PMC Aviation 2012-1 LLC v Jet Midwest Group LLC
2016 NY Slip Op 30972(U)
May 25, 2016
Supreme Court, New York County
Docket Number: 654047/2015
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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PMC AVIATION 2012-1 LLC and AMUR FINANCE IV LLC,

Index No.: 654047/2015

DECISION & ORDER

Plaintiffs,

-against-

JET MIDWEST GROUP LLC, PAUL KRAUS, and KAREN KRAUS,

Defendants.

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SHIRLEY WERNER KORNREICH, J.:

Motion sequence numbers 001 and 002 are consolidated for disposition.

Defendant Jet Midwest Group LLC (JMG) moves, pursuant to CPLR 3211(a)(1) and (7) and 3016(b), to dismiss 18 of the 25 causes of action in the Amended Complaint (the AC).[1] Seq. 001. Defendants Paul Kraus (Paul) and Karen Kraus (Karen) (collectively, the Krauses) separately move to dismiss 15 of the 25 causes of action in the AC.[2] Seq. 002. Plaintiffs PMC Aviation 2012-1 LLC (PMC) and Amur Finance IV LLC (Amur) oppose the motions. Defendants' motions are granted in part and denied in part for the reasons that follow.

I. Factual Background & Procedural History

As this is a motion to dismiss, the facts recited are taken from the AC (*see* Dkt. 10)[3] and the documentary evidence submitted by the parties.

This action concerns malfeasance allegedly committed by the Krauses while JMG, their

[1] The AC's causes of action are labeled "Counts". JMG seeks dismissal of Counts I-IV, VII-VIII, XI-XVI, XVIII, XX-XXII, and XXIV-XXV.

[2] The Krauses seek dismissal of Counts I-VIII, XI-XII, XV-XVI, XXI-XXII, and XXV. No party moves to dismiss Counts IX, X, XVII, XIX and XXIII.

[3] References to "Dkt." followed by a number refer to documents filed in this action in the New York State Courts Electronic Filing (NYSCEF) system.

wholly owned Delaware LLC, served as managing member of PMC. JMG owns 58% of the membership interests in PMC. The remainder of PMC is owned by Amur (29.4%)[4] and non-party Hellsnyc LLC (Hellsnyc) (12.6%).[5] Amur is now serving as PMC's managing member.

Paul was the CEO and managing member of JMG. Additionally, he is a member of the board and a partial owner of non-party Jet Midwest, Inc. (JMI), and is the Vice President, board member, and partial owner of non-party Jed Midwest Technik (JM Technik). Karen is the President, COO, and a board member of JMG. She is the President, Secretary, and partial owner of JMI and serves in those same capacitates and as Treasurer for JM Technik. Moreover, she is a member of non-party Jet Midwest Global (JM Global).

In 2012, the Krauses allegedly convinced members of Amur (Mostafiz Shah Mohammed) and Hellsnyc (Cecilia Park) to invest in PMC. The Krauses told them that PMC would purchase seventeen Boeing 767 aircraft (the Aircraft) from Air Canada;[6] PMC would then lease or sell the parts of the Aircraft for a profit. Plaintiffs claim the Krauses fraudulently induced their investment in PMC by making a number of alleged material misrepresentations. First, the Krauses allegedly represented themselves "as having expertise in valuing, maintaining, servicing, and profitably disposing of aircraft through sales based on their past experience in the industry." *See* AC ¶ 24. Plaintiffs claim these representations were knowingly false because the

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[4] Plaintiffs explain that "Amur is the successor in interest to SGCM #1 LLC, one of the original PMC members that signed the PMC LLC Agreement," and they "refer to SGCM # 1 LLC as Amur." *See* AC ¶ 8 n.1.

[5] This equity split is set forth in Exhibit B to PMC's operating agreement, discussed below. *See* Dkt. 28 at 41. However, Exhibit B provides for member voting rights that do not align with the members' equity interests, that is, 50% voting rights for JMG, 35% for Amur, and 15% for Hellsnyc. *See id.* The initial capital contributions are set forth in Exhibit C to the Operating Agreement: JMG-$989,450, Amur-$566,685, and Hellsnyc-$242,865. *See id.* at 42.

[6] The Aircraft are listed in Exhibit D to the Operating Agreement [*see* Dkt. 28 at 43-46] and Annex B to the Servicing Agreement [*see* Dkt. 29 at 25-29], discussed below.

Krauses "did not have sufficient expertise in the industry to realize value from the aircraft and were therefore grossly incapable of realizing the value they claimed could be realized from PMC's acquisition of the property." *See id.* Also, on March 22, 2012, they contend, Paul sent the members of Amur and Hellsnyc a spreadsheet with a "financial breakdown and asset evaluation" of the Aircraft. *See* AC ¶ 25. Plaintiffs explain:

> In the spreadsheet, [Paul] calculated in detail the value of each aircraft. [Paul] represented that the value of the seventeen aircraft would be $51,650,000 in total. Specifically [Paul] represented that: (i) nine of the aircraft could be dismantled and sold as parts for $1.7 million each (totaling $15.3 million); (ii) that one of the aircraft could be serviced and leased, or sold, for a total value of $3.45 million; and (iii) that the remaining seven aircraft could be serviced and leased, or sold, for a value $4.7 million each, or a total of $32.9 million.
>
> In addition, [Paul] explained the valuation for each of the first three years of the prospective contract based on sums that could be realized from leasing or selling the aircraft within those years. As part of this valuation, [Paul], in separate tabs of the same spreadsheet, described in detail each of the seventeen aircraft, including the usage and maintenance history of their engines, their specific avionics and communications equipment, the details of their interiors, and the type and maintenance history of their landing gear.

