SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS : CIVIL TERM: COMMERCIAL PART 8

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56 EAST INVESTORS LLC, individually as well as derivatively on behalf of East Upreal LLC, and East Upreal LLC,,

Plaintiffs, Decision and order

- against - Index No. 503964/2019

UPREAL BROOKLYN LLC, DAVID GOLDBERGER, EYAL YAGEV, BOAZ GILAD, ASSAF FITOUSSI & BROOKLAND UPREAL LIMITED,

MS # 1

August 22, 2019

Defendants,

- against -

EAST UPREAL LLC,

Nominal Defendant,

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PRESENT: HON. LEON RUCHELSMAN

The defendants have moved pursuant to CPLR §3211 seeking to dismiss the complaint or alternatively to stay the proceedings pursuant to CPLR §2201. The plaintiff opposes the motion. Papers were submitted by the parties and arguments held. After reviewing all the arguments, this court now makes the following determination.

According to the Complaint, during 2014 the plaintiff 56 East Investors LLC, which comprised eighteen individual investors, invested over two million dollars in a real estate development project located at 56 East 21st Street in Kings County. Pursuant to the operating agreement defendants David Goldberger and Eyal Yagev were made managers of the plaintiff corporation. Further, in connection with the project East Upreal LLC was formed which had

two members, the plaintiff, 56 East Investors LLC and defendant Upreal Brooklyn LLC a holding company owned by defendant Brookland Upreal Limited. Defendants David Goldberger and Boaz Gilad were the managers of East Upreal LLC.

Essentially, the Complaint alleges the defendants defrauded the plaintiff by failing to invest the funds and by committing waste, mismanagement, gross negligence and self-dealing. The Complaint alleges the entire investment has been lost. The Complaint alleges seven causes of action including breach of fiduciary duty directly and derivatively, fraud directly and derivatively, an accounting, breach of contract and conversion. The defendants have now moved seeking to dismiss the Complaint or for a stay.

Conclusions of Law

It is well settled that upon a motion to dismiss the court must determine, accepting the allegations of the complaint as true, whether the party can succeed upon any reasonable view of those facts (Davids v. State, 159 AD3d 987, 74 NYS3d 288 [2d Dept., 2018]). Further, all the allegations in the complaint are deemed true and all reasonable inferences may be drawn in favor of the plaintiff (Dunleavy v. Hilton Hall Apartments Co., LLC, 14 AD3d 479, 789 NYS2d 164 [2d Dept., 2005]).

Business Corporation Law §626(c) states that no derivative

lawsuit may be commenced unless the complaint alleges "with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making the effort" (id). As the Supreme Court noted, for a stockholder to sue derivatively "he must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court" (see, Hawes v. City of Oakland, 104 US 450, 14 Otto 450 [1881]).

The defendants argue the plaintiff failed to comply with that provision and that consequently the plaintiff has no standing to pursue the lawsuit. The plaintiff counters that specific evidence such notice would have been futile has been presented.

To succeed upon an assertion that notice would have been futile and hence not required, specific facts must be presented that the individuals at issue were self-interested in the transactions (see, Bansbach v. Zinn, 1 NY3d 1, 769 NYS2d 175 [2003]. Thus, the plaintiff must establish that if a demand would have been filed with the Board of Directors they could not have exercised independent and disinterested business judgement (id). Thus, the individual defendants will be considered incapable of being disinterested if facts support a personal benefit to them regarding the transaction being challenged (id). In that instance the business judgement rule is inapplicable and

demand futility is established.

In this case, the complaint alleges that defendants had material interests in the issues that comprise the causes of action, namely the treatment of the plaintiff as an equal partner of the restaurant. Thus, demand would obviously have been futile. The defendants argue the standard for demand futility has not been met since the futility has not been presented with sufficient particularity. However, particularity governs the totality of the futility and as long as such futility can be discerned by the court then the particularity will naturally suffice. Thus, where the directors are accused of self-dealing then obviously futility has been presented (see, Soho Snacks Inc., v. Frangioudakis, 129 AD3d 636, 13 NYS3d 31 [1st Dept., 2015]). The nature of the claims against the defendants that such demand would have been futile. Thus, demand futility has been established.

