Farro v Schochet
2017 NY Slip Op 31932(U)
September 12, 2017
Supreme Court, Kings County
Docket Number: 518007/2016
Judge: Sylvia G. Ash

At an IAS Term, Com 11 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at Civic Center, Brooklyn, New York, on the 18th of August 2017.

PRESENT:

HON. SYLVIA G. ASH,
Justice.

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MENACHEM FARRO, individually and derivatively as a shareholder in the right of LM INTERNATIONAL, INC., SELLER1ON1 INCORPORATED, WML COMMUNICATIONS, INC., and as a member in the right of LMEG WIRELESS, LLC,

Plaintiff,

Decision / Order

- against -

Index No. 518007/2016

ZALMAN SCHOCHET a/k/a SCHEUR ZALMAN SCHOCHET, LEVI WILHELM, LM INTERNATIONAL, INC., SELLER1ON1 INCORPORATED, WML COMMUNICATIONS, INC., LMEG WIRELESS, LLC, INTERNATIONAL LLC and LMZT LLC,

Defendants.

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The following papers numbered 1 to 4 read herein:	Papers Numbered
Notice of Motion/Order to Show Cause/ Petition/Cross Motion and Affidavits (Affirmations) Annexed	1 - 3
Opposing Affidavits (Affirmations)	4
Reply Affidavits (Affirmations)	

Defendants move pursuant to CPLR §§ 2221(a) and (e) to reargue this Court's Decision and Order, dated May 19, 2017 (the "Prior Order") and upon reargument to obtain the following relief: (a) dismissal of Plaintiff's Amended Complaint; and (b) denial of Plaintiff's cross-motion for leave to file a Second Amended Complaint. Plaintiff opposes and cross-moves to reargue the portion of the Prior Order which denied Plaintiff's motion for a preliminary injunction. For the reasons set forth below, Defendants' motion is granted and after reargument the Court reverses its

prior decision in part. The appraisal proceeding triggered by Plaintiff's filing of the notice of dissent is stayed.

Background

Plaintiff, Menachem Farro's ("Farro") commenced this action, in part, to challenge Individual Defendant, Zalma Schochet's ("Schochet") interest in LMEG. According to Farro's Amended Complaint, Farro and Individual Defendant, Levi Wilhelm ("Wilhelm") formed LMEG as equal 50 percent members in 2003. LMEG was created for the purposes of manufacturing, selling and distributing aftermarket accessories for cellular phones. After LMEG's creation, Farro and Wilhelm created LM International, Inc., Seller1On1 Inc. and WML Communications, Inc. (together with LMEG the "Businesses") as equal shareholders.

In 2008, Plaintiff and Wilhelm allegedly asked Schochet, a licensed attorney, to lend them money to keep the Businesses running. Farro claims that through Schochet's knowledge of the cellular phone industry, Schochet knew that the Businesses would need urgent funding at specific times of the year, particularly prior to the holiday shopping seasons. To that end, Schochet allegedly developed a plan whereby he would loan funds to the Businesses at usurious interest rates.

Unbeknownst to Farro or Wilhelm, Schochet allegedly knew that it would be difficult, if not impossible, for the Businesses to repay the principal on the loans. Schochet is said to have plotted to convert a portion of his loans to an equity ownership interest in the Businesses. According to Farro, in approximately 2008, the Businesses needed additional funds to remain in operation. Farro and Wilhelm allegedly secured multiple loans from Schochet at a usurious interest rate. Farro claims that the monies that Schochet used to fund these loans came from his attorney trust account at JP Morgan Chase.

Schochet allegedly never disclosed whether he was making the loans on behalf of himself or third parties. In or about 2011, the Businesses needed additional funding. Consequently, Farro and Wilhelm accepted additional loans from Schochet. Farro claims that Schochet affirmatively represented to him that the funds in his attorney trust account belonged to him personally and not to third parties.

