

Keith Kantrowitz & Assoc., Inc. v Strauss

2023 NY Slip Op 33495(U)

October 5, 2023

Supreme Court, Kings County

Docket Number: Index No. 525127/2022

Judge: Reginald A. Boddie

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.

At an IAS Commercial Term Part 12 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, located at 360 Adams Street, Borough of Brooklyn, City and State of New York on the 5th day of October 2023.

P R E S E N T:

Honorable Reginald A. Boddie
Justice, Supreme Court

-----x

KEITH KANTROWITZ AND ASSOCIATES, INC.

Plaintiff,

Index No. 525127/2022

-against-

Cal. No. 9, 10 MS 1, 3

MICHAEL STRAUSS,

Decision & Order

Defendant.

-----x

The following e-filed papers read herein:

NYSCEF Doc Nos.

MS 1

8-12

MS 3

30-33

Upon the foregoing papers, defendant Michael Strauss’s motion to dismiss the complaint (motion sequence one) pursuant to CPLR 3211(a)(1), (3), (7) and (10), and plaintiff Keith Kantrowitz and Associates, Inc.’s cross-motion for leave to amend the complaint (motion sequence three) pursuant to CPLR 3025(b), are decided as follows:

Background

On or about March 31, 2021, plaintiff, Sprout Mortgage, LLC (“Sprout”), and NV Mortgage LLC (“NV”) executed an operating agreement (“Agreement”) for Biscayne Mortgage, LLC (“Biscayne”). Defendant Michael Strauss signed the Agreement on behalf of Sprout as chief executive officer. Biscayne was formed for the sole purpose of engaging in the business of residential mortgage origination, and occasional commercial origination with the consent of the members with respect to properties in the State of Florida. According to the Agreement, plaintiff

and Sprout made capital contributions of \$750,000 in exchange for their respective 25% membership interests, while NV made capital contributions of \$1,500,000 in exchange for its 50% membership interest. Plaintiff asserts that Sprout was the sole manager of Biscayne with various responsibilities, such as permitting plaintiff's oversight of Biscayne's activities, maintaining detailed books and records, providing various financial reports, presenting annual budgets, and filing tax returns. Sprout purportedly breached multiple terms of the Agreement by engaging in unauthorized business with its affiliate, failing to maintain and present essential financial records and budgets, obstructing plaintiff's oversight, and failing to provide required access to financial records. Plaintiff also asserts that Sprout closed its business operation in July 2022. Plaintiff believes that Sprout might have engaged in fraudulent activities, as it was facing severe financial issues and potentially misused Biscayne's resources to cover its own debts.

On August 29, 2022, plaintiff commenced this action against defendant asserting six causes of action for fraud, piercing the corporate veil, breach of fiduciary duty, accounting, gross negligence/intentional tort, and conversion. On January 20, 2023, defendant moved, under motion sequence one, to dismiss the complaint based on CPLR 3211(a)(1), (3), (7) and (10). On August 2, 2023, defendant cross-moved, under motion sequence three, for leave to amend the complaint.

Defendant's motion to dismiss

Lack of standing

Defendant argues that the complaint must be dismissed for plaintiff's lack of standing to recover directly for the alleged injury to Biscayne, pursuant to CPLR 3211(a)(3). Defendant contends that the claims pertain to injuries to Biscayne rather than to plaintiff directly, and no demand was made on behalf of Biscayne prior to initiating this lawsuit.

In opposition, plaintiff argues that for a member to challenge an LLC's managing member, a court must evaluate who suffered the alleged harm—the entity or the suing member—and who would receive the benefit of any recovery or remedy. Plaintiff submits that it is entitled to bring a direct action seeking redress for its injury or upholding a duty owed to it. Plaintiff notes that the complaint alleges that defendant, instead of Sprout misappropriated its capital contribution. Plaintiff clarifies that the capital contribution is not posited as Biscayne's property. Plaintiff accuses defendant of misinterpreting the complaint, as the primary contention of the complaint lies in defendant's embezzlement of the capital contribution, justifying a direct action claim against defendant.

