Roth v McCutcheon
2015 NY Slip Op 31280(U)
July 21, 2015
Supreme Court, New York County
Docket Number: 651559/2013
Judge: Saliann Scarpulla
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 39

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CHRISTIAN FRANCIS ROTH,

Plaintiff,

DECISION/ORDER
Index No. 651559/2013

-against-

SCARLETT MCCUTCHEON

Defendant.

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HON. SALIANN SCARPULLA, J.:

In this action, plaintiff Christian Francis Roth ("Roth") moves to dismiss defendant Scarlett McCutcheon's ("McCutcheon") "Counterclaim and Third Party Complaint" ("stand-alone counterclaim") and "Amended Answer, Counterclaim, and Third Party Complaint" ("Amended Answer") pursuant to CPLR 3025(a) and (b), 3011, and 3211(a)(6) and (7). In an amended notice of motion, Roth also seeks "sanctions for frivolous conduct upon Defendant in the amount of $1,000, on the ground she filed the Amended Answer in response to Plaintiff's original Notice of Motion and supporting papers, knowing that her time to amend as of right had expired." [1] McCutcheon opposes

[1] Roth first filed his motion to dismiss seeking dismissal pursuant only to CPLR §§ 3011 and 3211(a)(6) and (7). Three days after this initial motion, and after McCutcheon filed an Amended Answer without leave of court, Roth filed an amended notice of motion and added an additional point in his memorandum of law, seeking dismissal on the additional grounds of 3025(a) and (b). In his amended filings, Roth also sought sanctions.

dismissal, and, in a cross-motion, asks for leave to amend her answer should I find dismissal of the Amended Answer appropriate.

On April 30, 2013, Roth commenced this action by filing a summons and verified complaint ("complaint"). According to the complaint, in 2007 Roth incorporated Christian Francis Roth, Inc. ("CFR" or "company"), and the company "is engaged in the design, manufacture and distribution of women's clothing under the label 'Francis', a registered trademark." The complaint also avers that Roth serves as CFR's principal, sole shareholder, secretary, sole director, and "is the clothing designer for the Francis label, oversees production of garments for the Francis label, and participates in management of CFR." McCutcheon is allegedly the president of CFR, and "[p]rior to the acts complained of [in the complaint], Roth and McCutcheon shared day to day responsibility for CFR's finances, including but not limited to keeping track of income and expenses and paying bills to creditors."

The following allegations are drawn from the complaint: "[o]n or about February 1, 2013, without Roth's knowledge or consent, McCutcheon removed the money from CFR's bank account and, upon information and belief, redeposited it in one or more bank accounts as to which Roth does not have knowledge or access." Additionally, beginning around this time, and without Roth's awareness or approval, McCutcheon redirected CFR's income to account(s) that are unknown or inaccessible to Roth. Similarly, Roth alleges that "[w]ithout Roth's knowledge or consent, McCutcheon has embarked on a campaign of diverting and misappropriating to her own use all CFR's income, including without limitation all checks, credit card and other payments." Moreover, around the

same time, and without Roth's awareness or approval, "McCutcheon seized control of, and denied Roth access to, CFR's financial books and records." Roth has made the following demands of McCutcheon, which she has refused: to return diverted money to CFR and to stop diverting any other funds; to pay outstanding CFR bills; to "restore [Roth's] access to CFR's bank account and financial books and records"; and to present an accounting of the company's income and expenses and diverted funds. The complaint alleges causes of action for a violation of Business Corporate Law ("BCL"), breach of fiduciary duty, conversion and misappropriation of corporate assets, and unjust enrichment.

On June 28, 2013, McCutcheon answered the verified complaint. On January 13, 2014, McCutcheon filed a document which is entitled "Counterclaim and Third Party Complaint," alleging counterclaims against Roth and new claims against his wife, Hannah Bradford ("Bradford"). On January 21, 2014, without leave of court and on the same day that Roth filed his motion to dismiss, McCutcheon filed an Amended Answer, which also contained counterclaims against Roth and a third-party action against Bradford.

