# SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BERNARD J. FRIED J.S.C. PART 60

0601132/2004

BOBROW, BETTY
VS
LIEBMAN, SAM

INDEX NO. 601132-04

MOTION DATE 9-3-04

MOTION SEQ. NO. 1

MOTION CAL. NO. 3

SEQ 1

DISMISS ACTION

The following papers, numbered 1 to _____ were read on this motion to/for _____

| | PAPERS NUMBERED |
|---|---|
| Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ... | |
| Answering Affidavits — Exhibits | |
| Replying Affidavits | |

**Cross-Motion:** ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

This motion is decided in accordance with the accompanying memorandum decision.

SO ORDERED



MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 2/17/05

BERNARD J. FRIED J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST

[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 60

----------X

BETTY BOBROW,

Plaintiff,

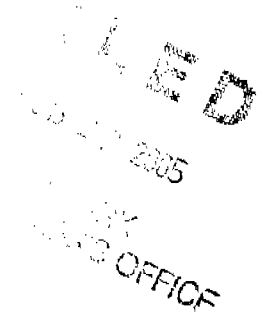
Index No.
601132/04

-against-

SAM LIEBMAN, NEIL TEPPER, 235 EAST 4TH STREET, L.L.C., DANIEL PERLA and PERLA ASSOCIATES, L.P.,

Defendants.

----------X



FRIED, J.:

Defendants Sam Liebman (Liebman), Neil Tepper (Tepper), 235 East 4th Street, L.L.C. (235), Daniel Perla and Perla Associates, L.P. (Perla Associates) move, pursuant to CPLR 3211 (a) (1) and (a) (7), for an order dismissing the complaint of Betty Bobrow (Bobrow), based on documentary evidence and failure to state a cause of action. Bobrow cross-moves, pursuant to CPLR 3212, for an order granting her partial summary judgment on the eleventh cause of action.

Liebman and Tepper are real estate investors and syndicators. 235 was formed to acquire, own, and operate an apartment building located at 235 East 4th Street, New York, New York (Property). 235 East 4th Street Management, L.L.C. (Management L.L.C.) was formed to acquire a 70% equity position in, and to become the managing member of, 235. Liebman and Tepper are the managing members of Management L.L.C., and together hold the majority interest in the equity of Management L.L.C. Bobrow is a member of both 235 and Management L.L.C..

Perla Associates provided a second $500,000 mortgage (Perla Mortgage) to 235 in connection with the purchase of the Property (the first and larger mortgage was held by the Dime Savings Bank of Williamsburgh). Daniel Perla is the principal of Perla Associates.

In December 1998, Liebman, Tepper and a third individual, James Kinsey, prepared a prospectus (Prospectus) describing the 4th Street project (Project). Defendants contend that they gave a copy of the Prospectus to Bobrow, but she denies that she ever received it prior to her investment. The Prospectus recited that the purchase price for the Project was $3.4 million, that $1.2 million would be raised from individual investors who would purchase units (Units; the individual investors are known as Unitholders), and that the remaining capital needs would be raised from a first and second mortgage on the Property. The Prospectus stated that the Unitholders would receive: (1) 30% of the equity of 235; (2) the greater of 30% of the annual profits or a defined Preferred Annual Return of between 8% and 10%; and (3) 50% of the proceeds of a planned 2003 mortgage refinancing.

In late 1998 or early 1999, Bobrow expressed interest in investing in the Project. In January 1999, Liebman sent Bobrow a memorandum (January 4 Memorandum) describing the terms of the investment. Bobrow was to contribute $400,000, in return for which she was to receive: (1) a 10% equity interest in 235 as a Unitholder; (2) the greater of her share of 30% of the "net cash flow" or the Preferred Annual Return (8% in the first year, 9% in the second year, and 10% thereafter), and (3) 50% of the proceeds of the planned 2003 refinancing. The January 4 Memorandum further stated that Bobrow would receive a 15% interest through the managing member (i.e., through Management L.L.C.). This meant that plaintiff would have ownership of a 21.43% interest in Management L.L.C. Defendants thus claim that Bobrow's total interest in the Project was 25%.

