

Knox, LLC v Capital L. Group, LLC
2013 NY Slip Op 31650(U)
July 22, 2013
Supreme Court, New York County
Docket Number: 651880/2012
Judge: Eileen Bransten
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

HON. EILEEN BRANSTEN
J.S.C.

PRESENT: _____
Justice

PART 3

Index Number : 651880/2012
KNOX, LLC D/B/A KNOX, LLC OF
vs.
CAPITAL L GROUP, LLC
SEQUENCE NUMBER : 002
DISMISS

INDEX NO. 651880/2012
MOTION DATE 3/12/13
MOTION SEQ. NO. 002

The following papers, numbered 1 to 3, were read on this motion to/for dismiss

Notice of Motion/Order to Show Cause — Affidavits — Exhibits No(s) 1
Answering Affidavits — Exhibits No(s) 2
Replying Affidavits No(s) 3

Upon the foregoing papers, it is ordered that this motion is

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 7-22-13

Eileen Bransten, J.S.C.
EILEEN BRANSTEN
J.S.C.

- 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 THREE

-----X
KNOX, LLC d/b/a KNOX, LLC OF NEW YORK and
DJW ADVISORS, LLC,

Plaintiffs,

-against-

Index No. 651880/2012
Motion Date: 3/12/2013
Motion Seq. No.: 002

CAPITAL L GROUP, LLC, JOHN R. LAKIAN,
DIANE W. LAMM, and JRL INVESTMENT GROUP,
INC.,

Defendants.

-----X
BRANSTEN, J.

Defendants John R. Lakian, Diane W. Lamm, and JRL Investment Group, Inc.

(“JRL”) (collectively “Moving Defendants” or “Defendants”) bring the instant motion to dismiss all counts asserted against them in Plaintiffs Knox, LLC (“Knox”) and DJW Advisors, LLC’s (“DJW”) Amended Complaint. Plaintiffs oppose the motion in its entirety. For the reasons that follow, Defendants’ motion is granted in part and denied in part.

I. Background

This matter stems from Plaintiffs’ investment in Defendant Capital L Group, LLC¹ (“Capital L” or “the Company”), a financial services business. Plaintiffs entered into

¹ Defendant Capital L is not a party to the instant motion to dismiss. Indeed, the Court has granted Plaintiffs’ motion for default judgment against Capital L (motion sequence 003).

Subscription Agreements with Capital L on February 4, 2011 whereby Knox purchased 1,934,350 common units of Capital L for \$2,000,000 and became a Member of the Company. (Am. Compl. ¶ 9.) Through the same agreements, DJW purchased 48,358 common units of Capital L for \$50,000 and likewise became a Member of the Company. *Id.* At that time, Defendant Lakian served as the CEO and Manager of Capital L, while Defendant Lamm was the COO. *Id.* ¶¶ 13, 14.

Prior to entering into the Subscription Agreements, Plaintiffs allege that Defendants Lakian, Lamm, and JRL made certain representations to Knox and DJW regarding their prospective investments. Specifically, Plaintiffs state that they were told that their investments “would be used by Capital L solely in furtherance of the operation of its financial services business and to accelerate its acquisition of investment advisors and transfer of their assets under management.” *Id.* ¶ 10. Plaintiffs allege that these representations were made in conversations between and among Lakian, Lamm, and Plaintiffs’ representative Don Whelley during eight phone calls and meetings occurring between July 29, 2010 and February 2, 2011. *Id.* (listing specific dates for each meeting or call and individual participants).

While Plaintiffs signed the Subscription Agreements and made their investments thereunder, Plaintiffs allege that the investments were never delivered to Capital L. *Id.* ¶

16. Instead, Lakian and Lamm purportedly diverted Knox and DJW's capital contributions for their personal use. *Id.* ¶ 15.

Plaintiffs initiated the pending action on May 31, 2012 and filed the Amended Complaint on October 5, 2012. The Amended Complaint asserts four claims against the Moving Defendants: fraudulent inducement; fraud; breach of fiduciary duty; and, conversion. In addition, Plaintiffs request a constructive trust, as well as punitive damages.

II. Motion to Dismiss

The Moving Defendants now seek dismissal of all counts asserted against them in the Amended Complaint, arguing that each fails to state a claim. Each argument will be addressed below in turn.

A. Fraudulent Inducement

Defendants principally attack Plaintiffs' fraudulent inducement claim (Count Eight) on the basis that it lacks the particularity mandated by CPLR 3016(b). Specifically, Defendants assert that Plaintiffs fail to comply with CPLR 3016(b) with respect to two elements of their claim: scienter and misrepresentation.