In the Amended Answer, McCutcheon avers that she is the treasurer and president of CFR and is a director and 50% owner of the company. McCutcheon alleges that Roth made a number of false representations to her in order to persuade her to invest in the company, and she also alleges that Roth mismanaged CFR. She claims that the actions she took in February 2013, such as opening a new account for CFR, were done "in order to avoid CFR experiencing financial demise." She brings counterclaims against Roth for

fraud, breach of fiduciary duty, breach of contract, usurpation of corporate opportunity, fraudulent conveyance, breach of implied covenant of good faith and fair dealing, and a violation of New York Labor Law. She also brings claims of fraudulent conveyance,[2] aiding and abetting breach of fiduciary duty, and aiding and abetting fraud against Bradford.

Roth moves to dismiss the stand-alone counterclaim because the document was not included with McCutcheon's answer as required by CPLR § 3011. Additionally, in response to McCutcheon's Amended Answer, Roth moves to dismiss that document because the time frame in which McCutcheon could have amended as of right had elapsed.

After filing the Amended Answer, McCutcheon opposed Roth's motion and cross-moved for leave to amend the answer. In her opposition memorandum of law, McCutcheon makes two arguments: (1) the Amended Answer was done as of right pursuant to CPLR § 3025; and (2) if McCutcheon improperly amended the answer without leave of court, she asks that I grant her leave to amend her answer.

In opposition to McCutcheon's cross-motion, Roth claims that McCutcheon's request for leave to amend is improper because she has not submitted an affidavit of

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[2] McCutcheon's first cause of action against Bradford is titled as a fraudulent conveyance claim, despite the fact that in her memorandum of law in opposition to Roth's motion and in support of her cross-motion ("opposition memorandum of law"), McCutcheon states that she has brought a claim for "aiding and abetting fraudulent conveyance" against Bradford. I address the first cause of action against Bradford as a claim for fraudulent conveyance, as that is how McCutcheon titled the cause of action in her Amended Answer.

merit and has not attached the proposed amended complaint showing changes from her original answer in accordance with CPLR § 3025(b). Roth also argues that McCutcheon fails to sufficiently plead fraud, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing. In a subsequent memorandum, Roth raised other substantive infirmities with the causes of action in the Amended Answer.

Discussion

McCutcheon's Claim that Amendment Was Taken as of Right

McCutcheon does not dispute that the stand-alone counterclaim was not an appropriate vehicle to impose her counterclaims. As such, the stand-alone counterclaim is dismissed as violative of CPLR § 3011. *See Newman v. Newman*, 245 A.D.2d 353, 354 (2d Dep't 1997) (stating that "a counterclaim may only be interposed through service of an answer"). Instead, McCutcheon argues that the counterclaims were properly imposed when she filed her Amended Answer, which, she claims, was done as of right following Roth's motion to dismiss.

McCutcheon's amendment to her answer was not done as of right. CPLR § 3025(a) states "[a] party may amend his pleading once without leave of court within twenty days after its service, or at any time before the period for responding to it expires, or within twenty days after service of a pleading responding to it." McCutcheon's claim that her amended answer, submitted more than six months after her original answer was filed, was done as of right because it was done "at any time before the period for responding to it expires" and "the period for responding to the Counterclaim [has] not

passed" is incorrect. As stated above, the stand-alone counterclaim was procedurally deficient, thus Roth had no obligation to respond to it. *See Newman*, 245 A.D.2d at 354.

Accordingly, I address Roth's motion to dismiss the Amended Answer and McCutcheon's cross-motion for leave to amend on the merits.[3]

McCutcheon's Cross-Motion for Leave to Amend

McCutcheon asks that if I find she did not amend as of right, that I grant her leave to amend because Roth will suffer no prejudice from the amendment. Roth first claims that the cross-motion for leave to amend is improper because it is not submitted either with a proposed amended answer clearly showing the differences between the original and amended answers or an affidavit of merit. McCutcheon claims that no affidavit of merit is necessary, and, in a supplemental submission, counsel for McCutcheon claims that his client's affidavit of merit sufficiently supports the cross-motion for leave to amend.

