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

PRESENT: _____ PART 56

Justice

Index Number : 600886/2007

JACOBSON, GUY J.

VS.

CROMAN, STEVEN

SEQUENCE NUMBER : 001

AMEND

INDEX NO. 600886/2007

MOTION DATE 9/15/08

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

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

FILED

OCT 10 2008

COUNTY CLERK'S OFFICE
NEW YORK

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

Dated: 10/6/08

RICHARD LOWE III

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 56
----------X

GUY J. JACOBSON,

Plaintiff,

Index No. 600886/07

-against-

STEVEN CROMAN, CROMAN FAMILY PARTNERSHIP, LLC, AND CROMAN FAMILY ASSOCIATES, LLC,

DECISION AND ORDER

Defendants.
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RICHARD B. LOWE III, J.:

Plaintiff Guy Jacobson moves for an order, pursuant to CPLR 3025(b), granting leave to amend his complaint to assert a derivative claim on behalf of 99-105 Third Avenue Realty, LLC ("Realty"), a limited liability company of which plaintiff is a member. Defendants Steven Croman, Croman Family Partnership, LLC ("CFP"), and Croman Family Associates, LLC (collectively referred to as "defendants"), oppose plaintiff's motion on the basis that the proposed amendment lacks merit.

BACKGROUND

Unless otherwise noted, the facts below are taken from the Amended Verified Complaint ("Complaint"), and will be deemed true for the purposes of this motion .

In July 2000, Plaintiff and CFP formed Realty for the purpose of "acquiring, developing, maintaining, improving and operating" 99-105 Third Avenue and 204 East 13th Street in Manhattan (the "Property"). Plaintiff had a 15% interest in Realty and CFP had an 85% interest. Plaintiff had previously owned the Property and transferred title as his capital contribution in

exchange for his membership interest in Realty.

Croman Family Associates ("CFA") is a limited liability company, which may be a successor entity to CFP. The term "CFP/CFA" refers to whichever of CFP or CFA was plaintiff's co-member in Realty at relevant times.

In accordance with Realty's Operating Agreement (the "Agreement"), Realty's management was Steven Croman ("Croman"), a member of CFP. According to the Agreement, Croman and CFP/CFA were supposed to provide funds to develop the Property. Specifically, the Agreement provided that within 18 months after the acquisition of the Property, Croman would cause $750,000 to be invested for the renovation and repair of the Property to ensure its maximum profitability. Plaintiff alleges that the parties discussed constructing a hotel on the Property.

The Agreement gave CFP/CFA the option to buy plaintiff's interest in Realty, which could be exercised after six years from Realty's acquisition of the Property. The option price was to be the greater of $339,000 or the value of plaintiff's 15% interest, computed pursuant to a formula set forth in the Agreement. An appraisal procedure was specified in the event of a dispute.

According to the Complaint, Croman and CFP/CFA took no steps to develop the Property in the intervening six years, and plaintiff received no return of capital or distributions from Realty during that time. Immediately after the passage of six years, by letter dated September 12, 2006, signed by Croman on CFA letterhead, CFA purported to exercise the option to purchase plaintiff's membership interest in Realty for $339,000. Plaintiff alleges that the defendants' failure and refusal to develop the Property, in accordance with their representations,

was purposely done to eliminate plaintiff's interest in Realty at the lowest possible price.

Plaintiff commenced the present action in March 2007. The Complaint seeks damages resulting from defendants' breaches of fiduciary duty. Plaintiff also asserts claims for breach of contract, violation of §409 of the Limited Liability Company Law, and fraud. In the proposed Second Amended Complaint, plaintiff asserts derivative claims on behalf of Realty to redress harm caused to Realty as a result of defendants' failure to develop the Property.

DISCUSSION

It is well settled that, pursuant to CPLR 3025(b), leave to amend will be freely granted, absent prejudice or surprise to the opposing party (*Sheets v Liberty Alliances, LLC*, 37 AD3d 170 [1st Dept 2007]; *Zaid Theatre Corp. v Sona Realty Co.*, 18 AD3d 352 [1st Dept 2005]). However, in order to conserve judicial resources, examination of the underlying merit of the proposed amendment is mandated (*see Watts v Wing*, 308 AD2d 391 [1st Dept 2003]; *Davis & Davis, P.C. v Morson*, 286 AD2d 584 [1st Dept 2001]). Leave will be denied where the proposed pleading fails to state a cause of action, or is palpably insufficient as a matter of law (*Ancrum v St. Barnabas Hosp.*, 301 AD2d 474 [1st Dept 2003]; *Davis & Davis, P.C.*, 286 AD2d 584, *supra*). In evaluating the merits of the amended pleading, the court's purpose is not to resolve disputed factual issues, but simply to ensure that the amended allegations establish a prima facie cause of action (*Tapps of Nassau Supermarkets, Inc. v Linden Blvd., L.P.*, 269 AD2d 306 [1st Dept 2000]).

