Sterling Silver Trading Corp. v MDB9695, LLC
2017 NY Slip Op 31036(U)
May 2, 2017
Supreme Court, New York County
Docket Number: 652553/2015
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: _____ **PART** 54
Justice

Index Number : 652553/2015
STERLING SILVER TRADING CORP.
vs.
MDB9695
SEQUENCE NUMBER : 003
DISMISS

INDEX NO. _____
MOTION DATE 12/8/16
MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ **No(s).** 227-256, 358
Answering Affidavits — Exhibits _____ **No(s).** 322-354
Replying Affidavits _____ **No(s).** 359-371

Upon the foregoing papers, it is ordered that this motion is

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 5/2/17

_____ **J.S.C.**
SHIRLEY WERNER KORNREICH

1. **CHECK ONE:** ..... ☐ **CASE DISPOSED** ☒ **NON-FINAL DISPOSITION**
2. **CHECK AS APPROPRIATE:** .....**MOTION IS:** ☒ **GRANTED** ☐ **DENIED** ☐ **GRANTED IN PART** ☐ **OTHER**
3. **CHECK IF APPROPRIATE:** ..... ☐ **SETTLE ORDER** ☐ **SUBMIT ORDER**
☐ **DO NOT POST** ☐ **FIDUCIARY APPOINTMENT** ☐ **REFERENCE**

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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STERLING SILVER TRADING CORP. and MIRANDA TANG,

Index No.: 652553/2015

DECISION & ORDER

Plaintiffs,

-against-

MDB9695, LLC, LAWRENCE BUTLER, as Executor of the Estate of Marshall Butler, MARILYN BUTLER, as Executor of the Estate of Marshall Butler, ELIOT BUTLER, as Executor of the Estate of Marshall Butler,

Defendants.

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SHIRLEY WERNER KORNREICH, J.:

Motion sequence numbers 003 and 004 are consolidated for disposition.

Defendants MDB965 LLC (MDB), Lawrence Butler (Lawrence), Marilyn Butler (Marilyn), and Eliot Butler (Eliot) move, pursuant to CPLR 3211, for partial dismissal of the amended complaint (the AC). Seq. 003. Plaintiffs Sterling Silver Corp. (Sterling) and Miranda Tang oppose the motion. Plaintiffs also move, pursuant to CPLR 3124, to compel defendants to make certain witnesses available for deposition. Seq. 004. Defendants oppose. For the reasons that follow, defendants' motion to dismiss is granted and plaintiffs' motion to compel is denied.

I. Factual Background & Procedural History

As this is a motion to dismiss, the facts recited are taken from the AC (*see* Dkt. 229)[1] and the documentary evidence submitted by the parties.

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[1] References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF). As discussed herein, plaintiffs were given leave to file the AC. However, they never actually filed the AC on NYSCEF. While the parties agree that the AC was deemed served as of April 5, 2016, plaintiffs are nonetheless directed to properly file it as an "Amended Complaint" on NYSCEF so the Clerk has a proper record of plaintiffs' operative pleading. The version cited to by the court, Dkt. 229, was filed as an exhibit to defendants' moving papers on their motion to dismiss.

This action concerns Sterling's economic interest in a non-controlling membership interest in Heights Riverside Developers, LLC (HRD), an LLC that wholly owns Heights HQ, LLC (Heights HQ), another LLC that owns a building located at 779 Riverside Drive in Manhattan (the Building). Seeking clarity about the status of Sterling's investment, on July 21, 2015, plaintiffs commenced this action by filing a complaint with two causes of action: (1) breach of fiduciary duty; and (2) an accounting. *See* Dkt. 1. On August 13, 2015, defendants filed an answer and a counterclaim for indemnity. *See* Dkt. 6. After some discovery was conducted, on January 14, 2016, defendants filed an accounting. *See* Dkt. 31. Plaintiffs filed objections to the accounting on April 1, 2016. *See* Dkt. 105. A final adjudication of the accounting has not occurred because the parties are still in the process of addressing the objections, namely by way of plaintiffs hiring an accountant to request additional documents from defendants that are necessary to vet the accounting.

Shortly after filing their objections, on April 5, 2016, plaintiffs moved for leave to amend their complaint. On May 10, 2016, they moved to compel defendants to produce certain additional discovery. The motions were resolved by orders dated May 26, 2016, which, among other things, granted plaintiffs' motion to amend without opposition. *See* Dkt. 203 & 204. The AC pleads the following 15 causes of action: (1) an accounting of plaintiffs' investment; (2) an accounting of MDB, a New York LLC formed by Marshall Butler (Marshall); (3) breach of contract; (4) constructive trust; (5) fraud; (6) coercion; (7-9) declaratory judgments regarding plaintiffs' rights in MDB and in money being held in escrow; (10-11) breach of fiduciary duty and aiding and abetting breach of fiduciary duty regarding Lawrence's role as sole manager of MDB; (12) breach of fiduciary duty regarding the "Cash Needs Loan"; (13) conversion; (14) a

declaratory judgment regarding Lawrence's role as sole manager of MDB; and (15) breach of fiduciary duty regarding the treatment of Sterling's investment. *See* Dkt. 229.

