Noe v Friedberg
2009 NY Slip Op 30421(U)
February 24, 2009
Supreme Court, New York County
Docket Number: 600884/08
Judge: Richard B. Lowe
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SCANNED ON 2/26/2009

[* 1]

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

PRESENT: HON. RICHARD B. LOWE, III

PART 56

Index Number : 600884/2008

NOE, ALFRED

vs.

FRIEDBERG, ALAN B.

SEQUENCE NUMBER : 002

AMEND

INDEX NO.

MOTION DATE 10/8/08

MOTION SEQ. NO.

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

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

FILED

FEB 26 2009

COUNTY CLERK'S OFFICE NEW YORK

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

Dated: 2/24/09

HON. RICHARD B. LOWE, III

J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56

---X

ALFRED NOE, individually and on behalf of
PAXTON 350, LLC,

Plaintiffs,

Index No. 600884/08

- against -

ALAN B. FRIEDBERG and DAVID GRUBER

Defendants.

---X

FILED
FEB 26 2009
COUNTY CLERK'S OFFICE
NEW YORK

Hon. Richard B. Lowe, III:

Plaintiff moves pursuant to CPLR 3025 for an order allowing the complaint to be amended. The defendants move pursuant to CPLR 3212 for an order dismissing the complaint.

Background

Plaintiff Alfred Noe, appearing individually and on behalf of Paxton 350, LLC (Paxton), brings this action against Alan B. Friedberg (Friedberg) and David Gruber (Gruber), his co-members in Paxton. Noe claims that defendants wrongfully excluded him from participation in the limited liability company and misused company funds. Noe moves to amend the complaint and defendants cross-move for summary judgment dismissing the complaint.

Paxton was created in 2003, when Noe and defendants entered into an Operating Agreement, as required by Limited Liability Company Law § 417 (a). Each member had a 33.33% interest in the company. Friedberg was the managing member.

In December 2003, Paxton and non-party Ciao-Di Restaurant Corporation (Ciao-Di) entered into a Development Agreement, whereby Paxton agreed to act as manager for a project to convert a building owned by Ciao-Di into commercial and residential condominium units. It

is alleged that Friedberg was in charge of the project.

The project did not go smoothly. In August 2007, Ciao-Di terminated Paxton from its manager position. On the 24th of that month, Ciao-Di commenced an action against Paxton and Friedberg, alleging a variety of wrongful actions, such as stealing money from Ciao-Di, issuing checks in excess of $10,000 without Ciao-Di's approval (a violation of the Development Agreement), soliciting kickbacks from contractors, and unduly extending the length and costs of the project.

On September 4, 2007, Friedberg issued a capital call for $50,000 from each member of Paxton. The capital call letter explained that Paxton needed the funds to defend itself in the Ciao-Di action. Noe did not pay the capital and Friedberg paid Gruber's share. Noe objected to the call on two grounds. First, Noe claims, the call violated the modified version of Paxton's Operating Agreement. The modification, made in December 2005, provided that the manager member would not put out a capital call pertaining to the project and would instead access the existing credit line and other sources of capital available to Paxton, including loans. Defendants deny that the Operating Agreement was modified.

Second, Noe claims, Friedberg wanted the capital contributions to pay not only Paxton's, but his own legal expenses. Noe alleges that both uses are improper and constitute a waste of Paxton's assets. According to Noe, defendants', especially Friedberg's, wrongful activities caused Paxton to be sued and to incur legal expenses.

Because Noe did not contribute the capital, Friedberg diluted Noe's membership interest in Paxton and transferred the difference between Noe's original interest and the diluted interest to himself. On March 5, 2008, Friedberg issued a second capital call, this time for $100,000.

This call did not state what the money was wanted for. Noe did not pay. Noe alleges that the funds were again sought for the improper purpose of paying the legal expenses of Friedberg and Paxton in the Ciao-Di litigation.

Noe seeks to enable Paxton to recover the monies expended on Friedberg's defense in the Ciao-Di case. Whether he also seeks to enable Paxton to recover the monies expended on Paxton's defense is not so clear. For now, the court will assume that the original and proposed amended complaints seek both kinds of relief for Paxton.