According to Farro, Schochet's representations as to the source of the funds in his attorney trust account proved to be false. Farro claims that the funds belonged, either in whole or in part, to unidentified third parties. And that relying on Schochet's representations, he and Wilhelm issued Schochet a one-third equity interest in the Businesses in 2011. On or about September 18, 2014, to legitimize his prior acts, Schochet allegedly prepared a handwritten document in which he pressured Farro to sign under extreme duress acknowledging that Schochet held a one-third equity interest in the Businesses.

The alleged duress included repeated threats by Schochet to falsely file criminal charges against Farro and to demand the payment of all outstanding loans. Farro claims that in late 2013, Wilhelm began to assist Schochet in his conduct. And that with Wilhelm's assistance, Schochet

formally became a director and manager of the Businesses. According to Farro, Wilhelm and Schochet colluded to remove him as a director and manager of the Businesses.

On or about October 3, 2016, Schochet as a Member of the Board of Directors of the Businesses, sent a "Notice of Special Meeting of Shareholders" (the "Meeting") to be held on October 14, 2016. The purpose of the Meeting was to sell the assets of the Businesses to third-party subsidiary entities, the identities of which, Farro claims were not disclosed to him. The Meeting was not held because Farro commenced this action on October 12, 2016. On October 13, 2016, Farro moved for a temporary restraining order to stay the Meeting. This Court granted Farro's application on October 19, 2016. However, on October 31, 2016, the Court denied Farro's request for a preliminary injunction.

Farro claims that upon denial of the preliminary injunction, the Meeting was not re-noticed in accordance with the provisions of the Business Corporation Law (BCL). Instead, an email was allegedly sent by counsel for Defendants unilaterally scheduling the Meeting for the following day, November 1, 2016. Farro attended the Meeting and reserved his rights to object to the Meeting's proceedings. At the Meeting, Farro voted against the transfer of the Businesses' assets. However, Schochet and Wilhelm approved the transfer.

On November 21, 2016, Schochet and Wilhelm served, on behalf of the Businesses, a Notice of Merger and Dissenters' Rights (the "Merger Notice") on Farro. The Merger Notice stated that Schochet and Wilhelm decided on November 16, 2016, to merge the Businesses into LMEG Acquisition, LLC ("LMEG Acquisition"). The Merger Notice stated that Farro would not receive any membership interest in LMEG Acquisition. But that Farro would be entitled to his interest's fair market value, $7,225,500.00. The Merger Notice further required Farro to serve a written notice of dissent within 20 days, if he disagreed with the valuation of his interest set forth in the Merger Notice.

On January 2017, Farro filed a proposed Second Amended Complaint. Farro alleges that he was not provided with any notice prior to the adoption of plan of the Merger. And that in derogation of the provisions of Article 10 of New York's Limited Liability Company Law (LLCL), Schochet and Wilhelm did not hold or notice a meeting to consider the Merger. The sole purpose of the Merger, Farro claims, was to deprive him of standing to assert derivative claims on the Businesses' behalf.

Defendants subsequently moved to dismiss Farro's Amended Complaint and opposed Farro's motion to file the Second Amended Complaint. Farro opposed Defendants' motion and cross-moved for a preliminary injunction to, among other things, toll his time to file a notice of dissent to the Merger. In issuing the Prior Order, the Court denied Defendants' motion in its entirety and granted Farro's motion to file the Second Amended Complaint. However, the Court denied Farro's request for a preliminary injunction as moot because the Merger had been completed.

In the instant motion, Defendants move to reargue the Prior Order. First, Defendants argue that, in denying their motion to dismiss the Amended Complaint, the Court overlooked or misapprehended the issues. Defendants argue that once a cash-out merger of an LLC is

consummated, New York law divests a dissenting member of standing to sue derivatively and bars all claims to challenge that merger. The exclusive remedy available to Farro, Defendants maintain, is an appraisal proceeding to determine the market value of his interest, pursuant to LLC §1002 (f) and (g). Bolstering their prior arguments for dismissal, Defendants point out that Farro filed a notice of dissent triggering an appraisal proceeding after the Court issued its Prior Order.

