Verderber v Commander Enters. Centereach LLC
2010 NY Slip Op 30199(U)
January 22, 2010
Supreme Court, Nassau County
Docket Number: 007691/2009
Judge: Ira B. Warshawsky
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SCAN

SHORT FORM ORDER

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SUPREME COURT : STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:
HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 8

JOSEPH E. VERDERBER, JUDITH VERDERBER and VERBENCO, LLC,

Plaintiffs,

INDEX NO.: 007691/2009
MOTION DATE: 12/16/2009
MOTION SEQUENCE: 004 and 005

-against-

COMMANDER ENTERPRISES CENTEREACH, LLC, COMMANDER ENTERPRISES, LLC, BENCO, LLC, PEMBROKE PROPERTIES, LLC, LEONARD SHAPIRO and JOSEPH G. SHAPIRO,

Defendants.

The following papers read on this motion:

Order to Show Cause, Affirmation, Affidavit & Exhibits Annexed 1
Memorandum of Law in Support of Plaintiffs' Motion for Receiver and and Disqualification 2
Affidavit in Opposition to Plaintiffs' Motion for Receiver and to Disqualify Ruskin Moscou Faltischek, P.C. of Joseph G. Shapiro & Exhibits Annexed 3
Memorandum of Law in Opposition to Plaintiffs' Motion for the Appointment of a Receiver, to Strike Article VII of CEC's Operating Agreement, and to Disqualify Ruskin Moscou Faltischek, P.C. from Representing Defendants 4
Affirmation of Austin Graff in Further Support of Motion for the Appointment of a Receiver and Other Relief, Affidavit of Jeffrey M. Weiner & Exhibits Annexed 5
Order to Show Cause, Affirmation, Affidavit & Exhibits Annexed 6
Memorandum of Law in Support of Plaintiffs' Motion for Re-Argument and TRO 7
Affirmation in Opposition to Plaintiffs' Motion to Reargue and for a Preliminary Injunction of Matthew F. Didora & Exhibits Annexed 8
Affirmation of Austin Graff in Further Support of the Plaintiffs' Motion to Re-Argue & Exhibits Annexed 9

Motion by plaintiffs to appoint a receiver is denied. Motion by plaintiffs to strike Article VII from the October 2000 operating agreement on the ground that it is against public policy is granted to the extent indicated below. Motion by plaintiffs to disqualify defendants' counsel is denied. Motion by plaintiffs for leave to reargue is denied. Motion by plaintiffs for a preliminary injunction restraining defendants from enforcing Article VII of the operating agreement is denied.

This is an action by minority members of a limited liability company seeking a declaration as to the enforceability of a buyout provision in the operating agreement. Defendant Commander Enterprises Centereach, LLC holds title to an office building located in Centereach. Plaintiff Joseph Verderber holds an 18% interest in CEC, and his wife, plaintiff Judith Verderber, owns 2% of the company. 80% of CEC is owned by defendant Benco, LLC, a limited liability company owned and controlled by defendant Joseph Shapiro.

Shapiro claims that the operating agreement governing CEC was executed by all parties shortly before October 2000, when the company was known as Pembroke Properties. Plaintiffs deny signing the October 2000 agreement and claim that an earlier agreement executed in July 1999 controls. The 1999 agreement contained a provision that if a member desired to sell his interest, he was required to give the other members an option to purchase on the same terms as were contained in the third party's offer. Article III, Sec. 8 of the October 2000 agreement provides that in the event any member desires to transfer all or any part of his interest, it must be transferred to Benco. Sec. 8 further provides that the membership interest must be sold "at the value set forth in Article VII." Article VII, entitled "death of a member," provides in sec. 4 that "The purchase price/buy out rate shall be determined by multiplying the net operating income by 8.80, and deducting the present mortgage balance. Such purchase price/buy out shall be paid over a term of five years in equal monthly installments." Article VIII of the agreement contains an alternative dispute resolution provision, providing for dispute resolution by the accountant and legal counsel to the company.

In its order dated October 15, 2009, the court determined that the October 2000

agreement was controlling.[1] However, the court denied defendants' motion to compel "arbitration" on the ground that defendants had waived their contractual right to alternate dispute resolution by affirmatively accepting the judicial forum. The court reasoned that defendants had affirmatively accepted the judicial forum by asserting a counterclaim for breach of the operating agreement.

