Mich II Holdings LLC v Schron
2011 NY Slip Op 34121(U)
June 16, 2011
Supreme Court, New York County
Docket Number: 600736/2010
Judge: O. Peter Sherwood
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: O. PETER SHERWOOD, *Justice* PART 49

MICH II HOLDINGS LLC, *et al.*,

Plaintiffs,

-against-

RUBIN SCHRON, *et al.*,

Defendants.

INDEX NO. 600736/2010

MOTION DATE March 21, 2011

MOTION SEQ. NO. 003

MOTION CAL. NO. ______

The following papers, numbered 1 to _____ were read on this motion to dismiss action

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☑ No

Upon the foregoing papers, defendants' motion to dismiss the complaint is decided in accordance with the accompanying decision and order.

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

Dated: June 16, 2011

O. PETER SHERWOOD, J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL PART 49

---X

MICH II HOLDINGS LLC and SEEVA II HOLDINGS LLC, individually and as members suing derivatively on behalf of SMV PROPERTY HOLDING LLC; MICH HOLDINGS LLC and SEEVA HOLDINGS LLC, individually and as members suing derivatively on behalf of SWC PROPERTY HOLDINGS LLC; SVCARE HOLDINGS, LLC; LEONARD GRUNSTEIN; and MURRAY FORMAN,

Plaintiffs,

-against-

RUBIN SCHRON; CAM-ELM COMPANY LLC; CAMMEBY'S FUNDING LLC; CAMMEBY'S EQUITY HOLDINGS LLC; HSA EQUIPMENT LLC; ELI SCHRON; AVI SCHRON; CHAYA COHEN; MARK (a/k/a MORDY) SCHRON; MIRIAM SCHER; BRACHA ROTHSTEIN; JEFFREY SCHRON; and SAMUEL SCHRON,

Defendants.

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DECISION AND ORDER

Index No.: 600736/2010

O. PETER SHERWOOD, J.:

This action arises out of the business relationships among Rubin Schron, Leonard Grunstein and Murray Forman and the entities they control or hold interests in. Defendant Rubin Schron ("Schron") is the sole manager of SMV Property Holdings LLC ("SMV") and SWC Property Holdings LLC ("SWC"), but is not a member of those companies. MICH II Holdings LLC ("MICH II") and SEEVA II Holdings LLC ("SEEVA II") are minority members of SMV. MICH Holdings LLC ("MICH") and SEEVA Holdings LLC ("SEEVA") are minority members of SWC. MICH, MICH II, SEEVA and SEEVA II are controlled by defendants Grunstein and Forman. CAM-Elm Company LLC ("CAM-Elm") is a majority member of SMV (with 77.35% equity interest) and SWC (with 83% equity interest). CAM-Elm is indirectly majority-owned by members of Rubin Schron's family: Eli Schron, Avi Schron, Chaya Coheyn, Mark Schron, Miriam Scher, Bracha Rothstein, Jeffrey Schron and Samuel Schron (the "Schron Children").

The complaint alleges that Schron "misappropriated more than $100 million from SMV, attempted to conceal his misappropriations, kept false and inaccurate books and records, and refused to provide audited financials for SMV and distribute them to its members as required by SMV's Operating Agreement." (complaint, ¶ 1). Plaintiffs also allege that Schron misappropriated over $11 million from SWC. (complaint, ¶ 9). The claims against the Schron Children are in their capacity as members of CAM-Elm. As the majority member of both SMV and SWC, CAM-Elm has the power to remove and replace the manager of the companies.

The complaint contains seventeen causes of action for: (1) misappropriation from SMV; (2) breach of the SMV Operating Agreement; (3) breach of fiduciary duty owed to SMV and its members; (4) breach of good faith duty of CAM-Elm to remove Schron as manager of SMV; (5) unjust enrichment at the expense of SMV; (6) accounting and constructive trust for the benefit of SMV; (7) removal of SMV manager and appointment of new managers; (8) misappropriation from SWC; (9) breach of SWC Operating Agreement; (10) breach of fiduciary duty owed to SWC and its members; (11) breach of good faith duty of CAM-Elm to remove Schron as manager of SWC; (12) unjust enrichment at the expense of SWC; (13) accounting and constructive trust for the benefit of SWC; (14) removal of SWC manager and appointment of new managers; (16) breach of agreement by Schron for failure to pay substantially all of the purchase price under an agreement with Grunstein and (17) defamation. The fifteenth cause of action was dismissed by Order and Decision of this Court, dated January 20, 2011.