Noe complains that Friedberg diluted his membership interest in contravention of the Operating Agreement and that, even if a dilution of his interest was called for, the amount by which it was diluted was improperly calculated. Noe further alleges that defendants excluded him from all aspects of the project because he refused to participate in their wrongful activities, such as shaking down vendors and subcontractors, receiving kickbacks, and diverting funds from the project to Paxton.

Noe sues individually, and derivatively on behalf of Paxton. The original complaint contains three causes of action. The proposed amended complaint leaves the first two causes of action unchanged, changes the third cause of action, and adds two more. This action commenced on March 26, 2008. The parties agreed to extend plaintiffs' time to respond to the counterclaims in defendants' answer to June 2, 2008. On June 2, 2008, the amended complaint was served on defendants, and was rejected. In the following month, plaintiffs moved for leave to amend the complaint.

Discussion

Leave to amend a pleading is freely granted absent prejudice or surprise resulting directly

from any delay in asserting the proffered claim (CPLR 3025 [b]; *McCaskey, Davies & Assoc. v New York City Health & Hosps. Corp.*, 59 NY2d 755, 757 [1983]). Leave to amend will be granted "unless the proposed amendment is palpably insufficient or patently devoid of merit" (*Lucido v Mancuso*, 49 AD3d 220, 222 [2d Dept 2008]). The proponent of the amendment must establish a prima facie cause of action by alleging facts that are congruent with the legal theory in the amendment: that is, the amended complaint must contain legally sufficient causes of action (*Daniels v Empire-Orr, Inc.*, 151 AD2d 370, 371 [1st Dept 1989]). If the proponent fails to make this showing or if the opponent shows that the facts relied upon in the amended pleading are "obviously not reliable," leave to amend will be denied (*id.*; *see also Non-Linear Trading Co. v Braddis Assoc.*, 243 AD2d 107, 117 [1st Dept 1998]).

Defendants do not argue prejudice or surprise. They argue that the proposed amended complaint is insufficiently pleaded and that the facts alleged therein are not facts at all. The amended complaint will be evaluated in the light of these objections.

Regarding defendants' cross motion for summary judgment dismissing the complaint, to be entitled to such relief, defendants "must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact" (*Ayotte v Gervasio,* 81 NY2d 1062, 1063 [1993] [citation omitted]). Defendants' arguments for summary judgment are the same as their arguments against amending the complaint.

First is the question of whether the first and second causes of action, which are unchanged, should be subject to summary judgment dismissal. The first cause of action in the original complaint seeks a declaratory judgment that the first capital call was invalid because it

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violated the modified version of the Operating Agreement, and that therefore restores Noe to his original ownership share in Paxton. The second cause of action seeks a declaratory judgment to the same effect regarding the second capital call. Defendants contend that these causes of action must be dismissed as the capital calls were properly made under the original Operating Agreement. They claim that the agreement was not modified.

Under the terms of the Operating Agreement, any modification had to be executed by all three members of Paxton. Defendants claim that the purported modification is ineffective, as Gruber did not sign it. The modification attached to the complaint shows the signatures of Noe and Friedberg, not Gruber. However, Noe claims that Friedberg told him that Gruber signed the modification. Noe claims there is a fully executed modification in existence and that it was Gruber's idea to modify the Operating Agreement. The parties' allegations show that whether they modified the Operating Agreement and whether defendants breached the modified version are issues of fact which cannot be determined at this point. Defendants fail to tender evidence to conclusively demonstrate that the agreement was not modified. Therefore, the motion to dismiss the first two causes of action is denied.

In the original complaint, the third cause of action pleads that it would be futile for Noe to demand that Paxton bring this action as the company is controlled by Friedberg. A conflict of interest exists between Friedberg and Paxton, as Friedberg misused Paxton's assets by using them to pay his legal expenses in the Ciao-Di case. Friedberg should repay those expenses.

In the amended complaint, the third cause of action is changed whereby it is asserted on behalf of both Paxton and Noe and adds claims against Gruber. Allegedly, both defendants wasted Paxton's assets and violated their fiduciary duties to Paxton and Noe, and Gruber aided

and abetted Friedberg's violation of his fiduciary duties. Defendants wasted Paxton's assets by making Paxton pay Friedberg's legal expenses and by causing Paxton to be sued and incur legal expenses. They also wasted the assets in that their wrongful conduct prevented Paxton from receiving the payments it should have received as the manager for the Ciao-Di project. As a remedy for Noe, the amended third cause of action seeks his proportionate share of the sums that should have been paid to Paxton pursuant to the project. For Paxton, the remedy sought is the return of the monies that Paxton paid for legal expenses in the Ciao-Di case and the monies it should have received from Ciao-Di's project.