In the October 15, 2009 order, the court also denied defendants' motion for a preliminary injunction, prohibiting plaintiffs from transferring their interests in CEC. The court found that defendants had failed to show a likelihood of success on the merits with respect to the enforceability of the restriction on alienation. The court noted that an operating agreement covering a limited liability company may contain a first option provision but may not prohibit a member from selling his interest to a third party. The court further determined that defendants had failed to show a danger of irreparable harm because an assignee of plaintiffs' interest is not entitled to participate in the management and affairs of the company (Limited Liability Law § 603(a)[2]). Additionally, the court granted plaintiffs' motion to dismiss the counterclaim on the ground that it was asserted, not by CEC, but by defendant Commander Enterprises, who was not a party to, or an intended third party beneficiary of, the operating agreement.

Following the court's decision, Joseph Shapiro wrote to plaintiffs, asserting that plaintiffs' transfer of their membership interests to Verbenco, their own limited liability company, triggered the buyout provision in Article VII of the operating agreement. At Shapiro's request, CEC's accountants, Peter, Friedman & Co., determined the net operating income for 2008 to be $389,389. Applying the formula provided in the agreement, the accountants calculated the buyout price for plaintiffs' 20% interest to be $36,629.[2] Plaintiffs estimate the value of their interest to be approximately $1.1 million and do not regard the buyout figure provided by the accountants as representing the fair value of their interests in the company.

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[1]Because plaintiffs had a full and fair opportunity to litigate the enforceability of the agreement on the motion to compel arbitration, that issue has become the law of the case. However, upon a proper showing, the court has discretion to reconsider the issue, in the course of deciding the present motions (See *People v Evans*, 94 NY2d 499, 502-03 [2000]).

[2]Order to show cause, sequence # 4, ex. E.

Plaintiffs move for leave to reargue the three prior motions to the extent that the court determined that the October 2000 agreement is controlling. By separate order to show cause, plaintiffs move to strike Article VII of the operating agreement on the ground that it is against public policy. Plaintiffs also request a preliminary injunction, prohibiting defendants from enforcing the buyout provision.

Additionally, plaintiffs move pursuant to CPLR § 6401 for the appointment of a temporary receiver to collect the rent for CEC and pay the expenses of the company. As grounds for the appointment of a receiver, plaintiffs allege that Shapiro retained new accountants more amenable to doing his bidding, failed to provide plaintiffs with third quarter financial statements, and commingled tenants' security deposits with funds of the company. Finally, plaintiffs move to disqualify defendants' counsel from representing CEC or Shapiro on the ground that CEC has a claim against Shapiro for waste and conversion of company assets.

Defendants argue that the restriction on alienation provision in the October 2000 operating agreement is valid and enforceable. Defendants argue that plaintiffs have not made the clear evidentiary showing which is required for the appointment of a receiver. Defendants assert that CEC's regular accountant, Marcum LLP, has not been replaced. Rather Peter, Friedman was retained only after plaintiffs refused to sign a "conflict waiver" and Marcum declined to perform the calculation. Defendants argue that plaintiffs are not entitled to the third quarter reports because they ceased to be members of CEC upon assignment of their membership interests (See Limited Liability Law § 603(a)[4]). Defendants oppose disqualification of their attorneys on the ground that plaintiffs' claims of waste and conversion are without merit.

CPLR 2221(d) provides that a motion for leave to reargue shall be based upon matters of fact or law allegedly overlooked or misapprehended by the court in determining the prior motion. While plaintiffs note that the court's determination as to which operating agreement is controlling was not necessary to the disposition of the prior motions, they do not identify any matter of fact or law which was overlooked or misapprehended by the court. The purpose of a motion to reargue is not to relitigate every determination of fact and law which the court made in the course of arriving at its decision. Additionally, in order to have standing to move for leave to reargue, a party must be aggrieved by the court's decision on the prior motion (*Wehringer v*

Gibbons, 49 AD2d 109 [1st Dept 1975]). Since plaintiffs' motion to dismiss the counterclaim was granted and defendants' cross-motions to compel arbitration and for a preliminary injunction were denied, plaintiffs were not aggrieved by the court's decision on the prior motions. Plaintiffs' motion for leave to reargue is denied.

Limited Liability Company Law § 509 provides, "upon withdrawal as a member of the limited liability company, any withdrawing member is entitled to receive any distribution to which he or she is entitled under the operating agreement and, if not otherwise provided in the operating agreement, he or she is entitled to receive, within a reasonable time after withdrawal, the fair value of his or her membership interest in the limited liability company as of the date of withdrawal based upon his or her right to share in distributions from the limited liability company."