Analysis

A. <u>*Schron Children's Motion to Dismiss*</u>

Of the seventeen causes of action in the complaint, only four are pled against the Schron Children explicitly: the sixth, seventh, thirteenth and fourteenth causes of action. Causes of action one through five and eight through twelve are pled against Schron, entities controlled by him and those who are alleged to have aided and abetted his wrongdoing.

By Motion Sequence Number 003, the Schron Children move to dismiss the complaint pursuant to CPLR 3211(a)(1), (3) and (7). With regard to the causes of action pled explicitly against them, the Schron Children argue that plaintiffs have failed to state a cause of action. With regard to the remaining aiding and abetting causes of action, the Schron Children move to dismiss on the grounds that they fail to satisfy the tenets of pleading under CPLR 3013 and the particularity requirements of CPLR 3016(b).

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1. *Sixth and Thirteenth Causes of Action*

The sixth and thirteenth causes of action seek an accounting to determine the full extent of SMV's and SWC's losses and an imposition of constructive trusts for the benefit of the companies on any funds unlawfully in the possession or control of the defendants as a remedy for unjust enrichment as a result of Schron's conduct. The elements of constructive trust are "(1) a confidential or fiduciary relation, (2) a promise, (3) a transfer in reliance thereon and (4) unjust enrichment." (*Sharp v Kosmalski*, 40 NY2d 119, 121 [1976]).

Pursuant to Delaware Limited Liability Company Act § 18-1101 (c), while limited liability companies may determine the extent of their members' duties to each other, the duty of good faith and fair dealing cannot be eliminated. Therefore, plaintiffs may argue that CAM-Elm, the majority member of both SWC and SMV, has certain fiduciary duties to plaintiff minority members. The Schron Children, however, are not themselves members of SMV or SWC and plaintiffs have failed to find support in law (and the court's research has uncovered none) for extension of the fiduciary duties of CAM-Elm to its members.

New York courts recognize a cause of action for "moneys had and received" (or unjust enrichment) when "in the absence of an agreement ... one party possesses money that in equity and good conscience [it] ought not to retain and that belongs to another" (*Board of Educ. of Cold Spring Harbor Cent. School Dist. v Rettaliata*, 78 NY2d 128, 138 [1991] [citing *Miller v Schloss*, 218 NY 400, 406-407]). This cause of action allows a plaintiff to recover funds which came into possession of defendant "impressed with a species of trust." *Id.* To reach the conclusion that one was unjustly enriched is to draw a legal inference from the circumstances surrounding the transfer of the funds and the relationship of the parties. (*Electric Ins. Co. v Travelers Ins. Co.*, 124 AD2d 431, 432 [3d Dept 1986]).

Applying both these standards to the Schron Children, it is clear that a cause of action for unjust enrichment has not been stated against them. It is CAM-Elm, as majority member of SMV and SWC, which has a relationship of trust with the Companies, not the Schron Children who are beneficial owners of CAM-Elm.

Plaintiff cite *Meisels v Schon Family Foundation*, 28 Misc.3d 1205(A), Slip Copy, 2010 WL 2674049 (Table) (Sup. Ct. Kings County 2010) for the proposition that unjust enrichment claims are

allowed when funds are transferred to a defendant's family. The Schon Family Foundation, a charitable entity that has the word "family" in its name, is not an individual and therefore could not be "family" of any alleged wrongdoer.

Plaintiffs also cite to *37 Park Drive South, Inc. v Duffy* (63 AD3d 1040 [2d Dept 2009]) in support of the proposition that "unjust enrichment claims are allowed where company officials take funds." *37 Park Drive South* is inapplicable here. In that case, the defendant president of the corporation diverted funds based on an alleged compensation contract that the court found never existed. The shareholders were allowed to sue on an unjust enrichment theory to recover the funds. *37 Park Drive South* may support an action against Schron, or perhaps CAM-Elm, but not against the beneficial owners of CAM-Elm.

Defendant counsel's analogy in the corporate context is illuminating here. If the Schron Children were shareholders of a corporation who received a dividend as a result of wrongdoing by a related corporation's directors or managers, plaintiffs would not be allowed to impose a constructive trust or to pursue an unjust enrichment claim against all shareholders. The same applies here. While the plaintiffs may be able to pursue claims against Schron or CAM-Elm, they fail to state a cause of action against the Schron Children. Plaintiffs have failed to support their proposed extension of unjust enrichment claims to tertiary parties with any New York or Delaware law.

