand. *Najjar Grp., LLC*, 110 A.D.3d at 639.

2. First Counterclaim – Direct Breach of Fiduciary Duty

The Lester-Lee parties next argue that the First Cause of Action for breach of fiduciary duty, asserted directly against Lester, must be dismissed because the wrongs alleged therein were committed against the Company. They argue the claim should have been brought derivatively. The Capo Parties counter that the wrongful conduct directly injured the individual members of the Company. The Court concludes that the First Counterclaim asserts derivative claims, and as a result must be dismissed.

As noted above, an LLC's member has no individual cause of action against a person that injures the entity, even if the injury diminishes the value of the member's interest. *Serino v. Lipper*, 123 A.D.3d 34, 39 (1st Dep't 2014). However, where a plaintiff alleges that a wrongdoer has breached "a duty owed directly to the shareholder which is independent of any duty owing to the corporation," he may state a direct claim on his own behalf. *Id.* at 39-40 (citing *Abrams v. Donati*, 66 N.Y.2d 951, 953 (1985)). In determining whether a claim is direct or derivative, the First Department adopted the test developed by the Supreme Court of Delaware. *See Yudell v. Gilbert*, 99 A.D.3d 108, 114 (1st Dep't 2012) (citing *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004). Pursuant to the *Tooley* test, a court must consider (1) who suffered the alleged harm and (2) who would receive the benefit of any recovery or other remedy. *Id.* In New York, "[a] complaint the allegations of which confuse a shareholder's derivative and individual rights will ... be dismissed." *Yudell v. Gilbert*, 99 A.D.3d 108, 115 (1st Dep't 2012) (citing *Abrams v. Donati*, 66 N.Y.2d 951, 953 (1985)).

The Lester-Lee parties correctly note that several injuries alleged in the First Counterclaim relate to the Company. (Third Party Compl. ¶ 47.) The First Counterclaim asserts that Lester "compromised the Company's members' membership interest in the Company," which the First Department has explicitly held cannot support a direct claim. *Serino v. Lipper*, 123 A.D.3d 34, 39, (1st Dep't 2014) ("It is black letter law that a stockholder has no individual cause of action against a person or entity that has injured the corporation. This is true notwithstanding that the wrongful acts may have diminished the value of the shares of the corporation. . . .").

The Capo Parties also allege that Lester "abdicated his responsibilities," engaged in "corporate waste and mismanagement," and spent "excessive resources in courting purported business prospects." (Third Party Compl. ¶ 47.) These allegations would only give rise to derivative claims for which only the Company could recover. *Abrams*, 66 N.Y.2d at 953. Moreover, to the extent that Plaintiffs have asserted any direct claims, "they are embedded in an otherwise derivative claim for . . . waste and mismanagement" in the First Counterclaim, and must be dismissed. *Yudell v. Gilbert*, 99 A.D.3d 108, 115 (1st Dep't 2012).

3. Third Counterclaim – Direct Aiding and Abetting a Breach of Fiduciary Duty

The Third Counterclaim corresponds to the First Counterclaim, asserting a direct claim against Lee for aiding and abetting Lester's direct breach of fiduciary duty. Because the Court concluded that the direct breach of fiduciary duty claim against Lester must be dismissed, (*see,* supra, Part III.B.2), the Third Counterclaim for aiding and abetting that underlying breach must also be dismissed. *OFSI Fund II, LLC v. Canadian Imperial Bank of Commerce*, 82 A.D.3d 537, 540 (1st Dep't 2011) ("As there is no breach of fiduciary duty claim, there can be no claim for aiding and abetting breach of fiduciary duty.").

4. Second Counterclaim – Derivative Breach of Fiduciary Duty

The Lester-Lee Parties next argue that the Second Counterclaim for breach of fiduciary duty (asserted derivatively against Lester) must be dismissed for failure to state a claim. First, they contend that Lester's delegation of certain duties to Lee cannot support the claim. Next, they maintain that the allegations of waste and mismanagement do not meet the specificity required under CPLR 3016(b), and that the alleged conduct is protected by the Business Judgment Rule.[7] For the following reasons, the Court

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[7] In addition to the allegations of delegation and waste and mismanagement, the Capo Parties allege that Lester's failure to provide the Company's books and records supports their derivative breach of fiduciary duty claim. (Third Party Compl. ¶ 51(iii).) This factual allegation cannot support a derivative claim for breach of fiduciary duty. While members of a limited liability company have an independent statutory right to conduct an

concludes that only the factual allegations related to the Second Lease can support a breach of fiduciary duty claim.

a. Lester's Alleged Delegation of Duties to Lee

In support for their contention that Lester's designation of Lee as his business contact amounted to a breach of fiduciary duty, Third Party Compl. ¶¶ 51(i), the Capo Parties cite *Out of Box Promotions, LLC v. Koschitzki*, 55 A.D.3d 575, 576 (2d Dep't 2008). *Koschitzki*, however, is entirely silent on this issue. *Id.* The Third Party Complaint alleges that Lester designated Lee as his contact for all business related to the Company, allowing Lee to assume his responsibilities. The Capo Parties do not adduce any legal support for the proposition that such delegation of duties could sustain a breach of fiduciary duty. Accordingly, the Court concludes that Lester's alleged delegation of duties to Lee is insufficient to support the First Counterclaim.

