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

PRESENT: Cahn Justice

PART 49m

Swenvest Corp

INDEX NO. 604033/06

MOTION DATE

- v -

MOTION SEQ. NO. 003

Stephen Wener et al

MOTION CAL. NO.

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

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE .....

FILED

JUN 17 2008

COUNTY CLERK'S OFFICE
NEW YORK

Dated: 6/13/08

J.S.C.

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

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 49

----------x

SWENVEST CORPORATION,

Plaintiff,

-against-

Index No. 604033/06

STEPHEN WENER, COWE ASSOCIATES, LLP and NEW RIVER INDUSTRIES, INC.,

Defendants.

----------x

Herman Cahn, J.:

Motion Sequence Numbers 003 and 004 are consolidated for disposition. Defendants Stephen Wener and Cowe Associates, LLP (Cowe) move for summary judgment dismissing the complaint as against them. Plaintiff Swenvest Corporation (Swenvest) cross-moves for leave to serve an amended complaint.

In this action, Swenvest invested in a holding company known as Jasco Acquisition, LLC (Jasco). Defendants Wener and Cowe also own membership units in Jasco, and are claimed to be its controlling members. They are alleged to manage and direct both Jasco, and the company for which Jasco is a holding company, Edenton Dyeing and Finishing, LLC (Edenton).

Swenvest claims that Wener and Cowe breached their fiduciary duty to the other members of Jasco, including Swenvest, by using their control over Jasco to favor other companies in which Wener has a controlling interest, including defendant New River Industries, Inc. (NRI) and Dillon Yarn. This was done at the expense of Jasco, Edenton, and Swenvest. It also claims that Wener and the companies he controls, NRI and Cowe, have aided and abetted the Jasco Manager's breach fiduciary of duty and breach of the covenant of good faith and fair

dealing under the Jasco Operating Agreement. Swenvest also asserts that it invested in Jasco based on misrepresentations by Wener.

Defendants contend in their motion that Swenvest's principal admitted in his deposition that Wener had not made the alleged misrepresentations. Further, it is argued that Swenvest had executed a subscription agreement negating that there was any fraud or misrepresentations. They also contend that Swenvest's principal also admitted that there was no basis for the breach of fiduciary duty or breach of the duty of good faith claims. Thus, they seek dismissal of the complaint. Swenvest seeks to amend its complaint to add a derivative claim, suing derivatively on behalf of Jasco Acquisition LLC, which is named as a nominal defendant.

BACKGROUND

Swenvest is a corporation that has been used by its president, Robert Levinson, as a personal investment vehicle (Levinson Aff., ¶ 2). It is a member of Jasco, a North Carolina limited liability company which is managed by a manager (the Jasco Manager) (Second Am. Compl., ¶¶ 1-2). Jasco is the sole owner and member of Edenton, which is a company that was formed in 2002 to purchase the assets of a dyeing company, United Piece Dyeing (UPD) (id., ¶ 1; Def. Statement of Undisputed Facts, ¶ 1). Jasco was Edenton's holding company (Def. Statement of Undisputed Facts, ¶ 3). Defendants Wener and Cowe, a limited liability partnership owned by Wener and members of his family who also invested in Jasco, are members of Jasco by virtue of their ownership interests in Jasco (Second Am. Compl., ¶ 3). Andrew Parise was Jasco's Manager from 2002 to 2004. Thereafter, Wener became the Jasco Manager (id.). NRI is a yarn weaving company in which Wener has a controlling interest (id., ¶ 13). Swenvest claims that Wener also owns or has a controlling interest in Dillon Yarn, a company which texturized

raw yarn for use by textile manufacturers and from which NRI purchased its yarn (id., ¶¶ 12, 14).

In 2002, Wener sought to purchase UPD which then became Edenton (Second Am. Compl., ¶ 15). On August 30, 2002, an Operating Agreement was made and executed with regard to Edenton (Lipsky Aff., Exh. F). It named Jasco as its sole member, with Andy Parise signing as Jasco's Manager (id. at 11). On September 4, 2002, Jasco was formed as the holding company of Edenton (Second Am. Compl., ¶ 16; Lipsky Aff., Exh. R).

Wener approached Levinson, the owner and president of Swenvest, requesting that he invest in Jasco (id.). Levinson has been in the textile business for over 50 years, many of them as an executive (Lipsky Aff., Exh. C, at 8-18). Swenvest invested $500,000, acquiring a slightly greater than 25% member interest in Jasco (Def. Statement of Undisputed Facts, ¶ 4). Wener has a 5.7% interest in Jasco, and Cowe own 25%, together owning 30.84% (Lipsky Aff., Exhs. D, Q).

In connection with this investment, Levinson, on behalf of Swenvest, signed a Subscription Agreement, dated September 5, 2002, which contained various representations by Swenvest (Lipsky Aff., Exh E). Specifically, Swenvest represented:

> 3.05 Speculative Nature. [Swenvest] recognizes the speculative nature of an investment in a membership interest of the Company [Jasco].
>
> 3.08 Economic Risk. [Swenvest] is willing and able to bear the economic risk of an investment in the Company (in making this representation consideration has been given to whether [Swenvest] can afford to hold a membership interest in the Company for an indefinite period of time and whether, at this time, [Swenvest] can afford a complete loss of [its] investment).

