

**Apparelnet, Inc. v Automated Sys. Outsourcing
Provider LLC**

2012 NY Slip Op 33405(U)

March 27, 2012

Sup Ct, New York County

Docket Number: 650968/11

Judge: Anil C. Singh

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

HON. ANIL C. SINGH
SUPREME COURT JUSTICE

Index Number : 650968/2011
APPARELNET, INC.
vs
AUTOMATED SYSTEM OUTSOURCING
Sequence Number : 001
DISMISS

PART 67

INDEX NO.
MOTION DATE
MOTION SEQ. NO.

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

Upon the foregoing papers, it is ordered that this motion is decided in accordance with the attached order.

DECIDED IN ACCORDANCE WITH
ACCOMPANYING DECISION / ORDER

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

Dated: 3/27/12

HON. ANIL C. SINGH, J.S.C.
SUPREME COURT JUSTICE

- 1. CHECK ONE: CASE DISPOSED, NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: MOTION IS: GRANTED, DENIED, GRANTED IN PART, OTHER
3. CHECK IF APPROPRIATE: SETTLE ORDER, SUBMIT ORDER, DO NOT POST, FIDUCIARY APPOINTMENT, REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 61

-----X
APPARELNET, INC.,

Plaintiff,

-against-

Index No.
650968/11

AUTOMATED SYSTEM OUTSOURCING PROVIDER
LLC, RGA ACCESSORIES, INC. and WORLDWIDE
DREAMS, LLC,

Defendants.

-----X

ANIL C. SINGH, J.:

Plaintiff Apparelnet, Inc. (Apparelnet) seeks damages and equitable relief for defendants' control over, and failure to share the profits of, defendant Automated System Outsourcing Provider LLC (ASOP). The 10-count complaint asserts causes of action for breach of contract, specific performance, an accounting, conversion, unjust enrichment, statutory and common-law breaches of fiduciary duties, constructive trust, dissolution, and appointment of a receiver. Defendants move to dismiss the complaint pursuant to CPLR 3211(a)(1), (5) and (7) as time-barred, for failure to state a cause of action, and based upon documentary evidence. Apparelnet opposes the motion and cross-moves for an order disqualifying defendants' attorneys, the law firm Katten Muchin Rosenman LLP (KMR), based upon a conflict of interest.

Factual Allegations

The complaint alleges that Apparelnet was a provider of various on-line data and information processing services. Non-party Garpac Corporation (Garpac), an affiliate of Apparelnet, owned software programs, including the "Garpac 4GL Apparel Management (Informix based) System" (Garpac Software), and allegedly licensed the software to

Apparelnet. RGA Accessories, Inc. (RGA) is an accessories distributor.

On November 20, 1996, Apparelnet and RGA entered into a Computer Services Agreement, whereby Apparelnet was to provide online data services to RGA and its affiliates, utilizing the Garpac Software. In December 1997, Apparelnet, RGA and Garpac restructured their business relationship by forming ASOP. On December 19, 1997, Apparelnet and RGA entered into an Operating Agreement for ASOP (Operating Agreement), which defendants submit as documentary evidence. Cotton Aff., Ex. B. Under the Operating Agreement, Apparelnet and RGA are each a Member and a 50% owner. The Operating Agreement stated that "RGA and ApparelNet have determined to terminate the Prior Computer Services Agreement and have agreed to form the Company in order to provide to RGA and its authorized users a fully converted, functioning and integrated computer system" Operating Agreement, at § 2.3.

The Operating Agreement provided that ASOP was to acquire the Garpac Software, pursuant to a contemporaneously executed Software Licensing Agreement. *Id.*, at § 2.3.1. Defendants submit a copy of the Software Licensing Agreement, also dated December 19, 1997, entered into between Garpac and ASOP. Cotton Aff., Ex. D. Apparelnet alleges that, under the Software Licensing Agreement, "the only authorized use of the Garpac Software was for purposes of ASOP's operations as a service bureau providing computer services to RGA and its affiliated entities." Complaint, Cotton Aff., Ex. A, ¶ 13. Also on December 19, 1997, ASOP and RGA entered into a new Computer Services Agreement (1997 CSA), whereby ASOP was to provide RGA with online data and information processing services. Apparelnet claims that, under the 1997 CSA, RGA was to pay ASOP 1.5% of RGA's gross sales

processed through the data processing services provided by ASOP.