CPLR 3016(b) provides that where a cause of action is based on fraud, “the circumstances constituting the wrong shall be stated in detail.” As explained by the First Department in *Houbigant, Inc. v. Deloitte & Touche*, 303 A.D.2d 92, 97 (1st Dep’t 2003), “[t]he language of CPLR 3016(b) merely requires that a claim of fraud be pleaded in sufficient detail to give adequate notice.” Therefore, “[a]lthough under section 3016(b) the complaint must sufficiently detail the allegedly fraudulent conduct, that requirement should not be confused with unassailable proof of fraud.” *Pludeman v. N. Leasing Sys., Inc.*, 10 N.Y.3d 486, 492 (2008). Accordingly, “section 3016(b) may be met when the facts alleged are sufficient to permit a reasonable inference of the alleged conduct.” *Id.*

1. Scienter

With regard to scienter, “it should be sufficient that the complaint contains a rational basis for inferring that the misrepresentation was knowingly made.” *Houbigant, Inc.*, 303 A.D.2d at 98 ; *see also* *AIG Fin. Prod. Corp. v. ICP Asset Mgmt., LLC*, 2013 WL 3388058, at *2 (1st Dep’t July 9, 2013) (“In any event, all that is needed to overcome a motion to dismiss a fraud claim is a rational inference of actual knowledge.”). Here, Plaintiffs assert that they were induced to make their investments in Capital L based on Lakian, Lamm, and JRL’s assertions² that their contributions would be used by Capital L

² Plaintiffs state that JRL made its misrepresentations through its CEO, Defendant Lakian.

in furtherance of the operation of Capital L's business. (Am. Compl. ¶ 59.) Plaintiffs further assert that Lakian, Lamm, and JRL knew that these representations were false and fraudulent when made. *Id.* ¶ 60. As support for this assertion, Plaintiffs cite to an email sent by Defendant Lamm on February 15, 2011, requesting that monies be transferred from Defendant JRL's account to accounts in the names of Defendants Lakian and Lamm, as well as to another JRL entity. *See* Am. Compl. Ex. D. Plaintiffs assert that the Lakian and Lamm accounts in this email were personal accounts and that the funds were diverted for personal use. *Id.* ¶¶ 15-16. This email, sent eight days after Plaintiffs allege that their investment monies were received, is not "unassailable proof of fraud," nor are Plaintiffs required to make such a showing to state a claim. Instead, giving Plaintiff all favorable inferences, as the Court must on this motion, the Court concludes that the pleading contains some rational basis for inferring that the Moving Defendants knowingly misrepresented to Plaintiffs that their capital contributions would be used to operate Capital L.

Plaintiffs likewise assert that they were induced to make their capital contributions to a JRL account – instead of directly to Capital L – by Moving Defendants' representation that it was necessary for "regulatory reasons." (Am. Compl. ¶ 59.) Plaintiffs also allege that they relied on this representation. *Id.* ¶ 61. Defendants object to this portion of Plaintiffs' fraudulent inducement claim, arguing that it is "illogical."

(Defs.' Reply Br. at 2.) Defendants state that "it makes no sense to contend that the fact that the money was wired to JRL instead of the Company is indicative of fraud where, as here, the Company is alleged to have been a participant in the misconduct." *Id.*

However, reading the Amended Complaint liberally and giving all required inferences to Plaintiffs, the Court concludes that this theory sufficiently alleges scienter. The Complaint could reasonably be read to assert that the monies were diverted to JRL so to facilitate Moving Defendants' transfer of the funds to their personal accounts. The Court struggles to see how the Company's participation in the alleged misconduct dictates (or vitiates) the existence of the claim.

Accordingly, Defendants' motion to dismiss Plaintiffs' fraudulent inducement claim on this basis is denied.

2. Misrepresentation

In addition to challenging Plaintiffs' scienter pleading, Defendant Lamm likewise contends that the Amended Complaint fails to allege with particularity that she made a misrepresentation to Plaintiffs. Lamm argues that the Plaintiffs merely allege her presence at certain meetings and do not plead that she made the misstatements at issue.