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inspection of the LLC's books and records, the Capo parties do not cite any support for the contention that a failure to provide such records to an individual member harms the company. *See Gartner v. Cardio Ventures, LLC*, 121 A.D.3d 609, 610 (1st Dep't 2014) (finding that an LLC's members have an independent statutory right to inspect its books and records); *see also* N.Y. LLC Law § 1102. Accordingly, the Court concludes that this portion of the Second Counterclaim cannot support a derivative claim for breach of fiduciary duty.

b. Waste and Mismanagement

The bulk of the Second Counterclaim is based on allegations of Lester's waste, mismanagement, and excessive spending. (Third Party Compl. ¶¶ 51(ii), 51(iv).) The Lester-Lee Parties contend (1) that the allegations of waste and mismanagement are not pled with sufficient particularity, and (2) that the Business Judgment Rule prevents the Court from scrutinizing the alleged conduct.

First, the Court concludes that the factual allegations of waste and mismanagement were pled with sufficient particularity pursuant to CPLR 3016(b). *See, e.g., Palmetto Partners, L.P. v. AJW Qualified Partners, LLC*, 83 A.D.3d 804, 808 (2011). The Third Party Complaint contains specific factual allegations that the Lester-Lee Parties over-spent on a Company safe, a website, staff, a 7-year commercial lease, and the Second Lease for unnecessary space. (Third Party Compl. ¶¶ 20-23.)

Although a complaint may set forth factual allegations of waste, the Business Judgment Rule "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." *Owen v. Hamilton*, 44 A.D.3d 452, 456 (1st Dep't 2007) (citing *Auerbach v. Bennett*, 47 N.Y.2d 619, 629 (1979)). "The presumptive applicability of the business judgment rule is rebutted, and judicial inquiry thereby triggered, however, by a showing that a breach of fiduciary duty occurred which includes evidence of bad faith, self-dealing, or by decisions made by directors demonstrably affected by inherent conflicts of interest." *Higgins v. New York Stock Exch., Inc.*, 10 Misc.3d 257, 278 (Sup.

Ct. N.Y. Cnty. 2005) (internal citations omitted). Thus, where managers engage in fraud or self-dealing, or make decisions affected by inherent conflicts of interest, the Rule does not foreclose judicial inquiry into their decisions. *Stilwell Value Partners, IV, L.P. v. Cavanaugh*, 41 Misc.3d 1216(A), at *2 (Sup. Ct. N.Y. Cnty. 2013), *aff'd*, 118 A.D.3d 518 (1st Dep't 2014).

Regarding most allegations of waste and mismanagement, the Third Party Complaint fails to set forth facts regarding fraud, self-dealing, or conflicts of interest sufficient to rebut the presumption of the Business Judgment Rule. The allegations that Lester and Lee spent excessive amounts on websites, consultants, and other business expenses are unaccompanied by factual allegations which suggest bad faith or fraud. (Third Party Compl. ¶¶ 20-21, 50(ii).) The claim that Lester spent too many resources courting prospective clients is similarly unaccompanied by facts demonstrating self-dealing or a conflict of interests. (Third Party Compl. ¶ 51(iv).) The same is true with regards to the seven-year lease entered into by the Company for a monthly rental of $20,000. (Third Party Compl. ¶ 22.) Without additional facts suggesting a breach of fiduciary duty, the Court cannot scrutinize these actions even if the results eventually showed that "what the directors did was unwise or inexpedient." *Jones v. Surrey Co-op. Apartments, Inc.*, 263 A.D.2d 33, 36 (1st Dep't 1999). Accordingly, the breach of fiduciary duty claims based on these facts must be dismissed.

c. The Second Lease

Conversely, the Third Party Complaint also alleges that Lester and Lee caused the Company to enter into the Second Lease at an annual rate of $14,966.55, which is "wholly unnecessary and has never been used for any function of the Company." (Third Party Compl. ¶ 23.) "In fact, this second property is used exclusively by and for Lee and Lester and their personal effects." *Id.* Viewing these allegations in the light most favorable to the Capo Parties, they support a claim that Lester and Lee entered into the Second Lease "affected by [an] inherent conflict of interest." *Cavanaugh*, 41 Misc. 3d 1216(A), at *2. As alleged, Lester used the Company's resources to enter into the Second Lease for his personal benefit, and not for any legitimate business purpose. Accordingly, as to this narrow allegation, the Second Counterclaim states a derivative claim for breach of fiduciary duty.

d. Conclusion

For the foregoing reasons, the Court concludes that most of the allegations in the Second Counterclaim fail to properly state a derivative claim for breach of fiduciary duty. Such claims therefore must be dismissed. However, the allegations that the Second Lease was for the personal benefit of Lee and Lester is sufficient to state a derivative cause of action for breach of fiduciary duty, and the Court declines to dismiss that particular narrow branch of the Second Counterclaim.

5. Fourth Counterclaim – Derivative Aiding and Abetting Fiduciary Breach

The Fourth Counterclaim corresponds to the Second Counterclaim, (*see*, supra, Part III.B.4), and asserts a claim against Lee for aiding and abetting Lester's derivative breach of fiduciary duty. As noted above, the derivative breach of fiduciary duty claim (Second Counterclaim) is dismissed except to the extent it alleges that Lester rented a second property for the sole purpose of keeping his personal effects. Accordingly, the derivative claim for aiding and abetting breach of fiduciary duty must be dismissed except to the extent that Lee is alleged to have aided and abetted Lester in entering into the second lease on behalf of the Company. *OFSI Fund II, LLC*, 82 A.D.3d at 540.

