

Xiaoyan Lu v Sagewood SFF III LLC

2021 NY Slip Op 32285(U)

October 26, 2021

Supreme Court, New York County

Docket Number: Index No. 651832/2020

Judge: Joel M. Cohen

Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various New York State and local government sources, including the New York State Unified Court System's eCourts Service.

This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 03M

-----X

XIAOYAN LU, YIMIN WU, XIAOZHEN ZHAN, COMPASS
 REAL ESTATE INVESTMENT LLC, Z&W MANAGEMENT
 LLC

Plaintiffs,

- v -

SAGEWOOD SFF III LLC, SAGEWOOD MANAGEMENT
 LLC, SAGEWOOD KT II LLC, KT SAGEWOOD
 LLC, JINGYING WU,

Defendants.

-----X

INDEX NO. 651832/2020

MOTION DATE 01/12/2021

MOTION SEQ. NO. 001

**DECISION + ORDER ON
 MOTION**

HON. JOEL M. COHEN:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23

were read on this motion to

DISMISS

In this action, a group of investors invoke a variety of contract and tort theories to pursue the recovery of allegedly misapplied or misappropriated funds. Defendants move to dismiss the second through eleventh causes of action upon documentary evidence, for lack of standing and failure to state a claim (CPLR 3211[a][1], [3] and [7]).

BACKGROUND/THE COMPLAINT

According to the complaint (NYSCEF 12), each of the plaintiffs invested \$200,000 in defendant Sagewood KT II, LLC (Fund II) and were repeatedly assured that their funds were rolled over into Sagewood SFF III LLC (Fund III). They were later advised that the funds had never been transferred, and that Fund II had lost all of its (and their) money.

Specifically, between June 14 and June 20, 2017, the plaintiffs executed subscription agreements for Fund II and wired in their contributions by November 2017. All plaintiffs

invested in Fund II directly except for plaintiff Yimin Wu (Yimin), who did so through plaintiff Z&W Management LLC, of which she and her husband are its only members (*id.*, ¶¶ 15-16).

Defendant KT Sagewood LLC (KT) is the managing member of Fund II. Defendant Jingying Wu (Wu) is a member of Fund II, and together with non-party Kenneth Tse (Tse) executed the operating agreements on behalf of both KT and Fund II. Wu is also a member of Fund III, of which defendant Sagewood Management LLC (Sagewood) is the managing member. Additionally, Wu is an agent of KT and Sagewood (*id.*, ¶¶ 7, 9-10, 17-18, 27-28).

In the spring or early summer of 2018, plaintiffs approached Wu with their concerns about the lack of information they were receiving about their investments in Fund II. Wu responded by presenting them with a pitch book about Fund III which detailed an investment opportunity focused around acquiring, renovating, and selling real estate. She informed plaintiffs that they could join Fund III and their capital contributions could be satisfied by rolling over the \$200,000 they had already invested in Fund II. She also met with three of the plaintiffs on August 4, 2018 and described the benefits of doing so (*id.*, ¶¶ 20-23).

On August 6, 2018, Wu sent plaintiffs, via the WeChat messaging service, documents prepared by Fund III and defendant Sagewood, including the Fund III Operating Agreement. The agreement provided, *inter alia*, for dissolution of Fund III no later than August 1, 2020, subject to a one-year extension in the sole discretion of the Managing Member. Plaintiffs made no changes to the operating agreement and promptly executed and returned the documents between August 6 and 9, 2018. Shortly thereafter, plaintiffs all received a "Net Capital Demand Notice" from Sagewood on behalf of Fund III asking for a capital contribution of \$50,000. However, on September 13, 2018, Wu informed them through WeChat that they

would not have to worry about funding Fund III because they were “all 100% rollover” (*id.*, ¶¶ 25-26, 29, 32, 34-35).

Wu also advised plaintiffs that they would continue to receive similar demands as they were sent out by email uniformly to all investors. Consequently, plaintiffs received a second demand for \$50,000 from Fund III on October 25, 2018, as well as an email from a Senior Sales Specialist from an entity called Sagewood Equity LLC, which attached the notice but stated that it was for informational purposes only as “the draw will be rolled over from Fund II.” Plaintiffs received a demand for \$100,000 on March 6, 2019, with a similar disclaimer, and the letter also stated that their unpaid capital contribution was \$0 (*id.*, ¶¶ 35-38).