Apparelnet claims that, under the Operating Agreement, ASOP was to operate as a stand-alone company, separate and apart from Apparelnet and RGA, with its own employees and payroll, and that ASOP's employees were not to be used by Apparelnet, RGA or Garpac. The Operating Agreement also allegedly stated that ASOP's profits were to be allocated and distributed among its Members in proportion to each Member's membership interest, and that within 90 days of the end of each taxable year, each Member was to receive a complete accounting of ASOP's affairs for the year.

According to Apparelnet, shortly after ASOP's formation, RGA was reorganized and its assets, including its rights and obligations under the Operating Agreement, were assigned to defendant Worldwide Dreams, LLC (WWD). Apparelnet claims that, after ASOP's formation, the Garpac Software was customized to meet ASOP's needs in performing its computer services under the 1997 CSA. To that end, the software was allegedly "designed to enable ASOP to provide WWD with business support applications, including sales, purchase and production order processing, inventory control, accounting and financial statements, import planning and control, warehousing management, EDI linkages with WWD customers and suppliers and customer billing." Complaint, ¶ 22.

WWD allegedly assumed full operational control over the affairs of ASOP, including control over all financial matters, but failed to hold Member meetings and excluded Apparelnet from participating in the management and operations of ASOP. Apparelnet claims that, since early 2000, ASOP, at the direction of WWD, has refused to provide annual financial accountings for ASOP, as required under the Operating Agreement. WWD also allegedly

caused ASOP to refuse to pay Apparelnet its share of ASOP's profits and distributions. WWD allegedly diverted all of ASOP's business to WWD's own exclusive benefit, thereby depriving ASOP of the ability to engage in the business of a stand-alone service bureau.

Defendants' Motion to Dismiss

Breach of Contract (1st Cause of Action)

Defendants move to dismiss the first cause of action for breach of contract, arguing that it fails to put defendants on notice of the transactions or occurrences underlying the claim, and that this cause of action is undermined by the Operating Agreement.

“On a motion to dismiss the complaint pursuant to CPLR 3211(a)(7) for failure to state a cause of action, the court must afford the pleading a liberal construction, accept all facts as alleged in the pleading to be true, accord the plaintiff the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory” (Martin v. Liberty Mutual Insurance Company, 2012 WL 503597 [2d Dept., 2012] (internal citations omitted)). “In determining such a motion, the sole criterion is whether the subject pleading states a cause of action, and if, from the four corners of the compliant, factual allegations are discerned which, taken together, manifest any cause of action cognizable at law, then the motion will fail” (Id.) (internal citations and quotation marks omitted). “On a motion to dismiss based upon documentary evidence [under CPLR 3211(a)(1)], dismissal is only warranted if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law” (Id.) (internal citations and quotation marks omitted).

The elements of a cause of action for breach of contract are: 1) formation of a contract between plaintiff and defendant; 2) performance by plaintiff; 3) defendant's failure to perform;

and 4) resulting damage (Furia v. Furia, 116 A.D.2d 694, 695 [2d Dept., 1986]). In order to plead a breach of contract cause of action, a complaint must allege the provisions of the contract upon which the claim is based (Sud v. Sud, 211 A.D.2d 423 [1st Dept., 1995]).

In the instant action, plaintiff alleges that defendants breached two written agreements – the Operating Agreement and the Computer Services Agreement. Specifically, the complaint alleges that “ASOP, under the direction and control of WWD, has failed and/or refused to pay Plaintiff its share of ASOP’s profits and/or to award distributions to Plaintiff, all as required by the terms of the Operating Agreement” (Verified Complaint, para. 29). The complaint alleges further that, pursuant to the terms of the agreements, plaintiff is entitled to a pro rata amount of any revenue distributable by ASOP; that defendants have breached their obligations under the agreements; and that plaintiff has sustained monetary damages (Verified Complaint, paras. 37-39).

After careful consideration, the Court finds that the facts alleged in the complaint are sufficient to state all the elements of a cause of action for breach of contract.

Specific Performance & Accounting (2nd and 3rd Causes of Action)

The second cause of action alleges that “[t]he failure to provide [Apparelnet] with an accounting of ASOP’s profits and losses and its affairs for ... each tax year commencing with tax year 1997 constitutes a willful default under the terms and conditions of the Operating Agreement.” Complaint, ¶ 41. The complaint then refers to section 9.4 of the Operating Agreement, which is titled “Specific Performance,” and provides as follows:

The parties recognize that irreparable injury will result from a breach of any provision of this Agreement and that money damages will be inadequate to fully remedy the injury.

Accordingly, in the event of a breach or threatened breach of one or more of the provisions of this Agreement, any party who may be injured (in addition to any other remedies which may be available to that party) shall be entitled to one or more preliminary or permanent orders (i) restraining and enjoining any act which would constitute a breach or (ii) compelling the performance of any obligation which, if not performed, would constitute a breach.

