SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER Justice

PART 45

JPS PARTNERS

-v-

MORETON BINN et al

INDEX NO. 650430/12

MOTION DATE _____

MOTION SEQ. NO. 004

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). _____

Answering Affidavits — Exhibits _____ | No(s). _____

Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion is by defendants to dismiss the complaint is DENIED in part and GRANTED in part for the attached Decision and Order.

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

Dated: April 5, 2013

Melvin L. Schweitzer 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 : PART 45

JPS PARTNERS in its own right, and derivatively in the right of BINN AND PARTNERS, LLC, Plaintiffs, -against- MORETON BINN, an individual, GUGGENHEIM SECURITIES, LLC, MISTRAL EQUITY PARTNERS, MISTRAL CAPITAL MANAGEMENT, LLC, and LILAC VENTURES MASTER FUND, LTD. Defendants, -and- BINN AND PARTNERS, LLC, Nominal Defendant.	Index No. 650430/12 DECISION AND ORDER Motion Sequence No. 004

MELVIN L. SCHWEITZER, J.:

JPS Partners (JPS) brings this action, in its own right, and derivatively in the right of Binn and Partners, LLC (Binn), against Moreton Binn (Mr. Binn) and Binn nominally (collectively referred to as the Binn defendants), for dissolution of Binn, breach of fiduciary duty, corporate diversion, breach of contract and an equitable accounting. Binn operates spas in airports around the world. Mr. Binn and Binn move to dismiss JPS's complaint pursuant to CPLR 3013, 3211 (a) (1), 3211 (a) (3) and 3211 (a) (7) on the grounds that JPS failed to properly plead demand futility, dissolution of Binn is unfounded pursuant to Binn's operating agreement and the New York Limited Liability Company Law, Mr. Binn did not breach his fiduciary duty to JPS or Binn, and Mr. Binn did not breach the operating agreement.

Background

Facts are taken from JPS's complaint.

JPS, a New York unincorporated association is a business venture between Mr. Jonathan and Peter Sobel. Binn is a New York limited liability company. Binn operates pursuant to the Third Amended and Restated Operating Agreement, dated June 16, 2008 (Operating Agreement). Mr. Binn is the manager of Binn. Mr. Binn and his wife, Marisol Binn, together control over 55% of Binn. JPS holds a 1.93% interest in Binn.

Prior to February 16, 2012, Binn held a controlling interest in subsidiaries branded as Xpress Spa. In a January 30, 2012 letter, Mr. Binn informed the members of Binn about a proposal by Mistral Capital Management (Mistral) to invest $23 million in Binn in consideration of a 42% equity interest in the enterprise. The letter described the investment as a recapitalization. It went on to explain that the investment capital would be used to reduce the bank debt Binn owed to Bank of America and to grow the Xpress Spa brand. The letter stated that investment funds would not be used to make distributions. The letter requested the members consent to the proposed transaction.

JPS opposed the transaction and filed its initial complaint on February 15, 2012. JPS sought a temporary restraining order and preliminary injunction to stop the meeting to vote on the Mistral proposal. The court denied relief.

On February 16, 2012, members of Binn, by majority vote, approved the Mistral transaction, pursuant to which Mistral purchased an equity interest in the spa business of Binn for $23.8 million in following manner:

First, Binn contributed its entire interest in the subsidiaries through which it operated its spa business to XpressSpa Holdings, LLC (Holdings), a newly formed Delaware limited liability company. Holdings was initially a wholly owned subsidiary of Binn; then Mistral purchased the equity interest in Holdings.

JPS claims that the January 30, 2012 letter falsely described the transaction as a recapitalization. JPS alleges that after Mr. Binn transferred the assets of Binn to Holdings, Binn was decapitalised and Holdings was capitalized with money from Mistral, and with assets formerly under the control of Binn. JPS asserts that since the entire XpressSpa business has been transferred to Holdings, a foreign limited liability company, Binn must be dissolved pursuant to the terms of its Operating Agreement, and the New York Limited Liability Company Law.

JPS alleges that Mr. Binn breached fiduciary duties owed to Binn and JPS. JPS alleges that Mr. Binn placed his own financial interest ahead of the interest of Binn and JPS. In this respect, it is alleged that following the transaction, Mr. Binn was repaid a portion of the loan he had made to Binn; the outstanding loan was refinanced at 12% (compounded monthly) from 10% per annum; Mr. Binn received unspecified salary, bonuses and equity kickers; and Mr Binn significantly reduced his guarantee of the loan which had been in place since 2008.