Plaintiffs additionally received quarterly reports for Fund III starting in the third quarter of 2018, in emails addressed to them as “investors” in Fund III. The reports provided information regarding the properties purchased with Fund III capital and the status of the renovation and sale process. The first quarter 2019 report listed the capital received as \$10 million, and the balance minus expenses as approximately \$7 million (*id.*, ¶¶ 39-42).

On August 20, 2019, the plaintiffs received an invitation to a Fund III “investor portal” which promised access to communications about their investments and fund documents. Through that portal, on September 30, 2019 they received statements of assets and liabilities and statements of operations. A line item of \$1,850,000 identified as “Equity rollover receivable” was listed as part of Fund III's assets (*id.*, ¶¶ 43-44).

In September 2019, plaintiffs received through the portal a notice of “Distribution of Unused Capital and Preferred Returns.” Each plaintiff was to receive from Fund III a net distribution consisting of \$23,454.79 -- \$20,000 of which was categorized as a partial return of their capital contribution while the remaining \$3,454.79 was categorized as a

distribution, both from Fund III. Plaintiffs thereafter received physical bank checks for the distributions (*id.*, ¶¶ 45-46).

Plaintiffs also received a Capital Account Statement for Fund III as of September 30, 2019. A footnote next to the line item "Contributions" stated that "[y]our original commitments to the Fund [Fund III] include \$200,000 of committed capital due as equity rollover from Sagewood KT II, LLC ("Fund II")." Additionally, plaintiffs were sent K-1 statements for 2018 reflecting their capital contributions of \$100,000 each to Fund III (*id.*, ¶¶ 47-48).

On a conference call on November 30, 2019, however, Wu claimed for the first time that the plaintiffs had no interest in Fund III. She stated that they were investors in Fund II only and that Fund II had lost all of its funds. In this connection, the complaint alleges that Fund II is suing Tse for breach of contract and conversion for failing to perform various real estate-related services (*id.*, ¶¶ 49-50).

In a December 6, 2019 email, Wu further advised plaintiffs that the distributions made to them from Fund III had been made in error. However, she then changed her position and claimed that plaintiffs were in fact investors in Fund III, but were each required to fund their subscriptions with \$200,000. On December 19, 2019, plaintiffs received a formal demand for the payment their capital contribution, with the notice identifying Wu as "partner" of Sagewood. Wu asserted that plaintiffs were in violation of the Fund III operating agreement and subscription agreements due to their failure to pay (*id.*, ¶¶ 51-53).

Thereafter, plaintiffs retained counsel and served a books and records demand upon both Fund II and Fund III, seeking detailed financial information including records reflecting the receipt and expenditure of plaintiffs' capital contributions. Fund II provided partial records which

did not contain information about the contributions, and Fund III refused to respond at all (*id.*, ¶¶ 55-58).

Plaintiffs then filed a petition seeking enforcement of their demands in an action captioned *Xiaoyan Lu et al v Sagewood SSF III LLC et al*, NY County Index No. 152990/2020, (the Books and Records action). The Fund III defendants opposed the petition in part upon the grounds that plaintiffs were not Fund III members, and that Wu acted outside of her authority when she purported to roll over plaintiffs' Fund II capital contributions into Fund III. Although the petition was granted, Fund III objected to nearly all of the demands, including one which sought its communications with its accountants regarding the preparation of the K-1 forms issued to plaintiffs (*id.*, ¶¶ 59-62).

The documents that were provided contained numerous discrepancies regarding Fund III's membership and assets. For example, plaintiffs are listed, together with their capital contributions and ownership percentages, among the 33 members in Schedule A of the Fund III operating agreement, but their names do not appear in the list of 25 individuals identified as members in a document entitled "Member Information." Additionally, in September 2019, 24 individuals were issued checks for Fund III distributions and partial return of capital, and six of them, including plaintiffs, were on Schedule A but not the membership list (*id.*, ¶¶ 63-65, 67).

