SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. Arthur F. Engoron PART 37
Justice

MORFOGEN MANAGEMENT LLC and STRATIS MORFOGEN,

Plaintiffs,

- v -

DAVE 60 NYC, INC., MERCHANT'S HOSPITALITY INC., RICHARD COHN, ABRAHAM MERCHANT, STEVEN BOXER, THE STEVEN BOXER 2013 IRREVOCABLE TRUST f/b/o LAUREN BOXER, STEPHEN KANTOR, THE STEPHEN L. KANTOR TRUST f/b/o CHILDREN, PHILIPPE CHOW a.k.a. CHAK YAM CHAU, and JOSEPH GOLDSMITH.

Defendants.

INDEX NO. 650343/14
MOTION DATE 3/17/14
MOTION SEQ. NO. 001 & 002

DECISION AND ORDER and DECLINATION TO SIGN

The following papers, e-filing numbered (NYSCEF Docs.) 9 to 14 and 16 to 82, were read on this motion for a preliminary injunction and to appoint a receiver (Mot. Seq. 001), and proposed order to show cause (Mot. Seq. 002) seeking an order of contempt against defendants for violating this Court's temporary restraining order and the immediate appointment of a receiver.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
DATED: J.S.C.

As plaintiff[1] tells it, defendants are literally a bunch of crooks and fraudsters actively seeking to steal a successful restaurant out from under him. As defendants tell it, plaintiff is a tax cheat who almost ran the restaurant into the ground and has failed to live up to his agreements. Both sides have papered this Court with reams of submissions, each allegedly evidencing the other's bad acts and bad faith, and have spewed forth hours' worth of vitriol about which side is really lying. However, when one reads all of the papers (and this Court has spent many hours pouring over them), it seems that while neither side is blameless, there is insufficient reason to impose a preliminary injunction; appoint a receiver, or issue a contempt order, as plaintiff urges.

The Parties

Plaintiff Stratis Morfogen and his LLC, Morfogen Management LLC (hereinafter collectively "plaintiff") is part owner of defendant Dave 60 NYC, Inc. ("Dave 60"), the former full owner, and current two-thirds owner, of Philippe restaurant. Initially, Dave 60 was owned by Stratis Morfogen, David Lee, Michael Reda and Philippe Chow. In 2011, Reda and Lee sold their interests in Dave 60 to Steven Boxer and Stephen Kantor (whose shares are currently held within their eponymous trusts), the final distribution leaving plaintiff with 30 percent ownership of Dave 60. On or about October 22, 2013, Dave 60, with the consent of all of its owners, entered

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION
Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

[1]For purposes of convenience this Court refers herein to plaintiff singularly, as the individual is the sole member of the LLC. It is noted that prior to October 22, 2013 the individual plaintiff was the party in interest and that after October 22, 2013 all of the individual's interest vested in, and operated through, the LLC.

into an agreement with Merchants Hospitality Inc. ("MHI") to sell a one-third share of the restaurant to MHI in exchange for MHI's assumption of $2.5 million of the restaurant's debt ("assumed liabilities"[2]), and to have MHI take over the day-to-day operation of the restaurant. As part of the agreement, the now 2/3 and 1/3 partners would form a new entity, Philippe NYC 1 LLC ("Newco"), which would assume the ownership of the restaurant. Additionally, in payment for operating the restaurant, MHI (under the name "Philippe Equities LLC," an affiliate formed just for this restaurant) would receive three percent of the gross sales. Half of this "management fee," along with one-third of the profits, plus additional money of its own from other sources, would be used by MHI/Philippe Equities LLC to pay the assumed liabilities and other expenses of the restaurant, thereby paying for its one-third ownership share. Lastly, as part of this October 2013 shareholder agreement, plaintiff was to relinquish any active part in the operation or management of the restaurant, and was to indemnify Dave 60 and its individual shareholders for any claims against Dave 60, Philippe (the restaurant) or Newco that were not part of the "assumed liabilities" and were incurred prior to the formation of Newco. Failure to indemnify would result in a forfeiture of plaintiff's shares.

The Events

As best as this Court can piece together, and as here relevant, the following events took place, in as close to chronological order as can be discerned:

In May 2011, Michael Reda sold his 25 percent share of Dave 60 to Stephen Kantor. In October 2011, David Lee divested himself of his 40 percent share of Dave 60 by selling 25 percent to Steven Boxer, and distributing the remaining 15 percent in equal 5 percent pieces to plaintiff, Chow and Kantor. Following the conveyance by Lee, the shareholders were: plaintiff (30%), Kantor (30%), Boxer (25%), and Chow (15%).