Second, Defendants argue that the Court should have denied Farro's request to file the Second Amended Complaint. Defendants highlight that one of the Second Amended Complaint's causes of action seeks to nullify the Merger for non-compliance with the notice requirement of LLCL § 1002(c). But, Defendants argue that courts have excused non-compliance with LLCL § 1002(c), so long as LLCL §407(a) is complied with. Defendants maintain that LLCL §407(a) permitted them to act without prior notice to Farro.

Third, Defendants argue that the Court overlooked or misapprehended that Farro's cause of action for fraud and rescission of the Merger fails to state a claim for relief as a matter of law. The crux of Farro's fraud claim is based on the allegation that Schochet misled Farro about the source of the loan funds from his attorney trust account. Defendants insist that Farro's allegations of fraud is refuted by Farro's own claims and by documentary evidence. Defendants point to Farro's admission in the Amended Complaint that he knew that Schochet's loans funds came directly from his attorney trust account.

Farro's knowledge of the source of the loan funds, Defendants argue, imposed a duty of inquiry upon Farro to determine precisely where those funds came from. Defendants argue that Farro's failure to perform this duty of inquiry vitiates his alleged reliance upon Schochet's misrepresentation. Further erosion of Farro's reliance argument, Defendants claim, is represented in the loan agreement executed by the parties in December 2011. In that agreement, Farro ostensibly acknowledges Schochet's one-third interest in the Businesses.

Further, Defendants argue that the Court overlooked that Farro did not suffer any damages due to Schochet's alleged misrepresentation. Defendants maintain that the source of the loan funds is immaterial because the Businesses benefited from the loans. Additionally, Defendants argue that rescission of the Merger is unavailable to Farro as a remedy because Farro has an adequate remedy at law. Defendants maintain that, to rescind Schochet's interest in the Businesses after six years of ownership would be impossible.

Fourth, Defendants argue that the Court overlooked that their prior motion sought to dismiss the entire Amended Complaint, not just the fraud and rescission claims. Defendants maintain that the breach of contract claim, based upon Schochet having provided "stolen and/or unauthorized funds" for his interest in the Businesses, is without merit. Defendants argue that the December 2011 loan agreement refutes that claim because it indicates that Schochet provided the following consideration for his ownership interest: (i) forbearance from foreclosing on prior loans; (ii) a reduction of the rate of interest of the prior loans; (iii) retirement of the prior loans.

Similarly, Defendants argue that the Amended Complaint's cause of action to remove Schochet as director of the Businesses should have been dismissed. Defendants argue that the exclusive remedy to seek removal of a director of a corporation is a vote of shareholders.

Defendants argue that such vote has not taken place and that the Amended Complaint fails to allege any action on the part of Schochet which would require his removal.

Lastly, Defendants argue that the Amended Complaint's causes of action for an accounting and unjust enrichment should also have been dismissed. Defendants argue that no confidential or fiduciary relationship exists between Farro and the Businesses, after the Merger, to serve as the basis for an accounting claim. And that Farro cannot assert an unjust enrichment claim because he concedes that the December 2011 loan agreement represents a valid contract between the parties.

Farro opposes Defendants' motion and cross-moves to reargue that part of the Prior Order which denied his motion for a preliminary injunction, tolling his time to file a notice of dissent to the Merger. First, Farro argues that his claims are not barred by the Merger because the Merger was improper. Farro maintains that Schochet fraudulently obtained his membership interest in the Businesses. And that it was only through Schochet's unlawful vote that the Merger was supposedly consummated. Second, Farro argues that the Merger is invalid because he was not given a copy of the Merger agreement in advance and was not notified of the meeting where the Merger would be voted on.