See AC ¶ 25-26 (paragraph numbering omitted). Plaintiffs allege that Paul's "presentations of the value of the seventeen aircraft were materially inflated and thus false;" that he "knew that the aircraft were worth far less than what he represented them to be worth," and that Karen helped Paul create these false valuations. *See* AC ¶¶ 27-29.

On April 13, 2012, Amur, JMG, and Hellsnyc executed an operating agreement for PMC. *See* Dkt. 28 (the Operating Agreement). PMC is a Delaware LLC, and the Operating Agreement is governed by Delaware law. *See id.* at 34.[7] Section 9.14 provides:

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[7] Section 9.2 of the Operating Agreement provides:

> Any dispute arising under or in any way in connection with this Agreement shall be settled by arbitration in New York, New York pursuant to the Commercial

> This Agreement and the attached Exhibits contain the entire understanding between the parties hereto and supersede any prior written or oral agreements between them regarding the same subject matter. There are no representations, agreements, arrangements or understandings, oral or written, between the parties relating to the subject matter of this Agreement which are not fully expressed in the Agreement.

See id. at 37.

Section 4.1.1 specifies that PMC is to be run by its Managing Member and Managers. *See id.* at 16. For instance, section 4.1.4(d)(ii) states that PMC's Managing Member will "provide all physical asset management services, including arranging inspections and transfers/deliveries of assets, and all marketing and sales services, including negotiating sales and leases and conducting 'part out' activities, associated with Company assets." *See id.* at 17. The Operating Agreement appoints JMG as the initial Managing Member and the Krauses as the Initial Managers. *See id.* at 9, 19. Section 4.1.2, which governs the amount of time the Managing Member and Managers must devote to PMC, provides that they "shall devote such time and attention to the management of the business of the Company as necessary to conduct such business." *See id.* at 16. However, section 4.1.2 explicitly provides:

> Notwithstanding the foregoing and, except as otherwise provided herein or in any other applicable agreement, the Manager(s), Members and all Affiliates of the Manager(s) and/or Members **may engage at any time in any other activity similar to or in competition with the Company [i.e., PMC] or the Company's business and may do so without any fiduciary duty to, and/or any duty to offer or present to, the Company or its other Manager(s) or Members any interest therein or in any other opportunity** of the Manager(s), any Affiliate of the Manager(s), any Member or any Affiliate of the Members.

See id. (emphasis added).

Section 7.1 delineates the records PMC must maintain, and section 7.2 sets forth the

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> Arbitration Rules of JAMS, and any judgment therein shall be final and binding among the parties for all purposes and may be entered in any court of law as such.

See Dkt. 28 at 34. Defendants have not moved to compel arbitration.

members' rights to inspect those records. *See id.* at 30-31.[8] Section 7.3 lists the financial reporting the members are to receive. *See id.* at 31.

The Operating Agreement memorializes the fact that PMC entered into a Servicing Agreement with JMG dated April 13, 2012, executed in conjunction with the Operating Agreement. *See id.* at 10, 19. The operative version is the Amended and Restated Servicing Agreement dated August 14, 2013. *See* Dkt. 29 (the Servicing Agreement). The Servicing Agreement is governed by New York law. *See id.* at 16. Section 2.1 of the Servicing Agreement states that PMC:

> [A]ppoints JMG as its agent (a) to service, manage and administer the Borrower Assets [defined in Annex A to mean "the Equipment, Equipment Proceeds and any Leases"; the Equipment includes the Aircraft] [*see* Dkt. 29 at 21-22], including but not limited to remarketing, leasing, selling and otherwise disposing of the Equipment, and (b) to enforce [PMC's] rights and interests in the Borrower Assets. JMG hereby accepts such appointment and agrees to service, manage and administer the Borrower Assets and enforce [PMC's] rights and interests in the Borrower Assets and to act in the capacity of Servicer in accordance with the terms of this Agreement until the termination of [JMG's] responsibilities pursuant to Sections 5.1 or 6.1.

See id. at 4.

Section 2.2 sets forth an extensive list of JMG's responsibilities as Servicer. *See id.* at 4-7. It begins by stating that JMG "shall take, or cause to be taken, all actions that may be, in [JMG's] reasonable opinion, necessary or advisable to manage remarket, lease, sell and otherwise dispose of the Equipment from time to time. [JMG] shall use its reasonable efforts to remarket, lease and/or sell the Equipment by providing the [delineated list of services]." *See id.* at 5. Simply put, JMG was in charge of all aspects of maintaining and managing the Aircraft,

[8] The parties' motion practice (Seq. 003) over plaintiffs' books and records demands was resolved by a so-ordered stipulation dated April 28, 2016. *See* Dkt. 98.

and was expressly obligated to ensure collection of all amounts due on the Aircraft's leases. *See* AC ¶¶ 50-60 (discussing JMG's duties under the Servicing Agreement).

Section 2.11(a) provides:

> Neither [JMG] nor any of the members, managers, directors, officers, employees or agents of [JMG] shall be under any liability to [PMC] or [Amur], except as provided under this Agreement, for any action taken or for refraining from the taking of any action pursuant to this Agreement or for errors in judgment; provided, however, that this provision shall not protect [JMG] or any such Person against any liability that would otherwise be imposed by reason of **willful misconduct, bad faith or gross negligence** in the performance of its duties or by reason of **reckless disregard of obligations and duties** under this Agreement. [JMG] and any member, manager, director, officer, employee or agent of [JMG] may rely in good faith on the advice of counsel or on any document of any kind prima facie properly executed and submitted by any Person respecting any matters arising hereunder.

See id. at 9 (emphasis added).