In the AC, plaintiffs explain that pursuant to a letter agreement dated June 28, 2006, Marshall[2] paid $1 million for a 50% membership interest in HRD and also loaned $2.5 million to HRD (defined as the Butler Loan). *See* Dkt. 231 (the Letter Agreement). Non-party Edward Penson owned the other 50% of HRD and was its managing member. HRD owns Heights HQ, which owns the Building and was the sponsor of its residential condominium offering.

Paragraph 2(A) of the Letter Agreement governs Marshall's right to receive money from HRD by virtue of his equity and loan. *See id.* at 3. Paragraph 2(B) contains a waterfall governing how cash flow from the Building is to be distributed, the first level of which is repayment of the amount due on a bank loan. The rest of the cash flow is to be distributed in the following order:

> (i) to pay all accrued interest on the Butler Loan and on the Deferred Development Fee [governed by paragraph 3] pari passu;
>
> (ii) to pay the principal of the Butler Loan and the unpaid balance of the Deferred Development Fee pari-passu;
>
> (iii) to pay interest on the Overcall Loans [i.e., capital calls for funding to eliminate a funding shortfall, which is governed by paragraph 5(B)] pari-passu;
>
> (iv) to pay the principal of the Overcall Loans pari passu;
>
> (v) to return capital contributed by [Marshall] and Penson, pari-passu; and
>
> (vi) to the Members of [HRD], pro-rata in accordance with their respective Profit Percentages, as the same may have been or will be adjusted.

Id.

[2] Marshall is now deceased. His interest in the Building is held by his estate. The three individual defendants, Lawrence, Marilyn and Eliot, are the executors of the estate.

Plaintiffs are not, and have never been, members of or in contractual privity with HRD or Heights HQ, nor do they have any direct ownership interest in the Building. Sterling, a British Virgin Islands company controlled by Tang, purchased an economic participation interest in Marshall's interest in HRD pursuant to a written agreement dated August 8, 2006. *See* Dkt. 230 (the Investor Agreement).[3] The Investor Agreement's whereas clauses memorialize Marshall's membership interest in and loan to HRD. *See id.* at 2. Paragraph 1 of the Investor Agreement states that Sterling, along with five other investors,[4] were acquiring a certain percentage beneficial ownership interest in Marshall's membership interest in and loan to HRD. *See id.* at 2-3. The amount contributed by each investor and their respective percentage interests are listed. *See id.* Sterling invested $1.05 million and obtained a 30% interest (an effective 15% interest, i.e., 30% of Marshall's 50%). *See id.* at 2.

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[3] Contrary to what plaintiffs claim repeatedly in the AC, plaintiffs and Marshall were never partners. Plaintiffs were, as discussed herein, non-controlling minority investors whose rights are governed exclusively by contract, which delegates all managerial authority to Marshall. While Marshall's control over Sterling's investment gives rise to fiduciary duties (a point defendants do not dispute), the parties are in an arms' length contractual relationship, not a general or limited partnership. Indeed, what the parties appear to have done is set up a contractual structure akin to a member managed LLC in which Marshall effectively functioned as sole manager with the exclusive right to manage the investment.

[4] Two of the investors, non-parties Borim Funding Corp. and 123 East Doty Street Corp. (Doty), are entities owned by Marshall's family members. The other investors are not related to Marshall. Defendants' counsel explained at oral argument that "the Doty interest, which was originally 14 percent, was split up between a trust that [Marshall] setup [sic] and Elliot, Marshall's son, who was 40 percent owner of Doty[]. And as a result of contributions that Marshall made, or his estate made to the investment that others did not, their percentage is up somewhat." *See* Dkt. 436 (12/6/16 Tr. at 15). As the court indicated on the record, there appears to be an issue of whether an improper dilution of Sterling's interest occurred. That being said, none of the causes of action in the AC asserts a claim for improper dilution. Nonetheless, Sterling may seek leave to amend to assert such a claim after a proper review of the accounting. The court will not further opine on the merits of a dilution claim that is not meaningfully addressed in the parties' briefs and which is not the subject of a pleaded cause of action.

Paragraph 2 states that "[e]ach Investor agrees that [Marshall] shall issue to such Investor a Form 1099 with respect to the profit or loss earned on the Interest multiplied by each Investor's percentage Interest, and such Investor shall be solely responsible for the payment of taxes with respect thereto." Paragraph 3 memorializes the investors' passive role in Marshall's investment by providing that:

> Each Investor acknowledges and agrees that he or it
>
> (a) will have no vote with respect to any matter brought before the members of [HRD] **and that [Marshall] shall have the sole right to vote and to exercise rights as a member and as holder of the Promissory Note**;
>
> (b) has not relied on any representation or warranty by [Marshall] with respect to the investment in [HRD] or [the] Note and that [Marshall] shall not be liable to any Investor in exercising his discretion as the Member or holder of the Note unless [Marshall's] conduct is found by a court of competent jurisdiction to have been undertaken in bad faith; and
>
> (c) [] shall jointly and severally defend and hold [Marshall] harmless from any liability, claim or expense (including reasonable legal) arising from the investment in the Interest and Note unless caused by [Marshall's] willful misconduct. **[Marshall] may withhold amounts due to the Investors from distributions with respect to the Interest or Note to satisfy the foregoing indemnity**.[5]

See id. at 3 (emphasis added).