Id. at 2. In addition, Swenvest also represented that it made its investment based on its own

knowledge and experience in financial and business matters, and not on the evaluation or analysis of any other individual:

> 1. Investment by [Swenvest]. [Swenvest] shall invest in the Company, the Investment Amount for the acquisition of a membership interest in the Company upon the terms and subject to the conditions set forth in this Agreement.
>
> 3.02 Receipt of Offering Documents. [Swenvest] has received a copy of the Articles of Organization and the Operating Agreement of the Company . . . and had read and understood the same.
>
> 3.03 Access. In addition to the information contained in the Offering Documents, [Swenvest] has had access to all documents, records and books pertaining to the Company and the Offering as requested by [Swenvest] . . . .
>
> 3.07 Financial Knowledge and Experience. [Swenvest] had knowledge and experience in financial and business matters so as to be capable of evaluating the merits and risks of an investment in the Company, is not utilizing any other person to be his "Purchaser Representative" . . . in connection with evaluating such merits and risks, and offers as evidence of his knowledge and experience in these matters the representations and information set forth in this Agreement.

Id. at 1-2. At his deposition, Levinson affirmed that the statements made by Swenvest in the Subscription Agreement were accurate (Lipsky Affirm., Exh. C at 52).

Swenvest claims that after the purchase, Wener and Cowe proceeded to operate Edenton for his own personal benefit and for the benefit of Wener's companies, Dillon and NRI, at the expense of Jasco members. It contends that Edenton never earned a profit and only existed to insure the survival of NRI and Dillon. Swenvest contends that Wener exhausted the working capital of Edenton, factored receivables with his factoring company, took a mortgage on the Edenton plant and incurred a large bank debt. It claims that Wener did this all without the

approval of Jasco investors. It contends that in January 2007, Wener sold certain assets of Dillon for $64 million, collapsed Edenton and placed NRI in bankruptcy. Thus, it is suing for fraud, breach of fiduciary duty and breach of the duty of good faith.

The Second Amended Complaint

The Second Amended Complaint alleges six causes of action. The first is against Wener and Cowe for breach of fiduciary duty and self-dealing, based on allegations that they directed Edenton's operations in favor of Dillon, NRI and Wener at the expense of Edenton. The second is against all defendants for aiding and abetting that breach. The third is against all defendants for tortious interference with contract, alleging interference with the Jasco Operating Agreement, based on allegations that Wener, both individually and on behalf of the other defendants, directed the Jasco Manager to breach the Jasco Operating Agreement and did so by making decisions regarding Jasco's and Edenton's operations for the benefit of defendants rather than Jasco or Edenton. The fourth is against Wener and Cowe for breach of the duty of good faith and fair dealing based on the Jasco Operating Agreement, again by making decisions regarding Jasco's and Edenton's operations for the benefit of defendants. The fifth is for fraudulent inducement, alleging that Wener advised Swenvest that: it was being offered an opportunity to become an owner of a dyeing facility, UPD, at a very favorable price; the assets and business of UPD were worth in excess of the $1,040,000 purchase price; there would be over $1 million in excess funding available for operating the business; this was an incredibly attractive investment that could not lose money, because the assets could always be sold for a sum in excess of the purchase price; and NRI would be a substantial customer, insuring a successful operation. Swenvest alleges that these were material misrepresentations and that it reasonably relied upon

them in investing in Jasco. The sixth is for fraudulent operation of Edenton, alleging that Wener: fraudulently formed and operated a series of companies with the investors' money, that he owned and/or controlled for his own benefit; took steps to secure for himself priority security interests and mortgages in Edenton's property, and transferred monies out of NRI so that they would be available to repay him for money he advanced to Edenton; made no efforts to shut down the Edenton plant, while it operated at a substantial loss, and repay Jasco investors for the funds they invested.

Defendants' Motion for Summary Judgement

In the motion for summary judgment, defendants argue that the complaint should be dismissed as a matter of law for several reasons. First, they urge that the deposition testimony, the terms of the Subscription Agreement and Swenvest's conduct directly contradict's its claims in the fifth cause of action that it was fraudulently induced into making its investment in Jasco. Defendants point to Levinson's deposition testimony in which Levinson testified that Wener told him that he expected Jasco to be very profitable because he had NRI as a customer and that it was a good deal because they could purchase the land and the plant for a million dollars, which Wener thought was very cheap (Levinson Aff., Exh. 7 at 43-45). Levinson further testified that Wener made no other statements to him regarding the dyeing plant or the Jasco acquisition (id. at 46). Defendants further point to Levinson's testimony in which when asked whether Wener ever told him that "if the company lost money or failed, that he would return Swenvest's investment," Levinson responded "No" (id. at 60). Defendants, therefore, argue that it is undisputed that Wener never told Levinson or Swenvest that: Jasco could not lose money; the assets could always be resold at an amount greater than the purchase price; or Jasco's operations were

guaranteed to be successful, as alleged in the complaint. Defendants urge that plaintiff's counsel's attempt at the end of the deposition to avoid the consequences of Levinson's damaging testimony by using leading questions to elicit testimony contrary to Levinson's earlier admissions (id. at 151-57) should be disregarded, because it created only a feigned issue of fact, and is insufficient to defeat this motion.