Section 8.5 states that "[t]his Agreement constitutes the complete agreement among the parties hereto with respect to the subject matter hereof, supersedes all prior agreements and understandings relating to the subject matter hereof, and may not be modified, altered or amended except as set forth in Section 8.6," which requires amendments and waivers to be set forth in a signed writing. *See id.* at 16.

Plaintiffs allege that the Krauses caused JMG to lease some of the Aircraft to companies they own and control, such as non-parties Jet Asia Airways Co., Ltd. (Jet Asia), a company based in Thailand, and Dynamic Airways LLC (Dynamic), a Virginia LLC.[9] According to plaintiffs, the Krauses lied about their interest in these companies. Plaintiffs allege that these leases were below market, that the Krauses executed multiple extensions of these leases and that they did not collect all of the lease payments due. Plaintiffs also claim that defendants committed a "commingling of engines" by installing JMG engines on PMC aircraft without

[9] PMC claims to have sued Dynamic in a Virginia state court. *See* AC at 4 n.2.

documenting or disclosing that they were doing so. *See* AC ¶ 161-167. Likewise, plaintiffs claim that defendants grossly mismanaged the Aircraft, not only by failing to adequately maintain them, but also by storing them in such a way that they suffered serious damage. Plaintiffs explain:

> In April and May of 2015, representatives of Amur visited JMG's Kansas City facility and were given photographs of PMC owned engines being stored uncovered in the snow and being tipped on end and having water, sand, and mud pour out. Amur representatives also saw sand and mud in the fan blades of PMC owned engines, which very significantly affects the market value of the engines.

See AC ¶ 177.

Plaintiffs also allege that the way in which the aircraft were stored scuttled a potential sale:

> On September 24, 2015, after visiting JMG's Kansas City facility and inspecting aircraft and parts stored there, Conecsus Aerospace, an independent third-party prospective purchaser, sent a proposal to representatives of Amur regarding the purchase of PMC parts in JMG's possession. In its proposal, Conecsus Aerospace noted that the "majority of inventory is so commingled with other [JMG] inventory we could not determine a gross value let alone understand which items were included in the offering." The Conecsus proposal further noted that "It is difficult at this time to determine the cost associated with the handle and transportation of the loose parts. We were not able to identify all the parts located at [JMG] due to the commingled inventories."

See AC ¶ 179.

Plaintiffs further complain about defendants' allegedly shoddy record keeping and failure to make the discussed, contractually required disclosures, and claim that defendants stole money from the company. Plaintiffs assert myriad other wrongdoing not relevant to this motion.

Plaintiffs seek to pierce JMG's corporate veil to hold the Krauses personally liable, alleging:

> [Paul and Karen] exercise complete and total domination and control over JMG, JMI, JM Technik, and JM Global such that they are alter egos of one another. Upon information and belief, [Paul and Karen] regularly transfer funds and

> property between JMG, JMI, JM Technik, and JM Global for no consideration. For example, following PMC's refinance in 2013 that was fraudulently induced and unnecessarily inflated by [Paul's] misrepresentations, [Paul] instructed PMC to transfer the $1.9 million equity payment that resulted from the refinance to his personal account even though it was owed to JMG as the equity member of PMC. As part of the [Servicing Agreement], JMG had access to a Reserve Account funded by PMC to be used to tear down the aircraft. [Paul and Karen] wrongfully distributed funds from the Reserve Account to JMI, JM Technik and JM Global and other entities under their control for little-to-no consideration and for their own personal benefit. Additionally, [Paul and Karen] regularly transact business between JMG, JMI, JM Technik, and JM Global, and third-parties to solely benefit themselves and not the corporate entity for which they act. [Paul's] individual ownership and/or control of JMG, JMI, JM Technik, and JM Global was used to perpetrate his wrongful and unjust acts toward Plaintiffs. [Karen's] individual ownership and/or control of JMG, JMI, JM Technik, and JM Global was used to perpetrate her wrongful and unjust acts toward Plaintiffs.

See AC ¶¶ 209-216 (paragraph breaks and numbering omitted).

On August 14, 2015, JMG resigned as Servicer under the Servicing Agreement and as Managing Member of PMC. An affiliate of Amur was immediately appointed as successor servicer, and Amur became the new Managing Member. PMC commenced this action on December 4, 2015. *See* Dkt. 1 (original complaint). On February 3, 2016, plaintiffs filed a 25 Count AC, which added Amur as a plaintiff. The AC alleges the following causes of action, numbered here as in the AC (the causes of action at issue on the instant motions are in bold): **(I) fraudulent inducement of the Operating Agreement, asserted by Amur against JMG and the Krauses; (II) aiding and abetting the fraud alleged in Count I, asserted by Amur against JMG and the Krauses; (III) fraud, asserted against JMG and the Krauses, regarding their performance under the Operating Agreement and Servicing Agreement; (IV) aiding and abetting the fraud alleged in Count III, asserted against JMG and the Krauses; (V) Tortious Interference with the Operating Agreement, asserted against the Krauses; (VI) Tortious Interference with the Servicing Agreement, asserted against the**