On a motion to dismiss for lack of standing pursuant to CPLR 3211(a)(3), “the burden is on the moving defendant to establish, prima facie, the plaintiff's lack of standing, rather than on the plaintiff to affirmatively establish its standing in order for the motion to be denied. [Whereas] [t]o defeat a defendant's motion, the plaintiff has no burden of establishing its standing as a matter of law; rather, the motion will be defeated if the plaintiff's submissions raise a question of fact as to its standing” (*Phoenix Grantor Tr. v Exclusive Hosp., LLC*, 172 AD3d 923 [2d Dept 2019] [internal citations and punctuation omitted]).

Here, plaintiff's claims relate to the alleged fraudulent misrepresentations made by defendant which caused plaintiff damages of its capital contribution. As such, defendant's attempt to characterize plaintiff's claims as derivative fail. The First Department has specifically found that claims that a defendant committed fraud to induce investment by misrepresenting and concealing the true nature of the investment are “properly brought as a direct claim, as the plaintiffs individually suffered the alleged harm and would benefit from any recovery” (*SFR Holdings Ltd.*

v Rice, 132 AD3d 424 [1st Dept 2015]). Therefore, the portion of the motion which seeks to dismiss plaintiffs' claims on the basis that plaintiffs' claims are derivative is denied.

Failure to join necessary parties

Defendant asserts that he signed the Agreement in the capacity as an officer of Sprout, not as an individual, thus that plaintiff has not correctly alleged any wrongdoing against him. Defendant argues that the complaint must be dismissed pursuant to CPLR 3211(a)(10) for failure to join necessary parties such as Biscayne, whose Agreement is purportedly breached, and Sprout, who is alleged to have breached the Agreement. Defendant contends that the absence of these parties will impede the Court's ability to fairly judge and resolve the dispute.

In opposition, plaintiff argues that dismissing a case for nonjoinder of a necessary party should be the last resort. Additionally, that if a necessary party is subject to court jurisdiction, the appropriate remedy is to summon the party instead of dismissing the case. Plaintiff asserts that defendant misconstrued the allegations in the complaint. Specifically, that the complaint alleges defendant misappropriated plaintiff's capital contribution, without asserting that the capital contribution is Biscayne's property or involving Sprout. Therefore, plaintiff submits that neither Sprout nor Biscayne are necessary parties under CPLR 1001(a). Even if the Court views them as such, plaintiff argues that they should be summoned instead of dismissed.

CPLR 3211(a)(10) provides, in relevant part, that a party may move for a judgment dismissing a cause of action on the ground that the court should not proceed in the absence of a person who should be a party (*BT Holdings, LLC v Vil. of Chester*, 189 AD3d 754 [2d Dept 2020]). The moving party should establish either that complete relief could not be accorded between the parties without the nonparty, or that the nonparty might be inequitably affected by a judgment in this action (*id.*).

Here, plaintiff asserts direct claims against defendant. Defendant fails to cite any legal authority to support his contention that Sprout is essential to the instant litigation based on its status as a member of Biscayne. Furthermore, defendant has not established that complete relief could not be accorded to the parties without the presence of Sprout. Accordingly, the portion of the motion which seeks to dismiss the complaint because of the absence of a necessary party is denied.

Failure to state a claim

Defendant argues that even if the Court does not accept the previous arguments, the action should still be dismissed pursuant to CPLR 3211(a)(7) because the six causes of action have not been sufficiently stated to grant any relief.

Fraud

Defendant argues that plaintiff's fraud claim is misdirected. Defendant asserts that if the fraud claim is against Sprout, the claim should be brought on behalf of Biscayne. Additionally, that defendant is not Biscayne's manager, so he cannot be liable for any fraud on Biscayne's behalf. Defendant also argues that the fraud claim lacks the necessary details required by law because the allegations are vague, with no specific factual support. Defendant further contends that the alleged fraud claim appears more like a claim for breach of contract, as plaintiff failed to provide clear details on who committed the fraud, when, and how it led to damages.

