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

PRESENT: COIN Justice

PART 63

JOHN LAPOLLA

- v -

PETER HORWITZ

INDEX NO. 654041/12

MOTION DATE

MOTION SEQ. NO. 1

MOTION CAL. NO.

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

MOTION(S) ARE DECIDED IN ACCORDANCE WITH ANNEXED DECISION AND ORDER.

This constitutes the decision and order of the Court.

Dated: 6/12/13

ELLEN M. COIN J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 63
----------X

JOHN LAPOLLA,
Suing Individually and as A Member of each of: Sussman-Molloy, LLC, Asante Communications, LLC, Noveida Health, LLC and Atozeta Productions, LLC,

Plaintiffs,

-against-

PETER HURWITZ, MARY HURWITZ, JUERG HEIM, Esq., IVEY, BARNUM & O'MARA, LLC, and ALVAREZ FAISON,

Defendants; and

Sussman-Molloy, LLC, Asante Communications, LLC, Noveida Health, LLC and Atozeta Productions, LLC,

As Nominal Defendants.

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Index No. 654041/12
Subm. Date:3/21/2013
Mot. Seq.: 001, 002

DECISION AND ORDER

ELLEN M. COIN, J.:

Motion sequence numbers 001 and 002 are consolidated for disposition.

In motion sequence number 001, plaintiffs move, by order to show cause, for a temporary restraining order and a preliminary injunction prohibiting defendant Peter Hurwitz from acting in the capacity of a manager or managing member of any of the LLC plaintiffs, from entering the companies' offices, transferring any monies of the companies, incurring any obligations of any kind on behalf of the companies, and/or interfering with the

management and/or administration of the companies, their managing member and/or any of the members or employees of the companies, and from threatening any such persons with litigation. This court granted a temporary restraining order.

Defendant Peter Hurwitz cross-moves for an order dismissing the complaint as to him, directing that plaintiffs not expend any company monies in the prosecution of this action pending further order of the court, and directing plaintiffs' counsel and plaintiffs to return any monies that they have received from the companies in connection with the prosecution of this action.

In motion sequence number 002, defendants Juerg Heim and Ivey, Barnum & O'Mara, LLC move, pursuant to CPLR 3211 (a) (7) and (8), to dismiss the action for failure to state a claim and for lack of personal jurisdiction over defendant Juerg Heim.

Plaintiffs seek sanctions against defendants for allegedly frivolous conduct in challenging the derivative action and challenging jurisdiction over defendant Jeurg Heim.

FACTS

Plaintiff John Lapolla (Lapolla) commenced this action individually and derivatively on behalf of Sussman-Molloy, LLC (SM), Asante Communications, LLC (Asante), Noveida Health, LLC (Noveida) and Atozeta Productions LLC (Atozeta; collectively, the Companies), seeking a declaratory judgment declaring that defendant Peter Hurwitz (Hurwitz) has ceased to act as the

managing member of any of the Companies, and that he has effectively resigned from that position, leaving Lapolla as the sole managing member. Alternatively, plaintiffs seek a declaration that Hurwitz has not been devoting substantially all of his time to the affairs of the Companies since April 30, 2012, and that there is "cause" to terminate Hurwitz. Plaintiffs also seek a permanent injunction precluding Hurwitz from acting as a manager or member of any of the Companies or from entering the Companies' offices, transferring any moneys, incurring any obligations, accessing the Companies' computers and/or interfering with the management and administration of the Companies and their members or employees, and from threatening legal action against them. In addition, plaintiffs seek damages against Hurwitz for breach of fiduciary duty by reason of his embezzlement of money from the Companies and his attempts to cover up his financial improprieties; for securities fraud; and for bank fraud. Plaintiffs seek damages against defendant Mary Hurwitz, Hurwitz's wife, for aiding and abetting Hurwitz in the breach of his fiduciary duties and embezzlement; against defendant Alvarez Faison (Faison), who kept the books at the Companies, for aiding and abetting Hurwitz and/or Mary Hurwitz in the breach of Hurwitz's fiduciary duties and in the improper use of the Companies' credit cards for personal purposes; and against defendants Juerg Heim (Heim) and Ivey, Barnum & O'Mara LLC (Ivey

Barnum), for aiding abetting Hurwitz in the breach of Hurwitz's fiduciary duties, misappropriation of moneys from the Companies, and for negligence and/or professional malpractice in preparing the operating agreements and other documents for the Companies, and in refusing to correct such deficiencies after notice from the Companies' accountants, the Citrin-Cooperman Firm.