In further support of dismissal, the Lester-Lee parties additionally argue that even if an underlying claim exists, the "aiding and abetting" cause of action fails to properly allege that Lee knowingly induced or participated in Lester's breach, a necessary element of the claim. For the following reasons, the Court disagrees.

A claim for aiding and abetting a breach of fiduciary duty requires: (1) a breach of fiduciary duty by another; (2) that the defendant knowingly induced or participated in the breach; and (3) that the plaintiff suffered damage as a result of the breach. *Kaufman v. Cohen*, 307 A.D.2d 113, 125 (1st Dep't 2003). A plaintiff need not allege that the aider and abettor had intent to harm, but must allege "actual knowledge of the breach of duty." *Id.* A defendant "knowingly participates" in a breach of fiduciary duty only when they provide "substantial assistance" to the primary wrongdoer. *Art Capital Grp., LLC v. Neuhaus*, 70 A.D.3d 605, 610, 896 N.Y.S.2d 35 (2010) (citing *Kaufman*, 307 A.D.2d at

125). This occurs "when a defendant affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the breach to occur." *Id.*

The Third Party Complaint claims that Lee and Lester caused the company to lease the second space, which is "used exclusively by and for Lee and Lester for their personal effects." (Third Party Compl. ¶ 23.) In addition, the Complaint asserts a delegation of duties to Lee and states that she was aware of Lester's role as Managing Member. (Third Party Compl. ¶¶ 40, 61.) Accordingly, the Court concludes that the Fourth Counterclaim states a cause of action, but only based upon the Second Lease allegedly used for Lee and Lester's personal effects.[8] The Court therefore denies the motion with regards to that branch of the Fourth Counterclaim which is based on the Second Lease, but dismisses the claim as to the remaining allegations.

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[8] The Capo Parties also argue that Lee aided Lester's breach of fiduciary duty to the Company by assisting Lester in withdrawing nearly $70,000 out of the Company without authority. (Br. Opp'n at 15.) But the Capo Parties concedes that this was an unsuccessful attempt, and the money was never withdrawn. (Third Party Compl. ¶ 32.) The Capo Parties fail to argue that the Company was otherwise injured by this attempted withdrawal, which they successfully thwarted. Accordingly, the Third Party Complaint does not sufficiently allege that the attempt to withdraw $70,000 caused any damage to the Company, a necessary element of both claims. *See Burry v. Madison Park Owner LLC,* 84 A.D.3d 699, 700 (2011) (breach of fiduciary duty claim requires pleading damages); *see also Kaufman*, 307 A.D.2d at 125 (a claim for aiding and abetting a breach of fiduciary duty requires pleading damages). Thus, this argument is unavailing.

6. Sixteenth and Seventeenth Counterclaims – Violations of N.Y. LLC Law §409

The Sixteenth and Seventeenth Counterclaims assert direct and derivative claims for violations of N.Y. LLC Law § 409. The claims are asserted against both Lester and Lee, and are founded upon the same allegations that purport to state claims for breach of fiduciary duty.

Section 409 requires that a manager perform his duties "in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances." N.Y. LLC Law § 409(a). It provides a statutory basis for imposing fiduciary duties on managers of LLCs. *See Tzolis v Wolff*, 39 A.D.3d 138, 146 (1st Dep't 2007), *aff'd*, 10 N.Y.3d 100 (2008). Therefore, managers owe common-law fiduciary duties as well as corresponding statutory duties rooted in Section 409. *Le Metier Beauty Inv. Partners LLC v. Metier Tribeca, LLC*, 13 CIV. 4650, 2015 WL 769573, at *8 (S.D.N.Y. Feb. 24, 2015).

At the outset, the Court dismisses the Section 409 claims against Lee. Although Lee is mentioned in the headings of both claims, the complaint alleges that only Lester had obligations under the N.Y. LLC Law. (Third Party Compl. ¶¶ 131, 135) ("N.Y. Limited Liability Company Law §409 requires *Lester* to . . . .") (emphasis added). Accordingly, the Sixteenth and Seventeenth Counterclaims fail to state causes of action against Lee.

Additionally, because the Court dismissed the direct breach of fiduciary duty claim, (*see*, supra, Part III.B.3), it logically follows that the analogous claim asserting a

direct violation of LLC Law §409 must also be dismissed. Accordingly, the Sixteenth Counterclaim is dismissed in its entirety.

Finally, the Second Counterclaim for a derivative breach of fiduciary duty was dismissed except for the narrow branch of the claim which alleges that Lester caused the company to enter into the Second Lease for personal use. *See*, supra, Part III.B.4.c. Accordingly, the Court concludes that the corresponding Seventeenth Counterclaim for breach of the N.Y. LLC Law §409 must be dismissed to the same extent.

For the foregoing reasons, the Sixteenth Counterclaim is dismissed in its entirety, and the Seventeenth Counterclaim is dismissed in part, except for the branch of the claim based on the allegations that Lester entered into a Second Lease for his personal benefit.