Here, Plaintiffs have pleaded sufficient detail to satisfy the dictates of CPLR 3016(b). Plaintiff has pleaded the dates of the misstatements allegedly made and where

they were made, as well as the contents of such statements. (Am. Compl. ¶ 10.) On this basis, the instant pleading is distinguishable from the two cases cited by Defendants in their papers – *DiPace v. Figueroa*, 128 A.D.2d 942, 943 (3d Dep’t 1987) and *Rand Int’l Leisure Prod., Inc. v. Bruno*, 22 Misc.3d 1111(a), at *4 (Sup. Ct. Nassau Cnty. 2009). Unlike *DiPace* and *Rand International*, this is not a case in which Plaintiffs offered generalized allegations of wrongdoing or lumped all parties together, attributing misstatements to “Defendants” collectively. Accordingly, the Court concludes that the Amended Complaint states sufficiently particularized allegations as to Defendant Lamm regarding misrepresentations made to Plaintiffs. Thus, Defendant Lamm’s motion to dismiss is denied.

B. *Fraud*

Defendants next seek dismissal of Plaintiff’s fraud claim (count nine). Defendants attack this claim on the same grounds that they attacked the fraudulent inducement claim. As discussed above, the Court sustained Plaintiff’s fraudulent inducement claim; therefore, Defendants’ arguments likewise fail as to Plaintiff’s fraud claim.

C. *Breach of Fiduciary Duty and Conversion Claims*

Defendants next seek dismissal of Plaintiffs' breach of fiduciary duty (count four) and conversion (count seven) claims, arguing that Plaintiffs' claims are derivative and that they therefore lack standing to assert either claim. Since each claim asserts a harm, as well as a remedy, to the Company, the Court concludes that Defendants are correct and that the motion to dismiss is granted.

Plaintiffs allege here that they entered into Subscription Agreements with Capital L whereby they made investments in Capital L. After these funds were paid and before Capital L received the funds it was due, Plaintiffs contend that the Moving Defendants diverted the funds to themselves. These allegations form the basis for Plaintiffs' breach of fiduciary duty and conversion claims.

Under Delaware law,³ the analysis of whether a claim is direct or derivative "turn[s] solely on the following questions: (1) who suffered the alleged harm (the corporation or the suing shareholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). The harm alleged with respect to both the fiduciary duty and conversion claim is

³ Since Capital L is incorporated in the state of Delaware, Delaware law applies to the question of whether claims are direct or derivative. See *Finkelstein v. Warner Music Group Inc.*, 32 A.D.3d 344, 345 (1st Dep't 2006).

harm to Capital L. Due to the Moving Defendants' alleged actions, the Company did not receive the funds due to it under the Subscription Agreements. Moreover, any recovery here would inure to the benefit of Capital L, as it would receive the investment to which it was contractually entitled under the Agreements. Accordingly, Defendants' motion to dismiss counts four and seven is granted.

D. *Constructive Trust*

Defendants offer no basis for dismissal of Plaintiffs' constructive trust claim, aside from their assertion that all of the other claims should be dismissed, rendering constructive trust inapplicable. Since Plaintiffs' fraud claim is sustained, Defendants present no argument for dismissal of count ten. Therefore, Defendants' motion is denied.

E. *Punitive Damages*

Finally, Plaintiffs seek punitive damages for their fraud claims. Punitive damages "may not be awarded to redress a private wrong, and accordingly ... such damages are not available in the ordinary fraud and deceit case." *Kelly v. Defoe Corp.*, 223 A.D.2d 529, 529 (2d Dep't 1996). Instead, exemplary damages are "permitted only when a defendant's wrongdoing is not simply intentional but evince[s] a high degree of moral turpitude and demonstrate[s] such wanton dishonesty as to imply a criminal indifference

to civil obligations.” *Hoeffner v. Orrick, Herrington & Sutcliffe LLP*, 85 A.D.3d 457, 458 (1st Dep’t 2011) (citations omitted). Plaintiff must demonstrate “circumstances of aggravation or outrage, or a fraudulent or evil motive on the part of the defendant.” *Id.*

Here, from the face of Plaintiffs’ pleading, taking all of their allegations as true, the misconduct alleged here does not resemble the egregious wrongdoing required for a punitive damages claim. Instead, this is an “ordinary fraud and deceit case,” for which punitive damages are not warranted. *See Kelly*, 223 A.D.2d at 529. Thus, Plaintiffs’ prayer for punitive damages is denied.

(Order follows on next page.)

ORDER

Accordingly, it is hereby

ORDERED that Defendants John R. Lakian, Diane W. Lamm, and JRL Investment Group, Inc.'s motion to dismiss is granted as to counts four and seven of Plaintiffs' Amended Complaint and Plaintiffs' prayer for punitive damages, and is otherwise denied; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 442, 60 Centre Street, on September 10, 2013, at 10 AM.

This constitutes the decision and order of the court.

Dated: New York, New York
July 22, 2013

ENTER



Hon. Eileen Bransten, J.S.C.