Doppelt v Smith
2015 NY Slip Op 31861(U)
October 1, 2015
Supreme Court, New York County
Docket Number: 650749/2014
Judge: Eileen Bransten

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

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JEFFREY DOPPELT and RICHARD MATIST,

Plaintiffs,

-against-

Index No. 650749/2014
Motion Seq. No. 001
Motion Date: 3/2/2015

HOWARD SMITH, Individually and Doing Business as SMITH ENERGY 1986-A PARTNERSHIP and SMITH ENERGY 1986-A PARTNERSHIP,

Defendants.

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Bransten, J.:

In motion sequence number 001, defendants Howard Smith and Smith Energy 1986-A Partnership ("Smith Energy") seek dismissal of plaintiffs' verified complaint, pursuant to CPLR 3211(a)(1), (3), (7), and (10). Defendants also request that this Court direct plaintiffs Jeffrey Doppelt and Richard Matist to post a bond to secure repayment of costs and attorneys' fees, as well as the costs for any required accounting, pursuant to N.Y. Partnership Law § 115-b. For the reasons that follow, defendants' motion to dismiss is granted in part and denied in part, while its request that plaintiffs post a bond is denied as moot.

I. Background[1]

Defendant Smith Energy is engaged in production and sale of crude oil. On April 30, 1986, defendant Smith, the general partner of Smith Energy, approached plaintiffs to invest in this limited partnership. Together, Plaintiffs purchased a one-third unit in Smith Energy for a total of $25,000, making them each limited partners of Smith Energy under the company's Partnership Agreement.

Plaintiffs allege that their investment entitled them to a proportionate share of Smith Energy's profits. Notwithstanding this entitlement, defendants purportedly have never provided plaintiffs with a distribution despite a record increase in the price of oil over the life of the partnership. Plaintiffs also allege that the Partnership Agreement required defendants to hire the accounting firm of Berenson, Berenson & Adler ("Berenson") as Smith Energy's collecting and disbursing agent, but that defendants failed to do so. Defendants likewise purportedly have failed to provide the partners of Smith Energy with yearly accountings, including a yearly K-1 accounting, since 2008.

The verified complaint asserts claims for breach of the Partnership Agreement, refusal to provide an accounting, negligence, breach of fiduciary duties, failure to make distributions, entitlement to distributions, dissolution of the partnership, and fraudulent inducement.

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[1] The following factual allegations are set forth in the verified complaint and for the purposes of this motion are accepted as true.

II. Analysis

Defendants now seek dismissal of plaintiffs' complaint in its entirety, on the grounds that plaintiffs (1) lack the capacity to bring dissolution claims; (2) lack standing to bring derivative claims; (3) fail to join indispensable parties; and (4) fail to state a claim. Defendants also seek an order directing plaintiffs to post a bond to secure repayment of costs and attorneys' fees, as well as costs for any accounting that might be required.

A. *Dissolution Claims*

Section 10.1 of the Partnership Agreement states, in relevant part:

> [t]he Limited Partnership shall be dissolved upon the occurrence of any of the following events: ...
>
> (d) By vote of at least a majority in interest of the Limited Partners to dissolve pursuant to Article XI...

(Affidavit of Howard Smith Ex. A.)

As holders of only 2.32% of Smith Energy, plaintiffs do not dispute that they lack the vote of "at least a majority in interest of the Limited Partners," as required by the Partnership Agreement. Instead, plaintiffs argue that they can dissolve the partnership pursuant to New York State Partnership Law § 99(1)(c), which grants a limited partner

the same rights as a general partner with regard to dissolution and winding up of the partnership by court decree.

It is well-settled that "partners may fix their partnership rights and duties by agreement." *Bailey v. Fish & Neave*, 8 N.Y.3d 523, 528 (2007) (citations omitted). This includes any rights and duties "'concerning the sharing of profits and losses, priorities of distribution on winding up of the partnership affairs and other matters. If complete, as between the partners, the agreement so made controls.'" *Id.* at 528-529 (quoting *Lainer v. Bowdoin*, 282 N.Y. 32, 38 (1939)). Thus, since the Partnership Agreement is not barred by law and provides a complete scheme for dissolution, it controls over New York Partnership Law § 99. *See Lainer,* 282 N.Y. at 38. Accordingly, given that plaintiffs lack the vote of at least a majority in interest of limited partners, they cannot seek to dissolve Smith Energy. The ninth, tenth, and eleventh causes of action for dissolution therefore are dismissed.