The Companies are all limited liability companies formed and existing under the laws of the State of New York. Heim is an attorney who resides in Connecticut and who is a partner of Ivey Barnum. Ivey Barnum's main office is in Connecticut, and it has an office in New York, New York as well. Heim works only in the Connecticut office. Heim and Ivey Barnum prepared and filed the initial documents forming the Companies.

Lapolla and Hurwitz were the two founding and managing members of the Companies, which provide continuing medical education and content for pharmaceutical companies. Hurwitz was responsible for financial oversight, while Lapolla was responsible for content development and dealing with clients and prospective clients. Hurwitz and Lapolla each owned approximately 35% of the equity and membership interests in each of the Companies, and were to receive equal salary and benefits.

The Companies, which were formed in 2008 and 2009, experienced rapid growth between 2009 and 2011. In November 2011, Hurwitz advised Lapolla that the Companies were

experiencing cash flow shortfalls, and that without a short-term loan, they could not meet payroll. Hurwitz arranged to obtain a loan of $250,000 at 8% interest from Jeffrey Gudin, M.D., who was given a ½% interest in the Companies as consideration for granting the loan.

Lapolla was concerned about Hurwitz's lack of prior disclosure of the situation, as well as the facts that Hurwitz had complete autonomy over the financial aspects of the Companies and that the bookkeeper reported only to Hurwitz. This concern was compounded by the shortfall occurring at a time when the Companies were enjoying favorable growth and increasing gross revenues. Lapolla decided to have his wife examine the accounting documents. Even though she is not an accountant, she was able to help him review and analyze the Companies' books and records. The examination revealed that Hurwitz had engaged in a systematic, continuing and pervasive course of using money from the Companies for his and his family's personal expenses. Hurwitz mischaracterized the nature and character of his expenses, and those of his wife, Mary Hurwitz, as business-related.

At about the same time, Lapolla discovered defendant Mary Hurwitz's participation in this conduct, in that she used the Asante American Express credit card for family travel and other transportation, hotel stays, gifts, children's toys, and other

personal items.

On March 28, 2012, Lapolla confronted Hurwitz with the evidence of his improper conduct, showing that he had taken nearly $300,000.00 from the Companies. At the meeting, Hurwitz told Lapolla that if he disclosed Hurwitz's financial activities to the non-managing members of the Companies "it would be the beginning of the end for the Companies." He further stated that it would not matter because all of the investor members were his friends.

Lapolla held a meeting of managers and members on April 7, 2012, at which he disclosed his preliminary findings. The members voted to remove Hurwitz from his responsibilities, including his right and authority to write checks from the Companies' accounts without Lapolla's approval and signature. Nonetheless, on April 14, 2012, Hurwitz wrote himself a check for $13,000.00 without getting any approval.

After the April 7, 2012 meeting, Hurwitz stopped coming to the offices on a regular basis, and performed few, if any, of his responsibilities. At Lapolla's request, after April 30, 2012, Hurwitz ceased coming to the offices, and ceased performing any manager's duties. Subsequently, Hurwitz worked for the Professional Television Network (PTN), which Lapolla contends is in direct competition with the Companies. Such employment is prohibited by the SM and Asante operating agreements. Hurwitz

denies that PTN competes with the Companies, asserting that Asante uses PTN's services.

In accordance with the wishes of the members of the Companies, Lapolla had the Companies' accountants, the Citrin-Cooperman Firm, provide an independent investigation and analysis of the Companies' books and records in order to verify Lapolla's findings. A formal preliminary forensic report was issued on May 4, 2012, which concluded that Hurwitz had embezzled or improperly converted approximately $297,863.55 from the Companies.

In order to avoid protracted litigation and business disruption, Lapolla negotiated with Hurwitz to buy out his membership interests and effectuate a formal termination, and separation, of Hurwitz from the Companies. Pursuant to the preliminary agreement, preliminary payments were made on behalf of the Companies to Hurwitz as follows: April 2012 $15,000; May 2012 $15,000; June 2012 $15,000; July 2012 $10,000; August 2012 $10,000; and September 2012 $10,000.