CPLR § 3025(b) states that "[a]ny motion to amend or supplement pleadings shall be accompanied by the proposed amended or supplemental pleading clearly showing the changes or additions to be made to the pleading." When McCutcheon submitted her cross-motion for leave to amend her answer, among other documents, she attached her answer and the Amended Answer. In doing so, she complied with CPLR § 3025(b) because the Amended Answer clearly shows the additions from McCutcheon's answer. For purposes of the cross-motion, I treat the already served Amended Answer as the

[3] I decline to award costs and sanctions to Roth, as he requests in his motion to dismiss.

proposed Amended Answer because overlooking this technical labelling failure does not prejudice Roth. *See* CPLR § 2001 (allowing the court to disregard a defect "if a substantial right of a party is not prejudiced").

While it is true that a party's "failure to submit an affidavit of merit in support of its motion to amend is not fatal to the motion," the movant still must "show that the proposed amendment is not palpably insufficient or clearly devoid of merit." *Delta Dallas Alpha Corp. v. S. St. Seaport Ltd. P'ship*, 127 A.D.3d 419, 420 (1st Dep't 2015). McCutcheon's original submission failed to meet that standard because the motion for leave to amend was only submitted along with a short attorney affirmation that merely attached the stand-alone counterclaim, the original answer, the Amended Answer, and a stipulation wherein counsel for Roth agreed to accept service of the stand-alone counterclaim on behalf of Bedford. *See id. Cf. MBIA Ins. Corp. v. Greystone & Co., Inc.*, 74 A.D.3d 499, 500 (1st Dep't 2010) (finding "proposed amendment was supported by a sufficient showing of merit through the submission of an affirmation by counsel, along with a transcript of relevant deposition testimony"). At oral argument, I directed counsel for McCutcheon to submit an affidavit of merit, supporting the cross-motion for leave to amend. I also allowed counsel for Roth to reply to this affidavit.

"Leave to amend the pleadings 'shall be freely given' absent prejudice or surprise resulting directly from the delay." *Fahey v. Cnty. of Ontario*, 44 N.Y.2d 934, 935 (1978) (citations omitted). Roth does not claim that he will be prejudiced or surprised by the amendment. *See id.* Accordingly, I review the causes of action to determine if the

"proposed amendment is not palpably insufficient or clearly devoid of merit." *Delta*, 127 A.D.3d at 420.

Fraud and Aiding and Abetting Fraud – First Counterclaim against Roth and Third Cause of Action against Bradford

McCutcheon's fraud claim is not "palpably insufficient or clearly devoid of merit," and is adequately supported by McCutcheon's affidavit of merit. *Id.*; *see Basis Yield Alpha Fund (Master) v. Goldman Sachs Grp., Inc.*, 115 A.D.3d 128, 135 (1st Dep't 2014) (enumerating elements of fraud cause of action). As stated during oral argument, I find that the particularity requirement has been satisfied and reject Roth's argument to the contrary. *See Pludeman v. N. Leasing Sys., Inc.*, 10 N.Y.3d 486, 492 (2008).

I also reject Roth's contention that reliance is insufficiently pleaded because McCutcheon, a business-savvy director and officer of CFR, could not have reasonably relied on any alleged misstatements made by Roth. McCutcheon's fraud claim arises from alleged misstatements not having to do with the state of CFR's finances, but in relation to Roth's business relationships—his clout within the fashion industry, the existence of possible interested investors, continued revenue from a relationship with QVC, and the existence of customers for a fashion line. These topics "could [not] readily have [been] investigated." *See Epic Sec. Corp. v. AMCC Corp.*, 103 A.D.3d 493, 493 (1st Dep't 2013).

Finally, McCutcheon's fraud claim is not duplicative of her breach of contract claim. While the fact that McCutcheon is seeking the same quantum of damages for the fraud and breach of contract causes of action is notable in this context, *see Triad Int'l.*

Corp. v. Cameron Indus., Inc., 122 A.D.3d 531, 531–32 (1st Dep't 2014) (affirming dismissal when fraud claim was duplicative of its contract-based cause of action because the party "seeks the same compensatory damages for both claims" and denying leave to amend), at this early stage of the litigation I do not have enough information to determine if the amount claimed as fraud damages is actually the amount McCutcheon loaned to CFR, such that McCutcheon would be "in the same position that [she] would have been in had [CFR] performed (i.e., made payment) under the contract." *Id.* at 532. Moreover, the misrepresentations that form the basis of the fraud claim are separate from the contract claim. *See Introna v. Huntington Learning Ctrs., Inc.*, 78 A.D.3d 896, 898 (2d Dep't 2010) ("However, a misrepresentation of a material fact which is collateral to the contract and serves as an inducement to enter into the contract is sufficient to sustain a cause of action sounding in fraud.").