Plaintiff's version of the deal is that she was to have a 10% interest in 235, i.e., one-third of the total Unitholders share of 30%, and that she would have a 21.43% interest in Management L.L.C, which would own the remaining 70%.

On January 11, 1999, Bobrow invested $400,000 in 235. The closing on the Property occurred that month.

The complaint alleges that plaintiff was advised that her $400,000 equity investment would constitute one-third of the total capital of $1.2 million to be contributed by "outside investors" who were to be Unitholders, and that any "shortfall" in the proceeds of the sale of units (the difference in money actually raised in the offering and the $1.2 million Liebman and Tepper represented was to be raised for the transaction) would be made up by Liebman and Tepper through loans or investment of their own funds to 235. Plaintiff claims that Liebman and Tepper actually obtained only $254,000 from outside investors other than plaintiff. It is alleged that instead of making a loan or investment of their own money, as they represented they would, Liebman and Tepper improperly "funded" the shortfall by placing and servicing the high interest $499,000 Perla Mortgage. According to plaintiff, Perla was a friend of Liebman and Tepper, so that the mortgage transaction was less than arms-length. Bobrow thus alleges that unknown to her, Liebman and Tepper used 235's own assets (the Property) to finance what was, in effect, their personal investments. It is claimed that Liebman, Tepper, and Perla "concocted" a Guaranty Agreement, dated January 8, 1999, to give the appearance that Liebman and Tepper had borrowed the money needed to fund the shortfall by personally guaranteeing repayment of the $499,000. Instead, plaintiff claims, immediately after the closing of the purchase of the Property was completed, Liebman executed a promissory note and mortgage obligating 235 to pay Perla 14% interest on the $499,000 loan.

The complaint alleges that, even though plaintiff invested 61.2% of the funds needed to close the deal, and should have had a 61.2% of the Unitholders' total equity in the Property of 30% (i.e. an equity interest of 18.36%), she received only a 10% equity interest in 235. It is further alleged that Liebman and Tepper gave themselves an additional 25% in the Units (approximately 25% percent of 30%, or 7.53%) without using their own money. In other words, it is claimed that, although the offering documents and representations of defendants indicate that the Unitholders have a 30% stake in 235, and that Management L.L.C. has a 70% interest in 235, Management L.L.C. took an additional 7.53% interest in 235 (Additional Equity Interest). This represented approximately one-fourth of the aggregate 30% equity interest in the Property allocated to the Unitholders. According to Bobrow, since she, as a member of Management L.L.C., owns 21.43% of Management, L.L.C., she should have been given a 1.5% share of the 7.53% Management L.L.C. interest taken exclusively by Tepper and Liebman.

Moreover, Bobrow claims that, after the purchase of the Property, Liebman and Tepper took an opportunity for themselves (to the exclusion of plaintiff) to purchase Kinsey's 26.19% share in Management L.L.C. This gave Liebman and Tepper an additional 26.19% in Management, L.L.C. and 18.33% of 235. As a result, plaintiff claims, she was unlawfully prevented from acquiring an additional 7.595% interest in Management L.L.C. and 5.32% interest in 235. She derives the 5.32% figure by multiplying the 26.19% interest of Kinsey by the 21.43% share of Management L.L.C. which she claims to own.

Plaintiff states that nearly one year after the closing on the purchase of the Property, a Confidential Private Placement Memorandum (Memorandum, as distinguished from the January 4 Memorandum referred to above) was prepared by Tepper and Liebman with respect to sale of the

Units. The Memorandum confirmed many of the terms of sale of the Units as plaintiff understood them to be. However, plaintiff contends, the Memorandum improperly sought to "ratify" Tepper and Liebman's alleged improper acts (i.e., their use of the Property and 235 to secure the Perla Associates loan to purchase 7.53% of 235).

