

Walsh v WWEBNET, Inc.

2011 NY Slip Op 33542(U)

December 20, 2011

Supreme Court, Nassau County

Docket Number: 023744/2010

Judge: Ira B. Warshawsky

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SHORT FORM ORDER

**SUPREME COURT: STATE OF NEW YORK
COUNTY OF NASSAU**

**HON. IRA B. WARSHAWSKY,
Justice.**

TRIAL/IAS PART 7

WALTER WALSH and FRANK MOSCATI,
Individually, and on behalf of WWEBNET, INC.,
a foreign corporation,

Plaintiffs,

- against -

INDEX NO.: 023744/2010
MOTION DATE: 10/21/2011
SEQUENCE NO.: 001, 002
003.

WWEBNET, INC., ROBERT KELLY, PAUL T. SWEENEY; RON INSANA, DAVID STACEY, TIM DEMERS, DOLNY, LTD., DIRECT CHOICE TV COMMUNICATIONS, LTD., RYMATICS LIMITED, and "JOHN DOES" 1 - 100, "JANE DOES" 1 - 100, and "XYZ CORPORATIONS" 1 - 100, the same being fictitious and intended to represent persons and/or entities presently unknown to the Plaintiffs but who are believed to have an interest adverse to the Plaintiffs in the subject litigation and to have breached a contract(s) and/or duty owed to the Plaintiffs, negligently performed an act and/or admission and/or perpetrated a fraud damaging the Plaintiffs,

Defendants

The following documents were read on this motion:

- Notice of Motion by Defendants Insana and Sweeney to Dismiss Complaint 1.
- Statement in Support of Assignment to Commercial Division 2.
- Affirmation of Elliott Z. Stein, Esq. in Support of Motion 3.

Memorandum of Law in Support of Motion 4.
 Memorandum of Law of Defendants WWEBNET, Kelly and Demers in Support 5.
 Reply Memorandum of Insana and Sweeney in Further Support of Motion 6.
 Affirmation of Charles A. Ross, Esq. in Support of Reply Memorandum 7.
 Motion Sequence # 2 to Dismiss on behalf of WWEBNET, Kelly and Demers 8.
 Cross-motion Sequence # 3 for Leave to Amend Complaint and Opposition 9.
 Reply Memorandum of Law in Further Support of WWEBNET, Kelly and Demers 10.

PRELIMINARY STATEMENT

Defendants Raul T. Sweeney and Ron Insana move to dismiss the Amended Verified Complaint on the following specified grounds:

- as to the 3rd, 5th, 7th, 9th, 11th, 13th, 15th and 17th causes of action pursuant to CPLR §§ 3211 (a)(3) and (a)(7) on the ground that plaintiffs are bringing derivative claims on behalf of WWEBNET without first making a demand on the board of directors, or alleging with particularity why such a demand would be futile;
- as to the 2nd, 4th, 6th, 8th, 10th, 12th, 14th, and 16th causes of action pursuant to CPLR §§ 3211 (a)(3) and (a)(7), on the ground that the alleged individual claims are, in fact, derivative claims which should be dismissed for failure to demand action by the board of directors or specifically assert why such demand would be futile;
- as to causes of action 2 through 13 pursuant to CPLR § 3211 (a)(7) for failure to plead with particularity causes of action for fraud and for breach of fiduciary duty;
- as to the 14th and 15th causes of action pursuant to CPLR § 3211 (a)(7), for failure to demand an accounting;
- as to the 16th and 17th causes of action pursuant to CPLR § 3211 (a)(7) for failure to demonstrate a basis for injunctive relief

These defendants also move to strike the request for punitive damages, and for a stay of discovery pending resolution of the motion.