The claim for aiding and abetting fraud, however, "is . . . palpably insufficient or clearly devoid of merit." *Delta*, 127 A.D.3d at 420.[4] As Roth notes, McCutcheon has not pleaded that Bradford knew about the underlying fraud. *See Stanfield Offshore Leveraged Assets, Ltd. v. Metro. Life Ins. Co.*, 64 A.D.3d 472, 476 (1st Dep't 2009). Accordingly, I deny leave to amend to add the aiding and abetting fraud claim.

Breach of Fiduciary Duty, Aiding and Abetting Breach of Fiduciary Duty, and Usurpation of Corporate Opportunity – Second and Fourth Counterclaims against Roth and Second Cause of Action against Bradford

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[4] It is unclear why counsel for Roth submitted arguments regarding the sufficiency of causes of action against Bedford when the memoranda of law are all submitted in Roth's name alone. While McCutcheon submitted a stipulation, showing that Roth's counsel would accept service of the stand-alone counterclaim, no one has formally entered an appearance for Bedford.

[* 10]

McCutcheon has not met her burden in making out the breach of fiduciary duty cause of action against Roth. The injury that McCutcheon complains of is that "Roth has not acted in the best interests of CFR or of McCutcheon by, among other things, failing to pay manufacturers and suppliers, defaulting on credit cards, and continuing to run up costs when CFR did not have adequate funds." These allegations are "[a]llegations of mismanagement," which are derivative, rather than direct claims. *Yudell v. Gilbert*, 99 A.D.3d 108, 113–14 (1st Dep't 2012). As a derivative claim, McCutcheon was required, but failed to, particularly plead demand futility, and "[n]one of the grounds for excusing demand appear in the complaint." *See id.* 115; *Marx v. Akers*, 88 N.Y.2d 189, 200–01 (1996). Because McCutcheon's breach of fiduciary duty cause of action against Roth is not cognizable, her aiding and abetting breach of fiduciary duty claim is also not cognizable. *See Kaufman v. Cohen*, 307 A.D.2d 113, 125 (1st Dep't 2003) (enumerating elements of aiding and abetting a breach of fiduciary duty, including "a breach by a fiduciary of obligations to another").

Similarly, McCutcheon's usurpation of corporate opportunity cause of action against Roth is not cognizable because it was brought as a direct cause of action rather than a derivative one. "Allegations of mismanagement or diversion of corporate assets also plead a wrong to the corporation, as is a diversion of a corporate opportunity." *Yudell*, 99 A.D.3d at 114 (internal citations omitted). Here, the allegations relate to CFR's, not McCutcheon's, opportunities—e.g., "Despite entering into a collaboration agreement with Wang wherein CFR would be compensated for Roth's work, Roth has

failed to give CFR any monies he has been paid by Wang." As discussed above, McCutcheon has not pleaded demand futility or any exceptions to the demand rule. *Id.* at 115.

Breach of Contract and Breach of Implied Covenant of Good Faith and Fair Dealing – Third and Sixth Counterclaims against Roth

McCutcheon has also failed to meet her burden in making out her breach of contract cause of action regarding money she loaned CFR. *See Delta*, 127 A.D.3d at 420. As Roth notes, the breach of contract claim implicates the statute of frauds. New York's General Obligations Law ("GOL") § 5-701(a) states, "[e]very agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking: . . . 2. Is a special promise to answer for the debt, default or miscarriage of another person." In the Amended Answer, McCutcheon does not claim that Roth executed a written guarantee. Further, McCutcheon does not allege facts that support the theory that an exception to the writing requirement exists, *see Martin Roofing, Inc. v. Goldstein*, 60 N.Y.2d 262, 267 (1983); *Carey & Assocs. v. Ernst*, 27 A.D.3d 261, 263–64 (1st Dep't 2006), nor does she allege that Roth intended to be primarily responsible for the CFR's debt as opposed to being a surety for CFR. *See Paribas Props., Inc. v. Benson*, 146 A.D.2d 522, 525 (1st Dep't 1989). Accordingly, I find that McCutcheon's breach of contract claim against Roth for his alleged personal guarantees is "palpably insufficient or clearly devoid of merit." *Delta*, 127 A.D.3d at 420.