In opposition, plaintiff argues that it has exceeded the required details for a fraud claim under CPLR 3016(b). Plaintiff asserts that the complaint alleges that defendant misused its capital contribution for purposes not related to Biscayne's business. Specifically, that defendant misused the capital contribution to benefit Sprout's affiliates, paying affiliate employees, and misrepresenting Sprout's financial stability. Plaintiff additionally asserts that the Agreement contains a detailed covenant regarding how the capital contribution should be used and who

Biscayne can engage in business with, and defendant violated such covenant. Plaintiff contends that defendant's breach of the Agreement by representing Sprout as financially healthier than it was, qualifies as fraud. Plaintiff further contends that the misrepresentation becomes evident when considering that Sprout closed and faced bankruptcy proceedings just over a year after the Agreement was executed.

In New York, the elements of a fraud, which must be pled with particularity (CPLR 3016(b)), "consist of a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury" (*Pasternack v Lab. Corp. of Am. Holdings*, 27 NY3d 817 [2016]).

Here, the complaint does not allege any misrepresentation defendant made to plaintiff. Plaintiff alleges, in moving papers, that defendant knowingly made misrepresentations of Sprout's financial conditions. Taking plaintiff's allegation as true, such claim belongs to Biscayne, not plaintiff. Additionally, plaintiff does not allege that any misrepresentation was intended to be relied upon by plaintiff. Thus, because plaintiff fails to identify any statements defendant made directly to plaintiff, plaintiff's fraud claim is dismissed.

Piercing the corporate veil

Defendant argues that plaintiff's second cause of action, which seeks to pierce Sprout's corporate veil and hold defendant liable, should be dismissed since New York law does not recognize an independent cause of action to pierce the corporate veil. Defendant maintains that piercing the corporate veil is an equitable remedy utilized to prevent fraud and achieve equity by potentially holding corporate operatives liable, despite the protections ordinarily offered by the

corporate structure. Defendant contends that the claim for piercing the corporate veil is also inadequately plead.

In opposition, plaintiff argues that the complaint alleges defendant overlooked the corporate form, commingled assets, and utilized plaintiff's capital contribution improperly. Plaintiff asserts that there are detailed allegations regarding defendant's control over Biscayne and its failure to uphold corporate formalities, substantiated by numerous references to violations in the Agreement. Moreover, plaintiff contends that the alleged premature closure and inadequate capitalization of Sprout further support that the corporate form of Biscayne should be disregarded. Thus, plaintiff argues that the complaint has sufficiently alleged all requisite elements for alter ego liability.

A party seeking to pierce the corporate veil must establish that (1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury (*Peery v United Capital Corp.*, 84 AD3d 1201 [2d Dept 2011] [internal citations omitted]). The party seeking to pierce the corporate veil must establish that the controlling corporation or individuals abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against that party such that a court in equity will intervene (*id.*). Indicia of a situation warranting veil-piercing include (1) the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, i.e., issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the

allegedly dominated corporation, (7) whether the related corporations deal with the dominated corporation at arm's length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own (*id.*).

Here, plaintiff's allegations are conclusory. The complaint fails to allege sufficient facts to find that defendant was the alter ego of Sprout or that the wrongdoings allegedly conducted by Sprout should be attributed to defendant. Thus, plaintiff's claim for piercing the corporate veil is dismissed.

Breach of fiduciary duty

Defendant argues that plaintiff's third cause of action, alleging a breach of fiduciary duty, lacks the requisite particularity and detailed factual support to substantiate each essential element of the claim, as mandated by CPLR 3013 and case law. Defendant contends that plaintiff's allegations intertwine a breach of fiduciary duty with a breach of the Agreement without detailing or explicating the fiduciary duties purportedly violated. Defendant further contends that he cannot be possibly liable for breaching a contract he is not a party to.

In opposition, plaintiff argues that defendant, as the equitable owner of Sprout and being aware of Sprout's financial conditions, misused his capital contribution. Plaintiff contends that the cause of action for breach of fiduciary duty is not subject to dismissal when the complaint alleges misappropriation of capital contribution and instances of self-dealing.

The elements of a cause of action to recover damages for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages directly

caused by the defendant's misconduct (Nachbar v Cornwall Yacht Club, 160 AD3d 972 [2d Dept 2018]).