A member may withdraw as a member of a limited liability company "only at the time or upon the happening of events specified in the operating agreement and in accordance with the operating agreement" (Limited Liability Company Law § 606). Article III, Sec. 9 of the October 2000 operating agreement provides that "A member may withdraw as a member of this company with the vote or written consent of a majority of the members, other than the member who proposes to withdraw as a member. If such consent is not given, a member may withdraw upon not less than six months prior written notice to this company...."

Defendants suggest that plaintiffs withdrew as members of CEC in January 2009 when they transferred their interests to Verbenco.[3] However, in accordance with Article III, Sec. 9 of the operating agreement, plaintiffs withdrew as members of CEC in January 2008 when plaintiffs proposed that Shapiro buy out their interests and Shapiro, the only other member of the company, consented to their proposal.[4] Thus, plaintiffs are entitled to the fair value of their membership interests as of January 2008, unless otherwise provided in the October 2000 operating agreement.

As between themselves, partners may include in the partnership agreement any provision they wish concerning winding up of the partnership affairs and other matters, provided the

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[3]See defendants' memorandum of law at 6 and the court's order of October 15, 2009 at 5.

[4]See the court's order of October 15, 2009 at 5.

provision does not violate a statute, rule of common law, or considerations of public policy (*Bailey v Fish & Neave*, 8 NY3d 523, 528-29 [2007]). The members of a limited liability company are granted a similar freedom in drafting their operating agreement and are bound by similar policy considerations.

Among the public policy considerations which limit the partners or members' power to contract is the policy against unreasonable restraints on the alienation of property. A provision in the certificate of incorporation requiring a shareholder in a close corporation to give the other shareholders a "first option" to purchase the stock at an agreed price or then-existing book value is a valid and reasonable restriction (*Allen v Biltmore Tissue Corp.*, 2 NY2d 534, 541 [1957]). However, a provision prohibiting sale of the stock to anyone except to the corporation at whatever price it wishes to pay is illegal and unenforceable (Id at 542). Attempting to equate the corporate structure to a partnership, shareholders of close corporations use share transfer restrictions to give the original stockholders the right to "veto the admission of a new participant" (Id at 543). Because the shares of a close corporation ordinarily do not have a readily ascertainable market value, some method of fixing the option price is usually provided in the agreement. Thus, a minority shareholder must show "more than mere disparity between option price and current value of the stock" in order to avoid the restriction (Id). However, if the restraint on alienation is unreasonable "in light of the circumstances and the purposes sought to be accomplished," it is not enforceable (*Levey v Saphier*, 54 AD2d 959 [2d Dept 1976]). In upholding the share transfer restriction in *Allen*, the Court of Appeals sought to discourage "expensive litigation" on the fair market value of the withdrawing shareholder's interest (2 NY2d at 542). However, § 509 clearly contemplates judicial resolution of fair value under the Limited Liability Company Law.

The restriction in the October 2000 operating agreement prohibits plaintiffs from selling their interests to anyone other than Benco, who is the other member of the limited liability company and Shapiro's nominee. The agreement provides that Benco must purchase the interests at a price based upon a set formula rather than whatever it wishes to pay. However, plaintiffs assert that the formula price is merely a fraction of fair value, and defendants do not dispute that claim. Were plaintiffs involved in the management of CEC, a discounted price

might be a reasonable restriction in order to discourage plaintiffs from withdrawing from the company (See *Gallagher v Lambert*, 74 NY2d 562 [1989]). However, plaintiffs are minority members with no role in management, and pursuant to § 603 their assignees have no right to manage the company. While an option to purchase a deceased member's interest at book value may be a reasonable way of providing a death benefit to the member's estate, plaintiffs seek to make an inter vivos transfer (See *Stern v Fabricant*, 206 AD2d 514 [2d Dept 1994]). Thus, there is no apparent purpose for the restriction on alienation other than to limit the amount which plaintiffs may receive for their investment and grant the controlling member a windfall. In these circumstances, the restriction on alienation is unreasonable. Accordingly, plaintiffs' motion to strike Article VII is granted to the extent of declaring that plaintiffs are entitled to the fair value of their membership interests as of January 2008.

In order to be entitled to a preliminary injunction, plaintiffs must show a likelihood of success on the merits, danger of irreparable injury in the absence of an injunction, and a balance of the equities in their favor (*Aetna Ins. Co. v Capasso*, 75 NY2d 860 [1990]). Clearly plaintiffs have established a likelihood of success on the merits because the court has determined that to the extent that Article VII provides that Benco may buy out plaintiffs for less than fair value, the provision is unenforceable. However, because plaintiffs may be compensated in the form of a money judgment for the fair value of their interests, plaintiffs have not shown a danger of irreparable harm. Plaintiffs' motion for a preliminary injunction restraining defendants from enforcing the buyout provision is denied.