One of the individuals on the schedule received a wire transfer equal to his or her entire \$300,000 capital contribution on same day that distributions were issued. In December of 2019, another member, Seapulse LLC, was issued a check for \$1 million for "Redemption," a sum which represented half of its capital contribution. A Fund II member also redeemed shares, receiving the \$196,002.90 balance of a \$200,000 capital contribution (*id.*, ¶¶ 68-70).

Fund III's financial information also did not comport with the quarterly reports plaintiffs received. According to Fund III's bank records, tax returns and financial statements, it did not have the \$7 million balance or ever receive close to the \$10 million in capital contributions, reflected by the March 2019 quarterly report. The 2019 K-1s issued to plaintiff by Fund III stated that plaintiffs had a beginning capital account of \$100,015 and withdrew or were distributed \$100,000, when no such transactions occurred. Furthermore, all plaintiffs received conflicting 2018 and 2019 K-1s as members of Fund II, except for Compass, which did not receive a 2019 K-1. Furthermore, the Fund II K-1s erroneously state that Yimin, Zhan and Lu's beginning capital accounts contain approximately \$196,000, a receipt of approximately \$24,000 as a withdrawal or distribution, and a loss of approximately \$16,000 (*id.*, ¶¶ 71-77).

The complaint sets forth eleven causes of action as follows:

- (1) A declaratory judgment that plaintiffs are full members of Fund III who have made the required \$200,000 capital contribution;
- (2) Breach of contract as against Fund III and Sagewood for failure to dissolve the fund in August 2020 and make distributions to the members;
- (3) Conversion as against Fund II, KT and Wu for retaining or disposing of the capital contributions to Fund II;
- (4) Conversion as against Fund III, Sagewood and Wu for retaining or disposing of the capital contributions to Fund III;
- (5) Breach of fiduciary duty as against KT and Wu for (a) engaging Tse as real estate developer for Fund II; (b) selectively reimbursing a capital contribution to another Fund II member; (c) retaining plaintiffs' capital contributions; and (d) issuing false K-1s;
- (6) Breach of fiduciary duty as against Sagewood and Wu for (a) denying that plaintiffs were members of Fund III; (b) providing false information about Fund III; (c) issuing false K-1s; and (d) selectively permitting redemptions by other members of Fund II;
- (7) An accounting as against Fund II, KT and Wu;

- (8) An accounting as against Fund III, Sagewood and Wu;
- (9) Unjust enrichment as against all defendants;
- (10) A constructive trust as against all defendants; and
- (11) Fraudulent misrepresentation as against Fund III, Sagewood and Wu.

DISCUSSION

Under CPLR § 3211(a)(7), dismissal is warranted if the plaintiff “fails to assert facts in support of an element of the claim, or if the factual allegations and inferences to be drawn from them do not allow for an enforceable right of recovery” (*Connaughton v Chipotle Mexican Grill, Inc.*, 29 NY3d 137, 141-142 [2017] [internal citation omitted]). When determining a motion to dismiss, the Court must accept all factual allegations as true, afford the pleadings a liberal construction, and accord plaintiff the benefit of every possible favorable inference (*see Leon v Martinez*, 84 NY2d 83, 87-88 [1994]). However, allegations that are “bare legal conclusions” or that are “inherently incredible or flatly contradicted by documentary evidence,” are not sufficient to withstand a motion to dismiss (*see JFK Holding Co., LLC v City of New York*, 68 AD3d 477, 477 [1st Dept 2009] [internal citation omitted]).

Dismissal under CPLR § 3211(a)(1) is warranted when “documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law” (*Beal Savings Bank v Sommer*, 8 NY3d 318, 324 [2007] [internal quotation marks and citations omitted]). A motion under that provision “may be appropriately granted only where the documentary evidence utterly refutes plaintiff’s factual allegations, conclusively establishing a defense as a matter of law” (*Goshen v Mut. Life Ins. Co. of New York*, 98 NY2d 314, 326 [2002] [citation omitted]). A submission qualifies as “documentary evidence” if it is unambiguous, of undisputed authenticity,

and its contents are essentially undeniable (*VXI Lux Holdco S.A.R.L. v SIC Holdings, LLC*, 171 AD3d 189, 193 [1st Dept 2019] [internal citation omitted]).¹

For the following reasons, Defendants' motion to dismiss is denied as to the claims for breach of contract and an accounting, and granted as to the remaining claims.