The complaint alleges that Mr. Binn received an improper payment of $1.084 million when he exercised his put options (set to expire on February 29, 2012). JPS alleges that the payment was possible only as result of the transaction with Mistral, and the put options were exercised the day of the closing of the transaction, February 23, 2012. JPS claims that had the transaction not closed, Mr. Binn could have exercised his options, but would have received obligations from Binn, instead of cash. Based on these allegations, JPS asserts that the Mistral transaction did not provide any economic benefit to Binn.

JPS claims that Mr. Binn looted the assets of Binn by transferring all its assets to Holdings (a Mistral controlled entity), and converting Binn from an entity with a controlling interest in a spa business into a non-controlling nominal parent of Holdings.

Prior to filing the amended complaint, JPS did not make a demand on Binn. JPS claims that a pre-action demand would have been futile.

JPS alleges that the transaction was made possible because of Mr. Binn's majority interest in Binn, and that his voting of the units he controlled was the only vote necessary to make the transaction possible. JPS alleges that Mr. Binn, in his capacity as the manager of Binn, is empowered by the Operating Agreement to enter into and execute all contracts and agreements on behalf of Binn. No decision with respect to any matter within the scope of Binn's business could be made unless approved by Mr. Binn. Mr. Binn is entitled to an additional and deciding vote in the event of a board deadlock. JPS alleges that some of the members on Binn's board were interested in the transaction, while the disinterested members had no authority to act on behalf of Binn without Mr. Binn's approval.

JPS alleges that the details of the February 16, 2012 transaction, including the consequences for minority members, were not adequately communicated to the disinterested members, prior to the transaction. JPS alleges that since the transaction was such an egregious oppression of the interests of the minority members, for the benefit of Mr. Binn, that it could not have been a product of sound business judgment. Based on these allegations, JPS claims that given the extent of dominance and control Mr. Binn exercised on the board, the board of Binn would not have been in favor of pursuing litigation and demand was futile.

Discussion

On a motion to dismiss for failure to state a claim, the court accepts all factual allegations pleaded in plaintiffs complaint as true, and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich,* 11 AD3d 120 (1st Dept 2004). The court must determine whether "[from the complaint's] four corners [,] factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Gorelik v Mount Sinai Hosp. CTR.,* 19 AD3d 319, 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 26888, 275 (1977)). Vague and conclusory allegations, however, are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD 2d 113 (1st Dept 2003).

On a motion to dismiss on the ground that defenses are founded upon documentary evidence, evidence must be unambiguous, authentic and undeniable. CPLR 3211 (a) (1); *Fontanetta v Doe*, 73 AD3d 78 (2d Dept 2010). "To succeed on a [CPLR 3211 (a) (1)] motion . . . a defendant must show that the documentary evidence upon which the motion is predicated resolves all factual issue as a matter of law and definitively disposes of the plaintiff's claim." *Ozdemir v Caithness Corp.*, 285 AD2d 961, 963 (3d Dept 2001), *leave to appeal denied* 97 NY2d 605. In other words, "documentary evidence must utterly refute plaintiff's factual allegation, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of New York*, 98 NY2d 314, 326 (2002).

Failure to plead Demand

JPS Partners first, second, third, seventh and ninth causes of action are derivative actions. In a derivative action, the member who seeks to file such a claim is required to first serve a demand upon the company. BCL 626 (c); *Bansbach v Zinn*, 1 NY3d 1, 8 (2003). A

pre-action demand, however, may be excused where the plaintiff can prove that a demand was not made upon the company because such a demand would have been futile. *Marx v Akers*, 88 NY2d 189 (1996). In order to successfully plead that a demand was futile, plaintiff must plead with particularity that a majority of the board of directors was interested in the challenged transaction or the board members did not fully inform themselves about the transaction to the extent reasonably appropriate, or that the transaction was so egregious on its face that it could not have been the product of sound business judgment. *Bansbach*, 1 NY3d 9; *Marx v Akers, supra.*

JPS claims that a pre-action demand on Binn would have been futile because of the power and authority Mr. Binn exercised over the board of Binn as its manager and as a majority board member. JPS asserts that the board of Binn lost its independence because Mr. Binn dominated and controlled its decisions. Hence, it would have been futile to serve a demand on the board.

Defendants contend that JPS has failed to properly plead that a demand on Binn would have been futile. Defendants assert that despite the fact that Mr. Binn, as the manager, possessed full power and authority to enter into the transaction on behalf of Binn, the transaction was approved by an overwhelming majority vote of disinterested members. Thus, they assert JPS is unable to plead demand futility.