CPLR § 6401(a) provides that "Upon motion of a person having an apparent interest in property which is the subject of an action in the supreme...court, a temporary receiver may be appointed...where there is a danger that the property will be removed from the state, or lost, materially injured or destroyed." The drastic remedy of a temporary receiver is to be used sparingly in partnership dissolution proceedings (*Trepper v Goldbetter*, 205 AD2d 363 [1st Dept 1994]). Where a limited liability company is in the course dissolution, a court should exercise similar caution in appointing a receiver, lest management and control of the limited liability company be effected.

Plaintiffs have prescinded from commencing a proceeding for judicial dissolution of CEC

pursuant to § 702 of the Limited Liability Company Law, and the parties have been unwilling or unable to agree to dissolution pursuant to § 701. However, as between the members themselves, plaintiffs' demand to be bought out was tantamount to the commencement of dissolution proceedings. § 606(a) of the Limited Liability Company Law provides that "unless an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to the dissolution and winding up of the limited liability company." Since there is no provision in CEC's operating agreement for a member to withdraw prior to dissolution, plaintiffs' withdrawal in effect worked a dissolution of the company. Thus, plaintiffs' application for the appointment of a temporary receiver must be scrutinized carefully by the court.

While Shapiro may have retained a "friendly accountant" to minimize 2008 operating income, there is no evidence that the company has been "materially injured" or its assets impaired. While Shapiro's failure to provide plaintiffs with the third quarter balance sheet is of more concern, it does not require a receiver because plaintiffs may obtain necessary financial information in the course of discovery. Finally, Shapiro's commingling of security deposits, while a violation of General Obligations Law § 7-103(1), is not equivalent to commingling rent with income derived from other property. The case upon which plaintiffs rely, *Gimbel v Reibman*, 78 AD2d 897 (2d Dept 1980) is further distinguishable in that it involves not the dissolution of a limited liability company or partnership but rather an action to partition real property. Plaintiffs' motion for the appointment of a temporary receiver is denied.

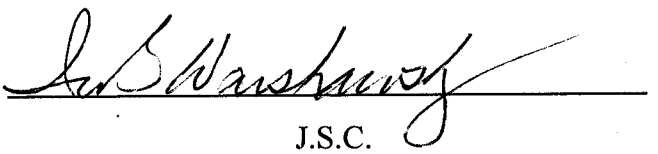
A lawyer retained by an organization is the lawyer for the organization and may not simultaneously represent its officers and directors if their interests differ from those of the organization (22 NYCRR § 1200.13). Thus, dual representation of a corporation and its directors is forbidden in a shareholder derivative suit, if the directors are alleged to have breached their fiduciary duties or committed fraud against the corporation (*Natomas Gardens Investment Group v Sinadinos*, 2009 U.S. Dist. LEXIS 83391 [E.D. Ca. 2009]). Despite the absence of statutory authorization, a member of a limited liability company may bring a derivative suit on behalf of the company (*Tzolis v Wolff*, 10 NY3d 100 [2008]).

Since Shapiro has an 80% interest in CEC, his interest is generally the same as that of the

limited liability company. Nevertheless, if plaintiffs alleged genuine breaches of fiduciary duty such as waste or self-dealing, there would be a basis for disqualifying counsel for Shapiro from also representing CEC, but, perhaps, not for complete disqualification (*Natomas Gardens Investment Group v Sinadinos*, supra). Plaintiffs allege that Shapiro's retaining of the new accountants to calculate the buyout price and paying them with CEC's money constitutes waste and conversion.[5] However, in his affidavit in opposition, Shapiro states that the accountants were retained by Benco.[6] While plaintiffs and Benco must each bear their own costs for expert witnesses on the question of fair value, it has not been established that Shapiro breached his fiduciary obligation by charging the cost of his expert witness to the company. Plaintiffs' motion to disqualify defendants' counsel is denied at this time.

This shall constitute the decision and order of the court.

Dated: January 22, 2010



J.S.C.

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JAN 26 2010
NASSAU COUNTY
COUNTY CLERK'S OFFICE

[5]Affirmation of Austin Graff at ¶ 39.

[6]Affidavit of Joseph Shapiro at ¶ 12.