Next, considering the causes of action, the court must now analyze whether such claims are direct or derivative. In Serino v. Lipper, 123 AD3d 34, 994 NYS2d 64 [1st Dept., 2014] the court explained that to distinguish a derivative claim from a direct claim the court must engage in two inquiries. First, whether any harm was suffered by the corporation or an individual stockholder and whether the corporation or the individual stockholder would receive the benefit of any recovery. As the court stated "if there is any harm caused to the individual, as opposed to the

corporation, then the individual may proceed with a direct action…On the other hand, even where an individual harm is claimed, if it is confused with or embedded in the harm to the corporation, it cannot separately stand" (id). Thus, where the alleged injury affects all shareholders not just the plaintiff then the action is only derivative and not direct (Vaughan v. Standard General L.P., 154 AD3d 581, 63 NYS3d 44 [1st Dept., 2017]). The plaintiff argues "where an individual member, such as Investors LLC, is injured independently from the LLC, such as a diminution of its membership interests, distribution rights or voting rights, a claim is both direct and derivative" (see, Memorandum of Law in Opposition, page 11). However, these harms are not direct since they do not relate solely to individual shareholders. As the court observed in Elghanian v. Harvey, 249 AD2d 206, 671 NYS2d 266 [1st Dept., 1998] "the motion court correctly determined that plaintiff's claim for diminution of the value of his stock holdings in defendant Artra was a derivative cause of action belonging to that corporation and not to plaintiff individually" (id). This is true even if the allegation is based upon the breach of a fiduciary duty (Hahn v. Stewart, 5 AD3d 285, 773 NYS2d 297 [1st Dept., 2004]). Likewise, claims of diminution of distribution rights are derivative in nature (Katell v. Morgan Stanley Group Inc., 1993 WL 10871 [Court of Chancery of Delaware, New Castle County 1993]). The plaintiff cites to El Paso Pipeline GP Co., LLC v. Brinckerhoff, 152 A3d

1248 [Supreme Court of Delaware 2016] for the proposition the claims enumerated in the Complaint may be both derivative and direct. However, that case narrowed the permissible nature of dual claims and held they would only be permitted where a transaction resulted in an improper transfer of both economic value and voting power (see, Klein v. H.I.G. Capital LLC, 2018 WL 6719717 [Delaware Court of Chancery 2018]). In this case although the plaintiff argues there has been a diminution of voting power, that harm is not mentioned in the Complaint where the direct claims of breach of fiduciary duty only assert a reduction in the value of the plaintiff's investment, depletion of the corporate assets and the denial of any profits (see, Complaint ¶ 54). Likewise, the direct claims based upon waste, mismanagement, gross negligence and fraud only allege the defendants engaged in conduct whereby any debt owed to the defendants was subordinated to the claims of the plaintiff (see, Complaint ¶ 66). As noted, these claims are only derivative and do not support any direct claims. Further, amending the Complaint to assert a diminution of voting rights would not render the claims direct since the conduct alleged by the defendants did not affect the voting rights of the plaintiff in any event (see, El Paso, supra, Footnote 76). cTherefore, based on the foregoing the motion to dismiss the first and third causes of action which assert direct claims is granted.

Concerning the cause of action alleging a breach of

fiduciary duty, it is well settled that when a claim for breach of a fiduciary duty is merely duplicative of a breach of contract claim where they are based on the same facts and seek the same damage then the breach of fiduciary claim cannot stand (Pacella v. Town of Newburgh Volunteer Ambulance Corps. Inc., 164 AD3d 809, 83 NYS3d 246 [2d Dept., 2018]). In this case the cause of action alleging any breach of a fiduciary duty is identical to the breach of contract claim, namely that the defendants failed to honor the terms of the operating agreement and other contracts entered into between the parties. Consequently, the motion seeking to dismiss the second count is granted.