Because there is no underlying enforceable contract, McCutcheon cannot maintain her cause of action for breach of good faith and fair dealing. *American-European Art Assocs., Inc. v. Trend Galleries, Inc.*, 227 A.D.2d 170, 171 (1st Dep't 1996) ("The second cause of action for breach of an implied duty of good faith and fair dealing by defendants in allegedly negotiating to sell the painting to another party despite plaintiffs' purported contract with defendants was also properly dismissed for lack of a valid and binding contract from which such a duty would arise.").

Fraudulent Conveyance – Fifth Counterclaim against Roth and First Cause of Action against Bradford

Although McCutcheon does not indicate the provision of the Debtor and Creditor Law under which she brings her fraudulent conveyance cause of action, the claim is nonetheless dismissed because, as discussed above, McCutcheon is a creditor of CFR, not a creditor of Roth. Because she is not a creditor of Roth, her fraudulent conveyance cause of action against him does not fall within the parameters of the statute. *See, e.g.*, § 273 (emphasis added) ("Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent *as to creditors* without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."). McCutcheon's cause of action against Bradford must similarly fail because any action Bradford allegedly took in having Roth's assets conveyed to her name is not actionable as to McCutcheon. *See id.*; *Delta*, 127 A.D.3d at 420.

Violation of New York Labor Law – Seventh Counterclaim against Roth

McCutcheon's seventh counterclaim is for a New York Labor Law violation. The Court notes that the cause of action is titled against CFR, discusses CFR's alleged failure to compensate McCutcheon, and avers CFR's joint responsibility to pay for fees and liquidated damages; moreover, the facts section of McCutcheon's opposition memorandum of law states that the claim is brought against CFR. However, not only has CFR not brought suit against McCutcheon, thus making the cause of action inappropriately styled as part of McCutcheon's counterclaims, but also the Amended Answer seeks improperly to impose liability on Roth for CFR's alleged violations.

Insofar as McCutcheon attempts to impose liability on Roth on the basis that he is an officer and shareholder of CFR alone, (*see* Amended Answer ¶ 105 ["Roth, as control person of CFR, is personally liable for CFR's violations of New York Labor Law."]), she may not do so:

> We note that section 197 of the Labor Law . . . and section 198 of the Labor Law . . . do not refer to civil actions for the recovery of wages against officers or agents of corporations. The logical inference from this omission is that the Legislature did not intend that a civil action against officers and agent of corporations for the recovery of wages should be implied under section 198-a of the Labor Law.

Stoganovic v. Dinolfo, 92 A.D.2d 729, 729 (4th Dep't 1983), *aff'd* 61 N.Y.2d 812 (1984); *see Picard v. Bigsbee Enters., Inc.*, 40 Misc.3d 1240(A), at *3 (Sup Ct, Albany County 2013) ("Settled law holds that an individual does not bear civil liability for unpaid wages under Labor Law article 6 ('Article 6') merely by serving as an officer, shareholder or agent of a corporation."). Accordingly, I deny McCutcheon's motion to assert a labor law cause of action against Roth. *Delta*, 127 A.D.3d at 420.

In accordance with the foregoing, it is hereby

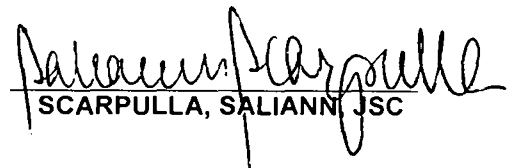
ORDERED that plaintiff's motion to dismiss the "Counterclaim and Third Party Complaint" and the "Amended Answer, Counterclaim, and Third Party Complaint" is granted; and it is further

ORDERED that the defendant's cross-motion for leave to amend her answer is granted insofar as she is granted leave to amend her answer to add the first counterclaim against Roth for fraud, and the motion is otherwise denied; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 208, 60 Centre Street, on September 30, 2015, at 2:15 PM.

This constitutes the decision and order of this Court.

DATE : July 21, 2015



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