Here, plaintiff fails to allege either an express or implied fiduciary relationship between the parties. Since defendant contends that he only signed the Agreement on behalf of Sprout as a chief executive officer, instead of individually, plaintiff fails to establish a fiduciary relationship exists. Therefore, plaintiff's claim for breach of fiduciary duty is dismissed.

Accounting

Defendant argues that claims alleging the diversion of corporate assets can only be asserted as a derivative claim, not a direct claim. Defendant refutes any contractual or fiduciary obligations owed to plaintiff since he is neither a member of Biscayne nor a signatory to the Agreement. Defendant points out plaintiff's failure to demonstrate that they demanded an accounting from him and that he refused to provide access, which is a necessary element for an accounting claim. Additionally, defendant emphasizes that plaintiff's accounting claim lacks the required elements: (a) evidence of a fiduciary or confidential relationship and (b) a breach of duty regarding property in which plaintiff has an interest. Defendant contests the existence of a fiduciary relationship merely based on an arm's length contractual transaction. Defendant further notes that plaintiff has not shown it has entrusted money or property to him. Lastly, defendant argues that plaintiff has other legal remedies available, and the accounting claim is redundant with other causes of action seeking the same damages.

In opposition, plaintiff argues that the complaint outlines defendant's wrongdoing in corporate bookkeeping under the Agreement, such as the failure to file tax returns, audit financial statements, provide a company budget, or maintain customary books and records, thereby leaving Biscayne's accounting in disarray. Additionally, plaintiff asserts that a demand for accounting is

futile given Sprout's closure and the alleged misappropriation of capital contributions by defendant. Plaintiff contends that where a fiduciary relationship exists, an absolute right to accounting can be asserted, even when an adequate remedy at law is available.

An accounting is an equitable remedy which a party may seek only where he or she can establish the existence of a confidential or fiduciary relationship and a breach of the duty imposed by that relationship respecting property in which the party seeking the accounting has an interest (*LMEG Wireless, LLC v Farro*, 190 AD3d 716 [2d Dept 2021]). To obtain an accounting, a plaintiff must show that there was some wrongdoing on the part of a defendant with respect to the fiduciary relationship concerning property in which the plaintiff has an interest (*id.*). To state a viable cause of action for an accounting, a plaintiff must also allege that he or she demanded an accounting, which the defendant refused to provide (*id.*).

Here, plaintiff fails to allege a fiduciary or confidential relationship between the parties and that defendant was entrusted with the capital contribution by plaintiff. Additionally, the accounting cause of action arises from the same operative facts as each of other cause of action did. As a result, plaintiff's cause of action for accounting is dismissed.

Gross negligence/intentional tort

Defendant argues that plaintiff's claim of gross negligence is insufficient because there is no established tort duty between the parties, and plaintiff has inadequately alleged a gross negligence claim under New York law. Defendant also argues that plaintiff conflates gross negligence with intentional torts and fails to specify the alleged intentional tort. Additionally, defendant contends that gross negligence differentiates from mere contract breaches and ordinary negligence, which requires a significant deviation from regular care. Defendant asserts that plaintiff's claim is grounded in the same allegations for other causes of action and has not

established a tort duty separate from contractual obligations, rendering their claims both for gross negligence and intentional torts flawed.

In opposition, plaintiff argues that defendants can be held accountable in tort when they have either breached a duty of reasonable care separate from their contractual duties or if they have engaged in tortious conduct beyond failing to uphold their contractual obligations. Even if some actions under scrutiny are related to the breach of contract, plaintiff contends that if these actions also breach duties outside the contract, they cannot be dismissed as merely duplicative. Notably, that plaintiff's claim of gross negligence/intentional tort is based on defendant's misappropriation of plaintiff's capital contribution, is predicated on conduct not covered by the Agreement.

It is a well-established principle that a simple breach of contract is not to be considered a tort unless a legal duty independent of the contract itself has been violated (*Clark-Fitzpatrick, Inc. v Long Is. R. Co.*, 70 NY2d 382 [1987]). This legal duty must spring from circumstances extraneous to, and not constituting elements of, the contract, although it may be connected with and dependent upon the contract (*id.*). Even if a legal duty independent of contractual obligations may be imposed upon the claimed tortfeasor, pure economic injury equivalent to the bargain of the transaction, instead of personal injury or property damage, does not give rise to separate and independent tort claim (*OFSI Fund II, LLC v Can. Imperial Bank of Commerce*, 82 AD3d 537 [1st Dept 2011]).