Despite the fact that Lee and Reda were no longer owners of Dave 60, in November/December 2011, Dave 60 renewed its liquor license with Lee and Reda still on it. Likewise, Lee (and

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[2]From the opening of the restaurant through at least 2012 and possibly well into 2013 (this Court cannot find a definitive end date), plaintiff was the president of Dave 60. During that time, the restaurant expanded into several different markets, though most of those expansions eventually went into bankruptcy or otherwise failed to thrive. Additionally, there was litigation over underpaid wages, trademark infringement and deceptive practices, which resulted in various judgments and/or settlements, as well as substantial attorney's fees. A significant working capital loan from Capital One Bank was also taken out on behalf of Dave 60, the final payments of which were due somewhere around the end of March 2014. It is these debts, among some other commitments or expenses, that essentially constitute the "assumed liabilities," estimated to be about $2.5 million.

possibly Reda, though this Court cannot tell for sure) remained on Dave 60's bank accounts and Lee's signature stamp remained usable on Dave 60 checks.

In October 2013, Dave 60 and MHI entered into the agreement outlined above.

In November 2013, Dave 60 again renewed its liquor license, still with Lee's and Reda's names on it. Shortly thereafter, on January 6, 2014, Dave 60 surrendered its liquor license in favor of a temporary (hopefully to become permanent) one, but in the name of Newco. Submitted as part of this application, allegedly to support the transfer of the license from one entity to another without interrupting the restaurant's business, was documentation showing the sale of Dave 60 to Newco for $100,000. The 1/6/14 application by Newco for a temporary liquor license (see exhibits attached as NYSCEF Doc. 67) included a partly-typed, partly-handwritten page with Abraham Merchant, Richard Cohn and Aristotle Hatzigeourgio listed as managers, but also showing them each to be 33-1/3 percent owners of Newco. Pursuant to the affidavit (NYSCEF Doc. 66) of Warren Pesetsky, Newco's liquor license attorney, this document was wrongly filled out (at least the hand-written part) by a paralegal in his office, who has since been fired. Pesetsky claims that the 1/6/14 application was not what was provided by Newco's principals, was not authorized by him, and does not accurately reflect the source of the $100,000 "purchase" of Dave 60 by Newco (shown on the 1/6/14 document as having come fully from Artistotle Hatzigeourgio). Further attached to the Pesetsky affidavit is a copy of the supposedly amended (though undated) liquor license application, pages 5 through 8, showing, according to Pesetsky, the intended and now corrected information regarding Newco's ownership. In court, plaintiff's counsel vociferously argued that Pesetsky's convenient "my paralegal did wrong and was fired" excuse was thoroughly unbelievable and was not the first time that Pesetsky had supposedly erred due to some "rogue" paralegal or office staff. However, despite plaintiff's myriad submissions, no evidence of Pesetsky's lack of ingenuity (not to mention integrity) has been submitted.

Also in November 2013, Dave 60 was apprised of a claim by the Department of Labor for unpaid wages with a possible exposure to Dave 60 of $3 million. Dave 60 requested that plaintiff indemnify it for this claim pursuant to the indemnification agreement. Plaintiff countered that this was not covered by said agreement. In January 2014, Dave 60 sued plaintiff before the Commercial Division of this court, seeking indemnification and/or forfeiture of plaintiff's shares of Dave 60.

Very early in January 2014, Newco removed the majority of the assets of Dave 60 from Capital One Bank and moved them to TD Bank, opening two accounts in the name of Dave 60: ostensibly, one a working capital account and the other the beginning of a "war-chest" to address the pending Department of Labor claim. Plaintiff claims that this was all part of a scheme to obscure the financials of the restaurant from plaintiff. Defendants claim that it was necessary to ensure that plaintiff would not have access to the funds. Of great concern to plaintiff, and one of the underpinnings of his request for an order of contempt, is that $400,000 of these funds were then transferred out of the TD Bank account on February 4, 2014, allegedly in violation of this

Court's 2/3/14 temporary restraining order limiting defendants to transactions solely performed in the ordinary course of business (NYSCEF Doc. 17). Defendants claim (see, collectively NYSCEF Docs. 50-54) that this transfer was made to defendants' counsel's IOLA account, to be held in escrow to address the pending Department of Labor claim, and that the transfer did not violate this Court's order, as assets were not dissipated.

Sometime in February 2014 (the First, according to defendants; sometime after the Third, and this Court's order of that date, according to plaintiff), MHI paid $248,000 (out a total of $600,000 in total money allegedly spent on behalf of the restaurant in general) of the assumed liabilities out of a distribution of the profits from the restaurant. Plaintiff argues that not only was MHI supposed to have paid this debt solely from its own money, but that the distribution to MHI was in violation of this Court's order, as it was done after February 3rd and is not "in the ordinary course of business." Moreover, plaintiff claims Dave 60, more specifically plaintiff, has not received any distribution despite MHI having received a share of the profits. In opposition, defendants claim that the distribution to MHI was made prior to this Court's order, was done in accordance with the October 22, 2013 agreement, and was done in accordance with the 1/3 (MHI) to 2/3 (Dave 60) shares of Newco, with Dave 60's portion of this money having gone into the escrow account for the ultimate resolution of the new (possibly $3 million) Department of Labor claim.