See also Complaint, ¶ 42. The third cause of action alleges that WWD controlled ASOP and usurped ASOP's operations, and demands an accounting of ASOP for tax years 1997 to present. *Id.*, ¶¶ 46, 49. Apparelnet claims that "ASOP has failed to provide [an] accounting despite the clear and unequivocal provisions of the Operating Agreement." *Id.*, ¶ 50.

The statute of limitations for an accounting is six years. CPLR 213; *Dryden Hotel Assoc. v Grimbilas*, 226 AD2d 163, 164 (1st Dept 1996). This action was commenced in April 12, 2011. Therefore, as the second and third causes of action both seek an accounting, they are time-barred for tax years prior to April 2005.

Moreover, as discussed above, it was incumbent upon both Members of ASOP to "cause ... a complete accounting of the affairs of the Company for the taxable year then ended." Operating Agreement, § 8.4. Having failed to allege that Apparelnet attempted to cause such an accounting, that it was ever thwarted by WWD in trying to do so, or that Apparelnet ever requested such an accounting from WWD, Apparelnet does not properly allege that defendants failed to perform under the Operating Agreement. Therefore, to the extent that these claims are timely, they are dismissed for failure to allege a breach of the Operating Agreement upon which they are based.

These causes of action are dismissed for the additional reason that they are duplicative

of Apparelnet's first cause of action for breach of contract. *Kurzman Karelsen & Frank v Kaiser*, 283 AD2d 330, 331 (1st Dept 2001) (affirming dismissal of "breach of fiduciary duty, accounting, conversion, and money had and received claims" as "either unfounded or duplicative of the breach of contract claim").

Conversion (4th Cause of Action)

The fourth cause of action for conversion is based upon the allegation that "WWD through its control and domination of ASOP, has converted Plaintiff's share of ASOP's distributions to its own use and benefit." Complaint, ¶ 54.

A conversion takes place when someone, intentionally and without authority, assumes or exercises control over personal property belonging to someone else, interfering with that person's right of possession. Two key elements of conversion are (1) plaintiff's possessory right or interest in the property and (2) defendant's dominion over the property or interference with it, in derogation of plaintiff's rights.

Colavito v New York Organ Donor Network, Inc., 8 NY3d 43, 49-50 (2006) (internal citations omitted). A claim for conversion of money must involve "a specific, identifiable fund and an obligation to return or otherwise treat in a particular manner the specific fund in question."

Manufacturers Hanover Trust Co. v Chemical Bank, 160 AD2d 113, 124-125 (1st Dept 1990).

The conversion cause of action is dismissed because it is "predicated on a mere breach of contract, and no independent facts are alleged giving rise to tort liability." *Kopel v Bandwidth Tech. Corp.*, 56 AD3d 320, 320 (1st Dept 2008); see also *Richbell Info. Servs. v Jupiter Partners*, 309 AD2d 288, 306 (1st Dept 2003).

Unjust Enrichment (5th Cause of Action)

The fifth cause of action for unjust enrichment is based upon Apparelnet's alleged

entitlement to “distributions from ASOP on a par with those, or other things of value received by WWD from ASOP.” *Id.*, ¶ 59. Thus, the unjust enrichment claim is based upon the same alleged right to receive distributions that are alleged in Apparelnet’s breach of contract cause of action, which is based upon the Operating Agreement. This “quasi-contractual claim is therefore barred by the existence of a valid and enforceable written contract.” *Frydman & Co. v Credit Suisse First Boston Corp.*, 272 AD2d 236, 238 (1st Dept 2000).

Breach of Fiduciary Duty (6th and 7th Causes of Action)

The sixth cause of action alleges that WWD breached section 409(a) of New York’s Limited Liability Company Law (LLC Law), by controlling ASOP and usurping ASOP’s operations for WWD’s own benefit, and by depriving ASOP from operating as a stand-alone business and diverting its revenues to WWD. Complaint, ¶ 63. The seventh cause of action asserts a claim for common-law breach of fiduciary duty, based upon the same allegations.