Finally, paragraph 4 provides:

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[5] While not raised by plaintiffs, this appears to be a classic third-party liability indemnity clause that does not make Marshall's right to reimbursement of legal fees in this action "unmistakably clear." *See Gotham Partners, L.P. v High River Ltd. P'ship*, 76 AD3d 203, 208-09 (1st Dept 2010), citing *Hooper Assocs., Ltd. v AGS Computers, Inc.*, 74 NY2d 487, 492 (1989). While the estate is currently escrowing Sterling's distributions under paragraph 3(c) pursuant to a stipulation signed by the parties (*see* Dkt. 21), the court will not issue any order regarding the propriety of it doing so because plaintiffs' counsel has not actually sought to vindicate Sterling's rights by seeking relief based on *Hooper* and its progeny. The only applicable claim at issue on this motion is a non-viable claim for conversion. Plaintiffs have not pleaded a claim for breach of paragraph 3(c) (but, as explained herein, they have pleaded a declaratory judgment claim, which is not at issue on this motion).

> In the event [Marshall] is required to, or does, contribute additional funds to [HRD], **each Investor shall be required to contribute his, or its pro rata shares up to 20% of his or its capital contribution**. Such additional contribution shall be treated in the same manner as [HRD] treats [Marshall's] additional contribution [i.e., pari passu].

See id. (emphasis added).

Between the outset of the investment in 2006 and November 2009, Marshall made Overcall Loans to HRD totaling $3,125,152. Marshall, exercising his right under paragraph 4 of the Investor Agreement, asked the other investors, including Sterling, to contribute their pro rata share of the Overcall Loans. Despite initially objecting, Sterling contributed $702,152.45 of the $935,400 requested from it by Marshall. After Tang informed Marshall that she did not want Sterling to have to make additional Overcall Loan contributions, on December 2, 2009, Marshall told Tang that he would exclusively fund any further amounts required by the Building. He did so on May 10, 2010 in the amount of $130,000. To date, Sterling has received approximately $600,000 on its investment (there is another $240,000 in escrow pursuant to the parties' stipulation).

In December 2010, Marshall formed MDB. Marshall (now his estate) is the sole member of MDB. On August 11, 2015, defendants named Lawrence as MDB's sole Manager. *See* Dkt. 315. It is undisputed that, as reflected in MDB's operating agreement (Dkt. 240), MDB is merely an SPV used by Marshall to hold his, and not the other investors', interest in the Building (through HRD and Heights HQ). Prior to MDB's formation, Marshall simply held such interest personally. The formation of MDB did nothing to change the nature of Sterling's economic interest in Marshall's stake in the Building or its rights under the Investor Agreement. Its rights are purely economic in nature. While Sterling proffers baseless legal claims to the contrary, there is no question that Sterling is not a member of MDB and that it remains in privity with

Marshall's estate with respect to its rights under the Investor Agreement. Nonetheless, MDB is not dismissed from this action because, as discussed herein, it did not seek dismissal of all of the claims asserted against it.[6]

On June 14, 2016, defendants filed the instant motion to dismiss the AC. They argue that (1) Tang should be dismissed as a plaintiff because she, unlike Sterling, was not an investor under the Investor Agreement; (2) all of Sterling's claims should be dismissed due to its non-conformance with Business Corporation Law (BCL) § 1312(a); and (3) the second through sixth and tenth through fifteenth (but not the first, seventh, eighth, or ninth) causes of action should be dismissed either because they are time barred or for failure to state a claim. On August 5, 2016, plaintiffs filed their opposition to the motion to dismiss, and separately moved to compel defendants to make certain additional witnesses available for deposition. The parties' remaining responsive briefs were filed on August 22, 2016. The court reserved on the motions after oral argument. *See* Dkt. 436 (12/6/16 Tr.). The court, however, issued interim orders staying discovery (*see id.* at 28-34) and requiring defendants to provide whatever documents plaintiffs' accountant required to vet defendants' accounting. *See* Dkt. 435.

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[6] Sterling's only claim to an interest in MDB is that Lawrence indicated in a bank refinancing loan application that plaintiffs were members of MDB (which Lawrence claims was a mistake). Plaintiffs cite no authority that a loan application on which plaintiffs did not detrimentally rely can create rights to a membership interest in an LLC by estoppel. Aside from this application, there is no allegation or evidence supporting the notion that the parties agreed (either orally or in writing) that plaintiffs would be given a membership interest in MDB. To the contrary, defendants have always taken the position that Marshall (and now his estate) is the sole member of MDB. As explained herein, MDB simply was a vehicle for Marshall to convert his interest in HRD from one held personally to one held by way of an interest in an SPV. The amount Sterling is entitled to on its investment could not and did not change by virtue of MDB's creation. For reasons that are unclear, defendants do not move to dismiss the seventh cause of action that seeks a declaration that plaintiffs have a 30% membership interest in MDB, despite arguing in their briefs that plaintiffs are not members of MDB. The court, therefore, does not formally rule on this claim. That being said, the court reaches defendants' arguments that seek dismissal of some of plaintiffs' other claims based on plaintiffs' lack of any interest in MDB.