In October 2012, the Companies retained counsel to more fully investigate Hurwitz's improprieties. Their attorney retained the accounting firm of Rosen Seymour Shapps Martin & Company LLP (RSSM) to render a more detailed formal report. In its final forensic report, dated November 16, 2012, RSSM determined that the aggregate amount of Hurwitz's financial improprieties was $486,855.00. Lapolla concluded that Hurwitz's

embezzlement and falsification of the Companies' financial statements led to the damages aggregating more than $2.5 million. Thus, he ceased making payments to Hurwitz on the buyout until a more definitive conclusion could be made as to the appropriate amount.

In February and March of 2012, Citrin-Cooperman, having discovered inconsistencies in the operational documents prepared by Heim and Ivey Barnum for the Companies, reported its concerns to the Companies' lawyers. It also provided Heim with a copy of its reports of those concerns. The reports discussed the manner in which the inconsistences had allegedly facilitated Hurwitz's misappropriation of monies from the Companies.

DISCUSSION

Preliminary Injunction

Plaintiffs contend that they require a preliminary injunction because Hurwitz has said, directly and through counsel, that he intends to return to the Companies' offices and to resume his position as a managing member, and seeks to invalidate the Companies' separation agreement with two former employees. Those employees, Sean Quinn (Quinn) and Jim Kappler (Kappler), were released from their respective non-compete provisions of their agreements. Quinn already intended to leave the Companies, and to compete with them. Lapolla determined that taking legal action to preclude that competition would not be

financially feasible, especially in view of the Companies' financial condition. He further concluded that much of the underlying business would have been lost soon anyway, due to reasons beyond the Companies' control. Therefore, Lapolla made an agreement with Quinn and Kappler, in which, in exchange for releasing them from the non-compete portions of their agreements, they would have to generate not less that $450,000.00 in fees by March 31, 2013, payable to the Companies.

Lapolla asserts that if Hurwitz returned, there would be a mass resignation of new and key management personnel. Further, although Hurwitz denies that he resigned in order to avoid potential criminal charges being lodged against him, he does not deny that he has not entered the Companies' offices since April 30, 2012, and has not acted as a managing member since that time. Thus, Lapolla has acted with unilateral authority during that time, and maintaining the status quo would require preventing Hurwitz from acting on his threat to return.

"A party seeking a preliminary injunction must demonstrate, by clear and convincing evidence, (1) a likelihood of success on the merits, (2) irreparable injury absent the granting of the preliminary injunction, and (3) a balancing of the equities in the movant's favor." *(Gilliland v Acquafredda Enters., LLC,* 92 AD3d 19, 24 [1st Dept 2011]).

Here, Lapolla has introduced evidence to support his assertion that Hurwitz embezzled money from the Companies and that he has not been involved with the businesses since April 30, 2012. While Hurwitz denies it, he does not offer any evidence to rebut the findings of the accountants who investigated the Companies' books. Rather, the thrust of his defense is that Lapolla also took funds improperly. That does not, in any way, negate Hurwitz's wrongdoing. Since Hurwitz's wrongdoing was against the Companies, any wrongdoing that Lapolla might have engaged in would not affect the Companies' right to an injunction.

Lapolla has also asserted that two key management employees would be likely to leave if Hurwitz were to return to the Companies, and that companies with which the Companies do business would be likely to lose confidence in the Companies if Hurwitz were permitted to have any management authority again. This suffices to demonstrate there would be irreparable harm to the Companies if Hurwitz were to return.

Hurwitz asserts that in the absence of affidavits from the key employees, Lapolla has not sufficiently brought forth evidence to support his claims. Further, Hurwitz maintains that a preliminary injunction is unnecessary because he has agreed not to write any further checks to himself, pending further order of this court or an arbitration panel, and he agrees not to enter

the office pending further order of this court or an arbitration panel. However, the record before the court shows that although Hurwitz was prohibited from writing any checks in early April 2012, he nevertheless wrote a check to himself thereafter. Further, if Hurwitz agrees to the limitations sought in the preliminary injunction, he cannot be injured by the limitations being set down in a court order. Insofar as he is concerned about limitations on his rights to be apprised of the financial situation of the Companies, there is nothing in the preliminary injunction sought by plaintiffs which would limit such rights.