To the extent that these causes of action are based upon WWD “systematically exclud[ing]” Apparelnet from “participating in the management, operation and affairs of ASOP” (*id.*, ¶ 27), WWD’s failure to pay Apparelnet its share of ASOP’s profits and distributions (*id.*, ¶ 29), and otherwise failing to comply with the Operating Agreement, they must be dismissed as duplicative of the breach of contract cause of action. *LaSalle Hotel Lessee, Inc. v Marriott Hotel Servs., Inc.*, 29 AD3d 464, 465 (1st Dept 2006). Apparelnet’s remaining allegations “are either expressly raised in [its] breach of contract claim or encompassed within the contractual relationship by the requirement implicit in all contracts of fair dealings and good faith,” thereby requiring dismissal for failure to “set forth allegations that, apart from the terms of the contract, the parties created a relationship of higher trust than

would arise from [their contracts] alone, so as to permit a cause of action for breach of a fiduciary duty independent of the contractual duties.” *Brooks v Key Trust Co. Natl. Assn.*, 26 A.D.3d 628, 630 (3d Dept 2006) (internal quotation marks and citations omitted).

To the extent that Apparelnet’s allegations could be construed as independent of the breach of contract cause of action, they fail to allege direct claims for breach of fiduciary duty. For instance, Apparelnet alleges that “WWD has diverted all of the business and business opportunities of ASOP to its own exclusive benefit, thereby depriving ASOP of the ability to engage in the business of a stand-alone service bureau” (Complaint, ¶ 31), and that “WWD, while enjoying all of the benefits of the computer services it contracted to obtain from ASOP, has failed and refused to pay ASOP the compensation it agreed to pay pursuant to the [1997 CSA]” (*id.*, ¶ 32). However, these allegations are derivative in nature, in that they fail to identify a duty owed to Apparelnet independent of any duty owed to ASOP. *Abrams*, 66 NY2d at 953. Apparelnet does not assert these claims derivatively, and, therefore, they must be dismissed. *Id.* In addition, the allegations of WWD’s dominance and control, and its purported diversion of unspecified business opportunities, are not pled with sufficient particularity, as required under CPLR 3016(b). *Burry v Madison Park Owner LLC*, 84 AD3d 699, 700 (1st Dept 2011).

Although the court need not reach the statute of limitations in order to dismiss these causes of action, the court notes that the breach of fiduciary duty causes of action are time-barred to the extent that they are based upon occurrences prior to April 12, 2008. *IDT Corp. v Morgan Stanley Dean Witter & Co.*, 12 NY3d 132, 140 (2009) (“three-year limitations period of CPLR 214 [4] applies” to breach of fiduciary duty cause of action, where plaintiff seeks

money damages). For the foregoing reasons, defendants' motion to dismiss the sixth and seventh causes of action is granted.

Constructive Trust (8th Cause of Action)

Apparelnet's eighth cause of action seeks to impose a constructive trust upon the assets "wrongfully diverted from Plaintiff and in the possession of WWD." Complaint, ¶ 74. "The elements necessary for the imposition of a constructive trust are a confidential or fiduciary relationship, a promise, a transfer in reliance thereon, and unjust enrichment." *Abacus Fed. Sav. Bank v Lim*, 75 AD3d 472, 473-474 (1st Dept 2010). Apparelnet fails to allege a promise or a transfer in reliance thereon, based upon the Operating Agreement. Nor has Apparelnet alleged unjust enrichment, for the reasons stated herein. Accordingly, defendants' motion to dismiss the eighth cause of action is granted.

Judicial Dissolution (9th Cause of Action)

The ninth cause of action seeks dissolution of ASOP, pursuant to section 702 of the LLC Law, based upon WWD allegedly: excluding Apparelnet from the operations and affairs of ASOP, failing to account to Apparelnet concerning ASOP's profits and losses, excluding Apparelnet from participating in ASOP's management and its disposition of property, failing to hold meetings of the members, and failing to pay Apparelnet its share of ASOP's profits and distributions. Complaint, ¶ 76.

Under section 702 of the LLC Law, the court "may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." Therefore, dissolution under section 702 "is initially a contract-based analysis." *In re 1545 Ocean Ave., LLC*, 72

AD3d 121, 128 (2d Dept 2010). Section 702 has been construed as requiring a showing, “in the context of the terms of the operating agreement or articles of incorporation; that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible.” *Id.* at 131.

Here, the Operating Agreement states that “Unanimous consent of both Members shall be necessary to effect ... the dissolution ... of the Company as set forth in Article 7 hereof.” Operating Agreement, § 5.1.8. However, Apparelnet does not allege any event that would trigger dissolution under Article 7, and it fails to identify any provision of the Operating Agreement that requires meetings of the members. To the contrary, the Operating Agreement provides that “[a] meeting of the Members *may* be called at any time by any Member.” *Id.*, § 5.3.1 (emphasis added). Moreover, none of Apparelnet’s allegations show that the continuation of ASOP is financially unfeasible.