B. *Derivative Versus Direct Claims*

Defendants next seek dismissal of plaintiffs' remaining claims, arguing that they are derivative in nature and therefore may only be brought on behalf of the corporation, Smith Energy.

"It is black letter law that a stockholder has no individual cause of action against a person or entity that has injured the corporation." *Serino v. Lipper*, 123 A.D.3d 34, 39 (1st Dep't 2014). This rule holds true even where the alleged wrongful acts diminished the value of the shares of the corporation or where the shareholder incurred personal liability. *Id.* at 39. A shareholder "may not obtain a recovery that otherwise duplicates or belongs to the corporation." *Id.* at 40 (citing *Herbert H. Post & Co. v. Sidney Bitterman, Inc.*, 219 A.D.2d 214, 225 (1st Dep't 1996)). There is a narrow exception, however, "where the wrongdoer has breached a duty owed directly to the shareholder which is independent of any duty owing to the corporation." *Serino*, 123 A.D.3d at 39 (citing *Abrams v. Donati*, 66 N.Y.2d 951 (1985)); *General Rubber Co. v. Benedict*, 215 N.Y. 18 (1915).

In assessing whether a claim belongs to the shareholder or to the corporation – that is, whether it is direct or derivative – the First Department in the case of *Yudell v Gilbert*, 99 A.D.3d 108 (1st Dep't 2012), explained that:

> a court should consider (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually).

Id. at 114 (quoting *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004)).

Thus, where the harm alleged is to the individual shareholder, and not to the corporation itself, the shareholder may proceed with a direct claim against the alleged

wrongdoer. However, if the allegations of the complaint confuse a shareholder's derivative and individual rights, even where some of the claims are direct in nature, the complaint will be dismissed. *Yudell*, 99 A.D.3d at 115 (citing *Abrams v. Donati*, 66 N.Y.2d 951, 953 (1985)). Such claims are intertwined with the harm to the corporation and cannot stand separately.

Here, defendants argue the first, second, third, fourth, fifth, sixth, seventh, eighth, and twelfth causes of action must be dismissed since they are asserted directly, notwithstanding the fact that they are derivative in nature. The claims will be reviewed in turn below.

1. Breach of the Partnership Agreement

Plaintiffs' first cause of action is for breach of the Partnership Agreement and is based on the allegation that defendants failed to retain the services of Berenson to act as the collecting and disbursing agent for Smith Energy.

Plaintiffs attest that, when they were approached about the partnership, Smith represented that Berenson would act as the independent agent to collect and disburse the partnership's profits, costs, and expenses. *See* Affidavit of Jeffrey Doppelt ¶ 4; Affidavit of Richard Matist ¶ 4. Plaintiffs further aver in their sworn affidavits that this

representation is set forth in the "partnership agreement/offering on page 10." *See* Affidavit of Jeffrey Doppelt ¶ 4; Affidavit of Richard Matist ¶ 4.

Before this court addresses the issue of whether this cause of action for breach of contract is a derivative claim, there is an issue as to whether the Partnership Agreement does, in fact, mandate the hiring of Berenson. Plaintiffs' counsel, in his affirmation in opposition, states that "partnership agreement (defendant's Exhibit 'A'), at page 10," affirms that "'[t]he General Partners ... have selected Berenson, Berenson & Adler to act as collecting and disbursing agent..." (Affirmation of Andrew T. Cupit at 12.)[2] However, after careful review of the Partnership Agreement, the Court finds that there is no mention on page 10, or any other page, that Berenson was to be hired as the collecting and disbursing agent for Smith Energy. Rather, Article III, Section 3.1 of the Partnership Agreement submitted to the court, provides that the general partners shall have exclusive and complete discretion in the management and control of the business of the Partnership and make all decisions affecting the business of the Partnership.

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[2] Plaintiffs' counsel did not submit a brief in opposition to Defendants' motion. Instead, counsel submitted a seventeen-page argumentative affirmation, in violation of the Uniform Rules for Trial Courts § 202.8(c), which states that "[a]ffidavits shall be for a statement of the relevant facts, and briefs shall be for a statement of the relevant law." Counsel's "brieffirmation" did not contain numbered paragraphs, as a proper affirmation should include. Therefore, the Court cites to the page on which counsel's representation regarding page 10 of the Partnership Agreement is found.

