

Kahn v Ran

2012 NY Slip Op 31620(U)

June 12, 2012

Sup Ct, Nassau County

Docket Number: 601288-11

Judge: Timothy S. Driscoll

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**SUPREME COURT-STATE OF NEW YORK
SHORT FORM ORDER**

Present:

HON. TIMOTHY S. DRISCOLL

Justice Supreme Court

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**ALAN R. KAHN, derivatively, on behalf of
MANHATTAN BRIDGE CAPITAL INC.,**

TRIAL/IAS PART: 16

Plaintiff,

NASSAU COUNTY

-against-

Index No: 601288-11

Motion Seq. No: 2

Submission Date: 5/4/12

**ASSAF RAN, MARK ALHADEFF,
PHILLIP MICHAELS, MICHAEL JACKSON,
ERAN GOLDSHMID and LYRON BENTOVIM,**

Defendants,

and

**MANHATTAN BRIDGE CAPITAL, INC.,
a New York Corporation,**

Nominal Defendant.

-----X

Papers Read on this Motion:

- Notice of Motion.....X**
- Affirmation in Support and Exhibits.....X**
- Memorandum of Law in Support.....X**
- Affirmation in Opposition and Exhibit.....X**
- Memorandum of Law in Opposition.....X**
- Reply Affirmation and Exhibits.....X**
- Reply Memorandum of Law.....X**

This matter is before the court on the motion filed by Defendants Assaf Ran, Mark Alhadeff, Phillip Michaels,¹ Michael Jackson, Eran Goldshmid, Lyron Bentovim and Manhattan

¹ In their Notice of Motion, Defendants assert that the correct name of Defendant Phillip Michaels is "Phillip Michals."

Bridge Capital, Inc. (“Defendants”) on January 31, 2012 and submitted on May 4, 2012, following oral argument before the Court. For the reasons set forth below, the Court determines that the Complaint does not allege with adequate particularity the futility of a demand on the Board of Directors, but the Court will permit Plaintiff to amend his complaint. Plaintiff is directed to serve and file his amended complaint within thirty (30) days of the date of this Order, and Defendants are directed to answer, or move, with respect to the amended complaint within thirty (30) days of service of the amended complaint on Defendants.

BACKGROUND

A. Relief Sought

Defendants move, pursuant to CPLR § 3211(a)(7) and New York Business Corporation Law (“BCL”) § 626(c), for an Order dismissing this action.

Plaintiff Alan R. Kahn (“Kahn” or “Plaintiff”) opposes Defendants’ motion.

B. The Parties’ History

The Verified Shareholder Derivative Complaint (“Complaint”) (Ex. A to Leitner Aff. in Supp.) alleges that Plaintiff brings this action derivatively on behalf of the nominal Defendant Manhattan Bridge Capital, Inc. (“MBC” or “Company”). The Complaint describes the nature of this action as follows:

This is a derivative action brought on behalf of the Company against its board of directors (the “Defendants”) seeking to remedy Defendants’ violations of state law, including breaches of fiduciary duties that have caused and threaten to cause substantial damage to MBC. Plaintiff is a shareholder of MBC and defendants are the directors of MBC.

Compl. at ¶ 1

The Complaint alleges that on August 9, 2010, MBC filed a Schedule 14A with the Securities and Exchange Commission (“SEC”) disclosing Defendants’ authorization and recommendation to grant 1,000,000 restricted shares of MBC common stock to Defendant Assaf Ran (“Ran”), MBC’s President and Chief Executive Officer (“CEO”), pursuant to an agreement (“Restricted Shares Agreement”) under which Ran would agree to the termination and cancellation of certain MBC options that he currently holds. Ran is also the founder and controlling shareholder of MBC and, therefore, elects the directors of the Company, including the

directors that authorized the Restricted Shares Agreement (“RSA”).

The grant (“Grant”) under the RSA is equal to nearly 30% of MBC’s market value at the time of the Grant, and will increase Ran’s ownership of the Company from approximately 50% to approximately 75%. Plaintiff alleges that the Board lacks justification for the Grant, which greatly exceeds the value of the options he is giving up and is “far in excess of any defensible compensation package” (Compl. at ¶ 3). As further evidence of the unfairness of the Grant, on September 8, 2011, Capstone Equities Capital Management LLC (“Capstone”) and G Asset Management, LLC (“GAM”), which together own approximately 5.5% of MBC’s shares, sent a letter (“Capstone Letter”) to MBC’s Compensation Committee detailing their concerns with the Grant. On September 14, 2011, MBC filed a Form 8-K with the SEC reporting the shareholder approval of the Grant to Ran.

