

Dragon Invs. Co. II LLC v Shanahan

2007 NY Slip Op 33688(U)

November 2, 2007

Supreme Court, New York County

Docket Number: 0602868/2005

Judge: Helen E. Freedman

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

PRESENT: _____

PART _____

Index Number : 602868/2005

DRAGON INVESTMENT CO. 11 LLC

vs

SHANAHAN, WILLIAM S.

Sequence Number : 003

DISMISS

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

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

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

FILED

NOV 09 2007

COUNTY CLERK'S OFFICE

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

Dated: 11/2/07

Hsu
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 39

-----X

DRAGON INVESTMENTS Company II LLC and
PRINCETON TECHNOLOGY LIMITED, on their
own behalf and on behalf of all
shareholders of Phoenix Telecommunications
Ltd. save William Shanahan, Rose-Marie Fox,
Marco Elser, and Antares, LLC,

Index No. 602868/05

Plaintiffs,

-against-

WILLIAM S. SHANAHAN, ROSE-MARIE FOX, and
ANTARES, LLC,

Defendants.

-----X

FREEDMAN, J.:

FILED
NOV 09 2007
COUNTY CLERK'S OFFICE
NEW YORK

This action arises out of alleged wrongful conduct by defendants William S. Shanahan, Rose-Marie Fox, and Antares, LLC (collectively, the SFA defendants) that harmed Phoenix Telecommunications Ltd. (Phoenix) and its shareholders by stripping Phoenix of its assets and business opportunities.

The SFA defendants now move to dismiss the amended complaint's breach of fiduciary duty claim against Rose-Marie Fox, the aiding and abetting a breach of fiduciary duty claim against William Shanahan and Antares, and the unjust enrichment claim against all three SFA defendants.

FACTUAL BACKGROUND AND ALLEGATIONS

The relevant facts and allegations in this action were set forth in a prior decision in this action dated June 14, 2006 (Prior Decision). In sum, Phoenix was established as a result of a Hong Kong liquidation proceeding involving Sino, a company invested in by plaintiff Dragon Investments Company II LLC (Dragon). During that proceeding, the Hong Kong court allowed

the Sino investors to establish Phoenix in order to fund Sino's obligations with respect to its investment in a China-based paging company (Li Gao joint venture). Fox assumed the role of Phoenix's director, and allegedly began to engage in wrongful conduct with the help of defendants Shanahan and Antares.

Plaintiffs allege that defendants Fox and Shanahan had a continuing plan, since early 2000, to usurp business opportunities belonging to Phoenix, specifically, with regard to the Li Gao joint venture. Plaintiffs allege that the SFA defendants wrongfully acquired 61.2% of the issued and outstanding stock, in order to carry out their plan.

Plaintiffs also allege that defendant Fox caused Phoenix to misrepresent that its China paging service business was an ongoing business. Defendant Fox allegedly made bogus complaints on behalf of Phoenix, for the sole benefit of defendants Shanahan and Antares, to bolster claims filed by those defendants in the United States District Court for the Southern District of New York. Plaintiffs claim that the bogus filings on behalf of Phoenix caused Phoenix to waste considerable assets on hiring law firms, accounting firms, and private investigators.

In September 2003, the SFA defendants allegedly transferred Phoenix's assets, including business opportunities, without adequate consideration, to Duck Limited (Duck), a shell company controlled by the SFA defendants.

Plaintiffs Dragon and Princeton Technology Limited originally brought this action against the SFA defendants and Phoenix (Original Action). All defendants in the Original Action moved to dismiss the complaint on the grounds that the complaint failed to state a cause of action. This court granted the defendants' motions, but stated that plaintiffs could replead

their causes of action derivatively on behalf of Phoenix against the SFA defendants, if so advised. The decision also held that claims made before August 8, 2002 were time-barred under New York law.

On December 14, 2006, plaintiffs Dragon and Princeton Technology, on their own behalf and on behalf of all shareholders of Phoenix, except William Shanahan, Rose-Marie Fox, Marco Elser, and Antares, filed an amended complaint. The amended complaint contains three causes of action.