II. Defendants' Motion to Dismiss (Seq. 003)

A. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1st Dept 1992); *see also Cron v Hargro Fabrics, Inc.*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

B. Standing & Capacity

Defendants correctly aver that Tang lacks standing. She, unlike Sterling, is not a party to the Investor Agreement. *See Leonard v Gateway II, LLC*, 68 AD3d 408 (1st Dept 2009) (breach

of contract claim requires privity). Tang's contention that she has third-party beneficiary rights [*see generally California Pub. Employees' Ret. Sys. v Shearman & Sterling*, 95 NY2d 427, 434-35 (2000)] is unavailing since such purported rights have no basis in the agreement itself. *See U.S. Bank N.A. v GreenPoint Mortg. Funding, Inc.*, 105 AD3d 639, 640 (1st Dept 2013) (dismissing third-party beneficiary claim because of "the absence of any clear language on the face of the [contracts]"). Nor has she alleged any fact upon which it can be inferred that Marshall intended to separately grant her personal rights in Sterling's investment.

New York takes corporate formalities seriously. *See Morris v NY State Dep't of Taxation & Finance*, 82 NY2d 135, 140 (1993) (requirements to pierce corporate veil).[7] New York, moreover, recognizes the legitimacy of operating through single purpose entities. *See Skanska USA Bldg. Inc. v Atl. Yards B2 Owner, LLC*, 146 AD3d 1, 13 (1st Dept 2016). Tang's self-serving conclusory allegation that the court should simply disregard Sterling's corporate form is a not a tenable basis to afford her standing, particularly here where she chose to protect herself by investing through a single purpose corporate entity. She cites no analogous case where a court disregarded an SPV's corporate form simply because the principal wanted to participate in the lawsuit on an individual basis. In fact, it is unclear what non-parties may have rights in Sterling other than Tang. "At her deposition, Tang testified that she did not know if she is the sole beneficiary of Sterling and she further admitted that she is not an officer or director of Sterling and did not sign the Agreement on its behalf." Dkt. 359 at 5. Her testimony indicates that her sisters, Sally and Eleanor, have rights in Sterling. *See id.* at 5-6. To permit Tang to assert an individual right in the investment would have the effect of depriving her sisters of their

[7] Tang also overlooks the issue that for her to be considered an alter ego of Sterling, British Virgin Islands law would have to be considered. *See Flame S.A. v Worldlink Int'l (Holding) Ltd.*, 107 AD3d 436, 438 (1st Dept 2013) (law of state of incorporation applies to claim to disregard corporate form).

proportionate share of the investment by virtue of their interest in Sterling. Tang's claims, therefore, are dismissed.

That being said, there is no merit in defendants' contention that Sterling's claims must be dismissed for failure to comply with the registration requirements of BCL § 1312. Sterling, incorporated in the British Virgin Islands, is merely an investment vehicle that maintains a passive indirect economic interest in the Building. While it appears that Sterling may have registered by now, that is of no moment because it does not conduct systematic business in New York within the meaning of BCL § 1312. "In order for a court to find that a foreign corporation is 'doing business' in New York within the meaning of [BCL] § 1312(a), 'the corporation must be engaged in a **regular and continuous** course of conduct in the State.'" *Highfill, Inc. v Bruce & Iris, Inc.*, 50 AD3d 742, 743 (2d Dept 2008) (emphasis added), quoting *Commodity Ocean Transp. Corp. of N.Y. v Royce*, 221 AD2d 406, 407 (2d Dept 1995); *see also Schwarz Supply Source v Redi Bag USA, LLC*, 64 AD3d 696 (2d Dept 2009) (plaintiff's business activities in New York must be "'systematic and regular' and essential to its corporate business"). Defendants cite no authority for the proposition that a passive investment vehicle engages in a regular and continuous business. The law, in fact, is to the contrary. *See 8430985 Canada Inc. v United Realty Advisors LP*, 148 AD3d 428 (1st Dept 2017) (real estate investment SPV not required to register under BCL § 1312). Thus, regardless of whether Sterling is now registered to do business in New York, it is not subject to the requirements of BCL § 1312.