Defendants next argue that the provisions of the Subscription Agreement bar the fraudulent inducement claim. According to defendants, even if Wener made the statements attributed to him in the complaint, they contradict the terms of the Subscription Agreement and, therefore, Swenvest could not reasonably rely upon them. Defendants further assert that even if the alleged statements were made, they were non-actionable expressions of opinion and puffery.

With respect to the sixth cause of action for fraud, defendants contend that this claim is essentially one for fraud by omission. The claim alleges that: Wener caused North Carolina counsel to form Jasco as a North Carolina limited liability company and form Edenton as a second North Carolina limited liability company, with Jasco as its owner; and that the Edenton Operating Agreement permitted the manager of Edenton to make all decisions concerning operations without the input of the other investors, such as Swenvest. Swenvest then alleges that during the course of operations: NRI forced Edenton to dye its fabrics at less than market prices; NRI withheld timely payments from Edenton; Wener, without Swenvest or the investors's knowledge or consent, took steps to secure for himself priority security interests and mortgages on Edenton's property; and Wener transferred monies out of NRI so they would be available to repay him for the loans he advanced to Edenton (Second Am. Compl., ¶ 67). Defendants contend that there was no secret structure to Jasco and Edenton, and Levinson admitted as much

at his deposition (Levinson Aff., Exh. 7 at 62). In addition, Levinson admitted that: he received Edenton's Operating Agreement, but never read it (id. at 54-55); he received financial statements from Edenton (id. at 74-75); and he actually signed the Jasco Operating Agreement (Lipsky Aff., Exh. R at 31). Thus, they argue that the allegations that Swenvest did not know of the two-tier structure of Jasco and Edenton defies credulity.

Defendants also contend that Swenvest has no standing to assert its remaining claims regarding the operation and management of Jasco and Edenton (the breach of fiducairy duty, aiding and abetting such breach, and breach of the duty of good faith), because these claims belong to Jasco and must be asserted derivatively. They argue that Swenvest cannot assert direct claims against Wener because, under North Carolina law, which governs these claims, a member only has standing to directly assert claims against another member regarding the operation of the company if that member is a majority owner of the company. Here, defendants maintain that it is undisputed that neither Wener nor Cowe are majority owners and, in fact, Wener owns 5.7% and Cowe owns approximately 25% of Jasco (Lipsky Aff., Exhs. D at 120, Exh. Q).

To the extent that the claims challenge actions or decisions relating to Edenton's operations, defendants argue that under North Carolina law, a member of a limited liability company may only sue a third party for injuries caused by that third party to the company if there is a special contractual duty to the member and the member has suffered an injury separate from that of the other members. Defendants urge that Swenvest cannot make such a showing.

In the alternative, defendants argue that even assuming that Swenvest had standing or could meet these requirements, the factual allegations underlying Swenvest's claims for breach of fiduciary duty, aiding and abetting such breach, and breach of the covenant of good faith in the

Jasco Operating Agreement cannot meet the requirements of paragraph 5.7 of the Jasco Operating Agreement, which limit members' liability for acts and omissions in their capacity as manager or member.

Finally, defendants argue that Swenvest's claims fail for lack of causation. They assert that Edenton's failure was the result of market forces, pointing to Levinson's testimony that the textile business had moved offshore, to China and Asia, because of cheaper labor costs there (Levinson Aff., Exh. 7 at 33-36). They also claim that Swenvest cannot quantify its damages, seeking only the return of its investment of $500,000 (id. at 125).

In opposition, Swenvest argues that, as members of a limited liability company, defendants owed a fiduciary obligation which bars not only blatant self-dealing, but also the avoidance of situations where the fiduciary's personal interest might conflict with those to whom it owes this duty of loyalty. It asserts that it is apparent from the outset that defendants intended to operate Jasco's only asset, Edenton, for their own benefit and without regard to Jasco's other investors. Swenvest submits the affidavit of Robert Levinson, in which he attests that: Edenton was only profitable in its first year; Edenton did not have enough business, i.e., customers, to survive; NRI did not timely pay its bills to Edenton; and NRI was paying too low a price to Edenton for the dyeing services performed (Levinson Aff., ¶¶ 11-25). According to Swenvest, by 2005, due to its unfavorable deal with NRI, Edenton was losing substantial sums and defendants blocked Edenton's manager, Joseph Drum, from increasing the prices to NRI (Maschio Aff., Exh. 3 at 43-49). Drum testified at his deposition that NRI was not paying Edenton based on what it was being billed. Rather, he would call the contact person at NRI, who would ask Drum what he needed NRI to pay Edenton to "keep the ship floating and [NRI] would send that amount

down," which was a greater sum than that being billed to NRI (id. at 46). Swenvest argues that this demonstrates that Edenton was being run for the benefit of NRI.