7. Sixth Counterclaim – Fraud by Lester and Lee

The Sixth Count asserts a fraud claim based upon Lester and Lee's misrepresentations about the Company's financial viability and its projected earnings. The Lester-Lee Parties argue that the Third Party Complaint fails to state a fraud claim because the alleged misrepresentations were opinions or puffery, or statements about future expectations. For the reasons that follow, the fraud claim is dismissed, without prejudice.

a. Elements of a Fraud Claim

To state a fraud claim, plaintiffs are required to plead: (1) a material misrepresentation or omission of fact; (2) knowledge of its falsity; (3) intent to induce reliance; (4) justifiable reliance; and (5) resulting damages. *Nicosia v. Bd. of Managers of Weber House Condo.*, 77 A.D.3d 455, 456 (1st Dep't 2010). The underlying circumstances of the alleged fraud must be pled with particularity. CPLR 3016(b); *FNF Touring LLC v. Transform Am. Corp.*, 111 A.D.3d 401, 402 (1st Dep't 2013). Where the misrepresentations consist of mere puffery, opinions of value, or future expectations, they cannot support a fraud claim. *Sidamonidze v. Kay*, 304 A.D.2d 415, 416 (1st Dep't 2003); *see also Laduzinski v. Alvarez & Marsal Taxand LLC*, 132 A.D.3d 164, 168 (1st Dep't 2015) (stating that representations regarding future expectations cannot sustain a fraud claim). Thus, representations about future expectations, which do not concern pre-existing facts, cannot support claims for fraud under New York law. *See Dragon Inv. Co. II LLC v. Shanahan*, 49 A.D.3d 403, 403 (1st Dep't 2008).

b. The Alleged Misrepresentations

The Lester-Lee Parties argue that the Third Party Complaint fails to point to specific misrepresentations within the documents provided to investors by Lester and Lee. As noted in Part III.A.1, *supra,* the Court agrees. While the documents contain financial projections and statements of expected future revenue, (Lester Aff., Ex. A, B, &

C),[9] such statements cannot support a claim for fraud. *Sidamonidze*, 304 A.D.2d at 416; *Dragon Inv. Co. II LLC v. Shanahan*, 49 A.D.3d 403, 403 (1st Dep't 2008) (". . . a prediction of something . . . which is expected to occur in the future will not sustain an action for fraud."). Notably absent from the Capo Parties' argument are citations to specific portions of the documents. (Br. Opp'n at 15-18.) Without specific allegations regarding misrepresentations about existing facts, the documents cannot sustain a fraud claim.

The Capo Parties also contend their investments were induced by oral misrepresentations regarding Lester and Lee's expertise, knowledge, and ability to raise sufficient capital on behalf of the Company. (Br. Opp'n at 17.) Specifically, Lester and Lee represented that "the Company expected gross revenues would grow from $3.0 million in 2013 to approximately $7.0 million in 2017." (Third Party Compl. ¶ 71.) In addition, Lester and Lee stated they would raise $1,000,000 to launch the Company. *Id.* Even in their attempts to persuade the Court, the Capo Parties belie their contentions by referring to alleged misrepresentations about "the Company's *expected* gross revenues and growth *potential.*" (Br. Opp'n at 17) (emphasis added). As stated above, such predictions are precisely the type of statements which cannot sustain an action for fraud. *Dragon Inv. Co. II LLC v. Shanahan*, 49 A.D.3d 403, 403 (1st Dep't 2008).

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[9] Docket Nos. 36-38.

Finally, the Capo Parties argue they were victims of an entire scheme which collectively involved all the alleged misrepresentations: "It was not a singular presentation or statement that duped the Investor-Members." (Br. Opp'n at 19.) They rely on *Basis Pac-Rim Opportunity Fund (Master) v. TCW Asset Mgt. Co.*, for the proposition that a fraudulent scheme can sustain a fraud claim. 40 Misc. 3d 1240(A), at *6 (Sup. Ct. N.Y. Cnty. 2013). In *TCW Asset Mgt. Co.*, however, the Court determined there were multiple misrepresentations which could sustain the claim, and that together they amounted to a fraudulent scheme. *Id.* Here, by contrast, the Court concludes no single allegation supports the claim. In this context, the collection of insufficient allegations cannot be aggregated to formulate an adequate cause of action.

c. Conclusion

For the foregoing reasons, the Sixth Counterclaim fails to point to specific misrepresentations that are sufficient to sustain a cause of action for fraud. *FNF Touring LLC v. Transform Am. Corp.*, 111 A.D.3d 401, 402 (1st Dep't 2013). Accordingly, the Court concludes that the Sixth Counterclaim for fraud, asserted against Lee and Lester, must be dismissed, without prejudice to replead factual allegations that support a fraud claim.

8. Seventh Counterclaim – Aiding and Abetting Fraud

A plaintiff asserting a claim for aiding and abetting fraud must allege the existence of an underlying fraud, actual knowledge, and substantial assistance by the alleged aider and abettor. *Oster v. Kirschner*, 77 A.D.3d 51, 55 (1st Dep't 2010). Where, as here, the court dismisses the underlying claim for fraud, the cause of action for aiding and abetting fraud must also be dismissed. *Alliance Network, LLC v. Sidley Austin LLP*, 43 Misc. 3d 848, 866 (Sup. Ct. N.Y. Cnty. 2014). Accordingly, the Seventh Counterclaim must also be dismissed.

9. Ninth and Tenth Counterclaims – Fraudulent Inducement and Negligent Misrepresentation

To properly state a claim for fraudulent inducement, a plaintiff must allege "a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury." *NM IQ LLC v. OmniSky Corp.*, 31 A.D.3d 315, 317 (1st Dep't 2006). Significantly, these are the same elements required to prove a common-law fraud claim. *Id.* (citing *Bernstein v. Kelso & Co.*, 231 A.D.2d 314, 321 (1st Dep't 1997)).

