SUPREME COURT-STATE OF NEW YORK
SHORT FORM ORDER
Present:

HON. TIMOTHY S. DRISCOLL
Justice Supreme Court

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ELAINE ZUCKERBROD, PHILIP SCHATTEN and HARVEY SCHATTEN, and all other members of the limited liability companies similarly situated,

Plaintiffs,

-against-

355 COMPANY LLC, 60 WEST 76 CO. LLC, 68 MONTAGUE CO. LLC, JANOFF & OLSHAN INC., MORTON OLSHAN, and

JOHN DOE'S # 1-5 and XYZ Corporations (Said names being fictitious, it being the intention of Plaintiffs to designate any and all parties, corporations or entities having or claiming an interest as the other members and/or managing agents of the limited liability companies.),

Defendants.

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TRIAL/IAS PART: 20

NASSAU COUNTY

Index No: 015075-10
Motion Seq. No: 2
Submission Date: 10/21/11

Papers Read on this Motion:

Notice of Motion, Affirmation in Support,
Affidavits in Support and Exhibits.....x
Defendants' Memorandum of Law in Support.....x
Zuckerbrod Affirmation in Opposition,
Affidavit in Opposition and Exhibits.....x
Memorandum of Law in Opposition.....x
Schulman Affirmation in Opposition and Exhibits.....x
Reply Affirmation in Further Support,
Affidavit in Further Support and Exhibits.....x
Supplemental Affirmation in Opposition and Exhibits.....x
Sur-Reply Affirmation in Further Support and Exhibits...x

This matter is before the court on the motion filed by Defendants 355 Company LLC ("355 Company"), 60 West 76 Co. LLC ("60 West"), 68 Montague Co. LLC ("68 Montague") (collectively the "LLCs"), Janoff & Olshan Inc. ("J&O"), and Morton Olshan ("Morton") (all collectively "Defendants") on July 8, 2011 and submitted on October 21, 2011. Pursuant to a Stipulation dated September 26, 2011 (Ex. A to Kassenoff Sur-Reply Affirmation in Further Support), the Schatten Plaintiffs withdrew their opposition to Defendants' motion for summary judgment and consented to the relief sought therein, thereby dismissing the Complaint in its entirety as against them, with prejudice and without costs. Thus, Zuckerbrod is the sole remaining Plaintiff. For the reasons set forth below, the Court grants the motion and dismisses the Complaint in its entirety.

BACKGROUND

A. Relief Sought

Defendants move, pursuant to CPLR § 3212, for an Order granting Defendants summary judgment dismissing this action.

Plaintiff Elaine Zuckerbrod ("Elaine" or "Plaintiff") opposes Defendants' motion.

B. The Parties' History

The Verified Complaint ("Complaint") (Ex. A to Kassenoff Aff. in Supp.) alleges as follows:

On or about 1960, Benjamin Schatten ("Benjamin"), the father of Plaintiffs, invested with Morton and/or J&O on New York City properties ("Properties") as a general partner. The Properties are located at a) 355 West 55th Street, b) 60 West 76th Street, and c) 68 Montague Street. Benjamin's interest in the Property located at 355 West 55th Street was five (5%) percent, his interest in the Property located at 60 West 76th Street was ten (10%) percent, and his interest in the Property located at 68 Montague Street was five (5%) percent.

After Benjamin's death, his interest in the Properties passed to his wife and children, and are owned as follows: a) the 5% interest in the West 55th Street Property is owned 1.875% by Elaine, 1.875% by Philip, and 3% by Harvey; b) the 10% interest in the West 76th Street Property is owned 3.5% by Elaine, 3.5% by Philip and 3% by Harvey; and c) the 5% interest in the 68 Montague Street Property is owned by Harvey.