Further, in his affidavit in support, Levinson asserts that Jasco's purchase of UPD was not for investment purposes, but rather to insure the continued operations of NRI and Dillon, and that the continued success of both of these companies would inure to the benefit of Wener and his family (id. at 19-23). He points to the fact that defendants replaced UPD employees with others, appointing many NRI and Dillon insiders to operate Edenton, and claims that Wener managed as he saw fit without consideration of Jasco's other investors (Levinson Aff., ¶¶ 28-30). Levinson contends that without Edenton, NRI would not have been able to operate and would not have survived, and without NRI, Dillon would lose substantial sales. With Edenton becoming a wholly controlled NRI dyeing house, Wener was able to maintain Dillon sales, enabling him to sell Dillon for over $64 million (id., ¶ 35). Swenvest claims that defendants used their control and influence over Jasco and Edenton to force Edenton to go into the jig-dyeing business, which operated at a loss because of the low prices NRI was paying. This part of the business was initially developed for NRI, and then for other customers (see Maschio Aff., Exh. 2 at 35-44). Therefore, Levinson claims, defendants acquired Edenton as a vehicle for Wener's other companies. Levinson also attests that: the property was sold for $1,450,000; Wener previously had secured for himself a first mortgage on the real estate owned by Edenton; and when the property was sold, he was paid $500,000 (Maschio Aff., Exh. 6). Levinson further states that because of the factoring of Edenton's receivables by Commodore Factors -- a Wener owned and controlled company -- the incurring of bank debt and the unprofitable operation of Edenton, there were no funds available for the Jasco investors (Levinson Aff., ¶¶ 38-39).

With respect to the fraud claim, Levinson states in his affidavit that Wener told him "that he never thought so many assets [UPD] could be purchased for $1 million, and that we could always sell the land and get our money out" (id., ¶ 40; Levinson Aff., Exh. 7 at 151-57). At his deposition, Levinson stated that Wener "didn't believe that you could buy so many assets for a million dollars, including all the land which had a great value and he felt that worse case we could always sell the land and this was a win, win situation" (Levinson Aff., Exh. 7 at 153). Swenvest contends that any inconsistency within Levinson's deposition testimony regarding Wener's misrepresentations, demonstrates that there is an issue of credibility for trial. Based on this, Swenvest argues that there is an issue of fact as to whether Wener defrauded it and that summary judgment dismissing that claim is inappropriate.

Finally, on the issue of breach of defendants' duty of good faith under the Jasco Operating Agreement, Swenvest asserts that defendants violated the duty by engaging in self-dealing, collusion and misrepresentation which had the effect of destroying Swenvest's right to receive the benefits of that agreement.

In response to defendants' arguments that it had no standing, Swenvest contends that as a minority shareholder with only a 25% interest in Jasco as compared to Wener and Cowe's combined controlling interest of 30.84%, it may sue in its own right for breach of fiduciary duty under the North Carolina Limited Liability Company Act.

In addition, Swenvest moves for leave to amend its complaint to assert its claims derivatively on behalf of Jasco (Order to Show Cause, Proposed Revised Am. Compl., Exh. B). Swenvest alleges that it did not demand that Wener and Cowe bring claims on behalf of Jasco because it would be futile, as their membership in Jasco and control over other Jasco members

makes Wener and Cowe the controlling members of Jasco and management participants (Order to Show Cause, Exh. B, ¶ 3).

DISCUSSION

Defendants' motion for summary judgment is granted, to the extent of dismissing the third cause of action for tortious interference with contract, the fifth for fraudulent inducement and the portion of the sixth for fraud based on the formation and structure of Jasco and Edenton, and is otherwise denied. The motion for leave to amend is granted.

Summary judgment is warranted on claims where there is no genuine issues of material fact, and the movant is entitled to judgment as a matter of law (Alvarez v Prospect Hospital, 68 NY2d 320, 324 [1996]).

The parties agree that plaintiff's substantive claims are governed by North Carolina law. The New York Limited Liability Company Act § 801[a] provides that the law of the jurisdiction under which the limited liability company is formed governs the liability of its members and managers. Swenvest's claims revolve around the operation and management of Jasco and Edenton, both of which are North Carolina limited liability companies. Thus, North Carolina law applies (see Teachers' Retirement Sys. of Louisiana v Welch, 244 AD2d 231, 232 [1st Dept 1997]; Hart v General Motors Corp., 129 AD2d 179, 185 [1st Dept], appeal denied 70 NY2d 608 [1987]). In addition, where there is no conflict between New York and North Carolina law, the claims may be analyzed under either (see Elson v Defren, 283 AD2d 109, 114 [1st Dept 2001]).

