Fremuth v Stetson
2017 NY Slip Op 30073(U)
January 11, 2017
Supreme Court, New York County
Docket Number: 650593/2016
Judge: Eileen Bransten

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

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GUNNAR B. FREMUTH,

Plaintiff,

-against-

Index No. 650593/2016
Motion Seq. No. 001
Motion Date: 3/29/2016

CHARLES P. STETSON, JR., JOHN M. BARGER, PRIVATE EQUITY INVESTORS, INC., and NORTHERNCROSS PARTNERS LLC,

Defendants.

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BRANSTEN, J.:

This action is brought by Plaintiff Gunnar Fremuth against one of his former business partners, the private equity firm they established, and a financial consultant retained by the firm. Defendants now seek partial dismissal of the Complaint, pursuant to CPLR 3211(a)(7). For the reasons that follow, Defendants' motion is Granted in Part and Denied in Part.

I. Background[1]

In 1992, Defendant Charles P. Stetson, Jr. founded Defendant Private Equity Investors, Inc. ("PEI Inc.") with non-party David Parshall. (Compl. ¶ 17.) Since its inception, Defendant PEI Inc. has raised and managed five private equity secondary funds with reported assets in excess of $300 million. *Id.* ¶ 19. These funds ("PEI Funds")

[1] The facts cited in this section are drawn from the Complaint, unless otherwise noted.

are referred to by the parties as PEI Fund I, PEI Fund II, PEI Fund III, PEI Fund IV, and PEI Fund V. *Id.*

Plaintiff Fremuth joined Stetson and Parshall at PEI Inc. in 1996. *Id.* ¶ 18. Fremuth had certain responsibilities relating to PEI Funds IV and V, including serving in an investment advisory position for the funds with Stetson and Parshall. *Id.* ¶¶ 2, 28. In exchange for his services, Fremuth received a portion of the management fees paid by PEI Funds IV and V to PEI Inc. *Id.* ¶ 27.

Non-party Benjamin Wilson later became a PEI Inc. partner in January 2013. *Id.* ¶ 28.

A. *Verbal Agreement*

According to Fremuth, he entered into a verbal agreement ("Verbal Agreement") with Defendant Stetson, Parshall, and Wilson in 2012. (Compl. ¶ 159.) This Verbal Agreement purportedly pertained to the "course of conduct to effectuate" a restructuring of PEI, Inc. into an LLC. *Id.* ¶ 44. Among other things, through this Verbal Agreement, Stetson, Fremuth, Parshall, and Wilson allegedly agreed that the restructured business would: (1) solicit, hire and pay the employees of PEI Inc., and (2) make distributions to Stetson, Fremuth, Parshall, and Wilson. *Id.* ¶ 45.

B. *LLC Agreement*

Stetson, Fremuth, Parshall and Wilson then entered into an LLC Agreement, which governed the restructured business, named PEI Funds, LLC. According to Fremuth, this LLC Agreement was effective January 1, 2013. *Id.* ¶ 30.

Under the LLC Agreement, PEI Funds, LLC would employ the personnel formerly employed by PEI, Inc., while PEI Inc. would remain in existence solely for the purpose of receiving the management fee to pay over to PEI Funds, LLC. *Id.* ¶ 32. As the Complaint explains, the continued existence of PEI Inc. was "a matter of convenience." *Id.* In addition, Section 4.02 of the LLC Agreement provided for quarterly distributions to Stetson, Fremuth, Parshall, and Wilson. *Id.* ¶ 39. Notably, for the purpose of the instant motion, the LLC Agreement contained a merger clause, stating that the LLC Agreement "contains the entire understanding of the parties relating to the subject matter hereof." *See* Affirm. Ex. B at § 10.06.

C. *Deterioration of the Stetson-Fremuth Relationship and Hiring of Barger and NorthernCross Partners, LLC*

For over two years, the four Managers – Stetson, Fremuth, Parshall, and Wilson – allegedly operated PEI Funds, LLC according to the LLC and Verbal Agreements. (Compl. ¶¶ 47-51.) However, by mid-2015, Stetson purportedly began allocating the PEI Fund's management fees to himself in order to shore up his personal finances. *Id.* ¶¶ 59-72. When his fellow Managers refused to fund Stetson's "lavish lifestyle," the Complaint asserts that Stetson embarked on a scheme to seize control of PEI Inc.'s bank accounts and remove Fremuth from his position as Manager. *Id.* ¶¶ 76-77.