2. Seventh and Fourteenth Causes of Action

The seventh and fourteenth causes of action seek removal of Schron as manager of the two companies and appointment of new managers. Plaintiffs argue that the Schron Children are "in ultimate control of CAM-Elm and should be directed to cause CAM-Elm to meet its fiduciary and other obligations to SMV, SWC and their members" by removing Schron as manager. (Plaintiffs' memorandum in opposition at 33). The Schron Children move to dismiss these causes of action because CAM-Elm, not the Schron Children, is the majority member of SMV and SWC with power to appoint and remove the companies' manager.

SWC and SMV are Delaware limited liability companies. While Delaware law provides default provisions for governance of LLCs, the operating agreement controls. 6 Del. C. § 18-1101(b); 6 Del. C. § 18-402. The SWC and SMV Operating Agreements expressly designate management function to a Manager to be designated by CAM-Elm. (SWC and SMV Operating

Agreements § 4.1[a]). Demands seeking removal of the manager and appointment of a new one should be directed at CAM-Elm.

CAM-Elm is a New York limited liability company, and under New York law, "[a] member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except where the object is to enforce a member's right against or liability to the limited liability company." NY LLC Law § 610. Therefore, the Schron Children are not proper defendants on the seventh and fourteenth causes of action.

3. First through Fifth and Eighth through Twelfth Causes of Action

The first through fifth and eighth through twelfth causes of action are pled against Schron, various entities controlled by him and those who are alleged to have aided and abetted his misconduct. Plaintiffs contend that this constitutes sufficient pleading to allow those claims to be brought against the Schron Children. The Schron Children move to dismiss these claims as to them on the grounds that the complaint fails to satisfy the pleading standards of CPLR 3013 and the particularity requirements of CPLR 3016(b).

CPLR 3013 requires that "[s]tatements in a pleading... be sufficiently particular to give the court and parties notice of the transactions, occurrences... intended to be proved and material elements of each cause of action." A claim for aiding and abetting a breach of fiduciary duty requires: (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damage as a result of the breach. (*Kaufman v Cohen*, 307 AD2d 113, 125 [1st Dept 2003]). Further, pursuant to CPLR 3016(b), "[w]here a cause of action or defense is based upon misrepresentation, fraud, mistake, willful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail."

Plaintiffs do not describe the "transactions or occurrences" that the Schron Children engaged in or how they participated in them to aid and abet Schron's alleged misconduct. During oral argument, defendants made several allegations that Eli Schron conspired with Rubin Schron on a swap transaction to misappropriate SMV funds. (Transcript, 78). However, these allegations are supported in the complaint by a single conclusory sentence: "[f]rom the beginning, defendant Eli Schron was deeply involved [sic] in arranging and handling the Schron Interest Rate Swap

Investment for his father." (complaint, ¶ 55). The other Schron Children are not mentioned anywhere in the complaint. The allegations in the complaint are not specific enough to satisfy the notice pleading requirements of CPLR 3013 and 3016(b) or to establish the "knowing inducement or participation" branch of the aiding and abetting claim. Therefore, the first through fifth and eighth through twelfth causes of action are dismissed as against the Schron Children.

B. *Schron and Entities' Motion to Dismiss*

By Motion Sequence Number 004, Schron and the related defendants move to dismiss the complaint under CPLR 327, 3211(a)(1), (3), (7), and (10). Specifically, defendants argue that causes of action one through fourteen are derivative claims, and pursuant to the Operating Agreements of the Companies, all claims against the Companies must be brought in Delaware. Causes of action one, five, six, eight, twelve and thirteen are explicitly derivative. Defendants further argue that the causes of action two through four, seven, nine through eleven and fourteen are also derivative. Plaintiffs vigorously oppose this characterization and argue that in addition to being derivative, the claims asserted are also direct claims by members against Schron.

It is a long-establish tenet of Delaware law, that "the same set of facts can give rise both to a direct claim and a derivative claim" (*Grimes v Donald*, 673 A2d 1207, 1212 [Del. 1995] [citing *Bennett v Breuil Petroleum Corp.*, 99 A2d 236, 241 [Del. Ch. 1953]]). However, in most derivative actions, "harm suffered by shareholders is only a natural and foreseeable consequence of the harm to the corporation." (*Agostino v Hicks*, 845 A2d 1110, 1119 [Del. Ch. 2004]). Therefore, to assert a direct claim, the shareholder, or member of the limited liability company must "allege more than an injury resulting from a wrong to the corporation." (*Grimes* at 1213 [citing *Kramer v Western Pacific*, 546 A2d 348, 351 [Del. 1988]]).