Tortious Interference and Fraud Claims

Swenvest's cause of action for tortious interference with contract fails as a matter of law. In that claim, Swenvest alleges that: the Jasco Operating Agreement required the manager of

Jasco to act in the best interests of Jasco; Wener and Cowe, as signatories to that agreement, were aware of those requirements; and Wener and Cowe directed the Jasco Manager, who was Wener, to breach the Jasco Operating Agreement in various ways. To state a claim for tortious interference with contract, a plaintiff must demonstrate that there was a valid contract between plaintiff and a third party, defendant's knowledge of that contract and defendant's intentional procurement of a breach of that contract without justification (see Embree Constr. Group, Inc. v Rafcor, Inc., 330 NC 487, 498 [NC 1992]; Snyder v Sony Music Entertainment, Inc., 252 AD2d 294, 299 [1st Dept 1999]; S & S Hotel Ventures Ltd. Partnership v 777 S.H. Corp., 108 AD2d 351, 354 [1st Dept 1985]). Here, the allegations do not involve a contract with a third party. Rather, the claim revolves around the defendants' actions with respect to Jasco's Operating Agreement, the very contract which established the limited liability company Jasco, and to which defendants Wener and Cowe are signatories. Essentially, this claim is a repetition of the breach of fiduciary duty claims, and is not a tortious interference claim. Swenvest failed to address this claim in opposing the motion, and it is dismissed.

The fifth cause of action, for fraudulent inducement, also fails as a matter of law. A claim for fraudulent inducement requires demonstration that: (1) the party made a representation of material facts; (2) the representation was false; (3) the party making the misrepresentation knew that it was false when it was made; (4) there was justifiable reliance; and (5) the relying party was damaged (Pope v Saget, 29 AD3d 437, 441-42 [1st Dept 2006], lv denied 8 NY3d 803 [2007], citing Channel MasterCorp. v Aluminum Ltd. Sales, 4 NY2d 403, 406-07 [1958]; Rowan County Bd. of Educ. v United States Gypsum Co., 332 NC 1, 17 [1992]; Terry v Terry, 302 NC 77, 83 [NC 1981]). Mere guesses, puffing or assertions of opinion are distinguishable from

representations of material facts (Rowan County Bd. of Educ. v United States Gypsum Co., 332 NC at 17; ESBE Holdings, Inc. v Vanquish Acquisition Partners, LLC, 2008 WL 961943, 2008 NY App Div LEXIS 3062 [1st Dept April 10, 2008]; Longo v Butler Equities II, L.P., 278 AD2d 97, 97 [1st Dept April 10, 2000]).

Here, the complaint asserts misrepresentations that: Swenvest was being offered the chance to become an owner of UPD at a favorable price; the assets and business was worth more than the purchase price; this was an attractive investment that could not lose money because the assets could always be sold for more than the purchase price; and NRI would be a substantial customer, insuring a successful operation. Levinson, testifying on Swenvest's behalf, attested only that Wener: told him "he couldn't believe how much you could buy for a million dollars;" expected Jasco to be very profitable because he had NRI as a customer; thought the purchase of UPD "[f]rom a financial standpoint . . . was very cheap;" and said "the worse-case scenario, . . . we could always sell the land and get our money back" (Levinson Aff., Exh. 7 at 42-46, 151-52). The representations, that the purchase was "at a favorable price," was an attractive investment that could not lose money, was going to be very profitable and was very cheap, can only be understood as non-actionable expressions of opinion and mere puffing (Rowan County Bd. of Educ. v United States Gypsum Co., 332 NC at 17; Longo v Butler Equities II, L.P., 278 AD2d at 97).

Moreover, Swenvest cannot demonstrate, or even raise a triable issue, as to reasonable reliance. In connection with its investment, Swenvest signed a Subscription Agreement. In this Subscription Agreement, Swenvest specifically stated that it: recognized the speculative nature of the investment in Jasco (Lipsky Aff., Exh. E at § 3.05); was willing and able to bear the

economic risk and could afford to hold an interest in Jasco for an indefinite period of time; and could afford a complete loss of its investment (id. at § 3.08). It further represented that it: received and understood the Articles of Organization and the Operating Agreement of Jasco; had access to all documents, records and books as requested; was knowledgeable and experienced in financial and business matters; was able to evaluate the merits and risks of the investment; and was not using any person as its representative in connection with evaluating the merits and risks (id. at §§ 3.02, 3.03, 3.07). At his deposition, Levinson affirmed that he had 50 years of experience in the textile business as an officer of such companies and the statements made by Swenvest in the Subscription Agreement were accurate (Lipsky Aff., Exh. C at 8-30, 52). Such disclosures and representations in the offering materials rendered any reliance by Swenvest on alleged contradictory oral representations unjustifiable as a matter of law (Matter of Dean Witter Managed Futures Ltd. Partnership Litigation, 282 AD2d 271, 271 [1st Dept 2001]; Societe Nationale D'Exploitation Industrielle des Tabacs et Allumettes v Salomon Bros. Intl. Ltd., 249 AD2d 232, 233 [1st Dept 1998], lv denied 95 NY2d 762 [2000]; see Global Minerals and Metals Corp. v Holme, 35 AD3d 93, 98 [1st Dept 2006], lv denied 8 NY3d 804 [2007]; Oberlin Capital, L.P. v Slavin, 147 NCApp 52, 59-60 [NC App 2001]; see also Elizabeth City Hotel Corp. v Overman, 201 NC 337, 337 [NC 1931]). Accordingly, the fifth claim for fraudulent inducement is dismissed.