C. Accounting of MDB (Second Cause of Action)

There is no question that Sterling has stated a claim for an accounting regarding its investment. *See Lawrence v Kennedy*, 95 AD3d 955, 958 (2d Dept 2012) (claim for accounting requires fiduciary relationship); *Morgulas v J. Yudell Realty, Inc.*, 161 AD2d 211, 213-14 (1st

Dept 1990). This is covered by plaintiffs' first cause of action, which defendants do not move to dismiss. Indeed, defendants have provided such an accounting. Claims for breach of fiduciary duty based on the accounting may be raised after a proper review thereof is completed.[8] That being said, as noted earlier, Sterling is not a member of MDB and has no rights to an accounting of it.[9]

D. Breach of Contract Claims (Third Cause of Action)

None of the 12 alleged breaches of the Investor Agreement, itemized in paragraphs 237(a) through (l) in the AC's third cause of action, state a claim upon which relief may be granted.

Alleged breaches (a), (b), (g), and (h) fail to state a claim for breach of contract because they do not contend that any provision of the Investor Agreement was breached, but only that Marshall made certain misrepresentations, for instance, about making future interest payments. Despite being labeled as contract claims, they plead facts which infer claims for fraudulent misrepresentations. Yet, the elements of fraud are not alleged, nor do plaintiffs ask the court to construe these claims as fraud claims. Moreover, plaintiffs cite no provision of the Investor Agreement that was allegedly breached by virtue of the alleged misrepresentations. Instead, plaintiffs ignore the terms of the Invertor Agreement, claim it does not govern, and rely on

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[8] Given plaintiffs' (misguided) assertion that the parties are partners, it bears mentioning that plaintiffs ignored the well settled rule that asserting fiduciary duty claims prior to examining the accounting is improper. *See Non-Linear Trading Co. v Braddis Assocs., Inc.*, 243 AD2d 107, 115 (1st Dept 1998) ("It is well established that an action at law may not be maintained by one partner against another for any claim arising out of the partnership until there has been a full accounting except where the alleged wrong involves a partnership transaction which can be determined without an examination of the partnership accounts.") (citations omitted).

[9] It is unclear what relevant information an accounting of MDB would reveal that an accounting of Sterling's investment will not.

alleged collateral oral representations that supposedly constitute the parties' agreement.[10] This assertion is foreclosed by paragraph 3(b) of the Investor Agreement, which disclaims collateral oral representations. *See* Dkt. 230 at 3. Here, where the Investor Agreement clearly sets forth all of the material terms of the parties' agreement, the court will interpret it in accordance with its plain meaning. *See Greenfield v Philles Records, Inc.*, 98 NY2d 562, 569-70 (2002). The claims in paragraphs 237(a), (b), (g), and (h) are dismissed for failure to allege conduct in violation of any provision of the Investor Agreement.

Breaches (c) and (d) concern two Overcall Loans made by Marshall to HRD. The first, a $150,000 loan made by Marshall (supposedly through non-party Butler Family LLC),[11] was made on October 11, 2007. It was paid back on December 9, 2008. Sterling claims that HRD prioritized repayment of principal and interest on this loan ahead of Sterling's pro rata revenue from HRD. Sterling makes a similar allegation regarding the second loan, which was made on May 13, 2010 in the amount of $130,000.

Sterling's claim regarding the first loan, made in 2007 and repaid in 2008, is time barred. Under New York law, breach of contract claims are subject to a six-year statute of limitations that accrues at the time of breach, regardless of when plaintiff finds out about the breach or suffers damages. CPLR 213(2); *ACE Secs. Corp. Home Equity Loan Trust, Series 2006-SL2 v DB Structured Prods., Inc.*, 25 NY3d 581, 594 (2015), citing *Ely-Cruikshank Co. v Bank of Montreal*, 81 NY2d 399, 403 (1993). Since this action was commenced on July 21, 2015, breaches allegedly occurring before July 21, 2009 are time barred.

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[10] Plaintiffs *do not* allege that the Investor Agreement was procured by fraud or is unenforceable.

[11] This allegation appears to be false, as Marshall, not the LLC, seems to have made the loans, but was repaid through the LLC. This issue is not worth probing further since the claim, as explain herein, is time barred.

In any event, neither the AC nor plaintiffs' brief contains a cogent explanation of why Marshall making these loans or being paid back constitutes a breach of the Investor Agreement. Marshall was required to make these Overcall Loans under the Letter Agreement. He subsequently received repayment of his Overcall Loans under the Letter Agreement's waterfall. In lieu of coherently explaining how a particular provision of the Investor Agreement was breached, Sterling suggests that it was somehow deprioritized[12] by virtue of these loans. But Sterling does not explain why it has the right to a share in loan repayment proceeds on an Overcall Loan for which it did not contribute. Further, Marshall was not the managing member of HRD, and therefore lacked the authority to determine when his Overcall Loans would be paid back. Since his making of such loans did not breach the Investor Agreement (again, he was required to make such loans under the Letter Agreement), and his receipt of repayment was beyond his control, it is unclear why Sterling maintains these are breaches of the Investor Agreement.