A negligent misrepresentation claim requires allegations of (1) a special or privity-like relationship imposing a duty on the defendant to impart correct information, (2) that the information provided by the defendant was incorrect, and (3) reasonable reliance on the information. *J.A.O. Acquisition Corp. v. Stavistky*, 8 N.Y.3d 144, 148 (2007). Like fraud claims, negligent misrepresentation claims cannot be sustained by allegations of

mere puffery, opinions of value or future expectations. *Sheth v. New York Life Ins. Co.*, 273 A.D.2d 72, 74 (1st Dep't 2000).

The Court concluded that the Sixth Counterclaim for fraud must be dismissed for failure to state a claim because the Capo Parties allege only misrepresentations of future expectations. For the same reason, the Ninth and Tenth Counterclaims – which rely on identical allegations of statements about expected revenues – must also be dismissed, without prejudice.

10. Twelfth Counterclaim – Breach of Contract

The Capo Parties allege that Lester breached their agreement because he "abdicated his responsibilities and turned over his duties to Third Party Defendant Lee." (Third Party Compl. ¶ 105.) They also argue Lester breached the agreement by failing to properly manage and operate the Company. (Br. Opp'n at 21.)

To state a breach of contract claim, a plaintiff must plead the existence of a contract, the plaintiff's performance thereunder, the defendant's breach, and resulting damages. *Harris v. Seward Park Hous. Corp.*, 79 A.D.3d 425, 426 (1st Dep't 2010). "It is well settled that in an action to recover damages for the breach of a contract, the facts constituting the breach must be pleaded. It is insufficient to plead generally that the defendant failed to fulfill his obligations under the contract, or that he has been guilty of a breach of the contract." *Clifden Futures, LLC v. Man Fin., Inc.*, 20 Misc. 3d 638, 643 (Sup Ct. N.Y. Cnty. 2008) (citing *Baby Show Exhibition Co. v. Crowell Pub. Co.*, 174

A.D. 368, 370 (1st Dep't 1916)). The Twelfth Counterclaim alleges that "[t]he parties agreed that . . . Lester would be a co-Managing Member of the Company" and that he and Capo would be solely responsible for the Company's operations. (Third Party Compl. ¶ 103-106.) Though the Third Party Complaint does not mention a specific agreement, in their brief the Capo Parties assert that Lester breached the Offering Memorandum. (Br. Opp'n at 21.) The alleged breach occurred when Lester "abdicated his responsibilities and turned over his duties to Third Party Defendant Lee," but the Capo Parties fail to point to language in the agreement that prohibited a delegation of his duties. *Id.* Their general allegation that Lester breached his obligation to properly manage and operate the company is insufficient to support a claim for breach of contract. *See Clifden Futures, LLC.*, 20 Misc. 3d at 643.

Accordingly, the breach of contract claim must be dismissed, without prejudice.

11. Thirteenth Counterclaim – Defamation

The Thirteenth Counterclaim alleges that Lester and Lee made disparaging statements about Capo. For the following reasons, the Court concludes this claim must be dismissed.

To properly plead a cause of action for defamation, a plaintiff is required to allege: (1) a false statement; (2) published to a third party; (3) without privilege or authorization; (4) which causes harm, unless the statement is the type which is actionable regardless of harm. *Stepanov v. Dow Jones & Co., Inc.*, 120 A.D.3d 28, 34 (1st Dep't 2014). Where a

plaintiff fails to set forth the particular allegations complained of, the complaint will be dismissed for failure to state a claim. *See* CPLR 3016(a); *Mitchell v. New York Univ.*, 129 A.D.3d 542, 543 (1st Dep't 2015). On a motion to dismiss, the court must decide whether the statements, considered in the context of the entire publication, are "reasonably susceptible of a defamatory connotation." *Id.* (citing *Silsdorf v. Levine*, 59 N.Y.2d 8, 12 (1983)).

a. Allegations Against Lester

The Lester-Lee Parties correctly note that Lester is mentioned in only two substantive paragraphs of the defamation claim, 110 and 112. Paragraph 110 alleges that Lester made "certain false and disparaging statements" to third parties, including executives at Sotheby's. Such generalized allegations cannot support a defamation claim. CPLR 3016(a); *Mitchell*, 129 A.D.3d at 543. Next, paragraph 112 alleges that Lee – not Lester – made certain statements "with Lester's endorsement." As a result, paragraph 112 fails to allege the most fundamental element of a defamation claim against Lester: that he himself made a false statement. *Stepanov*, 120 A.D.3d at 34. Accordingly, the Court concludes that the Thirteenth Counterclaim fails to properly state a defamation claim against Lester.

b. Allegations Against Lee

Lee allegedly stated to the Company's members and staff that Capo was a "slow player," that he made the Company look "stupid," and that he was dishonest and had perpetrated "tax fraud." (Third Party Compl. ¶¶ 108-09.) In addition, Lee allegedly told Sotheby's executives that Capo was a "toxic thief." *Id.* ¶ 111.

First, Lee argues that any statements made to the Company's members and employees are protected by the common interest privilege. The Court agrees. An otherwise actionable statement is protected by a qualified privilege where the communication is made to persons who have some common interest in the subject matter. *Foster v. Churchill*, 87 N.Y.2d 744, 751 (1996). This "common interest" privilege has been applied to employees and managers of organizations. *Kaiser v. Raoul's Rest. Corp.*, 112 A.D.3d 426, 427 (1st Dep't 2013) (statement by plaintiff's manager protected by the privilege); *Ashby v. ALM Media, LLC*, 110 A.D.3d 459 (1st Dep't 2013) (statement made by a management employee having responsibility to report on the matter in dispute was protected by common interest privilege); *Liberman v. Gelstein*, 80 N.Y.2d 429, 437 (1992) (statement made by one governing member to another protected by the privilege).