A claim of waste is generally a derivative, not an individual, claim (*Fellner v Morimoto,* 52 AD3d 352, 353-354 [1st Dept 2008]). Allegations of mismanagement or diversion of assets generally plead a wrong to the corporation and should be pleaded as derivative claims (*Abrams v Donati,* 66 NY2d 951, 953 [1985]). A shareholder or member of a limited liability company may not assert an individual cause of action to recover for the company's losses although that person thereby loses the value of his or her investment (*id.*; *Glenn v Hoteltron Sys., Inc.*, 74 NY2d 386, 392 [1989]). A shareholder or member has an individual cause of action where a wrongdoer has breached an obligation to that person which is independent of any duty owing to the company (*id.*).

Within the original and amended third causes of action is a derivative claim that defendants injured Paxton. It is alleged that Friedberg wrongly used Paxton's assets to pay his legal expenses in the Ciao-Di action, that he and the other defendant engaged in wrongful conduct that caused Paxton to incur such expenses, and that they caused Paxton to lose monies it should have earned from the Ciao-Di project. Ultimately, the resolution of these claims will

depend on the outcome of the Ciao-Di case. In the meantime, they can be maintained in this action. The complaint also alleges that defendants breached their fiduciary duty to Paxton. A breach of fiduciary claim may be brought derivatively (*see Pinnacle Consultants, Ltd. v Leucadia Natl. Corp.*, 94 NY2d 426, 431 [2000]).

The amended third cause of action contains Noe's individual claims. Noe alleges the unfair dilution of his membership interest in Paxton (*see Yatter v William Morris Agency*, 256 AD2d 260, 260 [1st Dept 1998] [plaintiff possessed an individual cause of action with respect to the alleged intentional undervaluation of his shares for purposes of their repurchase by defendant]). Noe's claim that he was forced out of participation in Paxton also states an individual claim (*see Barbour v Knecht*, 296 AD2d 218, 227 [1st Dept 2002] [plaintiff's complaint that she was frozen out of the management of a close corporation asserts a cognizable wrong]). Noe sufficiently alleges injury separate from the injury sustained by Paxton. Also, a shareholder or member may assert an individual claim for breach of fiduciary duty (*see PDK Labs, Inc. v Krape*, 277 AD2d 212, 213 [2d Dept 2000]). Noe has a cause of action for breach of fiduciary duty, along with his other individual claims.

Regarding the allegation that Paxton's payment of Friedberg's legal expenses is a waste of Paxton's assets, defendants point to the indemnification provision in the Operating Agreement. The Operating Agreement provides that Paxton indemnifies the managing member against any claims or damages that he suffers "on account of any act performed or omitted to be performed by him within the scope of his authority and made or omitted to be made in good faith or based on the opinion of counsel" (Operating Agreement, ¶ 5.06). In such a case, Paxton will pay the reasonable legal costs and fees incurred by the managing member. Paxton will not

indemnify the managing member "if a judgment or other final adjudication adverse to the Manager Member establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled" (*id.*). This provision tracks the language of Limited Liability Company Law § 420, which provides that a limited liability company may indemnify any member or manager against claims and demands, and advance expenses to that person. The statute includes the same provisions regarding dishonesty and bad faith as found in the Operating Agreement.

Defendants contend that the Operating Agreement permits Paxton to pay Friedberg's legal expenses. They argue that the claim of waste is premature, as there has been no adjudication that Friedberg acted in bad faith or dishonestly, or that he gained personal profit to which he was not entitled.

Where there has been no negative adjudication against the person seeking indemnification from a limited liability company, the company may advance that person money for legal expenses (*see Van Der Lande v Stout,* 13 AD3d 261, 261-262 [1st Dept 2004]; *Schindler v Niche Media Holdings, LLC,* 1 Misc 3d 713, 717 [Sup Ct, NY County 2003], *abrogated on other grounds Tzolis v Wolff,* 10 NY3d 100 [2008]). Advances are amounts due under an indemnification obligation, and advancement implies that if the underlying conduct is ultimately judged to be not entitled to indemnification, the advanced party must repay (Bishop and Kleinberger, Limited Liability Companies: Tax and Business Law § 10.08, sec. [1] [c] [2009] [Westlaw ed, Limited Liab Co 10.08]).