Krauses (VII) gross negligence, asserted against JMG and the Krauses, regarding their conduct under the Operating Agreement; (VIII) gross negligence, asserted against JMG and the Krauses, regarding their conduct under the Servicing Agreement; (IX) breach of fiduciary duty, asserted against JMG and the Krauses, regarding their conduct under the Operating Agreement; (X) aiding and abetting the breach of fiduciary duty alleged in Count IX, asserted against JMG and the Krauses; **(XI) breach of fiduciary duty, asserted against JMG and the Krauses, regarding their conduct under the Servicing Agreement; (XII); aiding and abetting the breach of fiduciary duty alleged in Count XI, asserted against JMG and the Krauses; (XIII) grossly negligent supervision, asserted against JMG, regarding the Krauses conduct under the Operating Agreement; (XIV) grossly negligent supervision, asserted against JMG, regarding the Krauses conduct under the Servicing Agreement; (XV) unjust enrichment, asserted against JMG and the Krauses, regarding their conduct under the Operating Agreement; (XVI) unjust enrichment, asserted against JMG and the Krauses, regarding their conduct under the Servicing Agreement**; (XVII) breach of the Operating Agreement, asserted against JMG; **(XVIII) breach of the implied covenant of good faith and fair dealing under the Operating Agreement, asserted against JMG**; (XIX) breach of the Servicing Agreement, asserted against JMG; **(XX) breach of the implied covenant of good faith and fair dealing under the Servicing Agreement, asserted against JMG; (XXI) conversion, asserted against JMG and the Krauses, regarding the Operating Agreement; (XXII) conversion, asserted against JMG and the Krauses, regarding the Servicing Agreement**; (XXIII) equitable accounting, asserted against JMG under the Operating Agreement; **(XXIV) equitable accounting, asserted against JMG under the Servicing Agreement; and (XXV) specific performance of the Operating Agreement and the**

Servicing Agreement, asserted against JMG and the Krauses.[10] Plaintiffs seek $74 million in compensatory damages, attorneys' fees, costs, and punitive damages.

Defendants filed the instant motions to dismiss on March 4, 2016. The court reserved on the motions after oral argument. *See* Dkt. 99 (4/28/16 Tr.).

II. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1st Dept 1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v*

[10] With respect to the twenty-fifth cause of action, plaintiffs assert a single specific performance claim for both contracts. As discussed below, this claim is dismissed because specific performance is a remedy, not an independent cause of action.

Mutual Life Ins. Co. of N.Y., 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

III. Discussion

Defendants do not seek dismissal of plaintiffs' claims for breach of fiduciary duty under the Operating Agreement, breaches of the Operating Agreement and the Servicing Agreement, and accounting under the Operating Agreement.[11] The court addresses the remaining causes of action in turn.[12]

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[11] This obviates the need to discuss (at this juncture) the degree to which the claims for breach of the Operating Agreement and breach of fiduciary duty under the Operating Agreement may be duplicative under Delaware law. *See AM General Holdings LLC v Renco Group, Inc.*, 2013 WL 5863010, at *10 (Del Ch 2013); *see also Feeley v NHAOCG, LLC*, 62 A3d 649, 660-65 (Del Ch 2012) (discussing fiduciary duties that managers have to the LLC, default rules under the Delaware LLC Act, and how to disclaim such duties in an operating agreement). The parties are urged to be mindful of Delaware's well-established rules governing fiduciary duties and contractual disclaimer of such duties (e.g., under section 4.1.2 of the Operating Agreement). As Chancellor Bouchard recently reiterated:

> When considering the rights of persons who choose to invest in alternative entity structures ... it always must be kept in mind that the express policy of this State is to give maximum effect to the principle of freedom of contract. This policy affords commercial parties the advantage of great flexibility to privately order their affairs, but that flexibility can come at a cost. As our Supreme Court recently reminded us, investors "must be careful to read those agreements and to understand the limitations on their rights" they impose.

Dieckman v Regency GP LP, 2016 WL 1223348, at *11 (Del Ch 2016) (citations omitted).

[12] The parties, often, fail to take a clear position on whether New York or Delaware law applies to each of the claims. With respect to the breach of contract claims, the Operating Agreement is governed by Delaware law and the Servicing Agreement is governed by New York law. With respect to the claims concerning the internal affairs of PMC and JMG (fiduciary duty and veil piercing), which are Delaware LLCs, Delaware law applies. *See MMA Meadows at Green Tree, LLC v Millrun Apts., LLC*, 130 AD3d 529, 530 (1st Dept 2015). The applicable law for the other tort and quasi contract claims is uncertain [*see, e.g., Kronenberg v Katz*, 872 A2d 568, 588 (Del Ch 2004) ("the mere presence of a choice of law provision in a contract selecting Delaware law did not have the effect of making Delaware law the appropriate law to govern a fraudulent inducement claim")], but since the applicable law in New York and Delaware appears to be the same, the court applies New York law. *See TBA Global, LLC v Proscenium Events, LLC*, 114

To begin, Amur has validly pleaded a claim for fraudulent inducement of the Operating Agreement with the requisite particularity. "The elements of a cause of action for fraud [are] a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009); *see Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 (1st Dept 2014). Pursuant to CPLR 3016(b), "the circumstances constituting the wrong shall be stated in detail." *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491 (2008).

Amur alleges that the Krauses lied about their experience in the aviation industry and provided false valuations and assessments of the Aircraft which, even if they constitute opinions (as opposed to statements of present fact), the Krauses did not believe. Defendants argue that the Operating Agreement's integration clause, section 9.14, bars these fraud claims. They are wrong. A clause, such as section 9.14, that generally disclaims collateral representations, does not preclude a fraudulent inducement claim if such clause does not specifically disclaim the subject representations. *See Hobart v Schuler*, 55 NY2d 1023, 1024 (1982), accord *Danann Realty Corp. v Harris*, 5 NY2d 317 (1959). As the First Department explained:

> The law is abundantly clear in this state that a buyer's disclaimer of reliance cannot preclude a claim of justifiable reliance on the seller's misrepresentations or omissions unless (1) the disclaimer is made **sufficiently specific** to the particular type of fact misrepresented or undisclosed; and (2) the alleged misrepresentations or omissions did not concern facts peculiarly within the seller's knowledge Accordingly, only where a written contract contains a **specific disclaimer** of responsibility for extraneous representations, that is, a provision that the parties are not bound by or relying upon representations or omissions **as to the specific matter**, is a plaintiff precluded from later claiming fraud on the ground of a prior misrepresentation as to the specific matter.