The Complaint provides details regarding the Defendant-directors’ involvement with the Company, including the dates that they became directors. Plaintiff alleges that Defendants breached their duty of loyalty by authorizing and recommending the RSA. The Grant was allegedly unfair to MBC and its public shareholders, excessive, and “approved through a flawed process undertaken by a conflicted Board” (Compl. at ¶ 37).

Plaintiff also alleges that it has not made a demand on the board of directors of MBC (“Board”) to institute this action because such a demand would be futile in light of the Defendants’ conflicts of interest which prevent them from taking appropriate actions on behalf of the Company. The allegations in the Complaint regarding why demand should be excused (¶¶ 44-48) include allegations that 1) the majority of the Board members were selected by Ran and have been Board members for over 10 years; 2) all of the Defendants have a substantial likelihood of personal liability for their breach of their fiduciary duties; 3) the members of the Compensation Committee, which approved the RSA, are unlikely to admit their wrongful conduct; and 4) the amount of Company shares granted to Ran is so excessive, and the terms of the RSA so egregious, that the RSA could not have been the product of sound business judgment by the Board.

The Complaint contains three (3) causes of action: 1) against all Defendants for breach of fiduciary duty, 2) against Ran for unjust enrichment, and 3) against all Defendants for corporate

waste. Plaintiff seeks a judgment 1) against all Defendants, and in favor of the Company, for damages sustained by the Company as a result of Defendants' alleged breach of fiduciary duties, 2) declaring the RSA void and ordering rescission of any acts or transactions taken thereunder; 3) ordering the implementation and administration of internal controls and systems at MBC designed to prohibit and prevent excessive and/or unwarranted executive compensation to MBC's CEO and other executives; 4) awarding MBC restitution from Defendants, and ordering disgorgement of all profits, benefits and other compensation obtained by Defendants; and 5) awarding Plaintiff the costs and disbursements of this action, including reasonable attorney's fees.

In support of Defendants' motion to dismiss, counsel for Defendants provides copies of the Schedule 14A and Form 8-K filed with the SEC (Exs. B and C to Leitner Aff. in Supp.), and the Certificate of Incorporation of MBC (*id.* at Ex. D).

In opposition to the motion, counsel for Plaintiff provides a letter from Capstone and GAM to MBC dated September 8, 2011 which was filed with the SEC (Ex. A to Farmer Aff. in Opp.).

C. The Parties' Positions

Defendants submit that 1) in ruling on the motion to dismiss, the Court may consider the content of documents cited in and relied upon in the Complaint, and take judicial notice of filings that have been made with government agencies, without converting Defendants' motion to dismiss to a motion for summary judgment; 2) the Complaint omits critical details regarding the RSA, and the matters considered by the Board in approving the RSA and recommending it to the shareholders; and 3) the details omitted from the Complaint are described at length in the SEC filings, including an August 5, 2011 filing which reflects certain limitations on Ran's disposition of Restricted Shares.

Defendants argue that the Court should dismiss the Complaint on the grounds that Plaintiff was not excused from making a demand on the Company's Board. Defendants submit that Plaintiff has failed to plead, with particularity, director interest, a failure of the Board to fully inform itself regarding the fairness and appropriateness of the RSA, and/or the egregiousness of the RSA, pursuant to *Marx v. Akers*, 88 N.Y.2d 189 (1996).

Defendants also contend that Plaintiff has failed to state a claim on which relief can be granted. With respect to the breach of fiduciary duty claim, in light of the fact that the Board was authorized by statute to determine how much to charge for the Restricted Shares, it could not have been a breach of the Board's fiduciary duties to approve the RSA. In addition, to the extent that the Complaint seeks an award of money damages against the Directors, that claim is barred by BCL § 402(b) and Article Eleventh of the Company's certificate of incorporation. Defendants also argue that the unjust enrichment claim against Ran is not viable because there is no showing that there was a breach of law, either tortious or fraudulent. Finally, Defendants contend that the cause of action for corporate waste cannot succeed because, as the Company received something of value in exchange for stock, the decision by the Board "may not be second-guessed" (Ds' Memo. of Law at p. 16).