Turning to the claim of fraud, it is well settled that to succeed upon a claim of fraud it must be demonstrated there was a material misrepresentation of fact, made with knowledge of the falsity, the intent to induce reliance, reliance upon the misrepresentation and damages (Cruciata v. O'Donnell & Mclaughlin, Esqs, 149 AD3d 1034, 53 NYS3d 328 [2d Dept., 2017]). These elements must each be supported by factual allegations containing details constituting the wrong alleged (see, JPMorgan Chase Bank, N.A. v. Hall, 122 AD3d 576, 996 NYS2d 309 [2d Dept., 2014]). Thus, fraud must be pled with a heightened degree of specificity and detail (Minico Insurance Agency LLC, v. AJP Contracting Corp., 166 AD3d 605, 88 NYS3d 64 [2d Dept., 2018]).

However, where a claim to recover damages for fraud "is

premised upon alleged breach of contractual duties and the supporting allegations do not concern misrepresentations which are collateral or extraneous to the terms of the parties agreement, a cause of action sounding in fraud does not lie" (McKernin v. Fanny Farmer Candy Shops Inc., 176 AD2d 233, 574 NYS2d 58, [2nd Dept., 1991]). In this case all the fraud allegations are essentially further elaborations of the breach of contract claim. Consequently, the motion seeking to dismiss the fraud claim is granted.

The defendants have moved to dismiss the accounting claim. As the court observed in Weiner v. King, 43 Misc3d 1203(A), 990 NYS2d 440 [Supreme Court New York County 2014] "the Court finds that it would be premature at this juncture to dismiss the accounting claim as duplicative of the claim for breach of contract. Indeed, as a form of remedy, as opposed to a separate cause of action, the request for an accounting cannot be considered duplicative of the breach of contract claim. As one court explained, '[s]o long as the underlying cause of action is well pled, requested relief styled as a claim [for an accounting] will not be stricken from the complaint'" (id). Therefore, the motion seeking to dismiss the accounting cause of action is denied.

Turning to the motion seeking to dismiss the conversion claim, it is well settled that to establish a claim for conversion the plaintiff must show the legal right to an identifiable item or items and that the defendant has exercised

unauthorized control and ownership over the items (Fiorenti v. Central Emergency Physicians, PLLC, 305 AD2d 453, 762 NYS2d 402 [2d Dept., 2003]). Clearly, the allegations support the existence of claims based upon conversion and consequently, the motion seeking to dismiss the conversion claim is denied.

Lastly, Count four contains four distinct causes of action, namely corporate waste, mismanagement, gross negligence and fraud. Although the fraud cause of action has been dismissed it is improper for three causes of action to appear as one count of a complaint. Therefore, the motion to dismiss count four is granted without prejudice. The plaintiff may re-plead those counts (see, CPLR §3014).

Thus, counts five, six and seven of the Complaint remain.

Turning to the request for a stay, Chapter 15 of the Bankruptcy Code mandates that an ancillary proceeding is required seeking a stay of an action in a United States court based upon a foreign bankruptcy proceeding (11 U.S.C. §1501-§1532). The first case that dealt with these statutes was United States v. J.A. Jones Construction Group, LLC, 333 BR 637 [E.D.N.Y. 2005] wherein the court held it had no authority to consider a request for a stay based upon a foreign bankruptcy because an ancillary proceeding had not been commenced pursuant to the above noted requirements. However, in Barclays Bank, PLC v. Kemsley, 44 Misc3d 773, 992 NYS2d 602 [Supreme Court New York County 2014] the court held as a matter of first impression that 11 U.S.C

§1509 regarding foreign representatives' and creditors' right of direct access to the bankruptcy court did not preempt state common law granting international comity. Thus, it did not prevent New York courts from recognizing a United Kingdom bankruptcy discharge granted in favor of an individual debtor in a bank's New York state court suit for breach of a loan agreement. The court held the section's plain language applied only to foreign representatives not individual debtors. Further, the court held there was no indication the section was applicable to foreign bankruptcy discharge orders issued to individual debtors. Therefore, individual debtors can obtain a stay despite the ancillary proceeding requirements of the Bankruptcy Code. However, any stay granted on the basis of comity can only apply to defendant Brookland Upreal Limited since the remaining entities were not subject to foreign court jurisdiction.

Therefore, the motion seeking a stay is granted only regarding defendant Brookland Upreal.

So ordered.

ENTER:

DATED: August 22, 2019
Brooklyn N.Y.

Hon. Leon Ruchelsman
JSC