Since there has been no adjudication that Friedberg acted badly, there was no impropriety

in Paxton advancing funds to Friedberg for his defense in the Ciao-Di action. At the same time, it does not follow that the claim for waste must be dismissed. The complaint contains allegations that, if proven true, would show that Friedberg acted with at least bad faith. If, in the future, there is an adjudication that Friedberg acted in bad faith, that may lead to an adjudication that he wasted Paxton's assets by using the assets to pay his legal expenses. He may have to return the advances to Paxton. These questions are yet to be determined.

Defendants correctly contend that the amended third cause of action improperly contains both Noe's and Paxton's claims. Individual and derivative claims may not be pleaded within the same cause of action (*see Baliotti v Walkes,* 134 AD2d 554, 555 [2d Dept 1987]). The mingling of derivative claims and individual claims requires dismissal of the causes of action so affected, with leave to replead if so advised (*Abrams,* 66 NY2d at 953). Because of the joining of the two kinds of claims, the motion to amend the third cause of action is denied. The denial is without prejudice. Plaintiffs may recast the cause of action in the proper form, separating the individual from the derivative claims.

The newly proposed fourth cause of action is asserted on behalf of Noe and Paxton. It states that Friedberg and Gruber wasted Paxton's assets by failing to properly perform the work on the project. Allegedly, defendants caused the plumbing, floors, and ceilings to be negligently installed, which is one reason that Ciao-Di sued Paxton and Friedberg. As Noe alleges, if Ciao-Di succeeds in showing that Paxton did not do the work properly, Ciao-Di may be relieved of the obligation to pay Paxton the amount that it would have been obligated to pay if the project had proceeded properly.

The new fourth cause of action states a case for harm to Paxton, but not to Noe. The

body of the cause of action sets forth derivative claims only, yet the heading wrongly states that it is asserted on behalf of both plaintiffs. Since the body of the cause of action does not mingle derivative and individual claims, plaintiff is granted leave to add it to the complaint. However, plaintiff should correct the heading.

The newly added fifth cause of action alleges a breach of the implied covenant of good faith and fair dealing in the Operating Agreement. While the heading announces that the cause of action is on behalf of Noe, the body includes claims that belong to both plaintiffs. It alleges that defendants violated the Operating Agreement by shaking down vendors and subcontractors, receiving kickbacks, mishandling project funds, and defending Friedberg in the Ciao-Di action to the detriment of Paxton. Regarding Noe, it is alleged that defendants violated the Operating Agreement by improperly diluting his interest in Paxton and excluding him from the project.

As a party to the Operating Agreement, Noe may allege individual injury to himself based on breach of that agreement (*see* Bishop and Kleinberger § 5.06, sec. [6] [b] [Westlaw ed, Limited Liab Co 5.06]). Paxton was not a party to the Operating Agreement and it is not clear that Noe may bring a derivative claim on Paxton's behalf for breach of the agreement (*id.* [discussing whether a limited liability company may enforce an Operating Agreement to which it is not a party]). Whether that is the case, however, does not matter because the claims pertaining to Paxton may be asserted without resort to a breach of contract claim.

Because the body of the newly added fifth cause of action improperly mixes individual and derivative claims, the motion to add the fifth cause of action to the complaint is denied without prejudice. Plaintiffs have leave to correct the new fifth cause of action and add it to the complaint.

Defendants argue that Gruber should be dismissed from this action. As they point out, Gruber is not a party in the Ciao-Di action. The original complaint states that the bad acts were those of Friedberg and/or Gruber. The amended third cause of action states that Gruber breached his fiduciary duty to plaintiff and aided and abetted Friedberg is his breach of said duty. Defendants argue that these allegations are conclusory and do not show that Gruber did anything wrong.

Noe submits affidavits in opposition to defendants' motion and in support of his own motion. One affidavit was written for the purposes of these motions. Others were written in connection with motions in the Ciao-Di case. When determining whether the alleged facts fit within any cognizable legal theory, a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint (*Leon v Martinez,* 84 NY2d 83, 87-88 [1994] [regarding a CPLR 3211 motion to dismiss for failing to state a cause of action]).