Plaintiff opposes Defendants' motion submitting, *inter alia*, that 1) Plaintiff's allegations show the futility of demand under each of the *Marx* exceptions in that Plaintiff has alleged a) director interest by virtue of Ran's financial interest in the RSA, the fact that Ran selected three of the Board members who have served on the Board for over ten years, and Alhadef's status as an employee of the Company, b) the Board's failure to fully inform itself of the circumstances of the Grant as demonstrated by the Board's failure to consult with a valuation expert and the flawed nature of the valuation advice that the Board received, and c) the egregiousness and excessiveness of the Grant, which far exceeds the value of the options that Ran was giving up, and exceeds any "defensible executive equity package" (P's Memo. of Law in Opp. at p. 12); 2) the Complaint states a claim for breach of fiduciary duty by alleging that a) Defendants owed duties of trust, loyalty, good faith and due care to the Company; and b) Defendants breached their fiduciary duties by authorizing and approving the RSA without properly informing themselves of its circumstances, and without justification; 3) BCL § 304 does not bar Plaintiff's claims; 4) Defendants' reliance on the exculpatory provision in MBC's Certificate of Incorporation is premature, as it is an affirmative defense on which Defendants have the burden of pleading and proof, not an element that Plaintiff must allege at the pleading stage; 5) even if the Court considers the exculpatory provision, MBC's directors are not insulated from liability for intentional misconduct, as alleged by Plaintiff; 6) Plaintiff has properly stated

an unjust enrichment claim by alleging that Ran was unjustly enriched at the expense, and to the detriment, of MBC as a result of Defendants' approval of the RSA; and 7) Plaintiff has adequately alleged a claim for waste of corporate assets by alleging Defendants' approval of the highly lucrative Grant and their failure to consider the Company's interests, and by alleging that the Restricted Shares do not qualify as performance based compensation.

In reply, Defendants submit *inter alia* that Plaintiff has not adequately pled any of the Marx exceptions to the demand requirement in light of the fact that 1) Plaintiff has not adequately alleged that a majority of the Board was interested in the transaction because a) Ran's power to elect the Board did not constitute control over the Board; b) the documentation provided reflects that some of the other members of the Board received minimal compensation from the Company and are handsomely compensated from other employment; and c) the Complaint fails to set forth with adequate particularity the conflicts on the Board; 2) Plaintiff has not pleaded with particularity that the Board failed to inform itself fully, and makes assertions, *e.g.*, that the Board failed to retain an independent valuation expert, that are not pleaded in the Complaint; and 3) Plaintiff has not pleaded with particularity the alleged egregiousness of the transaction, both in light of the justifications set forth in the Schedule 14A, which include providing Ran with an incentive to provide personal guarantees to the Company, and in light of Plaintiff's failure to quantify or compare the alleged benefits and drawbacks of the proposed transaction.

RULING OF THE COURT

A. Standards of Dismissal

A motion interposed pursuant to CPLR § 3211 (a)(7), which seeks to dismiss a complaint for failure to state a cause of action, must be denied if the factual allegations contained in the complaint constitute a cause of action cognizable at law. *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268 (1977); *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144 (2002). When entertaining such an application, the Court must liberally construe the pleading. In so doing, the Court must accept the facts alleged as true and accord to the plaintiff every favorable inference which may be drawn therefrom. *Leon v. Martinez*, 84 N.Y.2d 83 (1994). On such a motion, however, the Court will not presume as true bare legal conclusions and factual claims which are

flatly contradicted by the evidence. *Palazzolo v. Herrick, Feinstein*, 298 A.D.2d 372 (2d Dept. 2002).²

B. Shareholder Demand on Corporation

In New York, a demand would be futile if a complaint alleges with particularity that 1) a majority of the directors are interested in the transaction; or 2) the directors failed to inform themselves to a degree reasonably necessary about the transaction; or 3) the directors failed to exercise their business judgment in approving the transaction. *Marx v. Akers*, 88 N.Y.2d 189, 198 (1996).