On this motion, plaintiff's pleading is entitled to a "heavy presumption" of validity (*Otis Elevator Co. v 1166 Avenue of Americas Condominium*, 166 AD2d 307, 307 [1st Dept 1990]), and plaintiff need only come forth with facts establishing a prima facie right to relief (*see*

Daniels v Empire-Orr, Inc., 151 AD2d 370 [1st Dept 1989]; *accord Caribbean Constr. Services & Assoc., Inc. v Zurich Ins. Co.*, 267 AD2d 81 [1st Dept 1999]). Plaintiff has easily satisfied these standards through its allegations, based on his affidavit, that defendants may be derivatively liable to Realty for failing to garner at least $750,000 in investments for Realty within 18 months of Realty's acquisition of the Property, along with other actions that delayed developing the Property (Complaint ¶ 48). Indeed, the very same factual issues that underlie the proposed amendments (*i.e.*, whether and to what extent Realty's controlling members sought to develop the Property under the terms of the Operating Agreement) are raised by the plaintiff's claims for breach of fiduciary duty and breach of contract.

In opposition to the motion, defendants do not claim that they would be prejudiced by the amendment or that the motion to amend was untimely. Instead, defendants argue that the proposed amendment lacks merit and is insufficient as a matter of law because at the commencement of this action there was no legal basis or support for a member of a limited liability company ("LLC") to bring a derivative action. Defendants argue that the case providing for such derivative actions, *Tzolis v. Wolff* (10 NY3d 100 [2008]), must be applied prospectively. According to defendants, this conclusion is supported by "traditional retroactivity analysis," as considered in *Gurnee v Aetna Life & Cas. Co.* (55 NY2d 184, 191 [1982]).

In *Gurnee*, the Court of Appeals stated that retroactivity analysis is "traditionally used where there has been an abrupt shift in controlling decisional law" and is not "relevant with respect to the application of the first decision of the State's highest court interpreting a new statute" (55 NY2d at 190, *supra*). At issue in this case is the Limited Liability Company Law, which was enacted in 1994. *Tzolis* was the first case in which the Court of Appeals considered

the issue of whether a derivative action is available to a member of an LLC under the statute. Thus, *Tzolis* falls squarely within the class of cases where retroactivity analysis is not relevant. Furthermore, at the time the complaint was originally filed in this case (March 2007), case law in the First Department permitted members of an LLC to bring derivative claims (*see Tzolis v. Wolff*, 39 AD3d 138, 142-44 [1st Dept Feb 8, 2007]).

Even under traditional retroactivity analysis, however, it is clear that *Tzolis* should be accorded full retroactive effect. "Policies inherent in the common law require that a change in decisional law usually will be applied retrospectively to all cases still in the normal litigating process" (*Stuart v. N.Y. City Health & Hosps. Corp.*, 2005 NY Slip Op 25051, 2 [NY Sup Ct 2005] [*citing Gurnee*, 55 N.Y.2d at 191, *supra*; *Gager v White*, 53 NY2d 475 [1981]]). However, when this change is such a sharp break in the existing law that its "impact will wreak more havoc in society than society's interest in stability will tolerate," a court may order the new law to be prospective only (*Gurnee*, 55 NY2d at 191, *supra* [quotations and citations omitted]). In determining whether a new law shall be prospective only, three factors are to be considered (*id.*). First, does the new law establish a new principle of law by overruling clear, past precedent that was relied upon by litigants. Second, what is the history of the rule at issue and the impact of retroactive application upon its purpose and effect. Finally, do any inequities arise by retroactive application (*id.*).

Regarding the first factor, *Tzolis* did not overturn a long-standing and clear precedent in New York that the litigants relied upon. In fact, the Court of Appeals in *Tzolis* found that, in light of longstanding principles, havoc would result if it refused to recognize an LLC member's right to sue on behalf of the entity. The court stated:

> To hold that there is no remedy when corporate fiduciaries use corporate assets to enrich themselves was unacceptable in 1742 and in 1832, and it is still unacceptable today. Derivative suits are not the only possible remedy, but they are the one that has been recognized for most of two centuries, and to abolish them in the LLC context would be a radical step.

(*Tzolis*, 10 NY3d at 105, *supra*).

While defendants argue that prior to that decision an LLC member could not sue derivatively was well settled, the First Department observed in February 2007 that it had never decided whether LLC members could sue derivatively, and rejected the reasoning of the Second Department cases that decided the opposite (*Tzolis*, 39 AD3d at 142-44, *supra*). The First Department also noted two Federal courts had previously recognized the right of an LLC member to bring a derivative action under the New York statute (*see Bischoff v. Boar's Head Provisions Co., Inc.*, 436 F. Supp. 2d 626, 634 [SD NY 2006] [taking into consideration the common law, the Limited Liability Company Law, its legislative history, and federal and state court precedent, New York Court of Appeals would hold that a member of a New York limited liability company may bring derivative suit on behalf of company]; *Weber v King*, 110 F. Supp. 2d 124, 131 [ED NY 2000] [failure to include a derivative action provision in Limited Liability Company Law does not prevent recognition of such a right at common law]). Thus, contrary to defendants' argument, in affirming the holding of the Appellate Division, the Court of Appeals was resolving a question raised by conflicting decisions, rather than establishing any new legal principle.