Next, Farro argues that the Court did not overlook or misapprehend the facts or law in sustaining his fraud claim. Farro maintains that Schochet affirmatively represented to him that the funds in Schochet's attorney trust account belonged to him personally and not to third-parties. Farro insists that Schochet's alleged fraudulent representation is not refuted by the December 2011 loan document. Farro maintains that, his recognition of Schochet's interest in the Businesses in the December 2011 loan document does not negate his allegation that Schochet misrepresented the source of the loans. Additionally, Farro argues that his rescission claim is properly asserted because the Court possesses jurisdiction over the parties and can restore the status quo of the Businesses.

Further, Farro argues that the Court did not overlook or misapprehend issues of fact or law in refusing to dismiss the Amended Complaint's other causes of action. Farro maintains that the Merger did not divest him of standing to assert the derivative claims on behalf of the Businesses because he did not voluntarily tender his shares to secure his statutory appraisal rights. Rather, Farro argues that Defendants improperly forced the sale of his shares in the Merger, as a means of depriving him of standing to assert his claims.

In addition, Farro argues that the Court properly denied Defendants' request to dismiss the Amended Complaint's breach of contract claim. Farro maintains that Schochet's promise in the December 2011 loan document to reduce and forgive the loans, does not qualify as valid consideration because of Schochet's alleged misrepresentation about the source of the loans.

Furthermore, Farro argues that the Court properly ruled on his claim to remove Schochet as director and officer of the Businesses, as well as his claims for an accounting and unjust enrichment. Farro maintains that as a holder of at least 10 percent interest in the Businesses, he is permitted under NY BCL §706(d) to intimate an action to remove Schochet as a director and officer. And that his breach of contract claim is not duplicative of his unjust enrichment claim.

Lastly, Farro argues that the Court erred in denying his request for a preliminary injunction, tolling his time to file a notice of dissent to the Merger. Farro maintains that the Court's denial of the preliminary injunction left him no choice but to file the notice of dissent after the Court issued its Prior Order. Filing the notice of dissent, Farro maintains, started the running of the clock for the commencement of a special proceeding to appraise the value of his membership interest in the Businesses. Farro argues that it is impossible for the special proceeding and this action, which seeks to invalidate the Merger, to proceed simultaneously.

Discussion

A motion for leave to reargue "shall be based upon matters of fact or law allegedly overlooked or misapprehended by the court in determining the prior motion, but shall not include any matters of fact not offered on the prior motion" (CPLR 2221[d][2]; *see Matter of Anthony J. Carter, DDS, P.C. v Carter*, 81 AD3d 819, 820 [2d Dept 2011]). "While the determination to grant leave to reargue a motion lies within the sound discretion of the court, a motion for leave to reargue is not designed to provide an unsuccessful party with successive opportunities to reargue issues previously decided (*Matter of Anthony J. Carter, DDS, P.C. v Carter*, 81 AD3d 819, 820 [2d Dept 2011]). Here, the Court deems it appropriate the reconsider its Prior Order, based on the arguments proffered by the parties.

First, Defendants argue that the Merger divested Farro of standing to file the Amended Complaint. In New York, the remedy of a shareholder dissenting from a merger and an offered "cash-out" price is to obtain the fair value of his or her stock through an appraisal proceeding (*see* BCL § 623). This protects the minority shareholder from being forced to sell at unfair values imposed by those dominating the corporation while allowing the majority to proceed with its desired merger (*see Matter of Endicott Johnson Corp. v Bade*, 37 NY2d 585, 590 [1975]).

The pursuit of an appraisal proceeding generally constitutes the dissenting stockholder's exclusive remedy (*see* BCL § 623 [k]; *see also Breed v Barton*, 54 NY2d 82, 85 [1981]). An exception exists, however, when the merger is unlawful or fraudulent as to that shareholder, in which event an action for equitable relief is authorized (BCL § 623 [k]; *see Matter of Willcox v Stern*, 18 NY2d 195, 204 [1966]); *Breed v Barton*, 54 NY2d 82, 86, *supra*).