The first cause of action alleges that under the Memorandum and defendants' representations, which constitute a contract, plaintiff is entitled to 61.2% of the Units, representing 18.36% of the total equity of 235 (based on her contributions). Thus, plaintiff seeks a judicial declaration that she owns 18.36% of the equity of 235, rather than the 10% figure claimed by defendants.

The second cause of action seeks a judicial declaration that plaintiff owns an additional 7.595% of Management L.L.C. and an additional 5.32% of the additional interest in 235, by reason of Tepper and Liebman's allegedly improper purchase for themselves of Kinsey's interest.

The third cause of action seeks a declaration that Liebman and Tepper are not entitled to the 7.53% Additional Equity Interest. Plaintiff seeks cancellation of the Additional Equity Interest, and redistribution pro rata to the Unitholders, including plaintiff.

The fourth cause of action alleges that plaintiff relied in good faith upon the representations made by Liebman and Tepper in investing her money, and seeks a judicial declaration that she owns 18.36% of 235. Plaintiff also seeks a recalculation of all distributions previously made to 235 to her, based on a direct equity interest of 18.36%.

The fifth cause of action alleges that plaintiff relied in good faith upon the representation of Liebman and Tepper that she was a 21.43% owner in Management L.L.C., and that Liebman and Tepper failed to treat her equally with other members of Management L.L.C. in terms of the opportunity to participate pro rata in the purchase of Kinsey's shares. Plaintiff seeks a judicial

declaration that should she elect to purchase 21.43% of Kinsey's interest in Management L.L.C., she is entitled to an additional 5.35% interest in 235. She seeks a recalculation of distributions previously made from 235 to Management L.L.C. based upon such additional equity interest.

The sixth cause of action seeks cancellation of the Perla Mortgage and the promissory note, and a return of all monies of 235 used in connection with debt service. Plaintiff alleges that Perla knew that the Perla Mortgage was not authorized and was surreptitiously placed on the property by Liebman and Tepper.

The seventh and eighth causes of action allege that, at the closing on the Property, the first mortgagee took a $150,000 escrow fund, that the first mortgagee later returned the funds, but that Liebman and Tepper kept the escrow funds for themselves instead of returning them to 235. The seventh cause of action seeks an accounting, and the eighth cause of action seeks damages.

The ninth cause of action alleges that Liebman and Tepper fraudulently concealed from plaintiff that they were using Perla's funds to complete the purchase of the Property (instead of using their own funds to cover the shortfall of money raised from Unitholders), and, in effect, that Liebman and Tepper committed a fraud in entering into the Perla Mortgage. Plaintiff seeks recovery of damages.

The tenth cause of action alleges that Liebman, Tepper, and Perla have engaged in acts which violate General Business Law § 349, and seeks recovery of damages.

The eleventh cause of action alleges that, according to the January 4, 1999 Memorandum, Liebman promised that upon refinance of the loan on the Property, the refinance proceeds would be split equally between the limited partners and general partners (apparently meaning managing members and non-managing L.L.C. members), that a refinancing occurred on December 18, 2003,

but that Liebman and Tepper failed to pay the proceeds to her. Plaintiff seeks $108,424 as her share of the proceeds.

The twelfth cause of action alleges that, by reason of fraudulent and reckless conduct on the part of Liebman and Tepper, plaintiff is entitled to dissolution of 235 and Management L.L.C., pursuant to Limited Liability Corporation Law § 702.

Liebman and Tepper maintain that from 1999 to 2003, 235 and Management L.L.C. have fully recognized plaintiff's 10% interest in 235 and her 21.43% interest in Management L.L.C., and that distributions have been made to her, as well as to the other Unitholders. Defendants proffer a set of figures specifying the distributions supposedly made between 1999 and 2003.