A. Breach of Contract (Against Fund III and Sagewood)

Under Delaware law,² to state a claim for breach of contract the plaintiff must allege “the existence of the contract, whether express or implied; second, the breach of an obligation imposed by that contract; and third, the resultant damage to the plaintiff” (*VLIW Tech., LLC v Hewlett-Packard Co.*, 840 A2d 606, 612 [Del 2003]). The complaint sufficiently alleges a breach of the Fund III operating agreement, asserting that defendants failed to make distributions to plaintiffs upon dissolution of the fund in August 2020 as required by section 8.2.

¹ Consistent with those principles, the Court does not consider the factual assertions made by defendants in their memoranda of and law and at oral argument to the effect that Fund II lost all of its funds after Tse either stole them or failed to successfully develop the properties, and that Wu “provisionally” or “mistakenly” treated plaintiffs as members of Fund III in anticipation of recovering the funds from Tse and rolling them over into Fund III. She was unsuccessful, defendants assert, because Tse had other creditors, and plaintiffs never became members of Fund III after they failed to make the required capital contributions (D's Mem in Support, p. 1; Oral Arg. Tr. [NYSCEF 23], 25:12-15). Defendants have also raised concerns that Fund III investors would be unfairly penalized if plaintiffs were permitted to share in the assets of a fund of which they were not members and to which they had not contributed (Tr. 26:8-12). In this connection, argue that the two funds had separate owners, management, and company structures (*id.*, 9:21-24). They also urged (at oral argument in the Books and Records action) that the Fund II operating agreement stripped Wu of the power to confer memberships through a rollover by reason of its requirement that capital contributions be made only in cash (Oral Arg. Tr. [Index No. 152990/2020, NYSCEF 78] 19:13-19). Defendants have not supported these claims by an affidavit from a party with knowledge, and even if they had, they at best raise questions of fact.

² Section 14.6 of the Fund III operating agreement provides that its terms are to be governed by Delaware law.

First, the fact that Plaintiffs allegation as to the dissolution of Fund III is “on information and belief” is not fatal to their claims because the complaint supplies sufficient information to apprise defendants of their alleged wrongs, and the information concerns facts peculiarly within defendants’ knowledge (*Harris v Structuretech New York, Inc.*, 191 AD3d 470 [1st Dept 2021]). An allegation made upon information and belief warrants dismissal only where a heightened standard of pleading governs, as in cases involving fraud which require the plaintiffs to establish defendant’s state of mind (*see Cicchetti v TRNC Associates, Ltd.*, 2020 WL 5874842, *2 [Sup Ct, NY Co 2020] [collecting cases]). Defendants’ reliance on *Anderson v Livonia, Avon & Lakeville R.R. Corp.* 300 AD2d 1134 (4th Dept 2002) is misplaced, as that case merely held that an affidavit based upon information on belief has no probative value when submitted in opposition to a motion for summary judgment.

Second, Plaintiffs do not, as Defendants suggest, “admit” that they made capital contributions only to Fund II, and thereby defaulted on their obligation to contribute to Fund III. The core allegation of the complaint is that that Plaintiffs’ obligation to contribute to Fund III was satisfied by a rollover that Wu assured them had been completed.

B. Conversion (Fund II)

“Conversion is the unauthorized assumption and exercise of the right of ownership over another's property to the exclusion of the owner's rights” (*3P-733, LLC v Tawan Davis*, 187 AD3d 626, 628 [1st Dept 2020], *quoting Lemle v Lemle*, 92 AD3d 494, 497 [1st Dept 2012]). Money may be the subject of a conversion action where the funds are made sufficiently identifiable by placement in a specific, named bank account (*3P-733, LLC*, 187 AD3d 626, 628-29). Furthermore, “a cause of action for conversion may be stated by allegations of a corporate officer's misappropriation of corporate funds” (*id.*).