The second, third, ninth and tenth causes of action allege vast misappropriation by Schron from SMV and SWC in which CAM-Elm as majority member was complicit. Essentially, these are claims for waste, mismanagement and self-dealing which injured SWC and SMV. They are derivative in nature. (*see VGS, Inc. v Castiel*, 2003 WL 723285, *10 [Del. Ch. 2003]). The fourth, seventh, eleventh and fourteenth causes of action seek removal of Schron as manager of the Companies, an action which concerns the internal affairs of SWC and SMV, and is likewise a claim of the corporation. These claims amount to corporate waste and mismanagement and plaintiffs have not alleged any injury they have suffered independently.

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The company is an indispensable party in a derivative action. (*Sternberg v O'Neil*, 550 A2d 1105, 1124 [Del. 1988]). Discussing the nature of the derivative action, the Delaware Supreme Court stated "[i]f a claim belongs to the corporation, it is the corporation, acting through its board of directors, which must make the decision whether or not to assert the claim." (*Grimes*, 673 A2d at 1215). Here, the lack of Companies presence as defendants deprives them of opportunity to decide whether to take over the prosecution of the action.

Plaintiffs rely on *Vertical Computer Systems, Inc. v Ross Systems, Inc.*, 11 AD3d 375 (1st Dept 2004), for the proposition that the company need not be a defendant in a derivative action, but can be a plaintiff. The case does not stand for the proposition claimed. The court in *Vertical Computer Systems* never addressed the issue of whether the company needed to be a plaintiff or a defendant. In fact, it never even addressed the issue of whether the company was an indispensable party.

Here, the Companies are not parties to the action. Giving the plaintiffs an opportunity to amend their pleadings and include the Companies as defendants would be futile because, pursuant to Section 9.4 of the Second Amended and Restated Operating Agreement of SMV Property Holdings LLC (and same of SWC Property Holdings LLC), "any claim against the Company under this Agreement must be brought in the federal or state courts located in Delaware." (Engel Aff., Ex. B at 25, Ex. C at 24).

The Delaware Limited Liability Company Act (the LLC Act) was "designed to permit members maximum flexibility in entering into an agreement to govern their relationship." (*Elf Atochem North America, Inc. v. Jaffari*, 727 A2d 286, 293 [Del. 1999]). In *Elf*, the parties contracted to subject any disputes to the exclusive jurisdiction of the California courts. *Id.* at 294. The Delaware court decided that just because the LLC Act vested default subject-matter jurisdiction with the Court of Chancery, there was no reason "why the members [could not] alter the default jurisdictional provisions of the statute" and contract for a different venue for their claims under the agreement. *Id.* at 295.

Here, the claims arise from the actions Schron took in his capacity as the Companies' Manager. The claims against CAM-Elm are brought under Section 4.1(c)(ii) of the Companies' Operating Agreements and thus, arise under the Agreement. Therefore, the claims are governed by the Section 9.4 of the Agreement and should have been brought in Delaware.

1. Schron's motion to dismiss the sixteenth cause of action (breach of contract)

In the sixteenth cause of action, plaintiff Grunstein alleges that he and defendant Schron entered into an oral agreement in November 2007, in which Schron agreed to pay Grunstein $20 million for Grunstein's interests in Treetops II, Ltd. Plaintiff Grunstein further alleges that Schron breached the agreement by "failing to pay substantially all of the purchase price as required under the agreement." (Complaint, 188).

"The party pleading a cause of action for breach of contract must allege the existence of a contract between the parties, consideration, performance by the plaintiff, breach by the defendant and damages resulting from the breach." (*Finkelman v Greenbaum*, 14 Misc3d 1217(A) [Sup. Ct. Nassau County 2007] [citing *Furia v Furia*, 116 AD2d 694 [2d Dept 1986]]).

Here, the complaint lacks sufficient details about the existence of the contract to plead a cause of action for its breach. If this is an oral agreement as defendant alleges, "plaintiff should set forth all the relevant terms of that oral agreement." (*Bomser v Moyle*, 89 AD2d 202, 205 [1st Dept 1982]). Further, plaintiff Grunstein failed to plead his performance and damages.

