SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 19

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ROBERT SHAPIRO,

Plaintiff,

Index No. 653571/2014
Motion Seq. Nos. 003, 004

-against-

GABRIEL ETTENSON and DAVID NEWMAN,

Defendants.

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O'NEILL LEVY, J.:

Motion sequence numbers 003 and 004 are consolidated for disposition.

This action involves a dispute concerning the validity of an operating agreement for nonparty ENS Health, LLC (ENS), a New York limited liability company owned equally by plaintiff Robert Shapiro (Shapiro), and defendants Gabriel Ettenson (Ettenson) and David Newman (Newman). The five-count complaint asserts causes of action for declaratory judgments and damages. Specifically, the first cause of action seeks a declaration that the operating agreement and capital call relied upon by defendants are null and void. The second cause of action seeks a declaration that no member of ENS may receive a salary unless consented to by all of ENS's members, and damages for any outstanding salary owed to Shapiro as a result of salary payments to defendants that exceeded amounts agreed upon by the parties. Shapiro's third, fourth, and fifth causes of action seek relief identical to the relief sought in the second cause of action. Shapiro's claim for damages is based upon alleged breaches of contract, fiduciary duties, and the covenant of good faith and fair dealing.

In their answer, defendants assert five counterclaims for declaratory judgment, seeking declarations that the operating agreement, an amendment to ENS's articles of organization, and a

capital call are valid and binding upon ENS and its members. Defendants also seek a declaration regarding the applicability of New York's Limited Liability Company Law (LLC Law) in the absence of a valid operating agreement, ENS's ability to pay salaries to its members after December 2013, and defendants' authority to reduce Shapiro's salary by majority vote.

Defendants now move (in motion sequence number 003) for summary judgment on all of their counterclaims and dismissing the complaint. Shapiro moves (in motion sequence number 004) for summary judgment on his first and second causes of action.

Facts

Unless indicated otherwise, the following facts are undisputed. Shapiro, Ettenson, and Newman formed ENS in January 2012, and since its formation, these individuals have each held a one-third ownership interest in ENS. Complaint, ¶ 4; Answer, ¶ 4. ENS was formed as a "member-managed limited liability company." Complaint, ¶ 5; Answer, ¶ 5. At a meeting held in September 2013, Shapiro, Ettenson, and Newman agreed that their annualized salary rates would be $50,000 for Shapiro, and $100,000 each for Ettenson and Newman. Complaint, ¶ 26; Answer, ¶ 26. Shapiro claims that this salary arrangement was for the period October 1 through December 31, 2013 only. Complaint, ¶ 26. From September through December of 2013, the parties negotiated and exchanged drafts of a proposed operating agreement for ENS. Shapiro aff, exhibits G-J. Until December of 2013, ENS had no written operating agreement. Complaint, ¶ 11; Answer, ¶ 11.

On December 13, 2013, defendants adopted an operating agreement for ENS, without obtaining Shapiro's consent or signature (Operating Agreement). Complaint, ¶ 8; Answer, ¶ 8; Shapiro aff, exhibit K at 31. Shapiro submits with his motion papers a copy of the Operating

Agreement, executed by Ettenson and Newman. Shapiro aff, exhibit K. The Operating Agreement provided that "[t]he Managers of [ENS] shall be Shapiro, Newman, and Ettenson," that "the management of [ENS] shall be vested in the Managers and each Manager shall have equal Management Rights," and that "any action requiring the approval of the Managers shall be approved by a Majority of the Managers." *Id.*, § 6.01. The Operating Agreement defined "Majority of the Managers" as "[t]he vote of a majority of the Managers of the Company." *Id.* at 4. The Operating Agreement provided that actions taken by the members of ENS "may be taken by a Majority of the Members" (*id.*, § 6.03), which was defined as "[t]he vote of the Members whose aggregate Participation Interests exceed fifty (50%) percent of the Participation Interests of all of the Members." *Id.* at 4. The Operating Agreement also provided that "a Majority of the Members may determine if additional Capital Contributions are necessary to conduct [ENS's] business activity," in which case:

> "[n]otice shall be given to all Members specifying the due date, which shall not be less than thirty (30) days from the date of the notice, of any additional Capital Contributions which may be required. Each Member may, but shall not be required to, provide additional Capital Contributions to the Company in proportion to his Participation Interest. If any Member shall fail to make his proportionate contribution of additional Capital Contributions, then the other Members may contribute all or a part of the deficiency created by such failure. Upon the failure of a Member to provide all or part of his proportionate share of additional Capital Contributions and the provision of additional Capital Contributions by other Members, including any additional Capital Contributions made by the other Members to cover all or part of the deficiency created by such failure, the Participation Interests of the Members shall be adjusted proportionally to reflect any such deficiency and any additional Capital Contributions made by the other Members to cover such deficiency."