Motion Sequence No. 2 on behalf of WWEBNET, Kelly and Demers for dismissal of the Amended Verified Complaint pursuant to CPLR §§ 3016 (b), 3211 (a)(1) and or 3211 (a)(7) on the grounds that plaintiff have failed to state a claim upon which relief may be granted and/or a defense is based upon documentary evidence.; § 3211 (a)(3), Rule 23.1 of the Nevada Rules of Civil Procedure and/or § 626 (c) of the New York Business Corporation Law on the grounds that

plaintiffs have failed to allege the futility of a demand and/or that they are not adequate class representatives and thus lack standing; Rule 78.137(7) of the Nevada General Corporation Law and/or § 720 of the Business Corporation Law on the grounds that plaintiffs' claims are precluded by statute.

By Motion Sequence # 3, plaintiff seeks leave to amend the complaint in the form annexed to the moving papers.

BACKGROUND

Plaintiffs allege in their Amended Verified Complaint that they are shareholders in WWEBNET, and bring the action as individuals and on behalf of WWEBNET. They allege that defendant Insana was an officer, shareholder, employee and director of WWEBNET; and that defendant Sweeney was the Chief Financial Officer, shareholder, employee and director of WWEBNET. The thrust of the complaint is that defendant Kelly, under the guise of Research and Development payments, diverted WWEBNET revenues and other asset to three entities, RYMATICS, DOLNY and/or DIRECT, which were controlled by or owned by Kelly, thereby enriching himself at the expense of WWEBNET and the plaintiffs, as shareholders. The Complaint alleges that Insana and Sweeney knew, or should have known, of the diversion of funds to the three entities. There is no claim that Insana or Sweeney were affiliated with the entities, or benefitted from the diversion of funds.

DISCUSSION

Choice of Law

WWEBNET, DOLNY, and RYMATICS are foreign corporations, doing business in New York. The individual plaintiffs are residents of New York, and the actions of which they complain took place in New York. Under the "grouping of contacts" theory, the law of the jurisdiction most affected by the conduct will apply.¹ The Court concludes that the facts of this case lead to the inevitable conclusion that New York is the jurisdiction most interested in the outcome, and therefore, New York law applies.

¹ Am Jur 2d, Conflict of Laws, § 53.

Motion Sequence 01

The Summons and Amended Verified Complaint is annexed as Exh. "1" to the Statement in Support of Assignment to the Commercial Division and also Exh. "1" to the Affirmation of Elliott Z. Stein, Esq. in support of the Motion. It encompasses seventeen causes of action, both individual and derivative on behalf of Walter Walsh and Frank Moscati. Exh. "2" to the Statement is a lengthy email from Walsh, in which he tenders his immediate resignation from WWEBNET, and expresses his frustration as what he perceived as the lack of management direction and economic transparency, coupled with the lack of reliance upon him in his perhaps nominal title of Chief Technical Officer.

Defendants Sweeney and Insana direct their initial assault upon the complaint in a challenge to the standing of the plaintiffs as proponents of a derivative cause of action. A shareholder derivative action is one brought by one or more shareholders on behalf of a corporation to remedy or prevent a wrong to the corporation. Such suits were first recognized as a viable equitable claim in 1855.² New York courts have been in the forefront of limiting the availability of such actions, recognizing their potential for abuse, and the potential infringement on managerial discretion of corporate boards, and have created a stricter standard for plaintiffs wishing to overturn the business judgment of companies.³

The availability of shareholders' derivative action is contained in Business Corporation Law ("BCL") § 626, which provides in part as follows:

§ 626. Shareholders' derivative action brought in the right of the corporation to procure a judgment in its favor

- (a) An action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor, by a holder of shares or of voting trust certificates of the corporation or of a beneficial interest in such shares or certificates.
- (b) In any such action, it shall be made to appear that the plaintiff is such a holder at the time of bringing the action and that he was such a holder at the time of the transaction of which he complains, or that his shares or his interest therein devolved upon him by

² *Dodge v. Woolsey*, 59 U.S. 331 (1855).

³ *Auerbach v. Bennett*, 47 N.Y.2d 619 (1979).

operation of law.

(c) In any such action, the complaint shall set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort.