The equities clearly tip in plaintiffs' favor, since the evidence demonstrates that Hurwitz embezzled funds from the Companies, and Lapolla has been attempting to put the Companies back on a sound financial footing since Hurwitz's departure. While Hurwitz raises some questions regarding certain actions of Lapolla, those issues cannot be resolved on this motion, and are more properly addressed at trial.

Finally, since Hurwitz has not been involved in the running of the Companies since April 30, 2012, the status quo would be best maintained by Hurwitz's continued absence from the offices of the Companies, and his continued preclusion from holding any position within the Companies. Therefore, plaintiffs have demonstrated entitlement to a preliminary injunction.

Derivative Action

Hurwitz contests Lapolla's right to bring a derivative action on behalf of the Companies, in view of his failure to state that he made a demand on the Companies to bring an action, and specifying to whom such a demand was made. Absent such a demand, Lapolla was required to assert that a demand would have been futile, and explain why it would be futile. In their motion to dismiss, Heim and Ivey Barnum similarly object to the derivative nature of this action.

Lapolla responds by saying that he did not need authorization in order to bring this derivative action because he is the sole managing member left in the Companies. He further responds by including a resolution, passed in February 2013, signed by a super majority of the Companies' members, which, among other things, authorizes Lapolla to prosecute the derivative action.

The Court of Appeals determined, in *Tzolis v Wolff* (10 NY3d 100 [2008]), that members of limited liability companies, like minority shareholders, can bring derivative actions. The Court did not address any limitations on bringing such an action, stating it was leaving that inquiry for another day. However, since the prosecution of a derivative action by a member of an LLC is based upon the same common law that permits shareholders of a corporation to bring a derivative suit, the same

considerations limiting a corporate derivative suit are relevant to a derivative action on behalf of an LLC. Indeed, the First Department seems to have assumed that the same demand requirements and exceptions would apply. *(See Segal v Cooper,* 49 AD3d 467, 468 [1st Dept 2008]).

It is well settled that a shareholder who brings a derivative action on behalf of a corporation must set forth in his complaint, with particularity, that he attempted to have the corporation commence the action on its own behalf, and if he did not do so, the basis for his belief that seeking such action would be futile. *(Bansbach v Zinn,* 1 NY3d 1, 8-9 [2003]).

This requirement is in keeping with the purpose of a derivative action, which is to enable a member of a company from pursuing legal action when the company refuses to do so. That can happen, for example, when the majority shareholder of a corporation is dissipating corporate assets, and obviously will not agree to have the company prosecute an action against him. The minority shareholder can then proceed to try to obtain justice for the company.

Here, Lapolla seems to believe that commencing a derivative action is the equivalent of having the companies named as plaintiffs. His position, that he did not need to seek authorization because he was authorized to commence an action, cuts against his bringing a derivative action. Rather, he should

have brought an action together with the Companies as co-plaintiffs.

In view of the fact that the Companies clearly want this action to proceed, and there is no reason that they could not bring this action in their own names, the court will construe the action as one by the Companies rather than as having been brought derivatively by Lapolla. Accordingly, plaintiffs are directed to amend the pleadings within 30 days of this order to reflect that the Companies are the plaintiffs.

Heim and Ivey Barnum's Motion to Dismiss

Plaintiffs contend that Heim and Ivey Barnum committed a tortious act, in that they aided and abetted Hurwitz's embezzlement (eighth cause of action), and committed negligence or malpractice (ninth cause of action), and that these acts caused plaintiffs' damages.

To state a valid claim for aiding and abetting, allegations must provide a reasonable inference that, at the very least, defendants knew about the misconduct. (*See Eurycleia Partners, LP v Seward & Kissel, LLP,* 12 NY3d 553, 559-60 [2009]). A "necessary element of aiding and abetting fraud or conversion, means more than just performing routine business services for the alleged fraudster." (*CRT Invs., Ltd. v BDO Seidman, LLP,* 85 AD3d 470, 472 [1st Dept 2011]). While actual knowledge need only be pled generally at this point, because defendant's state of mind

may be difficult to discern at the pre-discovery stage, plaintiff's allegations must contain the minimum quantum of facts giving rise to an inference of knowing assistance in the alleged malfeasance. (*See Oster v Kirschner*, 77 AD3d 51,55 [1st Dept 2010]).