The first cause of action is against Rose-Marie Fox for breach of fiduciary duty involving fraud and willful misconduct arising out of her misrepresentations and concealment of material information, as well as the illegal transfer of Phoenix's assets. The second cause of action is against William Shanahan and Antares for aiding and abetting in the breach of fiduciary duty claim by participating in the scheme to obtain control of Phoenix and transfer Phoenix's assets to entities controlled by defendant Shanahan without adequate consideration. The third cause of action is against the SFA defendants for unjust enrichment, alleging that the SFA defendants were unjustly enriched at Phoenix's expense when they illegally transferred Phoenix's assets in the Duck deal.

The SFA defendants move to dismiss the entire amended complaint on the grounds that plaintiffs lack standing to bring this derivative action and the amended complaint fails to state a cause of action. The SFA defendants also argue that certain allegations contained in the amended complaint are time-barred.

HOLDING

The SFA defendants' motion to dismiss the amended complaint is granted. The amended

complaint improperly pleads individual claims on behalf of Dragon and Princeton. Plaintiffs have also failed to meet the requirements of Part 19.9 of the Civil Procedure Rules (England & Wales). However, plaintiffs are granted leave to replead on the condition that they apply to the court for permission to proceed with this action, supported by written evidence showing that they are entitled to sue on behalf of Phoenix. *See* Part 19.9 of the Civil Procedure Rules. Plaintiffs' claims occurring prior to August 8, 2002 are dismissed with prejudice, as well as plaintiffs' individual claims.

DISCUSSION

In this court's previous order, the plaintiffs Dragon and Princeton were given leave to replead this action derivatively. The SFA defendants argue that the amended complaint fails to satisfy the basic procedural rules governing a derivative action, because, based on the amended complaint's caption and certain allegations, the plaintiffs are pursuing this action only on their own behalf, and that of certain shareholders, to the exclusion of others.

Plaintiffs Dragon and Princeton cannot pursue a derivative action in their individual capacities, nor can they exclude certain shareholders, as a derivative action is brought on behalf of the company, and includes all of its shareholders, regardless of the alleged wrongdoing of some. Where there is a wrong against a corporation, a shareholder has no individual cause of action, unless the wrongdoer has breached a duty owed to the shareholder independent of any duty owing to the corporation wronged. *Abrams v Donati*, 66 NY2d 951, 953 (1985). "The remedy sought is for wrong done to the corporation; the primary cause of action belongs to the corporation; recovery must enure to the benefit of the corporation." *Marx v Akers*, 88 NY2d 189, 193 (1996) (internal quotation marks and citation omitted). This court's previous decision held

that plaintiffs Dragon and Princeton could not pursue this action individually. Plaintiffs Dragon and Princeton were given an opportunity to replead derivatively, and yet, still brought this action, in part, on their own behalf.

Plaintiffs have also failed to meet the basic requirement, in regard to standing, to proceed with a derivative action.

Standing

1. Choice-of-Law

Whether a party has standing to proceed in a derivative action is a question of substantive law. Therefore, standing must be decided according to the law of the state of incorporation, in this case the British Virgin Islands (BVI). *In the Matter of CPF Acquisition Co., Inc., by Michael Kagan, a shareholder v CPF Acquisition Co., Inc.*, 255 AD2d 200 (1st Dept 1998); *Graczykowski v Ramppen*, 101 AD2d 978 (3rd Dept 1984).

2. Applicability of the BVI Business Companies Act 2004

As an initial matter in regard to standing, there is a dispute as to whether the BVI Business Companies Act 2004 (2004 Act) and its section 184C, governing standing in derivative actions, applies to Phoenix, or whether this court must look to English common law to resolve the issue¹. Based on the statutory language of the 2004 Act, it does not apply to Phoenix in this action.

The 2004 Act became effective on January 1, 2005. However, there was a two-year transition period that extended from January 1, 2005 to December 31, 2006. Companies that

1. By virtue of the Common Law Ordinance (Cap. 13), BVI courts apply English common law, supplemented by legislation promulgated by local Legislative Council. *See* Affidavit of Martin S. Kenney, ¶ 24; Affidavit of William Hare, ¶ 4.