The complaint asserts that the plaintiffs were shareholders at the time of the transactions of which they complain, as well as of the time of commencing the action. What is absent, however, are any allegations setting forth in detail the efforts to induce the board of directors to take remedial action on behalf of the corporation; or, alternatively, an explicit explanation as to why such efforts would be fruitless.⁴ The demand requirement is a prophylactic one, designed to weed out cases which can be dealt with by the corporation, without resort to the Courts.⁵

For the foregoing reason alone, the claims set forth in the 3rd, 5th, 7th, 9th, 11th, 13th, 15th, and 17th causes of action are deficient and fail to state a claim upon which derivative relief can be granted. The motion to dismiss these causes of action is granted.

Defendants next contend that 2nd, 4th, 6th, 8th, 10th, 12th, 14th, and 16th causes of action are, in fact, derivative claims classified as individual claims, and must be dismissed for the same failure to allege in detail a request for remedial action by the board of directors, or, alternatively, an explanation as to why such request would be futile. This contention raises the somewhat difficult task of analyzing whether or not the true beneficiary of the claim would be the individual claimant, or the corporation. It also places squarely before the Court a more fundamental issue as to whether or not an individual plaintiff can adequately represent the interest of the corporation, or whether the interests are irretrievably conflicted.⁶

Rather than analyze the eight causes of action individually to determine whether or not they constitute derivative of individual claims, the simple fact is that if they are in fact derivative claims, they must be dismissed for failure to detail the requests to the board of directors to rectify

⁴ *Barr v. Wackman*, 36 N.Y.2d 371, 378 (1975); *See also, Marx v. Akers*, 88 N.Y.2d 189, 193 (1996).

⁵ *Id.* at 194.

⁶ *Zutrau v. Ice Systems, Inc.* 2011 WL 5137152 (Sup.Ct. Suff. Co. 2011) citing, *Tuscano v. Tuscano*, 403 F.Supp. 214, 223 (U.S.D.C., E.D.N.Y 2005 [Spatt, J.]).

the complaints, or to adequately assert the futility of such an effort. Alternatively, if the causes of action are individual in nature, they are inappropriately joined with derivative claims, and are dismissed for that reason.

The conflict which precludes the joinder of the derivative and individual claims “arises because the derivative action seeks to enhance the value of the corporation generally by seeking recovery for the corporation on its own behalf. Conversely, the plaintiff-shareholder seeks a recovery against the corporation. Naturally, the plaintiff will pursue more vigorously the claim, individual or derivative, that will bring her the greatest economic benefit, and the vigorous presentation of one claim will suffer”.⁷ “(I)ndividual claims raised by a shareholder in a derivative action present an impermissible conflict of interest such that [she] cannot adequately represent the other shareholders”.⁸

For the foregoing reasons causes of action 2nd, 4th, 6th, 8th, 10th, 12th, 14th, and 16th are dismissed. The Court finds it unnecessary to deal with the other bases for dismissal of the 14th, 15th, 16th, and 17th causes of action.

Defendants have not moved to dismiss the 1st cause of action, which alleged an individual claim by Walsh against defendants Dolny and Direct Choice TV Communications for breach of contracts to reimburse him 10% of the amount of funds raised on behalf of WWEBNET. This claim is not barred by the potential conflict, since there are no derivative claims against these corporations. The 1st Cause of Action stands.

Since the only remaining claim is for breach of contract, punitive damages are generally impermissible.⁹ To state a claim for punitive damages as an additional and exemplary remedy when the claim arises from a breach of contract: (1) the defendant's conduct must be actionable as an independent tort; (2) the tortious conduct must be of the egregious nature as outlined

⁷ *JFK Family Ltd. Partnership v. Millbrae Natural Gas Dev. Fund 2005*, 21 Misc.3d 1102(A) at 19 (Sup.Ct., West. Co., 2008).

⁸ *Zutrau v. Ice Systems, Inc.* 33 Misc.3d 1215(A) (Sup.Ct., Suff. Co. 2011).