Id., § 7.01 at 13.

Also on December 13, 2013, Shapiro was sent a copy of the Operating Agreement, with a transmittal letter stating:

> "Enclosed please find the following: (1) Notice of Action Taken Without a Meeting by Less Than Unanimous Written Consent, and (2) Written Consent of a Majority of Members to Action Without a Meeting, together with Exhibit A thereto, and (3) the Limited Liability Company Operating Agreement of ENS Health, LLC, signed by Messrs. Ettenson and Newman as members and for the Company."

Shapiro aff, ¶ 21 and exhibit L.

On December 23, 2013, Newman filed with the New York Department of State a "Certificate of Amendment of Articles of Organization" for ENS, changing ENS from a "member-managed" company (Complaint, ¶ 5; Answer, ¶ 5) to a company "managed by one or more managers." Shapiro aff, exhibit M. Shapiro claims that, from December 2013 to October 2014, ENS was operated by Shapiro, Newman, and Ettenson. Shapiro aff, ¶ 26.

On October 21, 2014, Shapiro received a document titled "Notice of Action Taken At Meeting Held on October 14, 2014," which was signed by Newman and Ettenson. Shapiro aff, ¶ 27 and exhibit N. The notice stated that Newman and Ettenson, as managers of ENS comprising "a majority of the Managers and a majority in interest of the Members, acted by affirmative vote at a meeting held on October 14, 2014 at which all Managers and Members of the Company were present." *Id.*, exhibit N. The notice notified Shapiro that Newman and Ettenson "reduce[d] the salary of Robert Shapiro to zero dollars ($0), for the reasons discussed at the meeting held on October 14, 2014," and requested "an additional Capital Contribution" from each of ENS's members in the amount of $10,000. *Id.* Included with the notice of salary reduction was a "Notice of Call For Additional Capital Contribution From Members," requesting the $10,000

capital contribution from each of ENS's members by November 21, 2014. *Id.*, exhibit O. The capital call notice stated that a member's failure to pay the capital contribution permitted the other members to "[c]ontribute all or a part of the deficiency created by such failure," resulting in each member's "Participation Interest" to be "adjusted proportionally to reflect any such deficiency and any additional Capital Contributions made by the other Members to cover such deficiency." *Id.* Shapiro claims that he did not agree to the $10,000 capital call or the reduction of his salary (Shapiro aff, ¶ 29), and he subsequently commenced the instant action.

Analysis

At the heart of the parties' dispute is the validity of the Operating Agreement. "Where an operating agreement . . . does not address certain topics, a limited liability company is bound by the default requirements set forth in the Limited Liability Company Law." *Matter of 1545 Ocean Ave., LLC*, 72 AD3d 121, 129 (2d Dept 2010). The LLC Law defines "[o]perating agreement" as "any written agreement of the members concerning the business of a limited liability company and the conduct of its affairs and complying with section four hundred seventeen of this chapter." LLC Law § 102 (u). As discussed above, it is undisputed that ENS had no written operating agreement prior to the Operating Agreement. Therefore, the LLC Law governs the issue of whether Newman and Ettenson properly adopted the Operating Agreement pursuant to the LLC Law.

The LLC Law provides that:

> "(a) Unless the articles of organization provides for management of the limited liability company by a manager or managers or a class or classes of managers, management of the limited liability company shall be vested in its members who shall manage the limited liability company in accordance with this chapter . . . .

> "(b) If management of a limited liability company is vested in its members, then (i) any such member exercising such management powers or responsibilities shall be deemed to be a manager for purposes of applying the provisions of this chapter, unless the context otherwise requires, and (ii) any such member shall have and be subject to all of the duties and liabilities of a manager provided in this chapter."

LLC Law § 401.