The court's opinion is that whether Mr. Binn wielded such influence over the board of Binn that it lost the ability to objectively deal with a demand upon it, raises substantial issues of fact. These include whether the minority members were fully informed of the consequences of the recapitalization. It is not the court's task at this stage of the proceedings to make factual determinations. On a motion to dismiss the court must accord the plaintiff, "the benefit of every

possible inference," *Nonnon v City of New York,* 9 NY3d 825, 827 (2007). Here there is a plausible factual inference that Mr. Binn dominated, controlled and misinformed the board of Binn to the extent it would be deemed interested in the transaction. The motion to dismiss is denied.

Dissolution of Binn LLC pursuant to Operating Agreement

JPS seeks an order for dissolution of Binn pursuant to the Operating Agreement. JPS asserts that Section 8.01 of the Operating Agreement provides for it to be dissolved upon transfer of substantially all of its assets. According to Binn's 2011 audited financial statement, on February 23, 2012 Binn contributed all of its assets and liabilities to Holdings.

Defendants counter that the Operating Agreement was amended prior to the transaction on February 1, 2012, and the amendment contemplated the continued existence of Binn after the February 23, 2012 transaction. Defendants claim that the amendment to the Operating Agreement is documentary evidence that establishes its defense as a matter of law.

In order for a defense to be founded on documentary evidence, the evidence must be unambiguous, authentic and undeniable. *Fontanetta v John Doe*, 1, 73 AD3d 78 (2d Dept 2010). Mr. Binn is authorized by the Operating Agreement to make amendments to it at his sole discretion. This unfettered authority to make unilateral amendments is limited in certain cases, such as when a member is adversely affected by an amendment relating to dissolution of the company. In such cases, written consent of the affected member is required. JPS alleges that the amendment to the Operating Agreement adversely affected its rights to dissolution in the event of a transfer of substantially all of the assets of Binn and that its written consent was not obtained in connection with adopting this amendment. Defendants counter that at the time of the

amendment JPS had no right to dissolution and consent was not required. They argue the amendment, and the subsequent transaction, did not adversely affect JPS.

The documentary evidence submitted by the defendants is not incontrovertible. JPS disputes Mr. Binn's authority to make amendments to the Operating Agreement on the subject of dissolution without it's written consent. The defendants have not established that the amendment did not require the written consent of the plaintiff. Their argument regarding a right to dissolution not being extant at the time of the amendment ignores the plain meaning of the Operating Agreement. It is without merit. The amendment is not documentary evidence under New York law, and does not establish a defense as a matter of law under CPLR 3211 (a) (1). JPS has pleaded sufficient facts to state a cause of action for dissolution, the defendant's motion to dismiss the first cause of action is denied.

Judicial dissolution of Binn LLC

Section 702 of the New York Limited Liability Company Law (NYLLC) provides that: "On application by or for a member, the supreme court. . . . may decree dissolution of a limited liability company whenever it is not reasonably practical to carry on the business in conformity with the articles of organization or operating agreement."

JPS claims that since Section 8.01 of the Operating Agreement provides for dissolution of Binn, and because the transaction with Mistral is an event of dissolution, Binn cannot carry on business and hence, ought to be dissolved.

JPS claims that judicial dissolution is warranted because the management, i.e., Mr. Binn, is unable to promote the stated purpose of Binn. JPS cites Section 1.06 of the Operating Agreement which says the stated purpose of Binn is "to engage in spa services predominantly at

large, high-traffic airport locations." JPS alleges that Binn is prevented from engaging in its stated purpose since substantially all of its assets have been transferred to Holdings.

The defendants counter that the Operating Agreement and February 1, 2012 amendment address when dissolution is to be decreed, and judicial dissolution is unwarranted. The defendants reject JPS's allegation that Binn is prevented from engaging in its stated purpose. They assert that after the transaction Binn continues to operate in accordance with its Operating Agreement and run spas, although in a different corporate structure, indirectly through Holdings.

The operating agreement determines the rules applicable to the operation of a particular limited liability company. *In re Matter of the Dissolution of 1545 Ocean Avenue LLC v Van Houten*, 72 AD3d 121, 128 (2d Dept 2010). Only where the operating agreement is ambiguous, contrary to law or does not contain any provision for the particular matter at issue, do the statutory provisions control. *Id.* at 129. Neither party argues that the Operating Agreement is ambiguous. Both have cited the Operating Agreement to support their arguments, although they dispute the applicable provision. There is no need to turn to the default provision of the NYLLC. Plaintiff's cause of action for judicial dissolution is dismissed.