⁹ *Soviero v. Carroll Group Intern.*, 27 A.D.2d 276 (1st Dept. 2006).

above; (3) the egregious conduct must be directed to the plaintiff; and (4) it must be part of a pattern directed at the public generally.¹⁰

No such conduct on the part of defendants Dolny or Direct has been alleged, and punitive damages are unwarranted. The claims for punitive damages are stricken.

Motion Sequence 02

By this motion defendants WWEBNET, Kelly and Demers also seek dismissal on the complaint on the grounds that plaintiffs have failed to allege a demand upon the board of directors with respect to their derivative claims; that under both Nevada and New York Law plaintiffs are statutorily precluded from making their claims. For the purpose of this motion, these defendants are similarly situated to the movants in Motions Sequence 01. For the same reasons, all causes of action, other than the 1st cause of action are dismissed.

Motion Sequence 03

Plaintiffs seek to amend their Second Amended Verified Complaint in the form annexed to the moving papers. Amendments of pleadings are governed by CPLR 3025, which provides in pertinent part as follows:

(b) Amendments and supplemental pleadings by leave. A party may amend his 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.

The language of the statute, and cases interpreting it, make it abundantly clear that amendment of pleadings is to be freely granted unless the proposed amendment is “palpably insufficient” to state a cause of action or defense, or it is patently devoid of merit. To the extent that prior decisions led to the conclusion that the movant was under a burden to establish the

¹⁰ *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308 (1995).

merit of the amendment, they erroneously stated the standard to be followed.¹¹

The proposed amended complaint, annexed to Motion Sequence 003, contains seventeen causes of action as follows:

- FIRST: Individual cause of action on behalf of Walsh against Dolny and Direct;
- SECOND: Individual cause of action on behalf of Walsh against all defendants;
- THIRD: Derivative cause of action on behalf of Walsh against all defendants;
- FOURTH: Individual cause of action on behalf of Moscati against all defendants;
- FIFTH: Derivative cause of action on behalf of Moscati against all defendants;
- SIXTH: Individual cause of action on behalf of Walsh against all defendants;
- SEVENTH: Derivative cause of action on behalf of Walsh against all defendants;
- EIGHTH: Individual cause of action on behalf of Moscati against all defendants;
- NINTH: Derivative cause of action on behalf of Moscati against all defendants;
- TENTH: Individual cause of action on behalf of Walsh against Kelly, Sweeney, Insana and Stacey;
- ELEVENTH: Derivative cause of action on behalf of Walsh against Kelly, Sweeney, Insana and Stacey;
- TWELFTH: Individual cause of action on behalf of Moscati against Kelly, Sweeney, Insana and Stacey;
- THIRTEENTH: Derivative cause of action on behalf of Moscati against Kelly, Sweeney, Insana and Stacey;
- FOURTEENTH: Individual causes of action by both plaintiffs against all defendants;
- FIFTEENTH: Derivative causes of action by both plaintiffs against all defendants;
- SIXTEENTH: Individual causes of action on behalf of both plaintiffs against all defendants;
- SEVENTEENTH: Derivative causes of action on behalf of both plaintiffs against all defendants.

Plaintiffs acknowledge in ¶ 6(A) of the complaint that no formal demand was made upon

¹¹ *Lucido v. Mancuso*, 49 A.D.3d 220, 230 (2d Dept. 2008).

the board of directors, and that any demand would have been futile, since the officers and directors are themselves the defendants in the action. Plaintiffs further state that their communications with defendants Kelly, Sweeney and Insana, as individuals, were all rebuffed. The requirement of a demand, however, must be such that a denial of the request constitutes an action of the corporation itself; and that failure to make such a demand can be excused only by extraordinary circumstances.¹² One exception to the requirement is when such a request would have been futile.¹³ This is the law of New York.¹⁴

Plaintiff has adequately justified their failure to make a demand upon the board of directors, showing as they have, that the defendants are the officers and directors of WWEBNET.