Under section 402 of the LLC Law:

> "(a) . . . in managing the affairs of the limited liability company, electing managers or voting on any other matter that requires the vote at a meeting of the members pursuant to this chapter, the articles of organization or the operating agreement, each member of a limited liability company shall vote in proportion to such member's share of the current profits of the limited liability company in accordance with section five hundred three of this chapter.
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> . . .
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> "(c) Except as provided in the operating agreement, whether or not a limited liability company is managed by the members or by one or more managers, the vote of a majority in interest of the members entitled to vote thereon shall be required to:
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> . . .
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> "(3) adopt, amend, restate or revoke the articles of organization or operating agreement, subject to the provisions in subdivision (e) of this section, subdivision (b) of section six hundred nine of this chapter and subdivision (b) of section four hundred seventeen of this article.
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> . . .
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> "(f) Whenever any action is to be taken under this chapter by the members or a class of members, it shall, except as otherwise required or specified by this chapter or the articles of organization or the operating agreement as permitted by this chapter, be authorized by a majority in interest of the members' votes cast at a

> meeting of members by members or such class of members entitled to vote thereon."

Section 102 (o) of the LLC Law defines "'[m]ajority in interest of the members'" as, "unless otherwise provided in the operating agreement, the members whose aggregate share of the current profits of the limited liability company constitutes more than one-half of the aggregate of such shares of all members."

Section 408 of the LLC Law contains similar provisions for manager-managed limited liability companies, as follows:

> "(a) If the articles of organization provides that the management of the limited liability company shall be vested in a manager or managers or class or classes of managers, then the management of the limited liability company shall be vested in one or more managers or classes of managers in accordance with this chapter, subject to any provisions in the articles of organization or the operating agreement and section four hundred nineteen of this article granting or withholding the management powers or responsibilities of one or more managers or class or classes of managers. A manager shall hold such offices and have such responsibilities accorded to him or her by the members as provided in the operating agreement.
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> (b) Except as provided in the operating agreement and in accordance with section four hundred nineteen of this article, the managers shall manage the limited liability company by the affirmative vote of a majority of the managers."

Thus, under section 401 (a) of the LLC Law, prior to the Operating Agreement, management of ENS was vested in its three members. Under section 402 (a), (c) (3), and (f), Shapiro, Ettenson, and Newman were each entitled to vote in proportion to their one-third ownership interests in order to "adopt, amend, restate or revoke the articles of organization or operating agreement." Together, Ettenson and Newman owned two-thirds of ENS, clearly

constituting a majority sufficient, under the LLC Law, to adopt the Operating Agreement and amend the articles of organization. Therefore, Ettenson and Newman have made a prima facie showing that they were authorized to approve and adopt the Operating Agreement and to amend the articles of organization, and that these documents are valid and enforceable.

In opposition, and in support of his own motion for summary judgment, Shapiro argues that, as "a contract" and "by statute, an operating agreement is to be entered into by all but not less than all of the members, and certainly not just a majority." Shapiro opening brief at 6; Complaint, ¶¶ 10-11. In support of this argument, Shapiro refers to section 417 of the LLC Law, which provides, in pertinent part:

> "(a) Subject to the provisions of this chapter, the members of a limited liability company shall adopt a written operating agreement that contains any provisions not inconsistent with law or its articles of organization relating to (i) the business of the limited liability company, (ii) the conduct of its affairs and (iii) the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents, as the case may be.
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> . . .
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> "(c) An operating agreement may be entered into before, at the time of or within ninety days after the filing of the articles of organization."

Nothing contained in section 417 requires "all" of the members of a limited liability company to enter into an operating agreement. Nor does section 417 prohibit a majority of the members from entering into an operating agreement. Moreover, while section 417 permits an operating agreement to be entered into within 90 days after filing the articles of organization, it does not mandate that the operating agreement be entered into within 90 days. *See e.g., Matter of Spires v Lighthouse Solutions, LLC*, 4 Misc 3d 428, 431 (Sup Ct, Monroe County 2004) ("[t]here is no

provision in the Limited Liability Company Law imposing any type of penalty or punishment for failing to adopt a written operating agreement"). In short, Shapiro's argument is not supported by the plain language of the LLC Law. *Matter of Rosenblum v New York State Workers' Compensation Bd.*, 309 AD2d 120, 123 (1st Dept 2003) ("interpretation of the statute" should "comport[] with its plain language"); *Matter of Cortland-Clinton, Inc. v New York State Dept. of Health*, 59 AD2d 228, 231 (4th Dept 1977) ("the plain language used in a statute . . . should be construed in its natural and most obvious sense").

Shapiro argues that the parties orally agreed that ENS would be member-managed, and that all material decisions would be by unanimous vote of all the members. As discussed above, the LLC Law defines "operating agreement" as "any *written* agreement of the members concerning the business of a limited liability company and the conduct of its affairs and complying with section four hundred seventeen of this chapter." LLC Law § 102 (u) (emphasis added). Prior to the Operating Agreement, there was no "written" operating agreement, and, therefore, the default provisions of the LLC Law controlled. Once the Operating Agreement was adopted, it became the operative, "written" agreement for ENS. Therefore, Shapiro's argument is unpersuasive.