The Complaint contains ten (10) causes of action: 1) J&O and Morton transferred the ownership of the Properties to limited liability companies ("LLCs") of which Plaintiffs are members and Defendants are managing members, and the managing members ("Managers") engaged in a plan to reduce the value of the shares of the LLCs resulting in damages to Plaintiffs; 2) Plaintiffs have been damaged as a result of Defendants' failure to produce financial records of and information regarding the LLCs, despite Plaintiffs' demand; 3) Plaintiffs have been damaged as result of Defendants' failure to notify Plaintiffs of, and provide Plaintiffs with an opportunity to participate in, LLC meetings ("Meetings"); 4) the Managers have breached their fiduciary duties by managing the Properties negligently and unprofessionally, and misusing income from the Properties, resulting in monetary damages to Plaintiffs; 5) as a result of the Managers' misfeasance, the value of the Properties declined resulting in monetary damages to Plaintiffs; 6) Morton has violated his fiduciary responsibility with respect to a Power of Attorney ("POA") granted to him regarding the Properties by acting in his own self interest rather than the interests of the principals and other members of the LLCs; 7) J&O and/or Morton, knowing that they were obligating Plaintiffs to pay taxes on money they never received, nonetheless continued to pay for expenses out of income from the Properties although alternate means were available to them, for which Plaintiffs seek punitive damages; 8) Morton and others took actions regarding the Properties without notifying members or calling a meeting, which conduct constituted gross negligence and gross management; 9) Defendants engaged in a scheme to defraud Plaintiffs of their rightful investment in the Properties and convert monies to which Plaintiffs were entitled; and 10) Defendants' actions were willful and resulted in Plaintiffs incurring extensive legal fees, and Defendants should be liable for those expenditures, including legal fees.

In support of Defendants' motion, Morton affirms that he is the Manager of the LLCs, and the President and Chairman of Mall Properties, Inc. ("Mall Properties"), the successor to J&O, the managing agent of the Properties. The Properties contain multi-level residential buildings ("Buildings") with numerous units that were constructed between 1908 and 1915 and, therefore, require substantial maintenance and repairs.

Until 1998, the Properties were owned by several partnerships. The members of the general partnerships decided to convert the general partnerships into LLCs, and transfer the

Properties to these new entities. To facilitate this conversion and transfer, Plaintiffs executed several POAs in favor of Morton (Exs. C, D and E to Morton Aff. in Supp.). The POAs, which were incorporated into the LLC agreements and signed by Plaintiffs, are identical for all of the LLCs.

In 1997 and 1998, Morton formed the LLCs and subsequently transferred the deeds ("Deeds") for the Buildings to the LLCs, copies of which are provided (Exs. I, J, and K to Morton Aff. in Supp.). Following these transfers, Morton did not use the POAs in any fashion and it is his understanding that, after the formation of the LLCs and transfer of the Deeds, the POAs in his favor terminated as a matter of law.

Morton also affirms that the parties' ownership in the LLCs is as follows: 1) 355 Company: Morton owns 29.375%, Elaine and Philip each own 1.825%, and Harvey owns 1.25%, 2) 60 West: Morton owns 26.25%, Elaine and Philip each own 3.5%, and Harvey owns 3%, and 3) 68 Montague: Morton owns 23.33%, and Harvey owns 5%. Morton avers, further, that with the exception of 68 Montague, the LLC operating agreements ("Agreements") are identical, and name Harvey as the Manager of the LLCs. The Properties are managed by J&O which was succeeded by Mall Properties, of which Morton is Chairman and President.

Morton outlines relevant provisions of the 355 Company, 60 West and 68 Montague Agreements that afford him numerous rights and responsibilities. Pursuant to those Agreements, J&O and Morton managed the Properties for the benefit of all members of the LLCs. With respect to Plaintiffs' allegations that Defendants mismanaged the LLCs and improperly converted funds, Morton affirms that "[n]othing is further from the truth" (Morton Aff. in Supp. at ¶ 38). Rather, the LLCs' profits ("Profits") were held in reserve to pay for approximately $3 million in anticipated capital improvements ("Improvements") in the Buildings. Morton refers to the Affidavit in Support of Robert Lay ("Lay") which addresses the Improvements. Morton submits that the decision to hold the Profits in reserve was a proper exercise of Defendants' business judgment. Morton notes, further, that the LLCs are not required to make distributions to his members and, to the contrary, the 355 Company and 60 West Agreements provide the Manager with sole discretion in deciding whether to make distributions to members, and the amounts of distributions in the event they are made. Morton affirms that he considered numerous factors in

deciding whether to make distributions, including but not limited to projected profits and losses and tenant turnover.