The motion to amend the second amended complaint is granted in part and denied in part.

Plaintiffs have shown their entitlement to proceed with a derivative claim against the defendants for damages sustained by the corporation. They are not entitled to recover for personal losses sustained by the conduct of which they complain. An individual shareholder does not have a cause of action to recover damages for a wrong against the corporation if the shareholder loses the value of his shares, or even incurs individual liability in an effort to preserve a corporation's solvency.¹⁵

Plaintiff's Second Cause of Action asserts misconduct by defendants directed at the corporation, resulting in damages to Walsh. Similarly, the Fourth Cause of Action alleges similar misconduct directed at WWEBNET, resulting in financial damages to Moscati. Neither of these causes of action are appropriate, and the motion to amend the complaint so as to include them is denied. The Sixth and Eighth Causes of Action allege conduct directed at undermining the corporation, for which plaintiffs claim individual damages. For the same reasons, the motion to amend the complaint to include the Sixth and Eighth Causes of Action is denied.

¹² *Kamen v. Kemper Fin. Svces. Inc.*, 500 U.S. 90, 95 (1991).

¹³ *Id.* at 101 — 102.

¹⁴ *Rypley v. Int'l. Rys. of Cent. Am.* 8 A.D.2d 310, 317 (1st Dept. 1959).

¹⁵ *Elenson v. Wax*, 215 A.D.2d 429 (2d Dept. 1995).

The Tenth and Twelfth Causes of Action assert breaches of fiduciary duty to plaintiffs. The alleged breaches include diversion of corporate assets, dissemination of confidential, unique and protected information. These actions are directed at the corporation. While majority shareholders owe a fiduciary duty to minority shareholders, this is not the nature of the action claimed. Plaintiffs are not entitled to claim damages as a result of the alleged misconduct of defendants directed at the corporation. The motion to amend the amended verified complaint to add the Tenth and Twelfth causes of action is denied.

In the Fourteenth and Fifteenth Causes of Action, plaintiffs demand an accounting, both individually and derivatively. Defendants contend that since the proposed amended complaint asserts neither a demand for an accounting, nor a detailed explanation as to the futility of such a demand, plaintiffs are not entitled to an accounting. The Court agrees with the requirement for a demand, or an explanation why such demand would be futile.¹⁶ Plaintiffs do not allege that they demanded an accounting from defendants; nor do they give a detailed explanation as to why such demand would have been futile. In order to enlist the aid of a court in vindicating the right to an accounting, the plaintiffs must show a demand for an accounting, and a failure or refusal of the persons with the books in their possession to produce them.

For the previously stated reasons, plaintiffs are not entitled to recover individually for the allegations of misconduct aimed at the corporation by the defendants. The motion to amend the complaint to include the Fourteenth Cause of Action is denied. The previously mentioned statements as to the efforts to obtain corrective action from individual officers and directors, and the futility of a formal demand to the board of directors, are considered relevant to the lack of a formal demand for an accounting. The motion to amend the complaint to include the Fifteenth Cause of Action is granted.

The Sixteenth and Seventeenth Causes of Action claim entitlement to injunctive relief against defendants and in favor of plaintiffs individually and derivatively.

“To establish entitlement to a preliminary injunction, a movant must establish (1) a likelihood or probability of success on the merits, (2) irreparable harm in the absence of an

¹⁶ *Conroy v. Cadillac Fairview Shopping Center*, 143 A.D.2d 726 (2d Dept. 1988).

injunction, and (3) a balance of the equities in favor of granting the injunction.”¹⁷

“Irreparable injuries for the purpose of equity, has been held to mean any injury for which money damages are insufficient”.¹⁸ On the contrary, “(e)conomic loss, which is compensable by money damages, does not constitute irreparable harm”.¹⁹ Failure to enunciate non-economic loss constitutes a failure to demonstrate irreparable harm so as to warrant equitable relief in the form of an injunction.²⁰