Discussion

Ultimately, plaintiff's claims and defendants' defenses are long on supposition and short on hard evidence. No one has produced the records from the restaurant showing what the profit has been or accounting, in hard numbers, for the distributions to MHI and to Dave 60. However, for all of plaintiff's allegations of nefarious conduct, he has not demonstrated that defendants have engaged in criminal or underhanded behavior, or done anything particularly untoward that plaintiff himself has not done. "One who seeks equity must do equity." Plaintiff's harping about the fraudulent use of the "David Lee" name stamp to transfer money out of the account begs the question as to why plaintiff himself did not remove David Lee's name from Dave 60's accounts for the two plus years between when Mr. Lee sold his shares and this alleged fraudulent use of that same stamp by defendants, much of which time plaintiff was the president of Dave 60. Likewise, plaintiff's argument that defendants improperly applied for a liquor license in Dave 60's name with David Lee and Michael Reda "fraudulently" listed as owners rings hollow given that plaintiff himself did just that very thing in November 2011 and allowed the license to remain with that misrepresentation for two years! In fact, plaintiff's own unclean hands makes his allegations seem like the "pot calling the kettle black." Even the inconsistencies in the current application for the liquor license, while admittedly shoddy practice, with a suspect excuse for the "mix-up" in the initial application, does not overtly seem designed as part of a plan to wrest away the restaurant from Dave 60, which in actuality is the true party in interest here, plaintiff owning less than a third thereof.

That brings this Court to the main issue, and the basis of defendants' best defense to the imposition of a preliminary injunction and/or receiver, namely that plaintiff has no standing to bring the majority of the claims herein, and therefore is not likely to succeed on the merits. It is well-settled that in order to obtain injunctive relief the movant must establish 1) a likelihood of success on the merits; 2) the possibility of irreparable injury should the relief not be granted; and 3) a balancing of equities in the movant's favor. Here, plaintiff has failed to meet any of these requirements.

As argued by defendants, and not addressed in plaintiff's reply, plaintiff, as a (minority) shareholder of Dave 60, does not have standing to challenge the management of Newco. Claims for the alleged breach of contract between Dave 60 and MHI are Dave 60's to bring, not plaintiff's. One of the hallmarks of a derivative claim is that it inures to the benefit of the corporation, not to the individual shareholder. "Where a member is harmed independent of the entity or is the only member harmed, the claim is direct." Billings v Bridgepoint Prtnrs., LLC, 2008 NY Slip Op 28351 (Sup Ct, Erie Cty, 2008). At best, plaintiff may sustain his claims against Dave 60 based on breach of the corporation's fiduciary duties to its stockholders, but these claims comprise only a small portion of his Complaint. Plaintiff's questionable standing and unlikely success on the merits of the majority of his claims precludes this Court from issuing a preliminary injunction.

Additionally, plaintiff has not demonstrated any likely harm to come to Dave 60 should the money currently in escrow remain as a hedge against the Department of Labor claim (as defendants maintain is its purpose); nor has plaintiff given this Court reason to believe that absent a receiver's oversight Dave 60's interests, the majority of which are held by several of the named defendants, are in jeopardy. As defendants somewhat cheekily point out, it now has been many weeks since plaintiff first came to this Court seeking a receiver, and yet the restaurant continues to be a profitable, going concern. In this Court's view, defendants have as much, if not more (considering that collectively they have much more invested, and therefore to lose, than plaintiff) interest in seeing the restaurant thrive. Plaintiff, as essentially 20 percent owner of Newco (3/10 owner of 2/3) is subject to the "majority rule" of Newco's owners, and absent a showing that that majority is wasting assets, which is in fact absent here, this Court will not impose the will of the minority upon the majority. Moreover, plaintiff claims he is protecting the interests of Dave 60, yet clearly the relief demanded in this action is mainly for the benefit of plaintiff himself. Plaintiff's continually conflates his individual interests with that of Dave 60, which is still a 2/3 owner of Newco. Plaintiff's accusations of wrongdoing with the liquor license can only have impact, and mainly a negative one at that, on Newco and the restaurant itself. It would almost seem that plaintiff is intent on killing the goose that lays the very golden eggs he wants to help himself to.

Lastly, for the above-reasons, this Court finds that the balance of the equities lie in defendants' favor and thus, plaintiff is not entitled to the preliminary relief he seeks.

Conclusion

Plaintiff's motion for a preliminary injunction and the appointment of a receiver is denied and any restraining order on defendants' operation of the restaurant and management of Newco is hereby lifted. Moreover, this Court has not seen hard evidence that defendants violated the temporary restraining order of 2/3/14 and therefore declines to sign plaintiff's Order to Show Cause (Mot. Seq. 002) seeking an order of contempt and the immediate appointment of a receiver.

Dated: April 10, 2014

Arthur F. Engoron, *J.S.C.*