Lay, the Senior Asset Manager of Mall Properties, affirms that he is in charge of the residential department where he oversees the Buildings, ensures that the Buildings are properly operated, addresses tenant-related issues and prepares annual budgets for the Buildings. He is familiar with the condition of the Buildings, including capital improvements and repairs that need to be made. The Buildings were built between 1908 and 1915 and, due to their age, require substantial maintenance and repairs. In addition, capital improvements are needed to ensure that the Buildings comply with relevant laws, including the New York City Building Code ("Code") and Americans with Disabilities Act ("ADA").

Based on estimates received from contractors, the cost of making capital improvements is at least $2,911,400.00, calculated as follows: 1) for 60 West, a total of at least $1,455,500 for the following expenses: a) $500,000 for sidewalk repair, b) $307,500.00 for boiler maintenance and installation, c) $220,000 for elevator improvements, d) $160,000 for hallway renovation, e) $60,000 to construct a parapet wall that complies with the Code, f) $8,000 for installation of a security camera to ensure the residents' safety, and g) $200,000 in legal fees regarding ongoing litigation with a tenant, 2) for 68 Montague, a total of at least $809,000 for the following expenses: a) $308,000 for boiler maintenance and repair, b) $250,000 for elevator improvements, c) $100,000 to replace the bulkhead roof, d) $85,000 to construct an ADA-compliant access ramp, e) $48,000 to install sprinklers in the laundry room to comply with the Code, and f) installation of a security camera to ensure the residents' safety, and 3) for 355 Company: a total of at least $647,000 for the following expenses: a) $300,000 for boiler maintenance and repair, b) $250,000 for improvements to the elevator, c) $45,000 to construct an ADA-compliant access ramp, and d) $52,000 to install sprinklers in the laundry room to comply with the Code.

All needed improvements are expected to be completed on or before 2013. Lay submits that it was appropriate for the LLCs to hold back profits in order to pay for these expenses.

Defendants also provide an Affidavit in Support of Frederick Meltzer ("Meltzer"), the managing partner of Meltzer Weissman LLP ("Meltzer LLP"), a partnership that provides financial services including accounting and auditing services to individuals, entities and agencies.

Meltzer LLP has been the accountant for the LLCs since 2005. In its capacity as the LLCs' accountant, Meltzer LLP reviewed the books and records of the LLC, compiled the LLCs' financial statements, including Statements of Assets, Statements of Revenues and Expenses and Statements of Member's Capital, and prepared the LLCs' tax returns.

Meltzer affirms that the LLCs' accounting is performed on an Income Tax Basis, pursuant to which any profits received by the LLCs are allocated to the individual members of the LLCs based on their proportionate ownership interests. Upon that allocation, each member is required to report his share of the profits and pay taxes on those allocated profits, irrespective of whether the profits are actually distributed to the members. In the event that the LLC decides not to distribute profits to its members, a member would still be required to pay taxes on the allocated profits.

With respect to the matters at issue in this action, the LLCs did not distribute all of the allocated profits to its members, but rather held back a substantial portion of the profits which were used to pay for capital improvements on the Buildings. As a result, Plaintiffs may have incurred tax liabilities exceeding the amounts they actually received. Although this method of accounting imposes potential financial liability on the members of the LLCs, including Plaintiffs, it is an "accurate and proper" method (Meltzer Aff. in Supp. at ¶ 12). Meltzer affirms, further, that "[i]n fact, there is no other way to account for the holdback of the LLCs' profits that would have prevented the members of the LLCs, including Plaintiffs, from incurring the tax liability they have incurred" (*id.*).

In opposition, Elaine affirms that she trusted Olshan, who had been her father's accountant and whom she has known for many years. Elaine agreed to sign the papers changing the ownership of the Properties from partnerships to LLCs. She affirms that "[i]t was only when I stopped receiving the normal distributions and was required to pay taxes on money that I had never received that I began to question his motives" (Elaine Aff. in Opp. at ¶ 5). She suggests that alternatives were available, such as short term financing. She also affirms that Olshan engaged in other questionable conduct, including but not limited to entering into contracts with companies that he controlled without notifying the minority members and setting management fees with his own company without obtaining comparisons from other management companies or

disclosing the arrangement to the minority members.

Counsel for Plaintiff apparently concedes that the Operating Agreements of the LLCs eliminated the need to hold annual meetings. He submits, however, that the managing members were required to advise the other members when they entered into contracts. Counsel also affirms that Defendants recently produced documents in partial response to Plaintiff's demands, but notes that the depositions of Olshan and his daughter, who is involved in management of the Properties, have not yet been held.

