3839 Holding LLC v Farnsworth
2019 NY Slip Op 30721(U)
March 15, 2019
Supreme Court, New York County
Docket Number: 654463/2016
Judge: O. Peter Sherwood

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49

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3839 HOLDING LLC,

Plaintiffs,

-against-

THEODORE FARNSWORTH,

Defendants.

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DECISION AND ORDER
Index No.: 654463/2016

Motion Sequence No.: 003

O. PETER SHERWOOD, J.:

Under motion sequence 003, defendant Theodore Farnsworth seeks summary judgment dismissing the one remaining claim in the case which is for breach of contract. Plaintiff 3839 Holdings, LLC, cross-moves to compel discovery, and for leave to amend the complaint a second time. For the reasons discussed below, the motion for summary judgment shall be granted, the cross-motion to amend the amended complaint shall be denied for failure to comply with CPLR 3025(b) with leave to re-plead second amended complaint and to permit revision of the proposed and the cross-motion to compel discovery denied as moot.

The parties have not exchanged 19-a statements of material facts. However, given the nature of the arguments, the motion for summary judgment may be resolved without them. The following background is taken from the complaint and this courts decision on the motion to dismiss.

I. BACKGROUND

This action arises out of an alleged agreement between the parties pursuant to which plaintiff invested $1 million in defendant Highland Holdings Group (HHG) in exchange for a 10% interest in the company (amended complaint 16-17). The agreement was memorialized in an Amendment to the HHG Shareholders Agreement (SHA Amendment), and designated plaintiff as a preferred shareholder (November 16, 2017 Decision and Order [NYSCEF Doc No. 52] at 1-2). Defendants Farnsworth and HHG allegedly did not use plaintiffs funds for the purposes stated in the SHA Amendment, or for transactions of any kind (*id.* at 2, citing amended complaint 26). Farnsworth and HHG have since returned half of the capital contribution, but $500,000 remains outstanding. Plaintiff contends that those funds were diverted to defendant Zone Technologies, Inc. (Zone), another company owned and operated by Farnsworth, in order to improve the prospects of a potential sale or merger of that company (id. at 3, citing amended complaint 26).

The amended complaint contained nine causes of action. On defendants motion to dismiss, this court disposed of all of them except the first claim for breach of contract as against Farnsworth. In its Decision and Order the court stated:

> "If 'Farnsworth and HHG...distributed...[Plaintiff's] Capital Contribution to Farnsworth and/or otherwise misappropriated the Capital Contribution' (amended complaint ¶ 36) resulting in HHG having insufficient funds remaining to return plaintiff's Capital Contribution, the claim is for waste, mismanagement and self-dealing and belongs to HHG, not plaintiff. Affording the amended complaint 'a liberal construction... and provid[ing] plaintiff the benefit of every possible inference'... the amended complaint can be construed as alleging that the Capital Contribution was 'misappropriated by Farnsworth and never deposited with HHG. As such, the First Cause of Action survives the Motion to Dismiss [as] to Farnsworth."

(November 16, 2017 Decision and Order [NYSCEF Doc No. 52] at 7). The amended complaint was dismissed in its entirety as to defendants HHG, Zone, and Helios and Matheson Analytics (HMNY) (*id.* at 20-21).

Defendant Farnsworth now brings this motion to dismiss the remaining claim against him on the grounds that HHG bank statements show that plaintiff's money was deposited in HHG's account, and therefore the only claim that may exist is for waste, mismanagement, and self-dealing, all of which belong to HHG, not plaintiff individually.

II. LEGAL STANDARD

The standards for summary judgment are well settled. Summary judgment is a drastic remedy which will be granted only when the party seeking summary judgment has established that there are no triable issues of fact (*see* CPLR 3212 [b]; *Alvarez v Prospect Hosp.*, 68 NY2d 329 [1986]; *Sillman v Twentieth Century-Fox Film Corporation*, 3 NY2d 395 [1957]). To prevail, the party seeking summary judgment must make a prima facie showing of entitlement to judgment as a matter of law tendering evidentiary proof in admissible form, which may include deposition transcripts and other proof annexed to an attorney's affirmation (*see Alvarez v Prospect Hosp., supra*; *Olan v Farrell Lines*, 64 NY2d 1092 [1985]; *Zuckerman v City of New York*, 49 NY2d 557 [1980]). Absent a sufficient showing, the court should deny the motion without regard to the strength of the opposing papers (*see Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851 [1985]).