Likelihood of ultimate success on the merits does not import a predetermination of the issues, and does not constitute a certainty of success. The requirement is a protection against the exercise of a court’s formidable equity power in cases where the moving party’s position, no matter how emotionally compelling, is without legal foundation.²¹

In balancing the equities, the court must weigh the harm each side will suffer in the absence or in the face of injunctive relief.²² This is, by definition, a fact-sensitive inquiry. Thus, for example, where a pharmaceutical manufacturer of a non-prescription product was seeking to enforce exclusivity agreement and preliminarily enjoin defendant from importing and marketing the same product, the balance of equities favored defendant, since plaintiff could recover damages, while defendant would have to remove product from the shelves for an indeterminate length of time.²³

¹⁷ *DeFabio v. Omnipoint Communications*, 2009 WL 3210142 (2d Dept. 2009) citing CPLR 3201; *Doe v. Axelrod*, 73 N.Y.2d 748, 750 (1988); *W.T. Grant v. Srogi*, 52 N.Y.2d 496, 517 (1981). See also, *Automated Waste Disposal, Inc. v. Mid-Hudson Waste, Inc.*, 50 A.D.3d 1072 - 1073 (2d Dept. 2008).

¹⁸ *Walsh v. Design Concepts*, 221 A.D.2d 454, 455 (2d Dept. 1995).

¹⁹ *EdCia Corp. V. McCormack*, 44 A.D.3d 991, 994 (2d Dept. 2007).

²⁰ *Automated Waste Disposal*, 50 A.D.3d at 1073.

²¹ *Tucker v. Toia*, 54 A.D.2d 322, 326 (4th Dept. 1976).

²² *Washington Deluxe Bus, Inc. v. Sharmash Bus Corp.*, 47 A.D.3d 806 (2d Dept. 2008).

²³ *OraSure Technologies, Inc. v. Prestige Brands Holdings, Inc.*, 42 A.D.3d 348 (1st Dept 2007).

The Court determines that plaintiffs have failed to meet their burden to establish entitlement to injunctive relief. It is not clear that the alleged wrongdoing, the outsourcing of work to companies in which defendant Kelly had an interest, could not have been a fully vetted corporate business decision, which would impact on the likelihood of success. Nor have they shown that they are likely to experience irreparable harm in the absence of an injunction. Lastly, if WWEBNET is seeking to continue to operate, the balance of equities would favor permitting them to continue. The motion, insofar as it seeks an injunction, is denied.

Plaintiffs also request an award of punitive damages. As a general proposition, "because a shareholders' derivative suit seeks to vindicate a wrong done to the corporation through enforcement of a corporate cause of action, any recovery obtained is for the benefit of the corporation."²⁴ But "(t)heir is ample precedent for distributing damages won in a derivative suit to deserving shareholders".²⁵

A plaintiff will not be permitted to amend a complaint to include a demand for punitive damages where the proposed amendments fail to sufficiently set forth a claim for punitive damages.²⁶ There is nothing enunciated in the proposed amended complaint which substantiates that defendants were guilty of gross recklessness, or of intentional, wanton, or malicious conduct aimed at the public generally so as to justify the award of punitive damages.²⁷ The motion to amend the Second Amended Complaint so as to include a claim for punitive damages is denied.

Plaintiff is authorized to serve an Amended Complaint in accordance with the foregoing.

This constitutes the Decision and Order of the Court.

Dated: December 20, 2011

ENTERED

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J.S.C.

**NASSAU COUNTY
COUNTY CLERK'S OFFICE**

²⁴ *Glen v. Hoteltron Systems, Inc.* 74 N.Y.2d 386, 392 (1989).

²⁵ *General Elec. Co. v. Bucyrus-Erie Co.*, 563 F. Supp. 970 (U.S.D.C., S.D.N.Y. 1983).

²⁶ *Barry v. City of New York*, 259 A.D.2d 718 (2d Dept. 1999).

²⁷ *Girardi v. Community Hosp. of Brooklyn*, 137 A.D.2d 788 (2d Dept. 1988)