Breach of Fiduciary Duty against Mr. Binn, manager of Binn LLC (Derivatively)

JPS states that Mr. Binn, as manager of Binn, owed a fiduciary duty to Binn to conduct its business in a fair, just and equitable manner and to act in furtherance of its best interests. JPS's amended complaint makes two distinct allegations of breach of this duty.

JPS alleges that Mr. Binn breached his fiduciary duty by negotiating and executing a transaction that put his financial interests ahead of Binn's. JPS alleges that Mr. Binn received cash distributions from Xpress. JPS alleges that he structured the transaction to reduce his own

personal bank guarantee, and receive dividends, fees, interest, and the ability to sell units regardless of whether other members, particularly JPS, received any return on their investments.

JPS alleges that Mr. Binn breached his fiduciary duty by improperly transferring assets of Binn to Xpress, given that Mistral contributed cash to Xpress and not to Binn. JPS claims that Mr. Binn's actions converted Binn from a company with a controlling interest in its business into a shell which is now a non-controlling nominal parent of a Mistral controlled entity.

JPS alleges that Mr. Binn's irresponsible and excessive corporate spending contributed to Binn LLC's alleged inability to meet its budgeted expenses.

Mr. Binn contends that the exculpatory provision in the Operating Agreement provides a shield from the breach of fiduciary duty allegations. He asserts that the allegations with respect to breach of fiduciary duty must be dismissed because JPS has failed to plead that his alleged actions amount to failure to act 'in good faith' or 'gross negligence' or 'reckless indifference' in order for the court to not enforce the exculpatory provision in the Operating Agreement. To the contrary Mr. Binn claims that his actions including personally guaranteeing loans for Binn, and making personal loans to Binn, illustrate that he always acted in the best interests of Binn. In addition, Mr. Binn cites the business judgment rule, his reliance upon financial advisors, and disclosure of his purported financial interest to the members when the approval of the transaction was obtained, as defenses against the claim of breach of fiduciary duty.

The exculpatory clause in the Operating Agreement, which shields Mr. Binn from liability in many situations, reads as follows: "Liability of Parties. No Manager or officer shall be liable to the Company or to any Member for (i) the performance of, or omission to perform, any act or duty on behalf of the Company if, in good faith, the Manager or the officer determined

that such conduct was in the best interests of the Company and such conduct did not constitute fraud, gross negligence or reckless or intentional misconduct." JPS has alleged, with specificity, that in negotiating and entering into the transaction, Mr. Binn acted in bad faith, and in his own self-interest, to the detriment of Binn. While Mr. Binn's arguments raise substantial issues of fact, they do not detract from the sufficiency of plaintiff's particular pleadings that Mr. Binn acted in bad faith, or that there was intentional misconduct on his part, thus nullifying the exculpatory provision.

On a motion to dismiss, the court must accord the plaintiff "the benefit of every possible favorable inference," *Nonnon v City of New York*, 9 NY3d 825, 827 (2007). Since the facts as alleged by JPS fit within a cognizable legal theory, Mr. Binn's motion to dismiss the third cause of action is denied.

Corporate Diversion (Derivative)

JPS makes two allegations in its claim for corporate diversion. First, JPS alleges that Mr. Binn improperly diverted corporate assets of Binn to his own bank account.

JPS also reiterates its allegations that Mr. Binn, by entering into the recapitalization transaction was able to reduce his personal bank guarantee and make profits through dividends, fees, compensation, interest and sale of units.

Mr. Binn contends he acted in good faith and in furtherance of Binn's legitimate interests. He asserts that Mr. Binn did not receive any improper cash payments. The payments were due and owing under the Operating Agreement.

Plaintiff's first allegation that Mr. Binn improperly diverted corporate assets to his bank account is vaguely phrased and conclusory. It is not sufficient to state a cause of action.

With respect to the second allegation concerning improper cash disbursements, these concern cash payments ($1.084 million) Mr. Binn received when he exercised his put options on February 23, 2012. The options were set to expire on February 29, 2012. JPS claims that Mr. Binn acted in bad faith and was motivated by self-interest. JPS asserts that had the transaction not closed, Mr. Binn could have exercised his options, but would have received obligations from Binn instead of cash.