The portion of the sixth cause of action for fraud by omission is dismissed to the extent that it is based on Swenvest's claim that defendants fraudulently formed Jasco as a North Carolina limited liability company. Specifically, Swenvest alleges that: Wener caused North Carolina counsel to form Jasco as an LLC; Wener caused Andrew Parise to be the initial manager

based on a two-thirds vote of investors under the Jasco Operating Agreement; Wener caused North Carolina counsel to form a second LLC, Edenton, with Jasco as Edenton's owner; and Edenton's manager made all decisions regarding Edenton's operations without the input of investors (Second Am. Compl., ¶ 65). It claims that Wener concealed the formation of the structure of Jasco and that he secretly created this structure to make all decisions regarding the company for his own benefit (id., ¶¶ 64-66).

To establish a claim of fraud by omission, plaintiff must show the elements necessary for fraud, discussed above, and show that the parties had a fiduciary relationship (see SNS Bank N.V. v Citibank, N.A., 7 AD3d 352, 356 [1st Dept 2004]; Piles v Allstate Ins. Co., 653 SE2d 181, 186 [NC App 2007]). The fiduciary relationship must have existed prior to the transaction from which the alleged wrong emanated, and not as a result of it (Elghanian v Harvey, 249 AD2d 206, 207-207 [1st Dept 1998]; Piles v Allstate Ins. Co., 653 SE2d at 186).

The allegations in the complaint regarding the claimed fraudulent omissions are contradicted by Levinson's own testimony on behalf of Swenvest. Levinson admitted that he was aware of the structure of Jasco and Edenton. When asked if anyone told him that Jasco was going to be a holding company for Edenton, which would be the operating company, Levinson affirmed, "I think that was my impression" (Levinson Aff., Exh. 7 at 62). When asked, "[a]nd that was your impression at the time of the acquisition," Levinson answered, "Yes" (id.). Levinson also admitted that, while he received the Edenton Operating Agreement at the time that Swenvest made its investment, he never read that operating agreement (id. at 54-55). Levinson admitted signing the Jasco Operating Agreement, and stated that he understood that Parise was going to be the manager of Jasco, while Parise was, at the same time, an employee of NRI (id. at

57-58). This undisputed proof negates the allegations in the complaint of this portion of the fraud by omission claim. Moreover, Wener became a fiduciary to Swenvest as a result of the formation of Jasco based on his status, together with his family-owned entity, Cowe, as a majority member of Jasco, and his eventual position as its Manager. To provide the basis for a fraud by omission claim, however, this fiduciary relationship must have existed prior to the transaction from which the wrong emanated – that is, the formation of Jasco – and it did not. Accordingly, to the extent that the sixth cause of action is for fraud by omission with respect to the formation and structure of Jasco and Edenton, this portion of the claim fails as a matter of law. The remaining portion of the sixth cause of action, regarding the defendants' fraudulent operation of Jasco and Edenton (Second Am. Compl., ¶¶ 66-69), is not challenged, triable issues are apparent and, thus, summary judgment relief would be inappropriate.

Standing

Defendants also challenge Swenvest's standing to assert the breach of fiduciary duty and breach of the duty of good faith claims, which are asserted in the Second Amended Complaint as individual claims on the ground that they can only be asserted derivatively. In response, Swenvest contends that it may assert the claims individually as a minority member of the LLC, and also seeks leave to amend to also assert the claims derivatively with Jasco as the nominal defendant.

The issue of whether Swenvest's claims may be asserted individually and/or derivatively is governed by the law of the place where Jasco was formed as a limited liability company, North Carolina (Finkelstein v Warner Music Group Inc., 32 AD3d 344 [1st Dept 2006]). Under North Carolina law, "minority shareholders in a closely held corporation who allege wrongful conduct

and corruption against the majority shareholders in the corporation may bring an individual action against those shareholders, in addition to maintaining a derivative action on behalf of the corporation" (Norman v Nash Johnson & Sons' Farms, Inc., 140 NCApp 390, 405 [NC App 2000]). In Norman, the plaintiffs, minority shareholders in a closely held corporation, asserted individual claims against the majority shareholders for, inter alia, breach of fiduciary duty (id.). The trial court dismissed the complaint based on a lack of standing, finding that the claims were derivative in nature (id. at 395). The North Carolina Court of Appeals reversed, holding that the minority shareholders had standing to assert both individual and derivative claims. It reasoned that it was appropriate to allow minority shareholders to file individual actions "when a dispute arises within the context of a family owned corporation, or other corporation in which all shares of stock are held by a relatively small number of shareholders" (id. at 404). It found that when the close relationship between the shareholders in a closely held corporation breaks down, "the majority shareholders are obviously in a position to exclude the minority shareholders from management decisions, leaving the minority shareholders with few remedies" (id.). The Court also pointed to other factors, which are relevant to the instant case, justifying individual claims by a minority shareholder who asserts wrongful conduct and corruption by the majority shareholders. "It would be unrealistic to expect the interests of the plaintiff minority shareholders who prevail in a derivative action to be protected by defendant majority shareholders who have allegedly converted, appropriated, and wasted corporate assets" (id. at 405). Further, it reasoned that if the action by the minority shareholders is treated as a derivative action, the burdensome procedural requirements of derivative litigation would apply (id.). With regard to businesses controlled by the majority shareholders and with which the corporation had