Here, plaintiff's claims for gross negligence/intentional tort allege that defendant misappropriated its capital contribution for his personal benefit. Such allegations are duplicative of plaintiff's other claims. Accordingly, plaintiff's tort claim is dismissed.

Conversion

Defendant argues that plaintiff's claim for conversion is baseless because its capital contribution was directed to Biscayne, not to defendant or Sprout, thus that any conversion claim regarding the contribution should be brought against Sprout by Biscayne. Defendant also argues that the conversion claim is insufficient because plaintiff failed to specify which asset was unlawfully controlled by defendant, lacking in detail regarding the nature, timing, and party responsible for the alleged conversion. Additionally, that plaintiff failed to establish defendant's unlawful taking of ownership to the exclusion of plaintiff's rights. Defendant contends that since the possession of the capital contribution is lawful in this case, a conversion claim can only be alleged when the property is not returned post a demand, which plaintiff also failed to allege.

In opposition, plaintiff argues that a conversion claim for money is valid when a specific and identifiable fund exists, and there is an obligation regarding its treatment. Plaintiff asserts that the complaint specifically alleges defendant inappropriately used plaintiff's capital contribution of \$750,000 for his personal benefit.

Conversion is the unauthorized exercise of the right of ownership over property belonging to another to the exclusion of the owner's rights (*State v Seventh Regiment Fund, Inc.*, 98 NY2d 249 [2002] citing *Vigilant Ins. Co. of Am. v Hous. Auth. of City of El Paso, Tex.*, 87 NY2d 36 [1995]). Money can be the subject of conversion when it can be described, identified, or segregated in the manner that a specific chattel can be and when it is subject to an obligation to be returned (*see generally, Republic of Haiti v Duvalier*, 211 AD2d 379 [1st Dept 1995]; *see also Hebrew Institute for the Deaf and Exceptional Children v. Kahana*, 17 Misc. 1110(A) [NY Sup 2007]).

Here, plaintiff alleges that defendant misappropriated its capital contribution of \$750,000 for his personal benefit. Such allegations sufficiently state a claim for conversion.

Defendant's cross-motion for leave to amend the complaint

Plaintiff argues that if the Court finds any deficiencies in the complaint, it should be granted leave to amend it under CPLR 3025(b) and relevant legal precedents, which provide that amendment requests should be freely given unless the allegations are without merit or cause prejudice. Plaintiff asserts that defendant bears the burden of proving the unreliability or inadequacy of the moving party's assertions. Additionally, plaintiff submits that the Court of Appeals endorses a lenient approach if a plaintiff intends to introduce a new theory grounded on a previously litigated matter. Plaintiff further contends that a mere potential for increased liability is inadequate to establish prejudice. Lastly, plaintiff asserts that mere delay in seeking to amend does not justify denying the motion if no prejudice is present.

“A party may amend his or her pleading or supplement it by setting forth additional or subsequent transactions or occurrences, at any time by leave of court or by stipulation of all parties. Leave shall be freely given upon such terms as may be just including the granting of costs and continuances. Any motion to amend or supplement pleadings shall be accompanied by the proposed amended or supplemental pleading clearly showing the changes or additions to be made to the pleading” (CPLR 3025(b)).

Here, plaintiff fails to present any additional or subsequent transactions other than those alleged in the original complaint. Additionally, plaintiff fails to submit any proposed amended or supplemental pleading clearly showing the changes or additions sought to be made to the pleading. Therefore, plaintiff's motion for leave to amend the complaint is denied without prejudice to renew upon a proper submission.

In conclusion, defendant's motion to dismiss the complaint is granted to the extent that the first, second, third, fourth, fifth causes of action are dismissed. The claim for conversion is sustained. Plaintiff's motion for leave to amend the complaint is denied.

ENTER:



Honorable Reginald A. Boddie
Justice, Supreme Court