AD3d 571, 572 (1st Dept 2014). The court, however, does provide some citation to Delaware law to demonstrate that there is no relevant conflict of law.

Basis Yield, 115 AD3d at 137 (internal citations omitted; emphasis added). The law is similar in Delaware. *See FdG Logistics LLC v A&R Logistics Holdings, Inc.*, 131 A3d 842, 859 (Del Ch 2016) (fraud claim not barred unless parties use "explicit anti-reliance language"). Section 9.14 neither refers to the Krauses' alleged representations about their industry experience and does not refer to the Aircraft valuations. It, therefore, does not bar Amur's fraudulent inducement claim.

Nor are the Krauses correct in contending that the alleged misrepresentations amount to mere puffery or inactionable expressions of opinion. On the contrary, the Krauses are alleged to have made misrepresentations of present fact about their experience in the aviation industry. Courts have long held that lies about a defendant's experience or expertise may be considered a material misrepresentation. *See Fed. Ins. Co. v Mallardi*, 696 FSupp875, 881 (SDNY 1988) ("A broker's misrepresentation of his status is actionable where, as here, it goes to the investment's quality, i.e. where the plaintiffs' investment decision was based on the broker's recommendations, **which the clients would not have accepted had they known the true nature of the broker's expertise**.") (emphasis added), citing *Manufacturers Hanover Trust Co. v Drysdale Sec. Corp.*, 801 F2d 13, 21-22 (2d Cir 1986); *see also Suez Equity Investors, L.P. v Toronto-Dominion Bank*, 250 F3d 87, 97 (2d Cir 2001).[13]

[13] It should be noted, however, that while a misrepresentation about a defendant's industry experience may be considered material to an investment decision, there are serious loss causation issues with such a claim. *See Laub v Faessel*, 297 AD2d 28, 31-32 (1st Dept 2002) (discussing federal case law, such as *Manufacturers Hanover*). That said, defendants do not move to dismiss for failure to plead loss causation, a questionable basis for dismissal under CPLR 3211 in light of recent First Department cases. *See Basis Pac-Rim Opportunity Fund v TCW Asset Mgmt. Co.*, 49 Misc3d 1209(A), at *11 n.17 (Sup Ct, NY County 2015) (discussing *Loreley Fin. No. 3 Ltd. v Wells Fargo Secs., LLC*, 797 F3d 160, 182 n.14 (2d Cir 2015), which noted "conflicting precedent in the First Department on whether loss causation must be pleaded and what that standard actually entails", comparing, e.g., *Loreley Fin. (Jersey) No. 4 Ltd. v UBS Ltd.*, 123 AD3d 413 (1st Dept 2014), with *Mosaic Caribe, Ltd. v AllSettled Group, Inc.*, 117 AD3d 421,

Moreover, the Krauses' assessments of the Aircraft are actionable since, even if such assessments could be construed to be opinions, they may give rise to a fraud claim if, as alleged by plaintiffs, the Krauses did not actually believe them. *See Flandera v AFA Am., Inc.*, 78 AD3d 1639, 1640 (4th Dept 2010) ("an assessment of market value that is based upon misrepresentations concerning existing facts may support a cause of action for fraud"), citing *Rodin Props.-Shore Mall, N.V. v Ullman*, 264 AD2d 367, 368-69 (1st Dept 1999) ("When a professional ... has a specific awareness that a third party will rely on his or her advice or opinion, the furnishing of which is for that very purpose, and there is reliance thereon, tort liability will ensue if the professional report or opinion is negligently or fraudulently prepared"), and *Cristallina S.A. v Christie, Manson & Woods Int'l, Inc.*, 117 AD2d 284, 294 (1st Dept 1986) ("Statement of value can, in certain circumstances, be regarded as a representation of existing fact."); *see Basis Pac-Rim*, 49 Misc3d 1209(A), at *5 (collecting cases standing for the proposition that "an expression of opinion may be actionable if the speaker does not genuinely and reasonably believe it or if it is without a basis in fact").

Likewise, there is no merit to defendants' contention that the fraud claims are not pleaded with sufficient specificity. The particularity required by CPLR 3016(b)[14] is not as exacting as what is required under Rule 9(b) in federal court. *See Sargiss v Magarelli*, 12 NY3d 527, 530-31 (2009) (discussing *Pludeman* standard, which "may be met when the facts are sufficient to permit a reasonable inference of the alleged conduct"); *cf. Pludeman,* 10 NY3d at 494 (Smith, J., dissenting) (proposing, contrary to the majority opinion, that New York state courts apply the

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422 (1st Dept 2014) (loss causation is a mandatory element of fraud claim and must be pleaded with particularity to survive motion to dismiss), and *Greentech Research LLC v Wissman*, 104 AD3d 540 (1st Dept 2013) (same). Justifiable reliance may also be an issue.

[14] Even if Delaware substantive law applies to the fraud claim, CPLR 3016(b), a procedural rule, applies in this action.

federal standard). The AC alleges fraudulent misrepresentations, who made them, to whom they were made, and when they were made. While there may be some question as to whether the proper claim against the Krauses is fraud or aiding and abetting fraud, that is an academic distinction at this juncture since plaintiffs are permitted to plead an aiding and abetting claim in the alternative. *See Allenby, LLC v Credit Suisse, AG*, 134 AD3d 577, 581 (1st Dept 2015). Plaintiffs have pleaded the Krauses' knowledge and involvement in the fraud and, hence, have pleaded the essential element of substantial assistance. *See Chambers v Weinstein*, 135 AD3d 450 (1st Dept 2016), citing *Oster v Kirschner*, 77 AD3d 51, 55 (1st Dept 2010).