In opposition to defendants’ motion, Apparelnet cites *Matter of Spires v Lighthouse Solutions, LLC* (4 Misc 3d 428 [Sup Ct, Monroe County 2004]). In *Spires*, the court granted dissolution in the absence of an express operating agreement, because: the evidence demonstrated that the petitioner wanted to withdraw as a member of the limited liability company and/or that the respondents wanted to remove the petitioner as a member; all three members wanted to end the business relationship; and the petitioner was locked out of the business by the physical change of locks and computer passwords. *Spires*, 4 Misc 3d at 437. There are no such allegations in the instant action. Therefore, *Spires* is distinguishable on its facts. Apparelnet also relies upon *Matter of Roller* (259 AD2d 1012, 1012 [4th Dept 1999]) for

the unremarkable proposition that a motion to dismiss should be denied where the pleading “adequately states a cause of action for judicial dissolution,” which Apparelnet fails to do here. Accordingly, defendants’ motion to dismiss the ninth cause of action is granted.

Appointment of Receiver (10th Cause of Action)

In the tenth cause of action, Apparelnet requests the appointment of a receiver to wind up the affairs of ASOP and maintain the status quo pending the resolution of this action.

The jurisdiction exercised by courts of equity to appoint receivers is exercised to prevent injury to the thing in controversy and to preserve it for the security of all parties in interest to be disposed of as the court may finally direct. From its very nature the remedy is provisional. It never is the ultimate object of the action.

Greene v New York United Hotels, 236 App Div 647, 649 (1st Dept 1932); *Old Republic Natl. Tit. Ins. Co. v Cardinal Abstract Corp.*, 14 AD3d 678, 681-682 (2d Dept 2005) (cause of action for appointment of receiver dismissed, because “[t]he appointment of a receiver is not a form of ultimate relief that can be awarded in a plenary action, but rather, is limited as a provisional remedy [see CPLR 6401 (a)] or as an aid in post-judgment enforcement [see CPLR 5228]”).

None of Apparelnet’s allegations support the conclusion that “there is danger that the property will be removed from the state, or lost, materially injured or destroyed.” CPLR 6401(a). Apparelnet relies upon section 703(a) of the LLC Law, which provides that, “[u]pon cause shown, the supreme court ... may wind up the limited liability company’s affairs upon application of any member ..., and in connection therewith may appoint a receiver or liquidating trustee.” However, the Court finds that Apparelnet fails to allege cause for winding

up ASOP's affairs. Therefore, defendants' motion to dismiss the tenth cause of action is granted.

Apparelnet's Cross-Motion for Disqualification

The cross-motion to disqualify KMR is based upon Apparelnet's assertion that ASOP has potential claims against WWD, and that the continued dual representation of these defendants constitutes a conflict of interest under Rule 1.7 of the New York Rules of Professional Conduct.

Rule 1.7(a) provides that "a lawyer shall not represent a client if a reasonable lawyer would conclude that ... the representation will involve the lawyer in representing differing interests." 22 NYCRR § 1200. Here, however, none of the direct claims are properly asserted against ASOP. Specifically, the first cause of action claims that WWD breached the Operating Agreement by failing to pay Apparelnet's share of revenue distributable by ASOP, and by "caus[ing] ASOP to do the same." Complaint, ¶ 38. While ASOP is the subject of the Operating Agreement, it is not a party to that agreement (Operating Agreement, Cotton Aff., Ex. B), and ASOP cannot breach a contract to which it is not a party. *Noise In the Attic Prods., Inc. v London Records*, 10 AD3d 303, 306 (1st Dept 2004) (breach of contract requires allegations of the existence of an agreement, performance, and damages).

Apparelnet fails to identify any existing conflict with respect to KMR's representation concerning the claim, or any potential for compromised loyalty or "affecting[] the obligations of the professional relationship." *Flores v Willard J. Price Assoc., LLC*, 20 AD3d 343, 344 (1st Dept 2005). Nor is there any indication that "open dialogue" between KMR and ASOP would be hampered by representing both WWD and ASOP (*id.* at 345), and the motion to disqualify,

based upon the existence of any purported conflict concerning these claims, is premature at this juncture.

Accordingly, it is hereby

ORDERED that defendants' motion to dismiss the complaint is granted in part, and the second, third, fourth, fifth, sixth, seventh, eighth, ninth and tenth causes of action are dismissed; and it is further

ORDERED that defendants are 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 the cross-motion to disqualify KMR is denied; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 320, 80 Centre Street, on June 6TH, 2012, at 9:30 AM.

DATE: 3/27/12
New York, New York



HON. ANIL C. SINGH
SUPREME COURT JUSTICE