Once the initial showing has been made, the burden shifts to the party opposing the motion for summary judgment to rebut the prima facie showing by producing evidentiary proof in admissible form sufficient to require a trial of material issues of fact (*see Kaufman v Silver*, 90

NY2d 204, 208 [1997]). Although the court must carefully scrutinize the motion papers in a light most favorable to the party opposing the motion and must give that party the benefit of every favorable inference (*see Negri v Stop & Shop*, 65 NY2d 625 [1985]) and summary judgment should be denied where there is any doubt as to the existence of a triable issue of fact (*see Rotuba Extruders, v Ceppos*, 46 NY2d 223, 231 [1978]), bald, conclusory assertions or speculation and "[a] shadowy semblance of an issue" are insufficient to defeat a summary judgment motion (*S.J. Capalin Assoc. v Globe Mfg. Corp.*, 34 NY2d 338, 341 [1974]; *see Zuckerman v City of New York, supra; Ehrlich v American Moninger Greenhouse Mfg. Corp.*, 26 NY2d 255, 259 [1970]).

Lastly, "[a] motion for summary judgment should not be granted where the facts are in dispute, where conflicting inferences may be drawn from the evidence, or where there are issues of credibility" (*Ruiz v Griffin*, 71 AD3d 1112 [2d Dept 2010], quoting *Scott v Long Is. Power Auth.*, 294 AD2d 348 [2d Dept 2002]).

III. ARGUMENTS

A. Farnsworth's Memo in Support

Defendant argues that the remaining claim can be refuted by bank statements showing that the funds at issue were properly deposited with HHG (*see* Farnsworth aff, exhibit A [NYSCEF Doc No. 66 bank statements]). The breach of contract claim remains in the case only because the amended complaint could be liberally construed to allege that Farnsworth misappropriated plaintiff's investment funds instead of depositing them with HHG. Farnsworth argues that the bank statements show that the allegation is "undisputedly untrue" (mem at 4). Plaintiff purchased its interest in HHG via wire transfer directly to a HHG bank account (mem at 2 n1, citing Farnsworth affirmation). The bank statements show that HHG received wire transfers from Riverside Abstract LLC (a title company designated by the Amended Shareholders Agreement to handle all HHG closings, [*see* NYSCEF Doc Nos. 67-68]) in four equal payments on the dates alleged in the amended complaint (mem at 2-3; Farnsworth aff ¶¶ 2-3). Shaul Greenberg is both the principal of Riverside Abstract LLC and of plaintiff. This is the company through which plaintiff made its investment in HHG (mem at 2-3).

B. Opposition and Cross-motion to Compel Discovery and to Amend Complaint

In opposition, plaintiff does not dispute that it deposited the funds in HHG's account. It argues "that Farnsworth directed the funds to be deposited into an HHG account which he then immediately raided, as opposed to accepting plaintiff's funds personally and then never depositing

them with HHG... is a distinction without a difference" (opp at 3). The bank statements that defendant submits shows that after the money was deposited, funds were immediately diverted to other companies and accounts controlled by Farnsworth (opp at 3; Bernstein affirmation, exhibit 1). For example, $373 was transferred to Millenial Hotel Group, Inc. The State of Florida Division of Corporations lists it as owned by Farnsworth (Bernstein affirmation, exhibit 2).

In its' prior holding, the court held that the amended complaint may be construed to allege a misappropriation by Farnsworth. While the bank statements show that deposits were made in a HHG account, they do not refute the allegations that there was a misappropriation, especially given that the bank statements also show immediate withdrawals (opp at 2). Defendant's argument that he had no obligation to do anything with plaintiff's money, and did not breach the SHA Amendment by taking the money from HHG after it was deposited, would mean that there was no consideration given for the funds and therefore, the contract is void (opp at 6, citing *Non-Linear Trading Co. v Braddis Assocs., Inc.*, 243 AD2d 107, 114 [1st Dept 1998]).

By cross-motion, plaintiff seeks to compel discovery. It asserts that summary judgment is inappropriate at this stage because defendants have not responded to plaintiff's discovery requests (opp at 7). In order to determine whether there was valid consideration to the contract, the question of whether defendant used his "best efforts to accomplish the purpose of [the] agreement" must be answered (*Non-Linear*, 243 AD2d at 114). The merits of the breach of contract claim depend on this factual inquiry, and thus summary judgment must be denied (opp at 8, citing *Kew Gardens Hills Apartment Owners, Inc. v Horing Wlkinson & Rosen, P.C.*, 35 AD3d 383, 385 [2d Dept 2006]).