Contrary to plaintiffs' arguments, the fraudulent inducement claim is not duplicative of the breach of contract claim since the alleged misrepresentations are not expressly addressed by the Operating Agreement itself. The First Department recently clarified[15] that a representation related to a contract may form the basis of a non-duplicative fraud claim if the allegations concern a misrepresentation of present fact. *See Wyle Inc. v ITT Corp.*, 130 AD3d 438, 439-42 (1st Dept 2015). In any event, the fraud claim asserted against the Krauses cannot be duplicative since they are not parties to the subject contracts. *See Allenby*, 134 AD3d at 581.[16]

That being said, while Amur has validly pleaded a claim that it was fraudulently induced to invest in PMC and execute the Operating Agreement, plaintiffs' claims that defendants committed fraud while serving as Managing Member and Managers under the Operating Agreement and Servicer under the Servicing Agreement are dismissed as duplicative. Plaintiffs

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[15] *But see, e.g., Vue Mgmt., Inc. v Photo Assocs.*, 81 AD3d 569 (1st Dept 2011) (fraud claim not allowed where it "was premised upon factual allegations *germane* to its initial claim for breach of contract") (emphasis added).

[16] It should be noted that the court has no occasion to opine on the adequacy of plaintiffs' due diligence (i.e., the reasonableness of their reliance) since that issue was not raised in defendants' briefs.

have stated a claim for breach of these agreements (which defendants did not move to dismiss) and for breach of defendants' fiduciary duties (which, as it relates to the Operating Agreement, defendants also did not move to dismiss).[17] To the extent defendants committed the extensive malfeasance alleged, all of that conduct may give rise to liability under a contract or fiduciary duty claim. It is not possible for defendants to prevail on these claims but, nonetheless, still have liability for committing fraud. The parties' rights are governed by their contracts and fiduciary obligations. If the contracts were not breached and defendants fulfilled their fiduciary obligations, they cannot have committed an actionable wrong. Likewise, if defendants did indeed breach the contracts or their fiduciary duties, there are no further damages available on a fraud claim since the conduct at issue on the fraud claim is the same as that at issue on the contract and fiduciary duty claims. Plaintiffs cannot state a viable independent cause of action for fraud by merely recasting their claims as contract and fiduciary duty breaches committed with scienter. *See Ka Foon Lo v Curis*, 29 AD3d 525, 526 (2d Dept 2006).

Similarly, plaintiffs' claim that defendants breached their fiduciary duties under the Servicing Agreement is dismissed as duplicative. The court has no occasion to reach the issue of whether defendants have independent fiduciary (as opposed to strictly contractual) duties under the Servicing Agreement since any actionable wrongdoing not duplicative of the claim for breach of that agreement would necessarily be a breach of defendants' contractual or fiduciary duties as Managing Member and Managers of PMC. For instance, if they misappropriated lease

[17] Since PMC is a plaintiff in this action, and the action is being prosecuted by its current managing member, Amur, the fiduciary duty claim is direct and not derivative. This obviates the need to assess issues such as demand futility, which defendants did not address. With respect to damages, plaintiffs must be mindful that any recovery sought based on damage caused to PMC (as opposed to damages uniquely suffered by Amur, such as fraudulent inducement of its investment in PMC) will result in an effective recovery for Amur commensurate with its interest in PMC (29.4%) and the interest of Hellsnyc (12.6%).

revenue due to PMC, they would have breached their fiduciary duties to the LLC and their fellow members, such as Amur. Whether such conversion can be couched as a separate fiduciary breach under the Servicing Agreement is, therefore, academic.

The Operating Agreement and Servicing Agreement were executed together. It was always the parties' understanding and intent that defendants would serve as PMC's initial Managing Member, Managers, and Servicer. There are no fiduciary duties that could exist under the Servicing Agreement that would be inconsistent with their duties under the Operating Agreement. Notably, the Operating Agreement partially disclaims the duty of loyalty. *See* Dkt. 28 at 16. This is permissible under Delaware law. 6 *Del C* § 18-1101(e) provides that LLC operating agreements:

> may provide for the limitation or elimination of **any and all liabilities for breach of contract and breach of duties (including fiduciary duties)** of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement; provided, that **a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing**.

(emphasis added); *see Wood v Baum*, 953 A2d 136, 141 (Del 2008); *see also The Haynes Family Trust v Kinder Morgan G.P., Inc.*, 2016 WL 912184, at *2 (Del 2016) (Strine, C.J.) ("with the benefits of investing in alternative entities often comes the limitation of looking to the contract as the exclusive source of protective rights.").

Nonetheless, Delaware law does not permit an operating agreement to disclaim the duty of good faith and fair dealing. *See Auriga Capital Corp. v Gatz Props.*, 40 A3d 839, 851 (Del Ch 2012), *aff'd* 59 A3d 1206 (Del 2012). Plaintiffs have not pleaded a valid claim for breach of the implied covenant. Under Delaware law, "[t]he implied covenant of good faith and fair

dealing involves ... inferring contractual terms to handle developments or contractual gaps that ... neither party anticipated." *See Nationwide Emerging Managers, LLC v Northpointe Holdings, LLC*, 112 A3d 878, 896 (Del 2015) (quotation marks omitted), citing *Nemec v Shrader*, 991 A2d 1120, 1125 (Del 2010); *see also Haney v Blackhawk Network Holdings, Inc.*, 2016 WL 769595, at *8 (Del Ch 2016) ("The implied covenant, however, only applies where a contract lacks specific language governing an issue and the obligation the court is asked to imply advances, and does not contradict, the purposes reflected in the express language of the contract.") (citation and quotation marks omitted).[18] Rather than separately pleading a gap filling claim, plaintiffs merely recast their contractual and fiduciary breaches as breaches of the implied covenant. This fails to state a claim under Delaware law. The term "good faith and fair dealing" is a term of art with the discussed, specified meaning. *See Dieckman*, 2016 WL 1223348, at *9 ("In the alternative entity context, an alleged breach of the implied covenant of good faith and fair dealing is contractual in nature" and good faith claims are not viable when such claims are incompatible with the scope of the parties' agreed-upon fiduciary duties). As with the fraud claim, a defendant's scienter or colloquial "bad faith" does not transform a contract breach into a breach of the implied covenant.