A conversion claim may not be based upon a mere breach of contract, without the allegation of independent facts that would support tort liability (*City of New York v Shellbank Rest. Corp.*, 169 AD3d 581, 582 [1st Dept 2019]; *lv dismissed*, 33 NY3d 1061 [2019]); *Forty Cent. Park S., Inc. v Anza*, 117 AD3d 523, 524 [1st Dept 2014]; *see Clark-Fitzpatrick, Inc. v Long Island R. Co.*, 70 NY2d 382, 389 [1987] [“a simple breach of contract is not to be considered a tort unless a legal duty independent of the contract itself has been violated”]). . Even assuming plaintiffs’ funds were placed into a segregated, identifiable account over which they had dominion, which is unclear, the relief they are seeking in tort is identical to that which could be sought in a contract claim – damages in the amount of their capital contributions. Their entitlement to those funds is governed by the Fund II operating agreement (NYSCEF 13). Indeed, in arguing that defendants’ retention of their funds was unauthorized, plaintiffs invoke sections 2.4 and 4.2 of that agreement. If Plaintiffs wish to pursue this claim, they can seek leave to amend the complaint to assert breach of contract against Fund II.

Plaintiffs’ reliance on New Jersey’s Limited Liability Company Act³ is misplaced. Although Section 42:2C-67 of that Act allows the individual members to sue directly rather than derivatively, a “[d]irect action by member” refers to the enforcement of “rights and interests *under the operating agreement* or this act or arising independently of the membership relationship” (emphasis supplied). Again, plaintiffs’ purported right to the return of their investment derives, if anywhere, from the terms of the operating agreement, and not from any duty arising independently of it.

³ Section 14.6 of the Fund II operating agreement provides that its terms are to be governed by New Jersey law.

C. Conversion (Fund III)

Plaintiffs' conversion claim against Fund III is duplicative of their breach of contract claim, and therefore must be dismissed (*Remora Cap. S.A. v Dukan*, 175 AD3d 1219, 1221 [1st Dept 2019]).

D. Breach of Fiduciary Duty (Fund II)

In moving to dismiss the breach of fiduciary duty claim relating to Fund III, defendants argue that (1) the claim is barred by the operating agreement, (2) the complaint fails to sufficiently allege a fiduciary relationship between Wu and the plaintiffs, or damages arising from the breach, and (3) any such claim would be derivative. The claim must also be dismissed. As with the conversion claims, “[a] cause of action for breach of fiduciary duty which is merely duplicative of a breach of contract claim cannot stand” (*William Kaufman Org., Ltd. v Graham & James LLP*, 269 AD2d 171, 173 [1st Dept 2000]; *Kagan*, 94 AD3d 67, 72).

Once again, the parties' debate over whether the conduct alleged constitutes gross negligence, fraud, intentional misconduct or a willful material breach under sections 2.4(a) and 7.5(d) of the Fund II operating agreement merely underscores that the claim sounds in contract rather than tort.

E. Breach of Fiduciary Duty (Fund III)

For the reasons stated above, the claim is also dismissed as duplicative of the contract claim.

F. Accounting (Fund II)

Defendants move to dismiss the claim for an accounting with respect to Fund II on the ground that the complaint fails to allege a demand for an accounting, or a refusal to comply with

such a demand. Here, the complaint alleges that defendants “have failed to provide all responsive documents to Plaintiffs’ properly issued books and records demand” (Compl. ¶ 139) and that they “have not rendered a full accounting of the financial status and operations of Fund II (*id.*, ¶ 142). These allegations satisfy the minimum pleading requirements for an accounting (*Kaufman v Cohen*, 307 AD2d 113, 124 [1st Dept 2003]; *Non-Linear Trading Co. v Braddis Assocs., Inc.*, 1243 AD2d 107, 119 [1st Dept 1998]; *Conroy v Cadillac Fairview Shopping Ctr. Properties (Maryland), Inc.*, 143 AD2d 726, 726–27 [2d Dept 1988]).