"[A] motion to dismiss under CPLR 3211(a)(1) obliges the court 'to accept the complaint's factual allegations as true, according to plaintiff the benefit of every possible favorable inference, and determining only whether the facts as alleged fit within any cognizable legal theory.'" *Amsterdam Hospitality Grp., LLC v. Marshall-Alan Assoc., Inc.*, 120 A.D.3d 431, 433 (1st Dep't 2014) (quoting *Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*, 10 A.D.3d 267, 270-271 (1st Dep't 2004)). "Dismissal is warranted only if the documentary evidence submitted utterly refutes plaintiff's factual allegations and conclusively establishes a defense to the asserted claims as a matter of law." *Id.* (internal citations and quotation marks omitted).

Here, the Partnership Agreement submitted in support of defendants' motion utterly refutes plaintiffs' allegations that defendants breached the Agreement by not hiring Berenson. There is no promise to hire Berenson memorialized in the executed Partnership Agreement. Thus, this cause of action must be dismissed for failure to state a claim based on documentary evidence.

Nevertheless, even if plaintiffs could show another controlling agreement executed by the parties requiring the hiring of Berenson, as stated, plaintiffs' claim for breach of contract must be brought derivatively. As discussed above, a plaintiff shareholder must allege an injury which is separate and distinct from that suffered by the corporation and plaintiffs, here, have not done so. The alleged harm caused by Smith not hiring Berenson

on behalf of the company is really a harm to the company, as it is alleged that Berenson was to handle all of Smith Energy's collections and disbursements of revenues, costs, and expenses, essentially managing these financial aspects of the partnership and keeping the company up-to-date with its collections and disbursements.

While plaintiffs, as shareholders, might have suffered harm as a result of Smith's failure to retain Berenson, it is not separate and distinct from the harm allegedly suffered by Smith Energy for Smith's failure. The failure to hire Berenson allegedly caused damage to the company, itself, as the company allegedly lacked proper management over its profits, costs, and expenses, affecting profits. Any recovery for damages suffered as a result of the failure to hire Berenson would belong to Smith Energy, and not to plaintiffs as individuals.

2. Refusal to Provide an Accounting

The second cause of action alleges that defendants failed to provide a "yearly K-1 accounting" to Smith Energy's limited partners in violation of state and federal laws. (Compl. ¶ 35.) Here, plaintiffs have alleged an injury which is separate and distinct from that suffered by Smith Energy. Applying the *Yudell* test, the benefit of receiving a K-1 accounting is to the shareholder as an individual, and not to Smith Energy. The shareholder needs the K-1 for filing his or her yearly tax returns, and it would be the

shareholder who receives the benefit of any remedy for the failure to provide such accounting. Thus, this cause of action can be maintained as a direct claim.

3. Mismanagement and Negligence Claims

In their third cause of action, plaintiffs allege that Smith's gross mismanagement and negligence in handling the affairs of Smith Energy resulted in a lack of profits to be disbursed. The fifth cause of action alleges that the lack of return on plaintiffs' investment was due to Smith's mismanagement of Smith Energy. Plaintiffs' seventh cause of action simply alleges that defendants have failed to make distributions to plaintiffs, and plaintiffs' eighth cause of action alleges that plaintiffs are entitled to distributions. All four causes of action distill down to a claim of mismanagement of Smith Energy and loss of profits.

Once again, plaintiffs have failed to allege an independent duty owed directly to them, separate and apart from any duty owed to the company. Accepting plaintiffs' contention that Smith mismanaged Smith Energy, the harm alleged was done to the company, even if plaintiffs' personal investment was diminished. *Serino*, 123 A.D.3d at 39). "[A]llegations of mismanagement or diversion of assets by officers or directors to their own enrichment, without more, plead a wrong to the corporation only, for which a

shareholder may sue derivatively but not individually." *Abrams*, 66 N.Y.2d at 953 (internal citations omitted).