New York's Court of Appeals has declined to adopt the Delaware approach to determining whether directors are interested, which is to view directors as interested because they are substantially likely to be held liable for their actions. *Wandel v. Eisenberg*, 60 A.D.3d 77, 80 (1st Dept. 2009), citing *Marx* at 198 and *Stone ex rel AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006). The First Department, in *Wandel*, explained the rationale for rejecting the Delaware approach to determining whether directors are interested:

Indeed, if we were to find demand futility wherever it was asserted that a majority of directors were “substantially likely to be held liable,” then “all well-pled complaints would be able to establish demand futility. If facts outside of the pleadings may be considered in determining ‘likelihood of liability,’ a trial on the merits would be needed to determine whether to apply the futility exception.”

Id., quoting *In re InfoSonics Corp. Derivative Litig.*, 2007 U.S. Dist. LEXIS 66043, * 20 (S.D. Cal. 2007).

The First Department, in *Wandel*, also concluded that the amended complaint at issue did not plead with the requisite particularity that the directors failed to inform themselves adequately regarding the transaction at issue, or that the transaction was so egregious on its face that it could not have been the product of the directors' sound business judgment. *Id.* at 81-82.

² Defendants cite *Lore v. New York Racing Ass'n Inc.*, 819 N.Y.S.2d 210 (Nassau Cty. Sup. Ct. 2006) for the proposition that the Court may consider the content of documents cited in and relied upon in the Complaint on a motion pursuant to CPLR § 3211(a)(7) (Ds' Memo. of Law at p. 1). The Court notes that the language from *Lore* quoted in Defendants' Memorandum of Law is from *Pisani v. Westchester County Health Care Corp.*, 424 F. Supp. 2d 710 (S.D.N.Y.), a federal case discussing the standard for dismissal under Federal Rule of Civil Procedure 12(b).

In *Tsutsui v. Barasch*, 67 A.D.3d 896 (2d Dept. 2009), the Second Department held that plaintiff had alleged with sufficient particularity that a majority of the directors were interested in the challenged transactions, and modified the trial court's determination that plaintiff's allegations were insufficient. *Id.* at 898. In *Tsutsui*, plaintiff's allegations included that 1) the company's chairman of the board and chief executive officer was accused of receiving a direct financial benefit by personally engaging in insider trading; 2) other directors owned, or were closely affiliated with, a business entity that allegedly profited through the sale of the company's stock on the basis of inside information; and 3) another director, although not alleged to have engaged in improper inside trading, was a member of a law firm that earned substantial fees for services rendered to the company. *Id.* The Second Department held that, under these circumstances, demand on the board of directors was excused. *Id.*

C. Application of these Principles to the Instant Action

The Court concludes that Plaintiff has failed to allege, with adequate particularity, that Plaintiff was excused from making a demand on the Board of Directors prior to filing this action. Plaintiff's allegations of director interest, a failure of the Board to fully inform itself regarding the fairness and appropriateness of the RSA, and/or the egregiousness of the RSA do not provide the level of detail required. The Court notes that, in addition to lacking adequate detail, the allegations include Plaintiff's assertion that demand should be excused because the directors are substantially likely to be held liable for their actions (Compl. at ¶¶45 and 47). In light of the reasoning of *Wandel*, cited *supra*, those allegations are insufficient to establish that demand was not required. Moreover, the Court declines to rely on documentation outside the four corners of the Complaint to determine the sufficiency of the Complaint and, more specifically, the sufficiency of the allegations in support of Plaintiff's claim that demand should be excused..

In light of the foregoing, the Court determines that the Complaint does not allege with adequate particularity the futility of a demand on the Board of Directors, but the Court will permit Plaintiff to amend his complaint. Plaintiff is directed to serve and file his amended complaint within thirty (30) days of the date of this Order, and Defendants are directed to answer, or move, with respect to the amended complaint within thirty (30) days of service of the amended complaint on Defendants.

All matters not decided herein are hereby denied.

This constitutes the decision and order of the Court.

The Court directs counsel for the parties to appear for a conference before the Court on September 12, 2012 at 9:30 a.m.

DATED: Mineola, NY
June 12, 2012

ENTER



HON. TIMOTHY S. DRISCOLL
J.S.C.

ENTERED

JUN 19 2012

**NASSAU COUNTY
COUNTY CLERK'S OFFICE**