Defendants also argue that plaintiffs have already been accorded relief in the Books and Records Action, and that if they are unsatisfied with defendants’ production they can continue to litigate it in that proceeding. However, “the right to an accounting is distinct from the right to books and records access” (*DPB Family LLC v Eutychia Group LLC*, 2018 WL 5043897,*4 (Sup Ct NY Co 2018)), and non-managing members of an LLC have a right to an accounting where access to the books and records has been denied (*Atlantis Mgmt. Grp. II LLC v Nabe*, 177 AD3d 542, 543 [2019]).

G. Accounting (Fund III)

Defendants seek dismissal of the accounting claim relating to Fund III on grounds that have been rejected above – *i.e.*, that was no demand or refusal, and that plaintiffs’ funds were not rolled over into Fund III. The motion to dismiss this claim is denied.

H. Unjust Enrichment

A claim for unjust enrichment is cognizable “only in unusual situations when, though the defendant has not breached a contract nor committed a recognized tort, circumstances create an equitable obligation running from the defendant to the plaintiff” (*Corsello v Verizon New York, Inc.*, 18 NY3d 777, 790 [2012]). As with the other tort claims, the claim is barred because the

operating agreements govern plaintiffs' entitlement to the funds (*see Pappas v Tzolis*, 20 NY3d 228, 234 [2012]).

I. Constructive Trust

The imposition of a constructive trust is not available where the plaintiff has an adequate remedy at law (*Davis v Richmond Cap. Grp., LLC*, 194 AD3d 516 [1st Dept 2021]). Plaintiffs' claims for damages in contract provide an adequate remedy. The constructive trust claim is duplicative of those claims because plaintiffs seek the same monetary damage and have therefore failed to plead a distinct harm (*Ashley MRI Mgmt. Corp. v Perkes*, 2006 WL 2050091 [Sup Ct, NY Co 2006]).

J. Fraudulent Misrepresentation

The claim for fraudulent misrepresentation is dismissed. A fraud claim which does not allege a breach of a duty collateral to or independent of the parties' agreements, and seeks damages which are recoverable under a contract measure of damages, must be dismissed as duplicative (*Cronos Grp. Ltd. v XComIP, LLC*, 156 AD3d 54, 63 [1st Dept 2017]). Plaintiffs' fraud claim is duplicative of their contract claim.

K. Punitive Damages

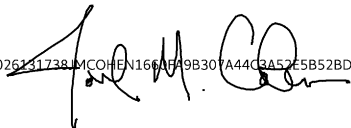
Finally, the plea for punitive damages is stricken, without prejudice. Because plaintiffs' only surviving claims sound in contract rather than tort, punitive damages are not available because "the complaint does not allege that the breach was associated with outrageous conduct that was part of a pattern directed at the public generally" (*Eisenberg v Weisbecker*, 190 AD3d 549 [1st Dept 2021]). If plaintiffs uncover evidence giving rise to a viable claim for punitive damages, they can seek leave to amend.

Accordingly, it is hereby

ORDERED that the defendants' motion to dismiss is granted as to the third, fourth, fifth, sixth, ninth, tenth and eleventh causes of action, and the plea for punitive damages, and is otherwise denied, and it is further

ORDERED that defendants are directed to serve an answer to the complaint within twenty (20) days after service of a copy of this order with notice of entry.

This constitutes the decision and order of the court.

20211026131738 JMC0HEN166AF99B307A44C8A57E5B52BDF1DB6F


JOEL M. COHEN, J.S.C.

10/26/2021

DATE

CHECK ONE:	<input type="checkbox"/>	CASE DISPOSED	<input checked="" type="checkbox"/>	NON-FINAL DISPOSITION	
	<input type="checkbox"/>	GRANTED	<input type="checkbox"/>	GRANTED IN PART	<input type="checkbox"/>
			DENIED		OTHER
APPLICATION:	<input type="checkbox"/>	SETTLE ORDER		<input type="checkbox"/>	SUBMIT ORDER
CHECK IF APPROPRIATE:	<input type="checkbox"/>	INCLUDES TRANSFER/REASSIGN		<input type="checkbox"/>	FIDUCIARY APPOINTMENT
				<input type="checkbox"/>	REFERENCE