To be sure, the accounting should reveal whether Sterling received all of its pro rata share of any amounts paid by HRD to Marshall to which it contributed. But that issue is not impacted by Overcall Loans that Sterling declined to participate in. While such loans may or may not have properly resulted in dilution under the Investor Agreement, the Investor Agreement

[12] Only the Letter Agreement speaks to payment priority; the Investor Agreement governs dilution, with the requirement that the investors be afforded pari passu treatment. The court does not understand Sterling's payment priority arguments that are supposedly grounded in the Investor Agreement. Sterling appears to conflate being deprioritized (a waterfall concept found only in the Letter Agreement, but not in the Investor Agreement), with having its stake under the Investor Agreement improperly diluted. Dilution and payment priority are distinct concepts; plaintiffs should be careful to distinguish between them. As discussed herein, Sterling's claim is really a breach of contract claim for non-payment of distributions for which it has pari passu entitlement. Confusingly recasting this claim by way of reference to alleged deprioritization does not change the nature of the claim nor the relief Sterling is entitled to.

contains no prohibition on Marshall keeping loan repayments made to it from HRD for which Sterling had no participation interest.

Turning now to breach (e), plaintiffs allege that "at some time between December 31, 2009 and September 30, 2010, [Marshall] converted and/or wrote off the principal and accrued interest due to Plaintiffs from the Overcall Loans without authority to do so under the Agreement, without Plaintiffs' knowledge and/or consent, and without consideration to Plaintiffs." Here, plaintiffs are complaining about Marshall converting the loans "into 25.5% of the equity in the Project and a payment in the amount of $710,000." *See* Dkt. 256 at 20. "As set forth in Marshall's December 17, 2010 Memo to Tang, all of the loans were 'wiped out' and Plaintiffs received a distribution of $135,000 and a tax loss of $1,317,000." *Id.* The court does not understand why plaintiffs claim this was a breach of the Investor Agreement. Paragraph 3(a) of the Investor Agreement gives Marshall the exclusive discretion to manage the loans. Plaintiffs do not explain why Marshall's exercise of such discretion in this instance was problematic. The project had financial difficulties. Resolving the debt by converting it to equity (and getting some cash plus a tax loss benefit) seems to be a commercially reasonable way to maintain an interest in the project without insisting on a cash payment HRD could not fund. Notably, plaintiffs do not allege that Marshall's decision to effectuate the conversion was an abuse of his business judgment. Given his absolute authority under the Investor Agreement, acts taken by virtue of the exercise of such judgment do not amount to a breach of contract.

Next, breach (f) complains that Marshall threatened to subordinate Sterling's interest if it did not contribute to the Overcall Loans. This is not an allegation of breach of contract. If improper subordination or dilution occurred, plaintiffs should specifically allege it. As noted earlier, it has not done so. For instance, Sterling may well have had a valid complaint about

Marshall insisting on it funding Overcall Loans in excess of 20% of its capital contribution. However, rather than taking legal action to protect itself from threatened dilution (e.g., seeking injunctive relief), Sterling agreed to fund such Overcall Loans. Sterling cites no authority for the proposition that a breach of contract can be based on a mere threat of adverse action that did not manifest by virtue of the plaintiff acceding to the defendant's demand. An economic duress claim is the closet analog,[13] a claim that might have permitted Sterling to complain about being afforded improper pari passu treatment by virtue of its refusal to participate in an Overcall Loan demand not required by paragraph 4 of the Investor Agreement. However, Sterling chose to make these Overcall Loan contributions, presumably got the pari passu benefits by doing so, and waited nearly six years without seeking to repudiate its Overcall Loan contributions. It is too late for Sterling to repudiate them. *Wujin Nanxiashu Secant Factory v Ti-Well Int'l Corp.*, 14 AD3d 352, 353 (1st Dept 2005) ("an agreement purportedly procured under duress must be **promptly** repudiated.") (emphasis added); *see Allen v Riese Org., Inc.*, 106 AD3d 514, 517 (1st Dept 2013) ("ratification occurs when a party accepts the benefits of a contract and fails to act promptly to repudiate it").

Similarly unavailing are alleged breaches (i) and (j), which concern Marshal's failure to properly account for the interest on Marshall's original loan to HRD and on the Overcall Loans. There is no obligation to account in the Investor Agreement. Consequently, a failure to account is not a breach of that contract. In any event, since Sterling was provided with an accounting, any complaint it has about the interest payments can be addressed by way of its objections.

Finally, breaches (k) and (l) claim that Marshall modified the terms of his original loan and the Overcall Loans, such as the interest rates, supposedly without authority and without

[13] As discussed below, Sterling abandoned its claim for "coercion."

plaintiffs' consent. Plaintiffs do not explain why he lacked the authority to do so or why their consent was required. The Investor Agreement gives Marshall sole management authority with no provision for Sterling's consent. To the extent Sterling has a complaint grounded in the fairness (or lack thereof) of the alleged amendments, a claim not asserted, that claim would be for breach of fiduciary duty.

In sum, none of alleged breaches in the third cause of action state a claim for breach of the Investor Agreement.