Plaintiff's Counsel submits that Plaintiff should be permitted to depose Olshan to determine, *inter alia*, 1) his motivation for paying for the repairs to the Properties out of current income rather than spreading the obligation over a period of time, 2) the reason for the "catch-up distribution" (Zuckerbrod Supp. Aff. at ¶ 10) that was made in late 2010, 3) the reason that Olshan entered into a management agreement with respect to the 355 Company Property, 4) the reason for the payment of leasing commissions between 2009 and 2011, as reflected on income statements (*id.* at Ex. C), and 5) an explanation for sudden changes in 2008 as to leasing fees, professional compensation and distributions to members.

C. The Parties' Positions

Defendant submit that 1) the First, Fourth and Seventh Causes of Action are barred by the business judgment rule, because the Limited Liability Company Law and LLC agreements at issue do not require Defendants to make distributions and because, if distributions were made, Olshan had sole discretion to determine the amount of those distributions; 2) Defendants are entitled to summary judgment dismissing the Fifth Cause of Action in light of the fact that, contrary to Plaintiff's allegations, her interest in the LLC has remained constant since 2006 (3.5% in 60 West and 1.825 in 355 Company); only the distributions made to her have changed; 3) Defendants are entitled to summary judgment dismissing the Third and Eighth Causes of Action because the agreements of 355 Company and 60 West do not require meetings; [1] 4) Defendants are entitled to summary judgment dismissing the Sixth Cause of Action on the

[1] The Court notes that the remaining Plaintiffs, prior to discontinuing this action, consented to dismissal of the third and eighth causes of action based on the LLCs' failure to hold meetings, affirming that "[t]he operating agreements of the LLC's in this case provide that annual meetings are not necessary and, therefore, the Schattens cannot oppose summary judgment as to the third and eighth causes of action as pled" (Schulman Aff. in Opp.).

grounds that a) it is deficient because it is a conclusion of law without any supporting facts; and b) the POAs, and any duty arising therefrom, expired as a matter of law after Olshan executed the documents necessary for the formation of the LLCs and transfer of the Buildings to the LLCs; 5) Defendants are entitled to summary judgment dismissing the Ninth Cause of Action in light of the fact that a) Plaintiff has failed to allege the fraud with specific particularity; b) no representations were made to Plaintiff regarding distributions; c) given that Defendants were not required to make any distributions, any reliance by Plaintiff would be unreasonable; and d) no cognizable action for fraud exists in light of the fact that Plaintiff did not have a possessory right to the LLCs' funds until Defendants chose to make distributions, and Defendants did not interfere with Plaintiff's right to those funds; and 6) Defendants are entitled to summary judgment dismissing the Tenth Cause of Action because there is no agreement, statute or court rules authorizing the recovery of legal fees.

Plaintiff opposes Defendants' motions submitting the Court should deny summary judgment and permit Plaintiff to depose Olshan, and his daughter who is involved in the management of the Properties, to obtain facts relevant to the allegations in the Complaint, including 1) his motivation for paying for the repairs to the Properties out of current income rather than spreading the obligation over a period of time, 2) the reason for the "catch-up distribution" that was made in late 2010, 3) the reason that Olshan entered into a management agreement with respect to the 355 Company Property, 4) the reason for the payment of leasing commissions between 2009 and 2011, as reflected on income statements, and 5) an explanation for sudden changes in 2008 as to leasing fees, professional compensation and distributions to members.

RULING OF THE COURT

A. Summary Judgment Standards

On a motion for summary judgment, it is the proponent's burden to make a *prima facie* showing of entitlement to judgment as a matter of law, by tendering sufficient evidence to demonstrate the absence of any material issues of fact. *JMD Holding Corp. v. Congress Financial Corp.*, 4 N.Y.3d 373, 384 (2005); *Andre v. Pomeroy*, 35 N.Y.2d 361 (1974). The Court must deny the motion if the proponent fails to make such a *prima facie* showing, regardless

of the sufficiency of the opposing papers. *Liberty Taxi Mgt. Inc. v. Gincherman*, 32 A.D.3d 276 (1st Dept. 2006). If this showing is made, however, the burden shifts to the party opposing the summary judgment motion to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact that require a trial. *Alvarez v. Prospect Hospital*, 68 N.Y.2d 320, 324 (1986). Mere conclusions or unsubstantiated allegations will not defeat the moving party's right to summary judgment. *Zuckerman v. City of New York*, 49 N.Y.2d 557, 562 (1980).