4. Breach of Fiduciary Duty Claims

The fourth and sixth causes of action allege that Smith breached his fiduciary duty to plaintiffs. These claims are also derivative in nature. The fourth claim expressly asserts a "breach of [Smith's] fiduciary duties to Smith Energy," *see* Compl. ¶ 42, while the sixth claim alleges mismanagement of Smith Energy's funds resulting in a failure to make distributions to the limited and general partners, *id.* ¶¶ 48-49. Just as the First Department concluded in *Yudell*, the breach of fiduciary duty claim asserted in the instant complaint is derivative "because any pecuniary loss plaintiffs suffered derives from a breach of duty and harm to the business entity." *Yudell v. Gilbert*, 99 A.D.3d 108, 114 (1st Dep't 2012). "It is only through loss to [the corporation] that plaintiffs suffer a loss at all." *Id.* Therefore, plaintiffs' breach of fiduciary duty claims are derivative.

5. Fraudulent Inducement

In their twelfth cause of action, plaintiffs allege that they were fraudulently induced to enter into the Partnership Agreement based on misrepresentations made with

regard to the payments of proceeds and the hiring of Berenson. Plaintiffs claim that they were damaged, since they have lost their investment in Smith Energy.

At first glance this claim appears to be direct in nature. However, after careful examination, it too is embedded with the derivative claims seeking damages due to Smith's mismanagement. The allegations that plaintiffs were fraudulently induced to enter into the Partnership Agreement based on misrepresentations that Berenson would be hired and that plaintiffs would receive profits from their investment turn on the allegations of Smith's mismanagement of the company. Therefore, these fraud allegaitons are not independent of claims made that are derivative in nature.

Even if not dismissed on this basis, plaintiffs' fraud claim would nonetheless merit dismissal as duplicative of their breach of the partnership agreement claim. Plaintiffs' fraud claim is based on the same allegations as its breach of contract claim – i.e. that defendants failed to retain Berenson to act as Smith Energy's collecting and disbursing agent in violation of the Partnership Agreement. "Generally, to recover damages for a tort, such as fraud, in a contract action, plaintiff needs to plead and prove a breach of duty distinct from, or in addition to, the breach of contract." *Non-Linear Trading Co., Inc. v. Braddis Associates, Inc.*, 243 A.D.2d 107, 118 (1st Dep't 1998). No such separate breach of duty is alleged here, and therefore, the fraud claim must be dismissed on these separate grounds.

C. *Bond For Security*

Finally, defendants seek an order directing plaintiffs to post a bond to secure repayment of costs and attorneys' fees, as well as costs for any accounting that might be required, if the court rules that any surviving causes of action are derivative in nature. As the causes of action found to be of a derivative nature are dismissed, the issue of whether a bond must be posted is moot. If plaintiffs replead these claims derivatively, defendants can raise this issue at the appropriate time, if they still deem it appropriate.

III. Conclusion

Based on the foregoing analysis, the court determines that the ninth, tenth, and eleventh causes of action for dissolution are dismissed as a matter of law, as plaintiffs lack the votes under the controlling Partnership Agreement to dissolve the company.

The first cause of action must be dismissed for failure to state a claim based on documentary evidence, as the Partnership Agreement refutes the allegations of the verified complaint. The third, fourth, fifth, sixth, seventh, eighth, and twelfth causes of action are derivative in nature, and, thus, must be dismissed; however, these derivative claims, with the exception of the fraud claim, are dismissed without prejudice. The second cause of action is direct in nature and, at this stage, survives dismissal.

III. Conclusion

Accordingly, it is

ORDERED that defendants Howard Smith and Smith Energy 1986-A Partnership's motion to dismiss the verified complaint is granted to the extent that all causes of action except the second claim are dismissed; and it is further

ORDERED that plaintiffs Jeffrey Doppelt and Richard Matist are granted leave to serve an amended complaint if they choose so as to replead the third, fourth, fifth, sixth, seventh, and eighth claims within 20 days after service on plaintiffs' attorney of a copy of this order with notice of entry; and it is further

ORDERED that, in the event that plaintiffs fail to file an amended complaint in conformity herewith within such time, leave to replead shall be deemed denied; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 442, 60 Centre Street, on Tuesday, April 21, 2015 at 10:00 am.

Dated: New York, New York
October 1, 2015

ENTER

Hon. Eileen Bransten, J.S.C.