Regarding the second factor, defendants argue that applying *Tzolis* retroactively strips the New York Business Corporation Law of the requirement of demanding an accounting prior to bringing a derivative action (*see* BCL § 626). However, this argument fails because, as

explained in *Evans v. Perl*, the ruling in *Tzolis* carries with it the BCL's demand requirement along with the exceptions to such a requirement (2008 NY Slip Op 50775U, *7 [NY Sup Ct 2008]). The *Evans* action started in 2005, and, in applying the *Tzolis* decision, found that "before bringing a derivative action against an LLC for an accounting, the member must make a prior demand on the LLC or otherwise make a showing that such a demand would have been futile" (*id.* at *8). This Court agrees with the holding in *Evans*, and finds that the BCL demand or futility of demand requirements is applicable in derivative claims brought on behalf of LLC (*see* BCL § 626(c) [plaintiff in a shareholders' derivative action "shall set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board [of directors] or the reason for not making such effort"]). Therefore, contrary to defendants argument, the Court is not 'forsak[ing] the necessary demand requirement by applying *Tzolis* retroactively."[1]

Finally, regarding the third factor, retroactive application of *Tzolis* would not prejudice defendants and similarly suited LLCs. Defendants argue that applying *Tzolis* retroactively would limit the ability of LLCs, and members of LLCs, to transition to the possibility of derivative suits brought against company fiduciaries and to take the precautions necessary to protect them from potential litigation. For instance, according to defendants, this new cause of action requires LLCs to buy insurance for the defense of such derivative actions. This new cause of action, however, does not impose new duties on the members or managers of LLCs. Therefore, all parties were on notice of their fiduciary obligations owed to Realty that are at issue in the derivative action. Additionally, as the Court in *Tzolis* explained, some courts have

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[1] Defendants do not argue that the plaintiff has failed to make a demand or establish futility, nor were they required to do so at this preliminary stage.

reasoned around the absence of any express provision for derivative actions in the New York statute by holding that members had their own claims against fiduciaries for conduct that injured the LLC, thus "blurring, if not erasing, the traditional line between direct and derivative claims" (10 NY3d at 105). Therefore, precautions necessary for defending a derivative action will generally be identical to those required by actions that defendants were properly "forewarned."

CONCLUSION

When all of the applicable criteria are considered it is clear that retroactive application of *Tzolis* is appropriate. Furthermore, while retroactive application of *Tzolis* has not been examined at great length, it appears that *Tzolis* has already been applied retroactively in a number of cases (*see Stack v. Midwood Chayim Aruchim Dialysis Assoc., Inc.*, 2008 NY Slip Op 7114, 2 [2d Dept Sept. 23, 2008] [applying *Tzolis* on an appeal]; *Billings v. Bridgepoint Partners, LLC*, 2008 NY Slip Op 28351, 4 [N.Y. Sup. Ct. Sept. 19, 2008] [applying *Tzolis* on a motion to dismiss a complaint originally filed in 2007]; *Evans*, 2008 NY Slip Op 50775U, *7, *supra*).

Accordingly, it is hereby

ORDERED that the motion for leave to amend the complaint is granted.

Dated: October 6, 2008

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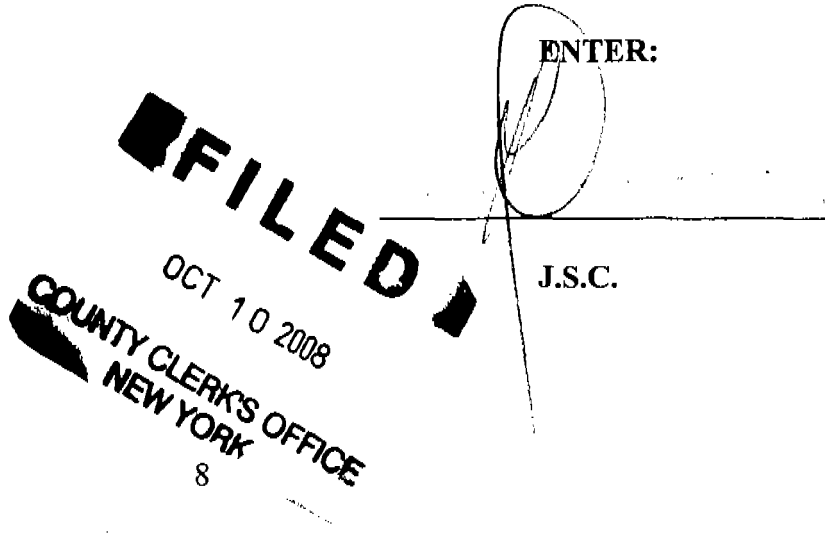

J.S.C.