dealings, the Court found that those businesses were not independent third parties. Instead, they were "inextricably wedded" to the majority shareholders based on the plaintiff's allegations that the businesses entered into a conspiracy with the majority shareholders to take corporate assets and opportunities, and redirect them to the majority shareholders (id. at 406; Woolard v Davenport, 166 NCApp 129, 137-138 [NC App 2004]; see also Farndale Company, LLC v Gibellini, 176 NCApp 60, 67 [NC App 2006]). Therefore, the plaintiff could pursue individual claims against those businesses (Tzolis v Wolff, 10 NY3d 100 [2008]).

Thus, clearly, Swenvest has standing to assert individual claims against the majority members of Jasco and NRI, as the business that was "inextricably wedded" to Wener and Cowe. It has not be disputed that Wener, Cowe and others are jointly majority members of the LLC. Wener and Cowe are very closely related in that Cowe is a limited liability partnership made up of Wener and his family members. Together their interest comprises 30.84% of the shares of Jasco (Lipsky Aff., Exh. Q). John Hickey, the former president of NRI, and Andrew Parise, a former employee of NRI and Manager of Jasco, own 15.65% and 12.54%, respectively. Swenvest asserts that at the time of the mismanagement by Wener and Cowe, Hickey and Parise were under Wener's control. The remaining shareholders or members of Jasco own smaller percentages and were either employed by Wener's companies, NRI, Dillon or Edenton, or were under Wener's control as alleged by Swenvest (Maschio Aff., Exh 1 at 172-73). Therefore, Swenvest's holdings of 25% was a minority interest, and Wener and Cowe's interest was a majority or controlling interest. However, this finding is limited to this motion; i.e. for the purpose of the Court's deciding that plaintiff has standing to bring this action. If appropriate, defendants could dispute the issue of who constitute the majority, or whether "control" is

sufficient for this purpose, at trial.

Swenvest claims that Wener and Cowe breached their fiduciary duties as majority members, with Wener eventually becoming the Manager of Jasco, by securing for themselves priority security interests and mortgages in Edenton's property, without the knowledge or consent of the other members. It also claims that defendants directed Edenton's operations to favor Dillon, NRI and Wener at the expense of Edenton and, thus, Jasco. It further asserts that defendants made loans to Edenton to ensure that it continued to operate so that Dillon and NRI could reap the benefits of Edenton's dyeing services, at below market prices and delayed payment schedules, all to the detriment of the non-controlling members of Jasco. Swenvest claims that Wener continued to operate Edenton and Jasco in this manner so that he could eventually sell Dillon for his own profit, but at the expense of the Jasco minority members. As in Norman, the majority members of Jasco would have been in a position to exclude Swenvest from any management decisions, such as whether to enter into factoring arrangements and mortgage the property, leaving Swenvest with few remedies. Moreover, it would be unrealistic to expect that Swenvest's interest, if it prevailed in a derivative action, would be protected by the parties accused of wasting and misusing corporate assets and mismanaging the company (Norman v Nash Johnson & Sons' Farms, Inc., 140 NCApp at 405). As to NRI, Swenvest alleges that it is under the control of Wener, or entered into an agreement with Wener, to: siphon off the assets from Jasco; deprive Jasco of opportunities; and redirect those assets and opportunities to Wener and Cowe. Thus, it is alleged that NRI is not an independent third party, but is inextricably wedded to Wener and Cowe. Accordingly, Swenvest may maintain a direct action against NRI (id. at 406).

Defendants' reliance upon Aubin v Susi (149 NCApp 320 [NC App 2002]) is misplaced. Aubin is clearly distinguishable as it involved parties which were each 50% shareholders in the corporation, not minority and majority interests (id. at 324-26). The Aubin Court itself distinguished Norman, and the cases it relied upon on that basis. Therefore, Swenvest has standing to assert individual claims for breach of fiduciary duty, aiding breach of fiduciary duty, and breach of the duty of good faith and fair dealing in the first, second, fourth, and the remaining portion of the sixth causes of action.

Defendants' argument, that plaintiff's claims for breach of fiduciary duty and breach of the duty of good faith are barred by the limitation of liability provision in the Jasco Operating Agreement, is rejected. That provision limits a manager's or member's liability for acts in their capacity as manager or member except for "(i) acts or omissions which a Manager [or member] knew at the time of the acts or omissions were clearly in conflict with the interests of the Company, [or] (ii) any transaction from which a Manager [or member] derived an improper personal benefit" (Lipsky Aff., Exh. R at § 5.7). Swenvest has raised triable issues as to whether Wener committed acts or omissions which were in conflict with Jasco's interests, and from which he derived an improper personal benefit.