By inartfully drafting documents, Heim cannot be said to have aided and abetted a person who committed a crime by taking advantage of the deficiencies in the documents or by exploiting a lack of corporate oversight for which neither Heim not Ivey Barnum was hired Additionally, plaintiffs have not explained how any alleged defect in the documents assisted Hurwitz in embezzling funds from the Companies. Therefore, the aiding and abetting cause of action is without basis.

A claim for legal malpractice is also specious. "A critical element of a malpractice action is proximate causation." *(Candela Entertainment,Inc. v Gillbert*, 2013 NY Slip Op 50835,*14 [Sup Ct, New York County 2013]). Plaintiffs assert that Heim and Ivey Barnum committed legal malpractice in drafting operating documents which enabled Hurwitz to embezzle money from the Companies. However, other than a conclusory statement that the failure to draft the documents properly "aided and abetted Hurwitz in embezzling" money from the Companies (complaint, ¶ 109), the complaint does not state how the allegedly improper drafting was connected with Hurwitz's actions. (*See Gamiel v*

Curtis & Riess-Curtis, P.C., 44 AD3d 327, 327-28 [1st Dept 2007]). Therefore, both the eighth and the ninth causes of action must be dismissed pursuant to CPLR §3211(a)(7). In view of the Court's dismissal of these claims for failure to state a cause of action, the portion of Heim's motion to dismiss for lack of jurisdiction is rendered moot.

Hurwitz's Cross-Motion

Hurwitz seeks to dismiss the action as against him because the claims are covered by an arbitration provision. Hurwitz relies on article 14.12 of the SM operating agreement, which provides for arbitration.

Hurwitz has not sought to compel arbitration, nor has he attempted to commence an arbitration proceeding. An arbitration clause can be a basis to stay an action pending arbitration, and to compel arbitration, but not to dismiss an action. (*See De Sapio v Kohlmeyer*, 35 NY2d 402, 405-06 (1974); *Aschkenasy v Teichman*, 12 AD2d 904 [1st Dept 1961]). The court also notes that Hurwitz provides an agreement to arbitrate only with respect to SM. There is no indication that the other Companies had comparable arbitration clauses.

Hurwitz also seeks to require Lapolla to return any monies that he has received to pursue this litigation, and to preclude the Companies from providing any further litigation expenses. Hurwitz has no basis upon which to make such a demand if the

Companies have chosen to pursue this action. Should the resolution of the entire action prove that there was any wrongdoing, any monetary impropriety involved in pursuing this litigation can be addressed at that time.

Consequently, Hurwitz's cross-motion is denied.

Sanctions

Plaintiffs seek sanctions against defendants for purported frivolous conduct in opposing their motion and bringing their own cross-motions. In view of the fact that defendants are correct that a derivative action was improper, any claim that their position was frivolous is, in itself, frivolous. Counsel would be well advised to refrain from inappropriately seeking sanctions, and is reminded that such conduct is also sanctionable. (22 NYCRR 130-1.1 (c)).

CONCLUSION

In accordance with the foregoing, it is hereby

ORDERED that plaintiffs' motion for a preliminary injunction is granted, on the condition that plaintiffs amend the complaint within 30 days of the date of the docketing of this order to reflect that the action is being brought by each of the limited liability companies in its own name rather than as derivatively; and it is further

ORDERED that in the event plaintiffs fail to amend the complaint within the deadline provided for herein, the

preliminary injunction will be vacated and deemed a nullity; and it is further

ORDERED that as a condition of continued enforcement of the preliminary injunction issued, plaintiffs shall post within fifteen (15) days from the date the complaint is amended an undertaking pursuant to CPLR §6312 (b) in the amount of $5,000.00, conditioned that plaintiffs, if it is finally determined that they were not entitled to an injunction, will pay to defendant Peter Hurwitz all damages and costs which may be sustained by reason of this injunction; and it is further

ORDERED that Defendant Hurwitz's cross-motion to dismiss the action as against him is denied; and it is further

ORDERED that the action as against defendants Juerg Heim, Esq. and Ivey, Barnum & Omara, LLC is dismissed without prejudice pursuant to CPLR §3211(a)(7), and the Clerk of Court is directed to sever and dismiss the complaint as against defendants Juerg Heim, Esq. and Ivey, Barnum & Omara, LLC, and the remainder of the action shall proceed.

Dated: June 12, 2013

Ellen M. Coin, A.J.S.C.