Noe's affidavit for these motions states that it was Gruber's idea to modify the Operating Agreement and that Gruber signed the modification. It further states that Gruber told Noe that he and Friedberg received materials and services for their homes for little or no cost from the same subcontractors that worked on the project.

In the Ciao-Di case, Ciao-Di moved for a preliminary injunction preventing the defendants in that action and Gruber from having anything more to do with the project, including project funds. The defendants in that case cross-moved for a preliminary injunction preventing certain persons from interfering in the project. By a decision dated February 25, 2008, the court granted Ciao-Di's motion and denied the defendants' cross motion. Noe submitted an affidavit in support of Ciao-Di's motion and in opposition to the defendants' motion. The affidavit

alleges that Gruber and Friedberg excluded Noe from all aspects of the project, in violation of the Development Agreement between Paxton and Ciao-Di, and Gruber sent an e-mail to a third party falsely stating that Noe was no longer involved with Paxton. Gruber made an agreement with an advertising broker to place ads at the project site in exchange for payments and wrongly diverted these payments to Paxton rather than paying them into the project account. The affidavit also alleges that almost $100,000 was diverted in this manner. Gruber told the principal of a scaffolding company that if he wanted to work on the project, he would have to pay Gruber some money.

Although most of the allegations are against Friedberg, the complaint, as amplified by the affidavits, adequately sets forth allegations that support claims of waste, breach of contract, breach of fiduciary duty, and aiding and abetting breach of fiduciary duty against Gruber. Defendants do not deny that members of a limited liability company have fiduciary duties towards each other and the company (*see Salm v Feldstein,* 20 AD3d 469, 470 [2d Dept 2005]; *Nathanson v Nathanson,* 20 AD3d 403, 404 [2d Dept 2005]; *Willoughby Rehabilitation and Health Care Ctr., LLC v Webster,* 13 Misc 3d 1230[A], 2006 NY Slip Op 52067[U], *3-4 [Sup Ct, Nassau County 2006], *affd* 46 AD3d 801 [2d Dept 2007]), but they claim that the aiding and abetting claim is not sufficiently pleaded.

The tort for aiding and abetting a breach of a fiduciary duty requires a breach of a fiduciary duty by another, the defendant's knowing participation in the breach, and injury sustained by the plaintiff as a result of the breach (*Kaufman v Cohen,* 307 AD2d 113, 125 [1st Dept 2003]). The allegations in the complaint and the affidavits sufficiently state that defendants had such a duty, that they breached it, and that Gruber participated in Friedberg's breaches of

duty, thereby injuring plaintiffs.

Defendants' affidavits deny the allegations in the complaint and present their versions of events. These affidavits only indicate that defendants disagree with plaintiffs, but they do not establish that defendants are correct. Therefore, what they show is the existence of issues of fact that cannot be resolved at this stage of the case.

Plaintiffs are granted leave to replead the third and fifth causes of action in the amended complaint. For the sake of clarity, they should correct the fourth cause of action in the amended complaint and clearly indicate that it is derivative. Also, the allegations about Gruber in the affidavits should be added to the complaint.

Defendants ask that plaintiffs be sanctioned for bringing frivolous claims. This request is denied, as none of the claims can be deemed frivolous.

Conclusion

In conclusion, it is

ORDERED that plaintiffs' motion to amend the complaint by adding new third, fourth, and fifth causes of action is granted as to the fourth cause of action and is denied without prejudice as to the third and fifth causes of action, and plaintiffs are granted leave to replead said causes of action; and it is further

ORDERED that within 30 days of service of this order with notice of entry, plaintiffs shall serve on defendants an amended complaint containing the changes indicated in this decision; and it is further

ORDERED that defendants' cross motion for summary judgment dismissing the

complaint is denied.

Dated: February 24, 2009

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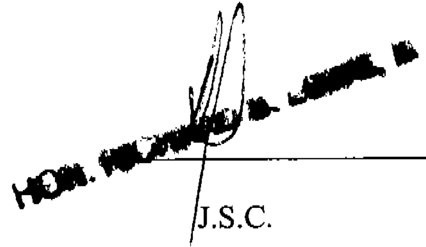

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