Defendants' arguments regarding causation and damages similarly fail to provide a basis for summary judgment dismissal. Whether the losses and the extent of the losses suffered by Jasco through Edenton were the result of market forces, or the result of Wener's alleged mismanagement and self-dealing, cannot be determined on this record. Defendants' assertion that plaintiff could not quantify its damages, based on Levinson's testimony that his calculation of his damages is the amount of Swenvest's initial investment (Levinson Aff., Exh. 7 at 125), and

Parise's testimony that he did not know exactly how much money Edenton was losing for the "jig-dyeing" work it was doing for NRI at below market prices (Maschio Aff., Exh. 1 at 69-70), fails to demonstrate its right to summary judgment. The Court further notes that neither party has raised the business judgment rule and, therefore, it was not considered on these motions.

Leave to Amend

Swenvest's motion for leave to amend is granted, and the complaint is amended as set forth in the proposed amended complaint annexed to the Order to Show Cause for Leave to Amend (Order to Show Cause, Exh. B). Leave to amend shall be freely granted absent prejudice or surprise (Spitzer v Schussel, 48 AD3d 233 [1st Dept 2008]). Mere lateness is not a barrier to such relief (id.). To establish prejudice, which must be significant, it must be clear that the opponent would be hindered in the preparation of its case or prevented from taking action to support its position (id.). In addition, leave should be freely granted where, as here, plaintiff seeks to amend to add an additional theory of recovery without allegations of any new or different transactions (Sample v Levada, 8 AD3d 465, 468 [2d Dept 2004]).

The proposed amendment involves asserting the claims for breach of fiduciary duty and breach of the duty of good faith derivitively, as well as individually, based on the allegations that Swenvest had not made a demand to Wener and/or Cowe "to obtain the action that plaintiff desires from the General Manager, Wener, as Wener is the wrongdoer herein and such demand would be futile" (Order to Show Cause, Exh. B at ¶ 3). The North Carolina Limited Liability Company Act provides that a member may bring derivative action if the following conditions are met:

> (1) The plaintiff does not have the authority to cause the limited

> liability company to sue in its own right ; and
>
> (2) The plaintiff (i) is a member of the limited liability company at the time of bringing the action, and (ii) was a member of the limited liability company at the time of the transaction of which the plaintiff complains, or the plaintiff's status as a member of the limited liability company thereafter devolved upon the plaintiff pursuant to the terms of the operating agreement from a person who was a member at such time.

North Carolina General Statutes Annotated § 57C-8-01 (a) (2007). It also sets forth the procedural requirements for such an action, providing that the complaint "shall allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the managers . . . and the reasons for the plaintiff's failure to obtain the action, or for not making the effort" (N.C.G.S § 57C-8-01 [b]).

Swenvest satisfies the conditions that it does not have the authority to cause Jasco to sue in its own right, and is a member and was a member at the time of the transaction. Further, it states that a demand to commence this litigation would have been futile. Wener is the Jasco Manager, the party to whom the demand would have been made, and the party that was allegedly involved in waste, mismanagement and self-dealing at the expense of Jasco (see Crouse v Minco, 658 SE2d 33, 40-41 [NC App 2008]). These allegations are sufficient to assert the futility of other avenues. Therefore, Swenvest has met the requirements under that statute for asserting a derivative claim.

Defendants will not suffer prejudice, because these claims are identical to the ones that have been pursued throughout this litigation. No additional discovery should be necessary, since no new or different transactions are involved. The Court has considered the defendants' remaining arguments, and finds them to be without merit. Therefore, leave to amend is granted,

and the proposed revised amended complaint shall constitute the amended pleading. Swenvest is directed to entitle this pleading the Third Amended Complaint.

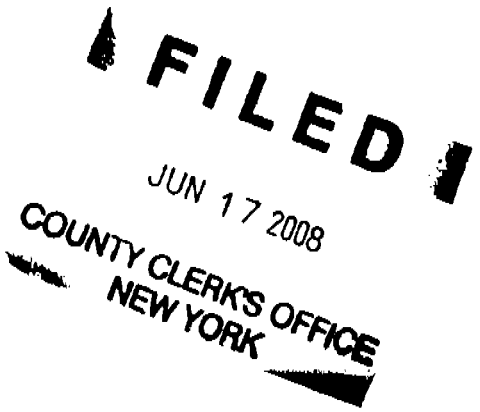
Accordingly, it is

ORDERED that the motion is granted only to the extent of granting partial summary judgment dismissing the third and fifth causes of action, and the portion of the sixth cause of action for fraud by omission with regard to the formation of Jasco, and is otherwise denied; and it is further

ORDERED that the Order to Show Cause for Leave to Amend is granted, and the amended complaint in the form proposed and attached to the moving papers, to be entitled "Third Amended Complaint," shall be deemed served upon service of a copy of this order with notice of entry thereof; and it is further

ORDERED that the defendants shall serve an answer to the Third Amended Complaint within 15 days from the date of this decision.

Dated: June 13 , 2008



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J.S.C.