E. Constructive Trust Upon MDB (Fourth Cause of Action)

"The elements necessary for the imposition of a constructive trust are a confidential or fiduciary relationship, a promise, a transfer in reliance thereon, and unjust enrichment." *Abacus Fed. Savings Bank v Lim*, 75 AD3d 472, 473-74 (1st Dept 2010). Plaintiffs do not seek the imposition of a constructive trust on Marshall's estate in the amount of their investment. Rather, they seek "the imposition of a constructive trust upon MDB." *See* AC ¶ 260. Plaintiffs have no interest in MDB. They are not members of MDB, nor are they in privity with MDB. Plaintiffs, therefore, lack the requisite fiduciary relationship. This claim is dismissed.

Plaintiffs, in the same cause of action, also seek the appointment a receiver for MDB. Without any rights in MDB, plaintiffs have no standing to seek the appointment of a receiver. In any event, since there is no claim of imminent irreparable harm (plaintiffs just want their money back), appointment of a receiver is not appropriate. *See* CPLR 6401(a); *In re Armienti*, 309 AD2d 659, 661 (1st Dept 2003) ("There must be danger of irreparable loss, and courts of equity will exercise extreme caution in the appointment of receivers, which should never be made until a proper case has been clearly established.").

F. Fraud (Fifth Cause of Action)

"The elements of a cause of action for fraud [are] a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009); *see Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 (1st Dept 2014). Fraud claims must be pleaded with the specificity required by CPLR 3016(b). *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491 (2008). Moreover, pursuant to CPLR 213(8), "a fraud-based action must be commenced within six years of the fraud or within two years from the time the plaintiff discovered the fraud or 'could with reasonable diligence have discovered'". *Sargiss v Magarelli*, 12 NY3d 527, 532 (2009).

Plaintiffs base their fraud claims on two alleged misrepresentations made by Marshall. The first, concerning Marshall's promise to pay interest, was made in March 2007 (*see* AC ¶ 262), and is therefore time-barred. The second claim is based on the allegation that, in a November 19, 2009 email, "[i]n order to induce Plaintiffs to transfer $300,000 in Overcall Loans, [Marshall] represented to Plaintiffs that '[a]ll the other [investors] have recognized their responsibility and fulfilled their obligations.'" *See* AC ¶ 268.[14] Plaintiffs claim this was false "based on the documents produced by Defendants in discovery," which purport to show that "at the time that [Marshall] made such representations to Plaintiffs all of the [investors] had not fulfilled their financial obligations under the Agreement." *See* AC ¶ 269. While this allegation is unclear about what "financial obligations" the other investors had not fulfilled (presumably,

[14] This fraud claim would be timely if it related back to the filing of the original complaint. *See* CPLR 203(f); *Giambrone v Kings Harbor Multicare Center*, 104 AD3d 546 (1st Dept 2013). The court will not reach the issue of whether the relation back doctrine is applicable (i.e., the question of whether the original complaint provides fair notice of the claim) because the claim fails on the merits.

this refers to their pro rata Overcall Loan contributions), plaintiffs do not plead or explain why this was either material to their decision to fund Overcall Loans, that they conducted any due diligence to verify Marshall's representation, or that plaintiffs' suffered any loss by virtue of the representation.[15] Defendants contend, and plaintiffs do not dispute, that the real estate crash during the financial crisis caused Sterling (and all of the other investors) to lose money on the investment (it invested in 2007, right before the crash), not the failure of the other investors to contribute money to the Overcall Loans. The extensive discovery record also confirms that Tang did not actually rely on the email because "in her deposition, Tang admitted that by November 10, 2009 (nine days before Marshall's alleged false statement) she had decided to pay the requested amount in four installments." *See* Dkt. 359 at 14, citing Dkt. 367 at 2-4. For these reasons, plaintiffs have failed to plead materiality, actual or reasonable reliance, and loss causation. The fraud claim is dismissed.

G. Coercion (Sixth Cause of Action)

This claim is dismissed because there is no cause of action for coercion under New York law. Plaintiffs appear to concede this point, as their brief did not oppose dismissal of this claim.

H. Breach of Fiduciary Duty & Aiding and Abetting Breach of Fiduciary Duty Regarding MDB (Tenth & Eleventh Causes of Action)

These causes of action are premised on the fallacy that defendants were required to obtain plaintiffs' consent before appointing Lawrence the sole manager of MDB. As discussed, plaintiffs have no rights in MDB and, therefore, have no right to input in its management.[16]

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[15] Indeed, if the other investors did not similarly fund the Overcall Loans, this, perhaps, would result in their dilution relative to Sterling. The issue can be sorted out in the accounting.
[16] Even if Sterling was a member of MDB, it would only have a minority stake that would be insufficient to prevent Lawrence from being named sole manager. *See* Limited Liability Company Law § 407.