B. Business Judgment Rule

The business judgment rule bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes. *Matter of 1st Rochdale Cooperative Group, Ltd. v. Altman*, 2008 U.S. Dist. LEXIS 4966, * 2 (S.D.N.Y. 2008), quoting *Auerbach v. Bennett*, 47 N.Y.2d 619, 629 (1979) and citing *Owen v. Hamilton*, 44 A.D.3d 452 (1st Dept. 2007). The business judgment rule, however, will not protect a decision that is the product of fraud, self-dealing or bad faith. *Id.*, quoting *Patrick v. Allen*, 355 F. Supp. 2d 704, 710 (S.D.N.Y. 2005). To earn the protection of the business judgment rule, directors must do more than merely avoid fraud, bad faith and self-dealing. *Id.*, citing *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 274 (2d Cir. 1986). The business judgment rule protects directors who act with "due care" and "conscientious fairness." *Id.* at * 3, citing *Hanson Trust, supra*, quoting *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 569 (1984). In other words, a director who exercises reasonable diligence in gathering and considering material information, who makes an informed decision after a reasonable investigation, will be protected from liability, even if the decision turns out to be unwise or inexpedient. *Id.*, citing *Levandusky v. One Fifth Ave. Apt. Corp.*, 75 N.Y.2d 530, 538 (1990), quoting *Pollitz v. Wabash R.R. Co.*, 207 N.Y. 113, 124 (1912).

C. Power of Attorney

Pursuant to General Obligations Law § 5-1511(1)(g), a power of attorney terminates when: the purpose of the power of attorney is accomplished. In *Friedman v. Fife*, 262 A.D.2d 167 (1st Dept. 1999), the First Department affirmed the trial court's dismissal of plaintiff's cause of action for breach of fiduciary duty in light of the fact that the agreement for defendant to act as

plaintiff's agent was very limited and terminated as soon as the transaction was consummated, and any fiduciary duty that arose from the agency terminated simultaneously with the agency. *Id.* at 168.

D. Relevant Causes of Action

The essential elements of a cause of action sounding in fraud are 1) a misrepresentation or a material omission of fact which was false and known to be false by defendant, 2) made for the purpose of inducing the other party to reply upon it, 3) justifiable reliance of the other party on the misrepresentation or material omission, and 4) injury. *Colasacco v. Robert E. Lawrence Real Estate,* 68 A.D.3d 706 (2d Dept. 2009), quoting *Orlando v. Kukielka*, 40 A.D.3d 829, 831 (2d Dept., 2007).

To establish a claim for conversion, a plaintiff must show that he had an immediate superior right of possession to the property and the exercise by defendants of unauthorized dominion over the property in question to the exclusion of plaintiff's rights. *Bankers Trust Co. v. Cerrato, Sweeney, Cohn, Stahl & Vaccaro,* 187 A.D.2d 384, 385 (1st Dept. 1992).

E. Application of these Principles to the Instant Action

The Court grants Defendants' motion and dismisses the Complaint in its entirety based on the Court's conclusion that the causes of action in the Complaint are not viable in light of the following: 1) the LLCs were not required to hold meetings; 2) the financial decisions made by Defendants were appropriate under the Business Judgment Rule, and there is no admissible evidence to the contrary; 3) the cause of action alleging fraud is not pled with adequate particularity; 4) even assuming that the fraud cause of action were pled with sufficient particularity, that action is not viable because Defendants did not make representations on which Plaintiff reasonably relied; 5) the cause of action for conversion is not viable because Plaintiff did not possess a superior right to the funds at issue, and has not established that Defendants exercised unauthorized control over those funds; 6) the cause of action for breach of fiduciary duty cannot survive in light of the fact that the POAs were limited to authorizing Olshan to execute documents necessary to convert the companies to LLCs and transfer the Properties to the LLCs, and terminated upon completion of those duties; and 7) there is no agreement, or legal authority, supporting Plaintiff's request for counsel fees.

All matters not decided herein are hereby denied.

This constitutes the decision and order of the Court.

The Complaint is dismissed in its entirety.

ENTER

DATED: Mineola, NY
December 8, 2011

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