Finally, plaintiff cross-moves to amend the complaint in light of the evidence submitted by defendants. The new evidence shows that defendant HHG's account balance was $17 on February 1, 2016. Plaintiff then made four deposits of $250,000 each between February and April, at the end of which HHG's account balance was $336,961.50. The bank statements show that $663,038.50 was transferred to various institutions and accounts. Credit card purchases and ATM withdrawals were also made from the account (Farnsworth aff, exhibit A [NYSCEF Doc No. 66 bank statements]). The bank statements show that plaintiff may have a new derivative claim on behalf of HHG, as well as revived individual claims for breach of the covenant of good faith and fair dealing, unjust enrichment, and fraudulent conveyance (opp at 8-11). The new facts warrant granting leave to amend (*Haga v Pyke*, 19 Ad3d 1053,1055 [4th Dept 2005]).

C. Reply and Opposition to Cross-motion

In reply, defendants note their position that the SHA Amendment does not require that funds be invested in real estate, nor that the investments necessarily result in returns (reply at 1). Otherwise, defendants do not respond plaintiff's argument. Defendant focuses instead on the cross-motion to amend, arguing that plaintiff has failed to state a claim against defendants for breach of contract, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment, fraudulent conveyance or alter ego liability. Although plaintiff did not include a breach of fiduciary duty claim in its proposed second amended complaint, defendants devote significant attention to arguments against a breach of fiduciary duty claim possibly asserted as a direct claim. Defendants distinguish the cases cited by plaintiff because those cases involve claims that are classically direct, unlike the claims asserted here (reply at 6-7, citing *In re BHC Communications, Inc. Shareholder Litigation*, 789 A2d 1 [Del Ch 2001]; *Odyssey Partners, L.P. v Fleming Cos.*, 735 A2d 386 [Del Ch 1999]; *Gentile v Rosette*, 906 A2d 91 [Del Ch 2006]; *Fischer v Fischer*, 1999 Del Ch LEXIS 217 [Ch Nov 4, 1999]; *McBeth v Porges*, 171 FSupp3d 216 [SD NY 2016]).

D. Plaintiff's Reply to the Cross-motion

In further support of the cross-motion, plaintiff contends that defendants have failed to cite to any law supporting the proposition that a plaintiff may not amend upon discovery of new evidence (reply to cross-motion at 2). Likewise, defendants have not argued that they will be prejudiced, nor that the amendment is "plainly lacking in merit" as CPLR 3205 requires (*id.* at 2). Finally, defendants' issue with plaintiff's potentially direct, as opposed to derivative, claims is not an issue to be decided on a motion for leave to amend (*id.* at 3, citing *Baker v Andover Assocs. Mgmt. Corp.*, 30 Misc. 3d 1218[A] [Sup Ct Westchester County 2009] [finding that is leave to replead is granted, then "[p]laintiff will have to choose whether she wishes to pursue her direct claims or her derivative claims"], 8-9).

II. DISCUSSION

A. Farnsworth's Motion for Summary Judgment

Defendant has made a prima facie showing of entitlement to grant of the motion for summary judgment as a matter of law, having tendered bank statements showing that the funds at issue in the complaint were deposited with HHG (Farnsworth aff, exhibit A [NYSCEF Doc No. 66, bank statements]). This court has previously stated that direct claim against Farnsworth could survive

only in the event that the funds were "misappropriated by Farnsworth and never deposited with HHG" (November 16, 2017 Decision and Orde. [NYSCEF Doc No. 52] at 7). The bank statements show that Farnsworth did not have possession of plaintiff's finds HHG did.

Plaintiff fails to raise any issue of material fact on rebuttal. Plaintiff argues that it is of no consequence whether Farnsworth took the money directly from plaintiff, or from the HHG account. But having made a capital contribution to HHG in exchange for a percentage interest in the company, plaintiff's interest would be a derivative one on behalf of HHG.