While the LLC Agreement provided a means for Fremuth to be removed as Manager with the approval of three of his co-Managers, Stetson allegedly circumvented this process. *See* LLC Agreement § 3.02; *see also* Compl. ¶ 88. Instead, Stetson

allegedly engaged in a scheme with financial consultant, Defendant John M. Barger, and Barger's firm, Defendant NorthernCross Partners, LLC ("NCP"). Barger and NCP allegedly participated in Stetson's machinations by: (1) destroying PEI Funds, LLC's business and directing it to Stetson and PEI Inc.; (2) seizing control of key bank accounts; (3) rendering Fremuth and PEI Funds LLC's performance impossible under the Verbal and LLC Agreements; (4) improperly soliciting PEI Funds, LLC's employees; (5) disparaging Plaintiff Fremuth; and, (6) interfering with Fremuth's compensation under the Verbal and LLC Agreements. (Compl. ¶ 6.)

D. *The Instant Litigation*

Plaintiff Fremuth commenced the instant action in February 2016, filing an eight-count Complaint that asserts a range of contractual and tort claims against Defendants: (1) breach of fiduciary duty; (2) aiding and abetting a breach of fiduciary duty; (3) breach of contract; (4) breach of the duty of good faith and fair dealing; (5) tortious interference with contract; (6) violation of New York Labor Law § 190; (7) unjust enrichment; and, (8) accounting. In addition, Fremuth seeks punitive damages for his tort claims.

II. Discussion

Defendants now move to dismiss Fremuth's demand for punitive damages, as well as his breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, and tortious interference claims pursuant to CPLR 3211(a)(7).

On a motion to dismiss for failure to state a cause of action, all factual allegations must be accepted as truthful, the complaint must be construed in a light most favorable to

the plaintiffs and the plaintiffs must be given the benefit of all reasonable inferences. *Allianz Underwriters Ins. Co. v. Landmark Ins. Co.*, 13 A.D.3d 172, 174 (1st Dep't 2004). "We . . . determine only whether the facts as alleged fit within any cognizable legal theory." *Leon v. Martinez,* 84 N.Y.2d 83, 87-88 (1994). This Court must deny a motion to dismiss, "if from the pleadings' four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law." *511 W. 232nd Owners Corp. v. Jennifer Realty Co.,* 98 N.Y.2d 144, 152 (2002) (internal quotation marks and citations omitted).

A. *Claims Against Stetson and PEI Inc.*

Stetson and PEI Inc. seek dismissal of three of the six claims asserted against them in Fremuth's Complaint – breach of contract, breach of the implied covenant of good faith and fair dealing, and breach of fiduciary duty. These claims will be addressed in turn.

1. Breach of Contract

Plaintiff's breach of contract claim encompasses two separate agreements – the Verbal Agreement and the LLC Agreement. Fremuth contends that Stetson and PEI Inc. each breached both agreements by using the management fees generated by the PEI Funds for unauthorized payments to Stetson, as well as by defunding and terminating Fremuth's employment by PEI Funds LLC. In addition, Plaintiff maintains that Stetson and PEI Inc. deprived Fremuth of the ability to recover retirement funds in excess of $1.5 million.

a. **LLC Agreement**

PEI Inc. first seeks to dismiss the claim that it breached the LLC Agreement, since it is not a party to that agreement. The Court agrees. Applying Delaware law, as required by Section 10.04 of the LLC Agreement,[2] a party cannot breach a contract to which it is not a party. *See, e.g., Wallace v. Wood*, 752 A.2d 1175, 1180 (Del. Ch. 1999) ("It is a general principle of contract law that only a party to a contract may be sued for breach of that contract."). Therefore, since PEI Inc. is not a party to the LLC Agreement, Plaintiff's claim against PEI Inc. for breach of that contract is dismissed.

b. **Verbal Agreement**

Stetson and PEI Inc. next seek dismissal of Plaintiff's claim for breach of the Verbal Agreement. Defendants maintain that the alleged Verbal Agreement is void under the Statute of Frauds.