Here, in dissenting to the Merger, ordinarily Farro's exclusive remedy would have resided in an appraisal proceeding. However, Farro challenges the Merger because Schochet allegedly fraudulently obtained his interest in the Businesses and along with Wilhelm initiated the Merger to prevent Farro from asserting his claims. Because Farro challenges the Merger as being fraudulent in regards to him, Farro is permitted to assert his claims for equitable relief. Therefore, after reargument, the Court adheres to its prior decision, with respect to that part of Defendants' motion.

Second, Defendants argue that the Court should have denied Farro's request to file a claim seeking to nullify the Merger, based on Defendants' failure to follow the notice requirement of LLCL § 1002(c). Pursuant to LLCL § 1002 (c), before an LLC may enter into a merger agreement, a meeting to vote on the merger must be held and the members must be given 20 days' notice of the meeting. However, LLCL § 407 (a) provides:

> "*Whenever under this chapter* members of a limited liability company are required or permitted to take any action by vote, except as provided in the operating agreement, such action may be taken *without a meeting, without prior notice and without a vote*, if a consent or consents in writing, setting forth the action so taken shall be signed by the members who hold the voting interests having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all of the members entitled to vote therein were present and voted" (emphasis added)".

Simply put, whenever the Limited Liability Company Law requires a member vote, section 407 (a) permits written consents in lieu of a meeting so long as the requisite majority of members execute written consents (*Slayton v Highline Stages, LLC*, 46 Misc. 3d 450 [Sup Ct, NY County 2014]). If consents in lieu of a meeting are utilized, section 407 (c) then requires "[p]rompt notice" of the action authorized by the consents to be given to members who did not execute consents (*id.*)

Here, Defendants did not provide Farro the required prior notice called for by LLCL § 1002(c) in effectuating the Merger. However, in support of their motion Defendants submit proof, in the form of documentary evidence, indicating that Schochet and Wilhelm, together the alleged majority shareholders of the Businesses, executed a written consent to proceed with the Merger without formal notifications and meetings. Further, upon the Merger's execution, Defendants promptly notified Farro that the Merger had taken place. Therefore, upon reargument, Farro's request to file a claim to nullify the Merger based upon insufficient notice under LLCL § 1002(c) is DENIED.

Third, Defendants argue that Farro's fraud and rescission claim is refuted by Farro's own allegation and by documentary evidence. "The elements of a cause of action sounding in fraud are a material misrepresentation of an existing fact, made with knowledge of the falsity, an intent to induce reliance thereon, justifiable reliance upon the misrepresentation, and damages" (*Introna v Huntington Learning Ctrs., Inc.*, 78 AD3d 896, 898 [2d Dept 2010]; *see Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]).

Here, Defendants' argument that Farro's knowledge of the existence of the attorney trust account imposed a duty on Farro to identity the owner of the funds therein is without merit. Farro alleges that Schochet explicitly informed him that the funds in the attorney trust account belong to him personally and not to third parties. Farro further alleges that he would not have consented to Schochet's partnership in the Businesses had he known the true source of the loans funds. That Farro confirmed Schochet's ownership interest in the December 2011 loan document does not eliminate the alleged initial misrepresentation in regards to the loan funds. Therefore, upon reargument, the Court adheres to its prior decision as to that part of the Defendants' motion.

Fourth, Defendants argue that the Court should have dismissed the breach of contract claim in the Prior Order because Schochet provided valid consideration to obtain his interest in the Businesses. The elements of a cause of action to recover damages for breach of contract are: (1) the existence of a contact, (2) the plaintiff's performance under the contract, (3) the defendant's breach of the contract, and (4) resulting damages (*see JP Morgan Chase v J.H. Elec. of N.Y., Inc.*, 69 AD3d 802, 803 [2d Dept 2010]). "It is axiomatic that every contract must be

supported by valid consideration" (*Umscheid v. Simnacher*, 106 AD2d 380 [2d Dept 1984]). An illegal consideration is no consideration (*Gerdes v. Reynolds*, 28 NYS2d 622, 660 [Sup Ct, New York County 1941]).