Defendants explain the Kinsey transaction as follows: In August 2000, Kinsey decided to separate his investment interests from Liebman and Tepper, and that Liebman, Tepper, and Kinsey entered into an exchange agreement by which Kinsey assigned his interest in various real estate projects (including 235) to Liebman and Tepper, and that Liebman and Tepper assigned their interests in certain other projects (not 235) to Kinsey in order to create an equal exchange. The net result was that Kinsey no longer owned any part of Management L.L.C. Management L.L.C. did not participate in this transaction.

Liebman and Tepper maintain as follows:

(1) The Memorandum promised plaintiff a 10% interest in 235 and 15% in Management L.L.C., and she actually received these amounts;

(2) 235 raised all $1.2 million, $400,000 from plaintiff, and $800,000 from twenty-nine other outside investors, so that there was no shortfall;

(3) As of the end of 1999, 235 had sold 22.47% of its membership interests to Unitholders,

and issued 70% of its membership interests to Management, L.L.C. That left 7.53% unsold. That 7.53% was not allocated to Liebman and Tepper, but was carried as "unsold" Units until subsequently sold to third parties for cash. During each year where "unsold" units were reserved to 235, a separate K-1 statement was prepared and issued to each member of Management L.L.C., allocating to each (including Bobrow) their respective share of losses to be allocated to the unsold percentage.

Where there is a motion to dismiss a complaint under CPLR 3211, the plaintiff is entitled to the benefit of all favorable inferences which may be drawn from the complaint, and is deemed to have alleged whatever may reasonably be implied from the complaint (e.g. Underpinning & Foundation Constructors, Inc. v Chase Manhattan Bank, N.A., 46 NY2d 459 [1979]).

In the instant case, the first and fourth causes of action are based upon Liebman's and Tepper's alleged taking of percentage interests to which they were not entitled. Although Liebman and Tepper have proffered documents in an effort to show that all funds that were supposed to have been contributed by themselves and the outside investors were, in fact, paid into 235, plaintiff has not yet had discovery. At the pleadings stage, I cannot determine, as a matter of law, that plaintiff has received all the percentage interest in 235 to which she is entitled. To the extent, if any, that Liebman and Tepper took an interest directly in 235, or an indirect interest through Management, L.L.C., based on funds contributed by others, plaintiff would have a proportionately higher percentage of ownership in 235. Thus, the first and fourth causes of action must be sustained. Liebman and Tepper may move for summary judgment upon completion of discovery.

The second and fifth causes of action refer to Liebman and Tepper's purchase of Kinsey's interest in Management L.L.C. In effect, plaintiff alleges that by acquiring Kinsey's membership

in Management L.L.C. in exchange for giving Kinsey an interest in other businesses owned in part by Liebman and Tepper, Liebman and Tepper were usurping a corporate opportunity. Under the corporate opportunity doctrine, a corporate fiduciary may not, without consent, divert and exploit for his own benefit any opportunity that should be an asset of the corporation. However, in order for the corporate opportunity doctrine to be applicable, the asset in question must be one that belongs to the corporation (Ackerman v 305 East 40th Owners Corp., 189 AD2d 665 [1st Dept 1993]). Liebman and Tepper maintain that plaintiff's remedy, if any, would have been a members' derivative action. Inasmuch as Management L.L.C. is a limited liability company, it presents a unique problem, since the Limited Liability Corporation Law (LLCL) does not permit derivative actions by members (Hoffman v Unterberg, 9 AD3d 386 [2d Dept 2004]; Schindler v Niche Media Holdings, L.L.C., 1 Misc 3d 713 [Sup Ct, NY County 2003]; see also, Practice Commentary to the LLCL, Chapter 34, 2005 Electronic Edition, by Bruce Rich, Section 1(F)). LLCL § 610 states that "a member of a limited liability company is not a proper party to proceedings against a limited liability company, except where the object is to enforce a member's right against or liability to the limited liability company. Thus, members of a limited liability company must assert individual, rather than derivative, causes of action.