New York law[3] provides that an agreement will not be recognized or enforceable if it is not in writing and "subscribed by the party to be charged therewith" when the agreement "[b]y its terms is not to be performed within one year from the making thereof." (General Obligations Law § 5-701(a)(1).) As explained by the Court of Appeals, this provision of the Statute of Frauds has been "long interpreted … to encompass only those contracts which, by their terms, *have absolutely no possibility in*

[2] Section 10.04 states that "[t]his Agreement and the rights of the parties under it shall be interpreted, construed and enforced in accordance with the internal laws of the State of Delaware without regard to principles of conflicts of laws." (LLC Agreement § 10.04.)

[3] The parties agree that New York law governs the Verbal Agreement claim.

fact and law of full performance within one year." *Cron v. Hargro Fabrics, Inc.*, 91 N.Y.2d 362, 366 (1998) (emphasis added). "As long as the agreement may be fairly and reasonably interpreted such that it may be performed within a year, the Statute of Frauds will not act as a bar however unexpected, unlikely, or even improbable that such performance will occur during that time frame." *Id.*

Stetson and PEI Inc. maintain that the Verbal Agreement runs afoul of the Statute of Frauds, and is thus unenforceable, since the Complaint alleges that it was in effect for longer than three years. However, "the determination of whether an alleged oral contract can possibly be performed within one year of its making is not conducted by looking back at the actual performance; it requires analysis of what was possible, looking forward from the day the contract was entered into." *Gural v. Drasner*, 114 A.D.3d 25, 28 (1st Dep't 2013). This requires an examination of the terms of the alleged Verbal Agreement.

Plaintiff offers only scant allegations regarding the terms of the Verbal Agreement. According to Fremuth, the Verbal Agreement provided that: "(i) [PEI Funds] LLC would solicit, hire and pay the employees of [PEI Inc.] and any other employees needed to operate the business, (ii) [PEI Funds] LLC would provide administrative and diligence services to the PEI Funds, (iii) [PEI] Inc. would transfer to [PEI Funds] LLC the management fees that [PEI] Inc. received from the PEI Funds so that, among other things, LLC would pay the compensation for all employees, and (iv) [PEI Funds] LLC would make distributions to Stetson, Fremuth, Parshall and Wilson as

Members of the LLC." (Compl. ¶ 45.) Notably, Fremuth alleges that the same terms are included in the LLC Agreement.

Plaintiff does not allege the duration of this Verbal Agreement. While the merger clause of the later-entered LLC Agreement makes clear that it supersedes the Verbal Agreement, *see* LLC Agreement § 10.06, the Verbal Agreement itself is not alleged to have a defined duration. Defendants instead urge the Court to consider the language in the subsequently-entered LLC Agreement providing that the PEI Funds LLC "shall have perpetual existence." *See* LLC Agreement § 7.01. Of course, the same provision providing for the perpetual existence of PEI Funds LLC also lists three circumstances under which the LLC "shall be dissolved," including a vote of the Managers in support of dissolution. *Id.* Nevertheless, the provisions of the later LLC Agreement do not inform the analysis of the earlier Verbal Agreement.

Under the terms alleged, the Verbal Agreement itself is capable of performance in one year. "Performance, if it means anything at all, is carrying out the contract by doing what it requires or permits..." *D&N Boening, Inc. v. Kirsch Beverages, Inc.*, 63 N.Y.2d 449, 456 (1984). The hiring of PEI Inc. employees, administration of the PEI Funds, and payment of distributions could be completed within one year. There are many potential circumstances under which this performance could occur, including, but not limited to, the dissolution of PEI Inc. or PEI Funds LLC. Although Defendants urge the Court to consider the likelihood that this Verbal Agreement could be performed in one year, the relevant inquiry is whether the agreement may be fairly and reasonably interpreted to be

capable of performance in one year, even if "unlikely or even improbable." *Cron*, 91 N.Y.2d at 366. Here, Defendants have not shown that there was "absolutely no possibility in fact and law" of performance in one year. *Id.*; *see also Cathy Daniels, Ltd. v. Weingast*, 91 A.D.3d 431, 434 (1st Dep't 2012).

Contrary to Defendants' assertions, the possibility of the Verbal Agreement's performance does not depend on its breach. The performance examples cited herein – i.e. dissolution of PEI Inc. and/or PEI Funds LLC – would not constitute breaches of the alleged terms of the Verbal Agreement itself. Therefore, the instant allegations fall outside the ambit of those cases in which "the contract was not … one which might be *performed* within a year, but rather one which could only be *terminated* within that period by a breach of one or the other party to it." *D&N Boening, Inc.*, 63 N.Y. 2d at 457 (emphasis in original).