[*7]

were incorporated under the old International Business Companies Act had until December 31, 2006 to voluntarily re-register under the 2004 Act, in order to be treated as a company incorporated under the 2004 Act. The 2004 Act specifically states, in relevant part, “a former Act company that is re-registered under this Schedule shall, from the date of its re-registration, be treated as a company incorporated under this Act.” Business Company Act 2004, Schedule 2, Transitional Provisions, ¶ 6 (2). Companies existing under the old International Business Companies Act that did not voluntarily re-register were governed by the old Act until January 1, 2007. It is apparent that during the transition period the two acts remained distinct, and if a company was still incorporated under the old act until the company was re-registered under the 2004 Act.

The amended complaint was filed in December 2006, before Phoenix was re-registered under the 2004 Act, and therefore, the 2004 Act does not apply to Phoenix in this action. Since the old International Business Companies Act does not specifically provide for bringing derivative actions, English common law determines standing.

3. Part 19.9 of the Civil Procedure Rules (England & Wales)

Pursuant to Part 19.9 of the Civil Procedure Rules (England & Wales), a plaintiff must apply to the court for permission to proceed with a derivative action, and submit written evidence to support that he is entitled to sue on behalf of a company. *See also* Affidavit of William Hare. These requirements, like the demand rules under New York law, are substantive conditions precedent put in place to protect a corporation from undue interference, and therefore, must be applied in this derivative action. *See Locals 302 & 612 of the Intl Union of Operating Engineers-Employers Constr. Indus. Retirement Trust v Blanchard*, 2005 WL 2063852 (SD NY

2005) (holding the Canadian Business Corporations Act's leave requirements, like New York's demand rules, are substantive in nature, and plaintiff was required to seek leave of a specifically enumerate Canadian court before proceeding with a derivative action). "Demand rules in derivative actions are substantive in nature." *id.* at *6 (internal citation omitted); *See also Levin v Kozlowski*, 2006 NY Slip Op 52142U (Sup Ct, NY County 2006). The issue is not only who may maintain a derivative action or how it will be brought, but if it will be brought, and no determination could be more substantive. *Locals 302 & 612 of the Intl Union of Operating Engineers-Employers Constr. Indus. Retirement Trust v Blanchard*, 2005 WL 2063852, *supra*. Plaintiffs have not complied with the requirements of Part 19.9 of the Civil Procedure Rules and cannot proceed with this action without doing so. Further, even if Part 19.9 of the Civil Procedure Rules were deemed procedural in nature, plaintiffs have not complied with the New York demand rule, nor have they set forth reasons why such demand would be futile. *Bansbach v Zinn*, 1 NY3d 1, 8-9 (2003). Therefore, the amended complaint is dismissed.

Leave to Replead

Plaintiffs seek leave to replead in the event that this court dismisses any part of the amended complaint. This application is granted on the condition that plaintiffs satisfy the requirements of Part 19.9 of the Civil Procedure Rules, i.e., apply to the court for permission to proceed with a derivative action and submit written evidence to support that he is entitled to sue on behalf of a company. However, as decided in this court's previous decision, all breach of fiduciary duty and aiding and abetting claims occurring prior to August 8, 2002 are time-barred and are again dismissed with prejudice. Further, all individual claims are dismissed with prejudice.

Accordingly, it is

ORDERED that defendants William Shanahan, Rose-Marie Fox, and Antares, LLC's motion to dismiss the amended complaint is granted, and the amended complaint is dismissed with costs and disbursements to defendants as taxed by the Clerk of the Court; and it is further

ORDERED that this decision is made partly without prejudice, as plaintiffs are granted leave to replead on the condition that they apply to the court for permission to proceed with this action, and support their application with written evidence; and it is further

ORDERED that plaintiffs' claims occurring prior to August 8, 2002 are dismissed with prejudice and plaintiffs' individual claims are dismissed with prejudice; and it is further

ORDERED that the Clerk enter judgment accordingly.

Dated: *November 2, 2007*

ENTER:

H. E. Freedman

J.S.C.

FILED
NOV 09 2007
COUNTY CLERK'S OFFICE
NEW YORK