Plaintiff also argues that there remains an issue of fact as to whether Farnsworth used his "best efforts" to further the purpose of the contract. Plaintiff argues that if he did not, then there was no valid consideration given to the contract, the contract would be void, and plaintiff "must be restored to the status quo" (opp at 6 n 4, citing *Non-Linear Trading Co. v Braddis Assocs., Inc.*, 243 AD2d 107, 114 [1st Dept 1998]; *Schwartz v National Computer Corp.*, 42 Ad2d 123 [1st Dept 1973]). But this court has already found as a matter of law that "[t]he SHA Amendment is clear on its face and contains no provisions requiring either Farnsworth or HHG to return the Capital Contribution or to invest in real estate by a time certain... There is no provision of the SHA Amendment that obligates the company to make distributions. Article 6 merely confers a preference on plaintiff [as] a 'Preferred Shareholder'" (November 16, 2017 Decision and Order [NYSCEF Doc No. 52] at 7). Plaintiff has therefore failed to raise a triable issue of material fact.

The motion for summary judgment may therefore be granted, and the complaint dismissed.

B. Cross-motion to Compel Discovery

Plaintiff complains that defendant has not responded to its discovery requests. Because the complaint is due to be dismissed, this branch of the cross-motion shall be denied as moot.

C. Cross-motion to Amend the Complaint

Leave to amend a pleading pursuant to CPLR § 3025 "shall be freely given," in the absence of prejudice or surprise (*see e.g. Thompson v Cooper*, 24 AD3d 203, 205 [1st Dept 2005]; *Zaid Theatre Corp. v Sona Realty Co.*, 18 AD3d 352, 354 [1st Dept 2005]). Mere lateness in seeking such relief is not in itself a barrier to obtaining judicial leave to amend (*see Ciarelli v Lynch*, 46 AD3d 1039 [3d Dept 2007]). Rather, when unexcused lateness is coupled with significant prejudice to the other side, denial of the motion for leave to amend is justified (*see Edenwald Contracting Co. v City of New York*, 60 NY2d 957, 958 [1983]). Prejudice in this context is shown where the nonmoving party is "hindered in the preparation of his case or has been prevented from

taking some measure in support of his position" (*Loomis v Civetta Corinno Const. Co.*, 54 NY2d 18, 23 [1981]).

In order to conserve judicial resources, examination of the underlying merit of the proposed amendment is mandated (*Thompson, supra*, 24 AD3d at 205; *Zaid, supra*, 18 AD3d at 355). Leave will be denied where the proposed pleading fails to state a cause of action, or is palpably insufficient as a matter of law (*see Aerolineas Galapagos, S.A. v Sundowner Alexandria*, 74 AD3d 652 [1st Dept 2010]; *Thompson, supra*, 24 AD3d at 205). Thus, a motion for leave to amend a pleading must be supported by an affidavit of merit or other evidentiary proof (*Delta Dallas Alpha Corp. v S. St. Seaport Ltd. Partnership*, 127 AD3d 419, 420 [1st Dept 2015]).

As the party seeking the amendment, plaintiff has the burden in the first instance to demonstrate their proposed claims' merits, but defendants, as the parties opposing the motion, "must overcome a presumption of validity in the moving party's favor, and demonstrate that the facts alleged in the moving papers are obviously unreliable or insufficient to support the amendment" (*Peach Parking Corp. v 346 W. 40th St. LLC*, 42 AD3d 82, 86 [1st Dept 2007]).

Plaintiff moves to amend in light of the evidence brought forth by plaintiff on the motion for summary judgment. Plaintiff satisfied the requirement that the motion to amend be accompanied by evidentiary proof. It has included a proposed amended second complaint along with the motion (Bernstein affirmation, exhibit 3 [NYSCEF Doc No. 72]), and defendants have made their opposition. However, plaintiff has not provided a blackline version clearly showing the changes to its first amended complaint as required by CPLR 3025 (b). Plaintiff's proposed second amended complaint appears to include new derivative claims for waste, mismanagement, and self-dealing against Farnsworth on behalf of HHG, as well as revived claims against Farnsworth individually for breach of contract and breach of the covenant of good faith and fair dealing, as well as revived claims brought individually and derivatively against Farnsworth for unjust enrichment and fraudulent conveyance. Defendants' opposition does not acknowledge the new claim for waste, mismanagement, and self-dealing but does address other claims that plaintiff is no longer pursuing, such as the claims for breach of fiduciary duty and permanent injunction. In any event, some of the new causes of action are not properly pleaded. The motion shall be denied with leave to replead.

It is hereby

ORDERED that defendants' motion for summary judgment is granted; plaintiff's motion to compel is denied, and plaintiff's motion to amend the amended complaint is denied with leave to replead within 20 days of service of the decision and order with notice of entry.

This constitutes the decision and order of the court.

DATED: March 15, 2019

E N T E R,

O. PETER SHERWOOD J.S.C.