Accordingly, Stetson and PEI Inc.'s motion to dismiss the breach of the Verbal Agreement claim on statute of frauds grounds is denied.

2. Breach of the Implied Covenant of Good Faith and Fair Dealing

Defendants Stetson and PEI Inc. next seek dismissal of Fremuth's claim for breach of the implied covenant of good faith and fair dealing. Fremuth's implied covenant claim alleges that Stetson and PEI Inc. violated the "essential purpose" of the Verbal and LLC Agreements by withholding funds from PEI Funds LLC and improperly firing Fremuth. (Compl. ¶¶ 124, 165-67.) However, according to Fremuth, this conduct also purportedly

breached the express provisions of both agreements pertaining to the payment of distributions and termination of employees. *Id.* ¶ 162.

Accordingly, this breach of the implied covenant claim is duplicative of Plaintiff's claim for breach of the LLC Agreement. *See Nationwide Emerging Managers, LLC v. Northpointe Holdings, LLC*, 112 A.3d 878, 896 (Del. 2015) ("The implied covenant of good faith and fair dealing involves ... inferring contractual terms to handle developments or contractual gaps that ... neither party anticipated. It does not apply when the contract addresses the conduct at issue.").[4] Likewise, the implied covenant claim is duplicative of the alleged breach of the Verbal Agreement. *See Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce*, 70 A.D.3d 423, 426 (1st Dep't 2010) ("The claim that defendants breached the implied covenant of good faith and fair dealing was properly dismissed as duplicative of the breach-of-contract claim, as both claims arise from the same facts and seek the identical damages for each alleged breach since it is premised on the same facts and seeks the same damages.").[5]

3. Breach of Fiduciary Duty

Plaintiff's breach of fiduciary duty claim asserts that Stetson and PEI Inc. breached their fiduciary duties to Fremuth by not distributing management fees under the Verbal Agreement, terminating Fremuth's employment, and badmouthing Fremuth.

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[4] Consistent with Section 10.04 of the LLC Agreement, Delaware law governs the breach of the implied covenant claim as it pertains to the LLC Agreement.

[5] The parties again agree that this claim as it pertains to the Verbal Agreement is governed by New York law.

Defendants again argue that these allegations are duplicative of the breach of contract claim, since the breaches alleged arise from the agreements, not an independent fiduciary duty.

Under Delaware law, a breach of fiduciary duty claim cannot proceed in tandem with a breach of contract claim "unless there is an independent basis for the fiduciary duty claims apart from the contractual claims." *Renco Grp., Inc. v. MacAndrews AMG Holdings LLC*, 2015 WL 394011, at *7 (Del Ch. Jan. 29, 2015). No such independent basis exists here. In fact, "the facts and harms cited in support of the fiduciary duty claims appear to be the same ones that underlie the breach of contract claims." *Id.* at *8. For example, Fremuth supports his breach of fiduciary duty claim with allegations that Stetson and PEI Inc. improperly terminated his employment by PEI Funds LLC, disparaged Fremuth, and failed to make payments due to Fremuth under the LLC Agreement. (Compl. ¶ 150.) These are the same acts giving rise to the breach of contract claim. *Compare* Compl. ¶ 150 (breach of fiduciary duty allegations) *with* ¶ 162 (breach of contract allegations). While Fremuth attempts to salvage this claim by arguing in his brief that Stetson engaged in self-dealing by secretly trying to negotiate a deal for himself and his privately owned company with non-party Nuclea, these allegations are nowhere to be found in the breach of fiduciary duty claim, *see* Compl. ¶¶ 147-151, and even if pled, still fail to allege any duty owed to Fremuth as opposed to PEI Funds LLC.

Accordingly, Fremuth's breach of fiduciary duty claim is dismissed.

B. *Claims Against Barger and NCP*

In addition to dismissal of certain of the claims brought against Stetson and PEI Inc., Defendants move to dismiss all claims brought against Barger and NCP – aiding and abetting breach of fiduciary duty and tortious interference with contract.