Notably, Capo does not argue that the privilege is inapplicable to the statements at issue here. Instead, he contends that the privilege "dissolves" where it is shown the statements were made with malice. (Br. Opp'n at 23.) Indeed, a plaintiff may defeat the common interest privilege by demonstrating that defendant spoke with "malice." *Liberman v. Gelstein*, 80 N.Y.2d 429, 437 (1992). Here, Capo argues that Lee's

subsequent false statements to third parties, calling him a "toxic thief," demonstrate malice sufficient to defeat the privilege as to the earlier statements made to the Company's members. (Br. Opp'n at 23.) This argument is unavailing. "In this context, spite or ill will refers not to defendant's general feelings about plaintiff, but to the speaker's motivation for making the defamatory statements." *Liberman*, 80 N.Y.2d at 439. Moreover, "[a]n allegation of falsity is insufficient to create an inference of malice." *Smith v. Montefiore Med. Ctr.*, 116 A.D.3d 573, 573 (1st Dep't 2014); *see also Ashby v. ALM Media, LLC*, 110 A.D.3d 459 (1st Dep't 2013) (allegations of malice that amount to "mere surmise and conjecture" are insufficient to defeat the common interest privilege). Accordingly, the Court concludes that the statements made by Lee to members and employees of the company are protected by the common interest privilege, and cannot sustain a defamation claim.

The only remaining allegation of false statements made to persons not covered by the common interest privilege (i.e., those outside the Company) is that Lee called Capo a "toxic thief" to certain Sotheby's executives. (Third Party Compl. ¶ 111.) Lee argues that this allegation cannot support a defamation claim because despite pleading the specific words, Capo has not pled sufficient facts to clarify the statement's context. (Br. Supp. at 21.) The Court agrees. It is well-settled that a plaintiff must plead the time, place, and manner of publication in order to properly state a defamation claim. *Dillon v. City of New York*, 261 A.D.2d 34, 40 (1st Dep't 1999); *see also Knopf v. Sanford*, 123 A.D.3d 521, 522 (1st Dep't 2014) (dismissing defamation counterclaim where plaintiff called

defendant a "fraud" and stated he "had stolen money" from plaintiff, because it failed to allege the time, place, and manner of the false statement). Here, Capo alleges that Lee told "Sotheby's executives Roberta Louckx and Daisy Edelstein" that he was a toxic thief on April 27, 2014. (Third Party Compl. ¶ 111.) However, there are no allegations regarding the place or manner of the statements, or any other facts that provide context for the Court's analysis. Because the Court determines that the defamation claims might possibly be cured through supplemental factual allegations, leave will be granted to replead this portion of the Complaint.

c. Damages

Finally, the defamation claims must also be dismissed for failure to plead damages. Capo argues that allegations of damages are unnecessary because the statement that he was a "toxic thief" is an accusation of a serious crime that supports a claim for defamation per se. (Br. Opp'n at 23.) While courts recognize that larceny constitutes a serious crime that may support a "per se" claim, calling someone a "thief," without more, is not sufficient. *Compare Epifani v. Johnson*, 65 A.D.3d 224, 234 (2d Dep't 2009) (defendant's statement that plaintiff was "terminated because [plaintiff] was stealing" from employer supported claim for defamation per se), *with Pawar v. The Stumble Inn*, 2012 WL 5363513, *4 (Sup. Ct. N.Y. Cnty. 2012) (allegations that defendant called plaintiff a "thief" were insufficient to state a claim for defamation per se). Accordingly, the allegations that Lee called Capo a toxic thief are insufficient to sustain a per se claim.

For the foregoing reasons, the Court concludes that the Thirteenth Counterclaim fails to state a cause of action for defamation against Lester and Lee. Accordingly, this count is also dismissed in its entirety.

12. Fourteenth Counterclaim – Accounting

The Lester-Lee parties argue that the Fourteenth Counterclaim fails to state a cause of action for an accounting because the Capo Parties fail to allege a fiduciary relationship involving the entrustment of money or property, and because the allegations fail to establish that no other remedies exist. (Br. Opp'n at 22.)

To state a claim for an accounting, a plaintiff must allege (1) a fiduciary relationship involving the entrustment of money or property, (2) that no other remedy exists, and (3) that plaintiff demanded and was refused an accounting. *Arbeeny v. Kennedy Exec. Search, Inc.*, 31 Misc. 3d 494, 503 (Sup. Ct. N.Y. Cnty. 2011). As to the first element, New York courts recognize the right of members of a limited liability company to seek an accounting. *Gottlieb v. Northriver Trading Co. LLC*, 58 A.D.3d 550, 551 (1st Dep't 2009). Thus, the Capo Parties have standing to seek an accounting. *E. Quogue Jet, LLC v. E. Quogue Members, LLC*, 50 A.D.3d 1089, 1091 (2d Dep't 2008).

Furthermore, the Fourteenth Counterclaim sets forth sufficient allegations to state the remaining elements of the claim. The Capo Parties allege that they have no other remedy at law, and that they have demanded and have been denied an accounting. (*See*

Third Party Compl. ¶ 124-25.) Accordingly, the Court declines to dismiss the Fourteenth Counterclaim.