Liebman and Tepper point to LLCL § 603 (a), which states that, except as provided in the operating agreement, a membership interest is assignable in whole or part. In response, Bobrow maintains that Kinsey was not permitted to "withdraw" as a member. LLCL § 606 (a) provides:

> A member may withdraw as a member of a limited liability company only at the time or upon the happening of events specified in the operating agreement. Notwithstanding anything to the contrary under applicable law, unless an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to

> the dissolution and winding up of the limited liability company. Notwithstanding anything to the contrary under applicable law, an operating agreement may provide that a membership interest may not be assigned prior to the dissolution and winding up of the limited liability company.

Liebman and Tepper maintain that a sale, or in this case, an exchange, by a member of his or her interest, does not constitute a "withdrawal" under the LLCL. This is obviously correct, otherwise, it would not have been necessary to insert the last sentence in the above-quoted statute, which specifically provides for restrictions in the operating agreement on the right to assign.

Moreover, Bobrow has not cited any provision of the Operating Agreement which restricts the rights of members to sell or exchange their respective interests. Thus, application of the corporate opportunity doctrine would be contrary to the Operating Agreement and to the statute. Since Liebman and Tepper were free to exchange their interests for those of Kinsey, the second and fifth causes of action must be dismissed.

There is an additional independent reason why the fifth cause of action must be dismissed. A cause of action for fraud cannot arise from lack of intent to perform under a contract (Wilmoth v Sandor, 259 AD2d 252 [1st Dept 1999]). The claim here, stripped of its verbiage, alleges, in effect, that Liebman and Tepper breached the Operating Agreement or the Memorandum. Since plaintiff has not shown that the Kinsey exchange violated either the Operating Agreement or the Memorandum, there is no cause of action based on the Kinsey exchange.

As stated above, the third cause of action seeks a declaration that Liebman and Tepper are not entitled to the 7.53% Additional Equity Interest. To the extent, if any, that Liebman and Tepper took an interest in Management L.L.C., based on funds contributed by others, plaintiff would have a proportionately higher percentage of ownership in that entity. Although this cause of action seeks

redistribution pro rata to all Unitholders of the Additional Equity Interest, plaintiff cannot represent any Unitholders other than herself. This follows from the conclusion that a derivative cause of action cannot be asserted on behalf of a limited liability company. However, I will sustain the third cause of action, provided that it is amended to seek recovery solely of plaintiff's own pro rata share of the Additional Equity Interest.

The sixth and ninth causes of action relate to the Perla Mortgage. Since the Perla Mortgage has been satisfied, it cannot now be "cancelled". Therefore, the sixth cause of action must be dismissed. However, the ninth cause of action for fraud, at least at the pleadings stage, states a viable claim. In order to recover for fraud, plaintiff must show a false representation, defendants' knowledge of falsity, reliance on the part of plaintiff, and damages (Small v Lorillard Tobacco Co., 94 NY2d 43 [1999]). If, in fact, Liebman and Tepper represented to Unitholders that the proceeds of any mortgages placed on the Property would be used to meet capital needs, but if, in fact, the Perla Mortgage was actually used to enable Liebman and Tepper to acquire an additional ownership interest in 235, Bobrow sustained damages, equal to the 14% loan interest paid to Daniel Perla Associates on the Perla Mortgage. That loan interest in such a case is recoverable from Liebman and Tepper. Moreover, if it can be shown that Daniel Perla and Perla Associates knew about and participated in Liebman and Tepper's alleged scheme to use the Perla Mortgage proceeds to fund their acquisition of an additional interest in 235, Bobrow can recover the loan interest from Daniel Perla and Perla Associates.

The seventh and eighth causes of action accuse Liebman and Tepper of improperly retaining for themselves escrow funds which were returned by the first mortgagee. Although Liebman and Tepper contend that the funds were placed in 235's account and used for general operating purposes,

plaintiff claims that the funds were actually used to pay down the Perla Mortgage. If it can be shown that the Perla Mortgage was improperly used to fund Liebman's and Tepper's acquisition of a larger interest in 235 than they otherwise would have had, then plaintiff is entitled to recover the amount of the escrow funds that were used for this allegedly improper purpose. While members of a limited liability company may not bring a derivative action, plaintiff can assert a cause of action in her individual capacity for her pro rata share of the losses allegedly sustained by the misappropriation of escrow funds. The seventh and eighth causes of action must be sustained.