For similar reasons, plaintiffs' tortious interference, gross negligence,[19] negligent supervision, conversion, and unjust enrichment claims also are duplicative. Moreover, under

[18] New York law also recognizes a similar implied covenant. *See 511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 153 (2002).

[19] The only possible relevance of gross negligence, as discussed below, is that it might vitiate the enforceability of section 2.11(a) of the Servicing Agreement. It need not, however, be pleaded as an independent cause of action. Rather, proof of gross negligence might preclude a defense against personal liability under the Servicing Agreement on the ground that section 2.11(a) restricts liability to JMG. As discussed below, gross negligence is an exception, both under

both New York and Delaware law, the unjust enrichment claim is not viable since the parties' obligations to each other are governed by written contracts. *See Goldman v Metro. Life Ins. Co.*, 5 NY3d 561, 572 (2005); *CIM Urban Lending GP, LLC v Cantor Commercial Real Estate Sponsor, L.P.*, 2016 WL 768904, at *2 (Del Ch 2016). That the Krauses are not parties to the Operating Agreement and the Servicing Agreement is of no moment. *See Randall's Island Aquatic Leisure, LLC v City of New York*, 92 AD3d 463, 464 (1st Dept 2012) ("there can be no quasi-contract claim against a third-party non-signatory to a contract that covers the subject matter of the claim"); *AM Gen. Holdings, LLC v Renco Group, Inc.*, 2013 WL 5863010, at *15 (Del Ch 2013)

The court also dismisses the equitable accounting and specific performance claims. Plaintiffs will be provided with all of the financial records they are entitled to in discovery. *See Unitel Telecard Distribution Corp. v Nunez*, 90 AD3d 568, 569 (1st Dept 2011) ("To be entitled to an equitable accounting, a claimant must demonstrate that he or she has no adequate remedy at law"). Moreover, since PMC is a named plaintiff, it is entitled to all of its records maintained by JMG when it served as Managing Member. Under Delaware law, an accounting is a remedy for breach of fiduciary duty, not an independent cause of action. *See Gallagher v Long*, 2013 WL 718773, at *4 (Del Ch 2013) ("any request for an accounting must be based on a successful claim for breach of fiduciary duty"), *aff'd* 65 A3d 616 (Del 2013), citing *Stevanov v O'Connor*, 2009 WL 1059640, at *15 (Del Ch 2009) ("A claim for an accounting ... generally reflects a request for a particular type of remedy, rather than an equitable claim in and of itself."). Specific performance also is a remedy, not a cause of action and, in any event, is unavailable where, as

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section 2.11(a) and New York law, to the general rule permitting enforcement of limitation of liability clauses.

here, monetary damages can adequately compensate plaintiffs. *See Sokoloff v Harriman Estates Dev. Corp.*, 96 NY2d 409, 415 (2001).

Finally, defendants seek dismissal of plaintiffs' veil piercing theory of liability. "To state a 'veil-piercing claim' [under Delaware law], the plaintiff must plead facts supporting an inference that the corporation, through its alter-ego, has created a sham entity designed to defraud investors and creditors." *Crosse v BCBSD, Inc.*, 836 A2d 492, 497 (Del 2003). "Delaware takes corporate formalities seriously." *Base Optics Inc. v Liu*, 2015 WL 3491495, at *23 (Del Ch 2015), citing *Wallace v Wood*, 752 A2d 1175, 1183 (Del Ch 1999). "[P]ersuading a Delaware court to pierce the corporate veil is a difficult task. Absent compelling cause, a court will not disregard the corporate form or otherwise disturb the legal attributes, such as limited liability, of a corporation." *Midland Interiors, Inc. v Burleigh*, 2006 WL 4782237, at *3 (Del Ch 2003) (quotation marks omitted). Delaware "courts have only been persuaded to pierce the corporate veil after substantial consideration of the shareholder-owner's disregard of the separate corporate fiction and the degree of injustice impressed on the litigants by recognition of the corporate entity." *Crosse*, 836 A2d at 497. "Determining whether to [pierce the corporate veil] requires a fact intensive inquiry, which may consider the following factors, none of which are dominant: (1) whether the company was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the controlling shareholder siphoned company funds; or (5) whether, in general, the company simply functioned as a facade for the controlling shareholder." *Winner Acceptance Corp. v Return on Capital Corp.*, 2008 WL 5352063, at *5 (Del Ch 2008).

Plaintiffs seek to hold the Krauses personally liable by piercing the corporate veil of JMG and the Krauses' other companies. Defendants contend that the AC does not contain sufficiently

well pleaded facts to support veil piercing liability. They are correct. The AC's veil piercing allegations are largely conclusory and parrot the applicable factors, such as commingling of funds. The corporate formality allegations, moreover, are insufficient since Delaware law, which permits LLC members to maintain the benefits of the corporate form without strictly adhering to a governance, cross-ownership, and control structure that would otherwise be problematic outside of the alterative entity context, such as with a corporation. *See generally Capone v Castleton Commodities Int'l LLC*, 2016 WL 1222163, at *7 (Sup Ct, NY County 2016), citing *In re Opus E.. LLC*, 528 BR 30, 57-66 (Bankr D Del 2015) (collecting cases). Hence, allegations regarding the Krauses' domination and control of their companies is insufficient to maintain a veil piercing claim. *See In re Opus*, 528 BR at 64-65 ("Merely presenting evidence of dominion or control ... without evidence of fraud or similar injustice [] will not support alter ego liability.") (citations omitted).