13. Fifteenth Counterclaim – Access to Books and Records

The movants' only argument in support of dismissal of the Fifteenth Counterclaim is a factual one: they contend that the documents and information sought are not in their possession. In support, they claim that a corporate resolution allowed Michael Capo to obtain the books and records from the Company's accountants. (Lester Aff. Ex. I.)[10] This factual argument is flatly contradicted by the Capo Parties' assertion that "Lee and Lester have caused all of the books and the records of the Company to be sent to their home at 81 East 2nd Street." (Third Party Compl. ¶ 34.) Because the Court must accept the complaint's allegations as true, *Leon v. Martinez*, 84 N.Y.2d 83, 87 (1994), the Fifteenth Counterclaim cannot be dismissed on these grounds. In the absence of any other argument, the Court declines to dismiss the Fifteenth Counterclaim.

14. Nineteenth Counterclaim – Declaratory Action

Finally, the Capo parties argue that the cause of action for a declaratory judgment must be dismissed because it is duplicative of the other claims. The Court agrees. A declaratory action is unnecessary where a plaintiff may be afforded an adequate remedy

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[10] Docket No. 44.

at law. *Empire 33rd LLC v. Forward Ass'n Inc.*, 87 A.D.3d 447, 448 (1st Dep't 2011); *see also Artech Info. Sys., L.L.C. v. Tee*, 280 A.D.2d 117, 125 (1st Dep't 2001) (finding no basis for a declaratory judgment where other cause of action provides adequate relief). Here, the Nineteenth Counterclaim seeks a declaration that "Lester violated his fiduciary duties to the Company." (Third Party Compl. ¶ 146.) Identical relief is requested in the breach of fiduciary duty claim, which would provide the Capo Parties an adequate remedy. Accordingly, the Nineteenth Counterclaim is dismissed.

15. Conclusion

For the foregoing reasons, the Court grants in part and denies in part the Lester-Lee Parties' motion to dismiss the Third Party Complaint (Motion Sequence No. 002). The motion is granted as to the claims asserted in Counts One, Three, Seven, and Nineteen, and these claims are dismissed with prejudice. The motion is also granted as to the claims asserted in Count Six, Nine, Ten, Twelve, and Thirteen, and these claims are dismissed without prejudice. The motion is granted in part and denied in part as to Counts Two, Four, and Seventeen, and those claims are dismissed in part, with prejudice, except as to the allegations regarding the Second Lease, which the Court has concluded could support claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and a violation of N.Y. LLC Law § 409. Finally, the motion is denied as to Counts Fourteen and Fifteen, which are permitted to go forward.

C. Rosenblum and Mazzeo's Motion to Dismiss the Complaint (Motion Seq. 003)

Defendants Kenneth Rosenblum and Jerome Mazzeo move to dismiss the causes of action asserted against them in the Complaint pursuant to CPLR 3211(a)(7). Count One alleges a derivative breach of fiduciary duty claim against both Rosenblum and Mazzeo, and Count Seven asserts a direct claim for defamation against Rosenblum. The Court will address each claim in turn.

1. Count One – Derivative Breach of Fiduciary Duty Claim

Rosenblum and Mazzeo argue that the first cause of action must be dismissed against them because as non-managing members they owed no fiduciary duties to the Company. Plaintiffs concede that Rosenblum and Mazzeo were originally non-managing members, but argue that the Complaint sufficiently alleges that they usurped the role of managers after ousting Lester.

Managing members of LLCs owe fiduciary duties to the company and its non-managing members. *Pokoik v. Pokoik*, 115 A.D.3d 428, 429 (1st Dep't 2014). As Plaintiffs concede, New York, like many other jurisdictions, does not impose similar duties on non-managers. *Kalikow v. Shalik*, 43 Misc. 3d 817, 826 (Sup. Ct. Nassau Cnty. 2014); *see, e.g.*, *Kuroda v. SPJS Holdings, L.L.C.*, 2010 WL 925853, at *7 n.28 (Del Ch. Mar. 16, 2010) (stating Delaware law does not impose fiduciary duties on non-managing or non-controlling members of an LLC); *ULQ, LLC v. Meder*, 293 Ga. App. 176, 185 (Ga

Ct. App. 2008) (". . . we hold that non-managing members owe no fiduciary duties to the LLC or the other members.").

Plaintiffs argue that the members of the Company passed certain resolutions in February 2014 (the "February 2014 Resolutions"), whereby Rosenblum became a signatory to the Company's bank accounts and Mazzeo assumed responsibility for the Company's finances. (Lester Aff.[11] Ex. A.) Where the articles of organization do not appoint a specific managing member, any member that handles the company's business may be found to owe a fiduciary duty to the Company. *See Laugh Factory, Inc. v Basciano*, 608 F.Supp.2d 549, 562 (S.D.N.Y. 2009) (evidence showing that member handled the operations of the LLC was sufficient to impose a fiduciary duty where the articles of organization did not otherwise appoint a specific manager). Here, the Company's articles of organization provide that the Company is to be managed by the Members. (Lester Aff. Ex B.) Accordingly, as long as the Complaint sufficiently alleges that Mazzeo and Rosenblum handled the Company's operations, they owed – and may have breached – a fiduciary duty to the Company. However, because Plaintiffs argue Mazzeo and Rosenblum did not manage the Company prior to February 2014, the Complaint must also allege that they took actions after that date which constituted a breach of their fiduciary duties. (Compl. ¶ 36.) ("Prior to February 2014, no member

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[11] Docket No. 74.

took part in the operations or decisions of the Company, other than Capo and Lester."). The Court concludes that it does not.