I. Breach of Fiduciary Duty & Aiding and Abetting Breach of Fiduciary Duty (Twelfth Cause of Action)

"In their Twelfth Cause of Action for breach of fiduciary duty, Plaintiffs allege that in or about 2013 [Lawrence] learned of relevant and material information regarding Heights HQ and failed to disclose such information to Plaintiffs. This 'relevant and material information' is nowhere identified in the [AC]." Dkt. 256 at 27. Plaintiffs also complain that Tang was not provided with the opportunity to participate in a "Cash Needs Loan" in 2014, but Tang "conceded in her deposition that she and Sterling had no interest in making any further loans to Heights HQ." *See id.* at 28, citing Dkt. 254 (Tang's 5/18/16 Dep. Tr. at 22). The record is clear that in December 2009, Tang unequivocally told Marshall that she was done putting additional money into the project. Also, contrary to the AC, Tang admitted that she received a copy of the Amended and Restated Operating Agreement for Heights HQ, which she claims was improperly withheld from her in an attempt to deceive her about the Cash Needs Loan. *See id.* Simply put, nothing alleged in this cause of action states a claim for breach of fiduciary duty.

J. Conversion (Thirteenth Cause of Action)

Plaintiffs complain that their distributions are being held in escrow pursuant to a stipulation executed by the parties, and that plaintiffs' right to such distributions give rise to a cause of action for conversion. Paragraph 3(c) of the Investor Agreement expressly addresses Marshall's right to withhold distributions based on his estate's (forthcoming) counterclaim for indemnity. While Marshall's right to do so in this case, as noted earlier, is questionable under *Hooper*, at worst, defendants are breaching the Investor Agreement. A claim that constitutes a breach of the parties' contract, where no extra-contractual duty is alleged to have been breached, cannot give rise to a claim for conversion. *See Fesseha v TD Waterhouse Inv'r Servs., Inc.*, 305

AD2d 268, 269 (1st Dept 2003). For reasons that are unclear, Sterling does not actually assert a claim for breach of the Investor Agreement with respect to this issue (it only pleads a declaratory judgment claim in the eighth cause of action, which defendants have not moved to dismiss). Nonetheless, a conversion claim cannot be maintained since the issue is governed by the contract. *See Sebastian Holdings, Inc. v Deutsche Bank, AG*, 108 AD3d 433 (1st Dept 2013).

K. Declaratory Judgment (Fourteenth Cause of Action)

Plaintiffs seek a declaratory judgment that Lawrence is not the sole manager of MDB. This claim is dismissed because, as discussed, plaintiffs have no rights in MDB and cannot challenge Lawrence's status as sole manager.

L. Breach of Fiduciary Duty (Fifteenth Cause of Action)

This claim is dismissed without prejudice. It asserts a laundry list of boilerplate fiduciary breaches without providing any specificity about what defendants did wrong. It also suggests that defendants acted wrongfully by failing to wind up the investment (plaintiffs' brief cites no on-point authority about why this was required). Construed liberally, this cause of action is a placeholder for Sterling to complain about whatever fiduciary breaches the accounting might reveal. Sterling may move for leave to amend to reassert this cause of action, provided it can actually articulate fiduciary duty breaches grounded in the accounting. To be clear, the claim may only be pleaded by Sterling, and not Tang, since Tang lacks standing to assert claims regarding the subject investment.

That being said, the Investor Agreement sets forth Sterling's rights in its investment – its pro rata share of Marshall's stake, based on whatever dilution was properly accounted for. Any relief to which Sterling is entitled should be capable of being awarded under a single claim for breach of the Investor Agreement, which Sterling may seek leave to assert by moving for leave

to amend. Even if what Marshall did also might be construed as a breach of fiduciary duty, since Sterling's right of recovery is really dependent on its contractual pro rata share in the investment, a separate claim for breach of fiduciary duty would be considered duplicative. *See Kaminsky v FSP Inc.*, 5 AD3d 251, 252 (1st Dept 2004).

At the end of the day, Marshall's estate is contractually liable for Sterling's share of Marshall's investment. The accounting should reveal what Sterling is owed. Sterling is cautioned not to replead claims not grounded in the accounting. To the extent new claims are pleaded, upon a motion to dismiss, counsel is expected to proffer a defense of such claims that is far more cogent than the one found in the opposition brief submitted on this motion, which, like the AC, was extremely confusing. These issues will be addressed more extensively at the conference ordered below.

III. Plaintiffs' Motion to Compel Discovery (Seq. 004)

In light of the stay of discovery, which remains in place, and in light of this decision narrowing the claims at issue in this case, plaintiffs' discovery motion is denied without prejudice. Plaintiffs may seek to lift the stay of discovery at the conference ordered below, at which time the question of what further depositions (if any) are warranted will be addressed. Accordingly, it is

ORDERED that defendants' motion for partial dismissal of the AC is granted to the following extent: (1) all of the claims pleaded by Miranda Tang are dismissed with prejudice; (2) the second-sixth and tenth-fourteenth causes of action are dismissed with prejudice; (3) the fifteenth cause of action is dismissed without prejudice; and (4) the motion is otherwise denied; and it is further

ORDERED that plaintiffs' motion to compel discovery is denied without prejudice; and it is further

ORDERED that the parties are to appear in Part 54, 60 Centre Street, Room 228, for a status conference on May 17, 2017 at 12:00 pm.

Dated: May 2, 2017

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C.