Here, in consideration for obtaining his interest in the Businesses, Schochet agreed, in the December 2011 loan agreement, to forbear from foreclosing on the loans, reduce the interest of the loans and retire portions of the loan. The record is devoid of any evidence that Schochet did not perform under the parties' December 2011 loan agreement. Further, the December 2011 loan agreement does not delineate the source of the loans as an essential part of the parties' contract. Therefore, after reargument, Defendant's motion to dismiss Farro's breach of contract claim is GRANTED.

Further, Defendants argue that the Court should have dismissed the cause of action which seeks to remove Schochet as a director of the Businesses. Under New York Law, directors of a corporation "may be removed for cause by vote of the shareholders" or by the action of the board, if such removal is provided for in the certificate of incorporation or "the specific provisions of a by-law adopted by the shareholders" (BCL § 706 [a]). "Any officer elected or appointed by the board may be removed by the board with or without cause. An officer elected by the shareholders may be removed, with or without cause, only by vote of the shareholders . . ." (BCL § 716 [a])." An action to procure a judgment removing a director [or an officer] for cause may be brought by the attorney-general or by the holders of ten percent of the outstanding shares, whether or not entitled to vote" (BCL §§ 706 [d], 716 [c]).

Here, as a holder of at least ten percent interest in the Businesses, Farro is permitted to bring an action to remove Schochet as a director for cause. Further, issues of fact exist as to whether sufficient cause exist to remove Schochet as a director and officer of the Businesses. Therefore, after reargument the Court adheres to its prior decision in regards to that part of Defendants' motion.

Additionally, Defendants argue that the Court should have dismissed Farro's accounting claim because the Merger terminated Farro's fiduciary relationship with the Businesses. However, whether Farro is an interest holder in the Businesses is an unsettled issue because Farro's complaint challenges the validity of the Merger. As such, the Court adheres to its prior decision in regards to that part of Defendants' motion.

As to the unjust enrichment claim, the existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter (*Clark-Fitzpatrick, Inc. v. Long Island R. Co.*, 70 NY2d 382 [1987]). A "quasi contract" only applies in the absence of an express agreement, and is not really a contract at all, but rather a legal obligation imposed in order to prevent a party's unjust enrichment (*Farash v Sykes Datatronics*, 59 NY2d 500, 504 [1983]).

Here, the December 2011 loan agreement appears to be a valid contract under which Schochet obtained his interest in the Businesses. However, Farro alleges that Schochet provided illegal consideration in connection with the December 2011 loan agreement, a charge that would render the contract void, if proven true. Therefore, to the extent that the December 2011 loan

agreement is voidable based on illegal consideration proffered by Schochet, the Court adheres to its prior decisions upholding Farro's unjust enrichment claim.

Lastly, Farro argues that the Court erred in denying his request for a preliminary injunction, tolling his time to file a notice of dissent to the Merger. However, after the Court issued its Prior Order, Farro filed his notice of dissent to the Merger, rendering Farro's request for an extension to file the notice of dissent moot. However, the Court deems it appropriate to stay the appraisal proceeding triggered by Farro's filing of the notice of dissent until the parties' interest in the Businesses is determined.

Accordingly, after reargument, it is hereby

ORDERED that Farro's request to file a claim to nullify the Merger based upon insufficient notice under LLCL § 1002(c) is DENIED, it is further

ORDERED that Defendant's motion to dismiss Farro's breach of contract claim is GRANTED, it is further

ORDERED that an appraisal proceeding deriving from Farro's filing of the notice of dissent is stayed, it is further

ORDERED that the Court otherwise adheres to its Prior Order.

This constitutes the Decision and Order of the Court.

ENTER,

Sylvia G. Ash, J.S.C

HON. SYLVIA G. ASH, JSC