While the Complaint sufficiently sets forth that Mazzeo and Rosenblum became managing members after the February 14, 2014 meeting, (*see* Compl. ¶ 108), the allegations purporting to sustain breach of fiduciary duty claims involve events that precede the 2014 Resolutions, or do not involve actions by Rosenblum or Mazzeo. (Compl. ¶¶ 100-126.) For example, Plaintiffs allege that the Company bank accounts were closed in January, and maintain that Capo and Lester were the only individuals with power over the accounts at the time. (*Id.* ¶¶ 37, 102.) Moreover, the Affidavit in Opposition[12] submitted by Lester does not contain allegations of wrongdoing occurring after February 2014. Accordingly, the Court concludes that the first cause of action for breach of fiduciary duty must be dismissed against Mazzeo and Rosenblum.[13]

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[12] Lester Aff. (Docket No. 74).

[13] In an eleventh hour attempt to save their fiduciary duty claims, Plaintiffs argue that the Complaint also states a claim against Rosenblum for "aiding and abetting Capo in his breach of fiduciary duties." (Br. Opp'n, Docket No. 73, at 10.) In the alternative, they request leave to amend the pleadings to state such claim. *Id.* Plaintiffs have not moved for leave to amend the pleadings, relying instead on a single paragraph in their Opposition Brief. First, the Court concludes that the Complaint fails to set forth the elements of a claim for aiding and abetting a breach of fiduciary duty, as it does not even mention that claim. In addition, while a plaintiff may request leave to amend a complaint pursuant to the CPLR, "[a]ny motion to amend or supplement pleadings shall be accompanied by the proposed amended or supplemental pleading clearly showing the changes or additions to be made to the pleading." CPLR 3025(b). Here, there is not even a motion, much less a proposed amendment for the Court's review. Accordingly, the Court denies Plaintiffs' request to amend the Complaint.

2. Count Seven – Defamation Claim Against Rosenblum

The seventh cause of action asserts a defamation claim against Rosenblum (as well as Capo). Rosenblum argues that count seven fails to state a cause of action because it does not allege the time, place and manner of the false statements. Lester attempts to cure any defects in the defamation claim with an affidavit. This attempt is unavailing.

It is well-settled that a plaintiff must plead the time, place, and manner of publication in order to properly state a defamation claim. *Dillon v. City of New York*, 261 A.D.2d 34, 40 (1st Dep't 1999). Moreover, plaintiffs alleging defamation must plead "the particular words complained of." CPLR 3016(a). Here, Plaintiffs' allegations are insufficient to state a defamation claim. The Complaint alleges that in January 2014, "Capo and Rosenblum, *or their agents*, knowingly made false statements to JP Morgan Chase Bank, and the members of the Company, that Lester had stolen cash from the Company's premises, committed bank fraud and otherwise defrauded the Company." (Compl. ¶ 183) (emphasis added). The Complaint's allegations are vague and inadequate, particularly because they fail to delineate whether Rosenblum, Capo, "or their agents," made the statements. Just as the Court found that the Capo Parties could not state a defamation claim against Lester based on Lee's statements, (*see*, supra, Section III.B.11.a.), neither can Lester state a defamation claim against Rosenblum based on others' words. The affidavit submitted in opposition to this motion fails to cure this defect. In it, Lester avers that "Capo and Rosenblum and their agents" made certain false

statements, but again fails to make precise allegations about who made particular statements.

Accordingly, the Court concludes that the cause of action for defamation against Rosenblum must be dismissed, without prejudice.

3. Conclusion

For the foregoing reasons, the Court concludes that Defendants Mazzeo and Rosenblum's motion to dismiss the claims against them (Motion Sequence No. 003) must be granted in its entirety. Accordingly, the first and seventh causes of action in Plaintiffs' Complaint are dismissed insofar as they are stated against Mazzeo and Rosenblum. The First Count is dismissed with prejudice, and the Seventh Count is dismissed without prejudice to re-plead the alleged defamatory statements with particularity.

IV. CONCLUSION

Accordingly, it is hereby

ORDERED that Joseph J. Asterita's motion to dismiss the Third Party Complaint as against him (Motion Sequence No. 001) is GRANTED, with prejudice; and it is further

ORDERED that Plaintiffs Marc Lester and MLAB, and Third Party Defendant Patricia Lee's collective motion to dismiss the Third Party Complaint (Motion Sequence No. 002) is GRANTED IN PART, and DENIED IN PART; and it is further

ORDERED that Defendants are granted leave to amend only the Counterclaims and Third Party Claims asserted in Counts Six, Nine, Ten, Twelve, and Thirteen of the Third Party Complaint, within 30 days of service of notice of entry of this Order; and it is further

ORDERED that Defendants Jerome Mazzeo and Kenneth Rosenblum's motion to dismiss the claims against them in the Complaint (Motion Sequence No. 003) is GRANTED; and it is further

ORDERED that Plaintiffs are granted leave to amend only the Seventh Count of the Complaint within 30 days of service of notice of entry of this order; and it is further

ORDERED that to the extent not dismissed herein, the remaining causes of action in the Complaint and the Third Party Complaint are severed and allowed to continue; and it is further

ORDERED that the parties are directed to appear for the previously scheduled status conference in Room 442, 60 Centre Street, on February 9, 2016.

This constitutes the decision and order of the Court.

Dated: New York, New York
February 5, 2016

ENTER:

Hon. Eileen Bransten, J.S.C.