The tenth cause of action, which seeks recovery under General Business Law § 349, must be dismissed. Section 349 concerns itself with practices that have a broad impact upon consumers at large (Champion Home Builders Co. v ADT Security Services, Inc., 179 F Supp 2d 16 [NDNY 2002]; citing Teller v Bill Hayes, Ltd., 213 AD2d 141 [2d Dept 1995]). Private contract disputes, unique to the parties, do not fall within the purview of § 349 (Champion Home Builders v ADT Security Services, Inc., supra). Plaintiff's opposition papers did not discuss this cause of action, and I presume that it has been abandoned.

The twelfth cause of action seeks a dissolution of 235. LLCL § 702 provides that dissolution is available, upon an application by a member, "whenever it is not reasonably practicable to carry on the business in conformity with the articles of incorporation or operating agreement." This means that dissolution is available where the business is unable to function as intended, or is failing financially (Schindler v Niche Media Holdings, L.L.C., 1 Misc.3d 713, supra). There is no allegation that the business is failing financially. Plaintiff claims that Liebman's and Tepper's alleged acts, such as their procurement of the Perla Mortgage to fund their own acquisition of interests in 235, and the failure to return escrow funds, constitute grounds for dissolution. Although it is far more likely

the failure to return escrow funds, constitute grounds for dissolution. Although it is far more likely that plaintiff's remedy, if any, will be an adjustment of her percentage ownership in 235 and Management, L.L.C. and recovery of damages, I will not rule out dissolution, at least at the pleadings stage. The twelfth cause of action is sustained.

Plaintiff seeks summary judgment on the eleventh cause of action, which, in turn, seeks recovery of a pro rata portion of the proceeds of the refinanced mortgage. Liebman and Tepper acknowledge that plaintiff's share of the proceeds is $152,816. However, although Liebman and Tepper state that, while plaintiff would otherwise have been entitled to a pro rata portion of the proceeds, 235 is prepared to assert defenses or counterclaims. Liebman and Tepper state that, in December 2003, 235 refinanced the principal mortgage, and that all Unitholders, except Bobrow, cooperated in the transaction. They further state that shortly thereafter, 50% of the net proceeds were distributed to Unitholders other than plaintiff, but that, by reason of plaintiff's refusal to cooperate with the refinancing efforts, plaintiff's share of the refinancing was placed in escrow. The affidavit of Sam Liebman, dated November 1, 2004, states that, after Bobrow allegedly refused to sign the documents necessary for refinancing, he and Tepper were required to seek counsel as to how a refinancing could occur without Bobrow's signature, and that Bobrow's refusal to cooperate resulted in additional legal fees, a higher interest rate, additional points, additional brokerage fees, and other costs, totaling at least $75,000. Summary judgment should not be granted where, as here, issue has not yet been joined (Rine v Higgins, 244 AD2d 963 [4th Dept 1997]). In any event, there are triable issues of fact relating to plaintiff's alleged non-cooperation with the refinancing that cannot be resolved on the basis of the affidavits and exhibits submitted. The cross-motion must therefore be denied.

Accordingly, it is

ORDERED that the motion is granted only to the extent that the second, fifth, sixth, and tenth causes of action are dismissed, and that plaintiff is directed to amend the third cause of action to limit recovery to her own proportionate share of the Additional Equity Interest; and it is further

ORDERED that the cross-motion for summary judgment is denied; and it is further

ORDERED that plaintiff is directed to serve the amended complaint within 20 days after service of a copy of this order with notice of entry.

Dated: 2/17/05

ENTER:

J.S.C.

BERNARD J. FRIED
J.S.C.