Shapiro challenges the capital call issued by defendants, citing to section 502 of the LLC Law. Section 502 (a) provides that "a member is obligated to the limited liability company to perform any promise to contribute cash or property or to perform services that is otherwise enforceable in accordance with applicable law, even if he or she is unable to perform because of death, disability or any other reason." Section 502 (b) provides that "the obligation of a member to make a contribution . . . may be compromised only by consent of all the members." Here,

however, the capital call was not obligatory, but rather, it was merely "requested" of ENS's members (Shapiro aff, exhibit O), thereby failing to trigger section 502. The capital call was consistent with both the LLC Law and section 7.01 the Operating Agreement. Moreover, section 502 (c) expressly permits an operating agreement to "provide that the membership interest of any member who fails to make any required contribution . . . be subject to specified consequences of such failure," including the "reduction or elimination of the defaulting member's interest." Section 417 (b) of the LLC Law is not implicated, as is argued by Shapiro (Shapiro opening brief at 9), because that provision applies only to "amended" operating agreements, and it is undisputed that ENS had no operating agreement prior to the Operating Agreement. There is no amendment at issue here.

Shapiro also challenges the termination of his salary, arguing that section 411 of the LLC Law "prohibits a manager from benefitting from transactions which favor a manager or group of managers over other managers or members." Shapiro opening brief at 11. As a preliminary matter, section 411 (e) expressly authorizes the managers of the limited liability company "to fix the compensation of managers for services in any capacity." In any event, while section 411 pertains to transactions involving "[i]nterested managers" – that is, "contracts or other transactions between a limited liability company and one or more of its managers" – Shapiro does not allege that defendants increased their own salary at his expense, but rather, defendants merely voted to reduce Shapiro's salary. Shapiro does not allege that defendants derived a personal benefit from the decision to eliminate his salary, thereby failing to raise an issue under section 411 of the LLC Law.

Shapiro next argues that, under section 9.01 of the Operating Agreement, "no

compensation can be paid to plaintiff or defendants for their services in managing [ENS] or in providing services for [ENS] relating to the business of selling [ENS's] products." Shapiro opening brief at 13. Article 9 of the Operating Agreement is titled "Management Fees and Expenses," and section 9.01 provides that "[n]o compensation shall be paid to the Managers for their services in arranging transactions contemplated by the Company and managing the Company." Shapiro aff, exhibit K at 15. While Shapiro challenges the elimination of his salary, he does not allege that defendants are receiving "Management Fees" in violation of the Operating Agreement. *Id.* Therefore, this argument is unpersuasive.

The court notes that, even assuming for the moment that the Operating Agreement was invalid and there was no written operating agreement, the default provisions of the LLC Law would apply. *Matter of 1545 Ocean Ave., LLC*, 72 AD3d at 129. Under the default provisions, section 401 vested ENS's management in its three members. Under section 402, Ettenson and Newman held a combined majority interest, thereby permitting them to reduce Shapiro's salary and issue the capital call. Therefore, defendants' actions were valid even in the absence of an operating agreement. For the foregoing reasons, Shapiro fails to raise a factual issue or otherwise rebut defendants' prima facie showing of their entitlement to declaratory relief.

In addition to declaratory relief, the complaint alleges that defendants breached the parties' agreement, the implied covenant of good faith and fair dealing, and fiduciary duties, based upon the same conduct for which Shapiro seeks declaratory relief. Complaint, ¶¶ 20, 34-35, 39, 43-44. As damages, Shapiro seeks any "salary paid to defendants Ettenson and Newman which was in excess of any salary paid to plaintiff Shapiro other than what was agreed to for the period October 1, 2013 through December 31, 2013, plus interest." *Id.*, ¶¶ 31, 36, 40, 45. As

discussed above, defendants demonstrated that they adopted the Operating Agreement, reduced Shapiro's salary, and issued the capital call in accordance with the LLC Law. In any event, each of Shapiro's claims for damages fails on the following independent grounds. The breach of contract claim fails because, as discussed above, it is based upon an unenforceable oral agreement. *Harris v Seward Park Hous. Corp.*, 79 AD3d 425, 426 (1st Dept 2010) (breach of contract claim requires, among other things, "the existence of a contract"); *Matter of 1545 Ocean Ave., LLC*, 72 AD3d at 129 (default requirements of LLC Law control in the absence of an operating agreement); LLC Law § 102 (u) (defining "operating agreement" as "any *written* agreement of the members" [emphasis added]). Shapiro's claim for breach of the implied covenant of good faith and fair dealing is "dismissed as duplicative of the insufficient breach of contract claim." *Jacobs Private Equity, LLC v 450 Park LLC*, 22 AD3d 347, 347-348 (1st Dept 2005).