The AC does not set forth facts to support the essential allegation that JMG and the other companies controlled by defendants are sham entities designed to defraud investors and creditors. Plaintiffs conflate their substantive allegations of malfeasance with their veil piercing claims. *See EBG Holdings LLC v Vredezicht's Gravenhage 109 B.V.*, 2008 WL 4057745, at *12 (Del Ch 2008) ("the requisite element of fraud under the alter ego theory must come from an inequitable use of the corporate form itself as a sham, and not from the underlying claim"); *Medi-Tec of Egypt Corp. v Bausch & Lomb Surgical*, 2004 WL 415251, at *4 (Del Ch 2004) ("[plaintiff's] alter ego argument also fails because it has not alleged that the corporate form in and of itself operates to serve some fraud or injustice, distinct from the alleged wrongs of [defendant]"). While defendants may have wronged plaintiffs, plaintiffs do not allege that the Krauses' companies do not otherwise operate as legitimate corporate entities.

There is no authority to support the notion that every company that commits wrongdoing will automatically have its veil pierced. It cannot be the case that every tort committed by a company vitiates the protections of doing business through the corporate form. This would be devastating for the company's non-controlling investors and would have chilling effects on capital markets. Veil piercing is an extreme remedy that turns on whether the company functions as a genuine corporate entity, and not whether there is liability in a lawsuit. That is why "persuading a Delaware court to pierce the corporate veil is a difficult task" and will not be done "[a]bsent compelling cause." *Midland Interiors,* 2006 WL 4782237, at *3. The AC fails to plead compelling veil piercing claims, and, therefore, they are dismissed without prejudice. It should be noted that the remedy of veil piercing may not ultimately afford plaintiffs additional recovery in this action since the Krauses' themselves may be held personally liable under the causes of action surviving this decision. *See generally Feeley*, 62 A3d at 660-65.

Similarly, the Krauses may not be able to avoid liability for their conduct under the Servicing Agreement based on section 2.11(a) because they are alleged to have committed gross negligence.[20] *See Pacnet Network Ltd. v KDDI Corp.*, 78 AD3d 478, 480 (1st Dept 2010) ("Contractual limitation of liability provisions are generally enforceable unless the party seeking to avoid liability has engaged in grossly negligent conduct"), citing *Colnaghi, U.S.A., Ltd. v Jewelers Protection Servs., Ltd.*, 81 NY2d 821, 823-24 (1993) ("Public policy ... forbids a party's attempt to escape liability, through a contractual clause, for damages occasioned by 'grossly negligent conduct.'").[21] "'[G]ross negligence' differs in kind, not only degree, from

[20] It should be noted that other extreme conduct, such as willful misconduct, also is carved out in section 2.11(a).

[21] Since the Servicing Agreement is governed by New York law, New York law governs the gross negligence exception.

claims of ordinary negligence. It is conduct that evinces a reckless disregard for the rights of others or 'smacks' of intentional wrongdoing." *Colnaghi,* 81 NY2d at 823-24, quoting *Sommer v Fed. Signal Corp.*, 79 NY2d 540, 554 (1992); *see Pegasus Aviation I, Inc. v Varig Logistica S.A.*, 118 AD3d 428, 433 (1st Dept 2014), citing *Hartford Ins. Co. v Holmes Protection Group*, 250 AD2d 526, 527 (1st Dept 1998) (same). The allegations in the AC suffice to plead gross negligence. As an independent cause of action, it is duplicative for the reasons set forth earlier. Nonetheless, whether the Krauses' committed gross negligence, a question of fact requiring discovery, impacts the enforceability of section 2.11(a). They are alleged to have allowed the Aircraft to fall into a state of disrepair and to have engaged in conduct that "smacks of intentional wrongdoing," such as using Aircraft and their parts for their own personal benefit, entering into below market leases with companies they own, and refusing to collect all of the lease payment from those companies. Simply put, defendants are alleged to have abandoned their duties of care and loyalty to plaintiffs in favor of their own interests in their other companies. Assuming these allegations to be true for the purposes of this motion to dismiss, plaintiffs have pleaded a claim for recovery against the Krauses for their conduct under the Servicing Agreement despite the liability limitations of section 2.11(a).[22] Accordingly, it is

ORDERED that the dismissal motions of Jet Midwest Group LLC, Paul Kraus, and Karen Kraus are granted to the following extent: (1) Counts III, IV, V, VI, VII, VIII, XI, XII, XIII, XIV, XV, XVI, XVIII, XX, XXI, XXII, XXIV, and XXV are dismissed; (2) the gross negligence claims, which are dismissed as duplicative independent causes of action, may nonetheless be used to seek to negate the limitations of liability in section 2.11(a) of the

[22] To be clear, the Krauses cannot be held liable for directly breaching the Servicing Agreement because they are not parties to that contract. However, their conduct under the Servicing Agreement is alleged to constitute a breach of their fiduciary duties as Managers of PMC.

Servicing Agreement; (3) the veil piercing claims are dismissed without prejudice; and (4) the motions are otherwise denied.[23]

Dated: May 25, 2016

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C.

[23] The parties will be directed to appear at a preliminary conference and to commence fact discovery after the pending disqualification motion (Seq. 004), scheduled for oral argument on June 22, 2016, is decided.