1. Aiding and Abetting Breach of Fiduciary Duty

Barger and NCP first seek dismissal of Plaintiff's claim for aiding and abetting breach of fiduciary duty. This claim asserts that Barger and NCP provided substantial assistance to Stetson and PEI Inc. in the breach of fiduciary duty alleged in count one of the Complaint. Since the Court already has dismissed the underlying breach of fiduciary duty claim, the aiding and abetting breach claim is likewise dismissed. *See McBride v. KPMG Int'l*, 135 A.D.3d 576, 579 (1st Dep't 2016) (affirming dismissal of aiding and abetting breach of fiduciary duty claim where "there was no underlying breach of fiduciary duty.").[6]

[6] The parties offer no choice of law analysis for the aiding and abetting breach of fiduciary duty claim. Defendants cite to New York and Delaware law interchangeably and note that "courts are split on whether the law of the state of incorporation or the law of the forum state applies," without advocating that one or the other applies. *See* Defs.' Moving Br. at 20 n.6. Plaintiff simply states that Delaware law applies, without offering any supporting analysis. *See* Pl.'s Opp. Br. at 16 n.9. Therefore, in the absence of any cited conflict of laws or choice of law analysis, the Court will apply New York law; however, the Court notes that Delaware law is in agreement with New York that an underlying breach of fiduciary duty is a requisite element of an aiding and abetting claim. *See In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 734 (Del. Ch. 1999) ("Generally, where allegations of aiding and abetting are made, a claim will survive a motion to dismiss only where the plaintiff pleads the following elements: "(1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, and (3) knowing participation in that breach.").

2. Tortious Interference with Contract

To state a tortious interference with contract claim, Plaintiff must allege "the existence of its valid contract with a third party, defendant's knowledge of that contract, defendant's intentional and improper procuring of a breach, and damages." *AREP Fifty-Seventh, LLC v. PMGP Associates, L.P.*, 115 A.D.3d 402, 407 (1st Dep't 2014). In support of his claim, Fremuth contends that Barger and NCP interfered with the Verbal and LLC Agreements by assisting Stetson with his plan to terminate Fremuth and seize control of PEI Inc. and PEI Funds LLC's assets. *See* Compl. ¶¶ 78-88.

While Defendants contend that this claim must be dismissed because there is no underlying breach of contract, the Court already denied Defendants' motion to dismiss the breach of Verbal Agreement contract claim and granted dismissal of the LLC Agreement. *See supra* at 6 to 9. As such, the arm of Defendants' motion which seeks dismissal of the tortious interference claim in granted only as it pertains to the LLC Agreement. The branch which seeks dismissal of the Verbal Agreement contract claim is denied.

Defendants' next dismissal argument fares no better. Defendants argue that Fremuth has failed to allege intentional procurement of the breach since the Complaint does not state that NCP and Barger acted outside the scope of normal business activities. Nevertheless, the Complaint is replete with allegations that NCP and Berger provided assistance to Stetson with regard to, among other things, his allegedly wrongful seizure of PEI Inc. and PEI Funds LLC's accounts, his withholding of distributions, and his

improper termination of Stetson. *See* Compl. ¶¶ 89-145. At this juncture, the Court cannot deem these "normal business activities" that fail to constitute substantial assistance as a matter of law. Accordingly, NCP and Berger's motion to dismiss this claim is denied.

C. *Punitive Damages*

Finally, all Defendants seek dismissal of Plaintiff's request for punitive damages with regard to his tort claims. Nonetheless, exemplary damages are "permitted only when a defendant's wrongdoing is not simply intentional but evince[s] a high degree of moral turpitude and demonstrate[s] such wanton dishonesty as to imply a criminal indifference to civil obligations." *Hoeffner v. Orrick, Herrington & Sutcliffe LLP*, 85 A.D.3d 457, 458 (1st Dep't 2011) (citations omitted). Plaintiff must demonstrate "circumstances of aggravation or outrage, or a fraudulent or evil motive on the part of the defendant." *Id.*

The instant case is a garden-variety commercial dispute. Fremuth has not alleged that Defendants' wrongdoing "evince[s] a high degree of moral turpitude and demonstrate[s] such wanton dishonesty as to imply a criminal indifference to civil obligations". *Ross v. Louise Wise Services, Inc.* 8 N.Y.3d 478, 489 (2007).

Therefore, Defendants' motion seeking dismissal is Granted in part and Denied in part.

III. Conclusion

Therefore, for the reasons stated herein, Defendants motion seeking dismissal is granted in part, and denied in part.

Dated: New York, New York
January 11, 2017

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Hon. Eileen Bransten, J.S.C.