2. Schron's motion to dismiss the seventeenth claim (defamation)

The seventeenth cause of action alleges that defendant Schron made certain defamatory statements about plaintiffs Grunstein and Foreman at a meeting of SMV shareholders. Schron moves to dismiss this cause of action on the ground that his statements were protected by the common interest privilege.

A communication is conditionally privileged if made to persons who share a common interest in a particular subject matter and is one which the speaker believes the audience has a right to know. (Rest 2d Torts §596; *see also Shapiro v Health Ins. Plan of Greater New York* 7 NY2d 56, 60 [1959]). The courts have given this qualified privilege broad application because of society's interest in fostering the free exchange of information among parties sharing a common interest (*see Grier v Johnson*, 23 AD2d 846, 847 [3d Dept 1996]). A commonly found application of the qualified privilege based on common interest of the publisher and recipient arises where the communication is made by a member of a board of directors to other directors and to senior officers of the organization (*see e.g., Foster v Churchill*, 87 NY2d 744 [1996]; *Liberman v Gelstein*, 80 NY2d 429 [1992]; *Ferguson v Sherman Square Rlty Corp.*, 30 AD3d 288 [1st Dept 2006]; and *Lerwick v Krna*, 29 AD3d 1206 [3d Dept 2006]). The members of a limited liability company fall

into the category of persons with common interests. (Rest 2d of Torts, § 596, Comment d ["fellow officers of a corporation for profit, fellow shareholders and fellow servants" are "conditionally privileged to communicate among themselves matter defamatory of others which concerns their common interests"]; *Garriga v Townsend,* 285 App Div 199, 201 [3d Dept 1954] ["the law recognizes a qualified privilege which may attach to communications within a business organization"].

The privilege granted is qualified and not absolute: "it may be overcome and defeated by a showing based on evidentiary facts that the defamatory statements were motivated by either 'actual malice', 'actual ill-will' or 'personal spite or culpable recklessness or negligence'." (*Stillman v Ford,* 22 NY2d 48, 53 [1968]).

While "a defense may provide a basis for dismissing a complaint if that defense is founded upon documentary evidence" (*Sokol v Leader*, 74 AD3d 1180, 1182 [2d Dept. 2010]), more often a "claim of qualified privilege is an affirmative defense to be raised in defendants' answer." (*Garcia v Puccio*, 17 AD3d 199, 201 [1st Dept 2005]). Since plaintiffs claim that Schron lost the qualified a privilege when he acted with malice, they have pleaded facts sufficient to withstand a motion to dismiss. The motion to dismiss the seventeenth cause of action against defendant Schron is denied.

Accordingly, it is

ORDERED that the motion of defendants Eli Schron, Avi Schron, Chaya Coheyn, Mark Schron, Miriam Scher, Bracha Rothstein, Jeffrey Schron and Samuel Schron to dismiss the complaint (Motion Seq. No. 003) is herein GRANTED and complaint is dismissed in its entirety as against said defendants, and the Clerk is directed to enter judgment accordingly in favor of said defendants; and it is further

ORDERED that the motion of defendants CAM-Elm Company LLC, Cammeby's Funding III LLC, Cammeby's Equity Holdings LLC and HSA Equipment LLC to dismiss the complaint (Motion Seq. No. 004) is GRANTED and complaint is dismissed in its entirety as against said defendants, and the Clerk is directed to enter judgment accordingly in favor of said defendants; and it is further

ORDERED that the motion of defendant Rubin Schron to dismiss the complaint (Motion Seq. No. 004) is GRANTED IN PART and the first through sixteenth causes of action of the complaint are dismissed and is DENIED as to the seventeenth cause of action; and it is further

ORDERED that the remaining cause of action is severed and continued as against defendant Rubin Schron; and it is further

ORDERED that defendant, Rubin Schron, is directed to serve an answer to the complaint within 20 days after service of a copy of this order with notice of entry; and it is further

ORDERED that counsel for the remaining parties shall appear for a preliminary conference on Wednesday, July 27, 2011 at 9:30 AM, in Part 49, Courtroom 252, 60 Centre Street, New York, New York; and it is further

ORDERED that counsel for the moving parties shall serve a copy of this order with notice of entry upon the County Clerk (Room 300) and the clerk of the Trial Support Office (Room 158).

This constitutes the Decision and Order of the Court.

DATED: June 16, 2011

E N T E R:

O. PETER SHERWOOD
J.S.C.