The officers and directors of a corporation stand in a fiduciary relationship to the corporation, owe to the corporation their individual loyalty, and are not permitted to derive a personal profit at the expense of the corporation. *Bertoni v Catucci*, 117 AD2d 892 (3d Dept 1986). The essence of a waste claim is the diversion of corporate assets for an improper or unnecessary purpose. *Arnoff v Albanese*, 85 AD2d 3 (2d Dept 1982). JPS has pleaded with particularity that Mr. Binn profited from the payments as the result of the transaction and it was improper to settle those obligations as part of the transaction. The determination of whether or not Mr. Binn was entitled to such payments or not is largely a question of fact. For these reasons, defendant's motion to dismiss the claim for corporate diversion is denied.

Breach of Fiduciary Duty against Mr. Binn

JPS states that notwithstanding its derivative claim for breach of duty against Mr. Binn, it also has a direct claim against him for breach of fiduciary duty. JPS asserts that Mr. Binn breached his fiduciary duty to make full disclosure of all material facts to it. JPS claims that Mr. Binn failed to disclose material information regarding the extent of Binn's supposed need for capital, and the extent to which the value of its interests in Binn could be reduced to zero by

Mistral in the future. JPS alleges that as a direct result of Mr. Binn's conduct, JPS was unable to prevent the transaction from closing, which it claims negatively impacted its interest in Binn.

Mr. Binn moves to dismiss on the grounds that the plaintiff has not met with the requirement of distinguishing its alleged injury from other members of Binn. Mr. Binn contends that the allegations underpinning the direct cause of action are identical to those of the derivative cause of action for breach of fiduciary duty.

The managing member of a limited liability company owes a co-member a "fiduciary duty to make full disclosure of all material facts." *Salm v Feldstein*, 20 AD3d 469, 470 (N.Y. App. Div., 2d Dept 2005). JPS has alleged that Mr. Binn breached his fiduciary duty to fully disclose all material facts regarding the transaction. As a direct result of Mr. Binn's conduct, JPS claims that its interests in Binn have been damaged. JPS has properly stated a direct claim against Mr. Binn for breach of fiduciary duty. Defendant is incorrect to assert that plaintiff's allegations for a direct claim for breach of fiduciary duty are identical to its derivative claim for breach of fiduciary duty. This claim is for more disclosure, the derivative claim was for self dealing. Plaintiff has stated sufficient facts to claim that Mr. Binn breached his fiduciary duty to it, independent of any alleged breach of fiduciary duty owed to Binn. Defendant's motion to dismiss the fourth cause of action is denied.

Breach of Contract

JPS claims that Mr. Binn violated the terms of Section 4.10 of the Operating Agreement that provides: "Liquidity. Commencing in 2010, the Company will use reasonable efforts to create liquidity (i.e., enabling the Members to sell their Units), either through a sale of the Company or public offering by the Company, provided that this can be done without having an

adverse impact on the business operations or future plans of the Company." JPS alleges that Mr. Binn's efforts in connection with the recapitalization were directed towards securing his own exit from Binn, and creating liquidity for select members of Binn.

JPS claims that by transferring the spa business of Binn to a Mistral controlled entity, it is highly probable the minority unit holders will be unable to sell their units since Mistral can designate the sale price. JPS asserts that if Mistral were to designate a sale price (at which its financial return is realistically maximized), the value of units held by minority unit holders might be zero.

To adequately allege the essential elements of a breach of contract claim, the plaintiff's complaint must plead the existence of a contract between the parties, plaintiff's performance under the contract and defendants breach of the contract; and plaintiff's resulting damages. *JP Morgan Chase v J.H. Elec. of New York, Inc.*, 69 AD3d 802 (2d Dept 2010). The plaintiff's complaint asserts that as a result of the breach of contract by Mr. Binn, it is a highly probable outcome that the business shall be sold at a price that would yield substantial profits for Mistral but wipe out the interests of JPS. The damages claimed by JPS are speculative and there is no argument by it to suggest that it has suffered damages to date. For this reason, the complaint does not state a cause of action for breach of contract. *Kenford Co. v County of Erie*, 67 NY2d 257, 261 (1986).

Defendant's motion to dismiss the eighth cause of action is granted.

ORDERED that defendant's motion to dismiss the first, third, fourth and seventh causes of action is denied; and it is further

ORDERED that defendant's motion to dismiss the second and eighth causes of action is granted.

Dated: April 5, 2013

ENTER:

J.S.C.

MELVIN L. SCHWEITZER