There is no claim for breach of fiduciary duty independent of the claims for declaratory judgment. Instead, the complaint contains only conclusory allegations of breaches of fiduciary duties, without alleging bad faith, self-dealing, or any other conduct that would constitute a breach of fiduciary duty. *See* LLC Law § 409 (a) and (c) (a manager who "perform[s] his or her duties as a manager . . . in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances . . . shall have no liability by reason of being or having been a manager of the limited liability company"); *see also TPZ Corp. v Reddington*, 239 AD2d 301, 301 (1st Dept 1997) (finding "conclusory allegations of . . . breach of fiduciary duties" insufficient); *Steinberg v Carey*, 285 App Div 1131, 1131 (1st Dept 1955) ("charges must be supported by factual assertions of specific wrongdoing rather than conclusory

allegations of breaches of fiduciary duty," and "[m]atters depending on business judgment are not actionable"). Moreover, as discussed above, the LLC Law authorized Ettenson and Newman, as managers of ENS, "to fix the compensation of managers for services in any capacity." LLC Law § 411 (e). Therefore, Shapiro's breach of fiduciary duty claim is dismissed.

Accordingly, it is hereby

ORDERED that the branch of defendants' motion (motion sequence number 003) which seeks a declaratory judgment with respect to the subject matter of the complaint's first, second, third, fourth, and fifth causes of action and the first, second, third, fourth, and fifth counterclaims is granted; and it is further

ORDERED that plaintiff's motion for summary judgment (motion sequence number 004) on its first and second causes of action is granted to the extent of granting declaratory relief concerning the validity of the Limited Liability Operating Agreement of ENS Health, LLC, dated December 13, 2013, the Notice of Call for Additional Capital Contributions from Members of ENS Health, LLC, dated October 15, 2014, and the salaries received by the members of ENS Health, LLC, and the motion is otherwise denied; and it is further

ADJUDGED and DECLARED that:

(i) Gabriel Ettenson and David Newman were authorized to adopt the Limited Liability Operating Agreement of ENS Health, LLC, dated December 13, 2013, that operating agreement was duly and properly adopted in accordance with New York's Limited Liability Company Law, and its provisions are valid and binding upon ENS Health, LLC and its members: Robert Shapiro, Gabriel Ettenson, and David Newman;

(ii) Gabriel Ettenson and David Newman were authorized to amend the Certificate of Amendment of Articles of Organization of ENS Health, LLC, filed December 23, 2013, that amendment was duly and properly authorized in accordance with New York's Limited Liability Company Law, and its provisions are valid and binding upon ENS Health, LLC and its members: Robert Shapiro, Gabriel Ettenson, and David Newman;

(iii) the default provisions of New York's Limited Liability Company Law govern the operation of ENS Health, LLC and its members in the absence of any controlling provision of the Limited Liability Operating Agreement of ENS Health, LLC or other valid and binding written operating agreement for ENS Health, LLC;

(iv) Gabriel Ettenson and David Newman were authorized to issue the Notice of Call for Additional Capital Contributions from Members of ENS Health, LLC, dated October 15, 2014, and that capital call is valid and binding upon the members of ENS Health, LLC: Robert Shapiro, Gabriel Ettenson, and David Newman; and

(v) the payment of salaries to the members of ENS Health, LLC after December 2013 is authorized, Gabriel Ettenson and David Newman were authorized to reduce the salary of Robert Shapiro to zero dollars ($0.00) by majority vote, and the reduction of Robert Shapiro's salary to zero dollars ($0.00) is valid and binding; and it is further

ORDERED that the branch of defendants' motion which seeks dismissal of plaintiff's

claims for damages, including claims for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing is granted and these claims are dismissed; and it is further

ADJUDGED that plaintiff's claims for damages, including claims for breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing are dismissed.

Dated: August 16, 2015
New York, New York

ENTER:

Kelly O'Neill Levy

Hon. Kelly O'Neill Levy, A.J.S.C.

HON. KELLY O'NEILL LEVY