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

PRESENT: MELVIN L. SCHWEITZER Justice PART 45

DAVID E. DANOVITCH AND JOHN RILEY

- v -

GERSTEN SAVAGE LLP, et al

INDEX NO. 650569/13

MOTION DATE

MOTION SEQ. NO. 001

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 by defendants Jay and Sheila Kaplowitz to dismiss the complaint is GRANTED to the following extent:

1) the claims asserted by plaintiff David E. Danovitch are DISMISSED as ~~premature~~ premature, with leave to replead a claim for an accounting

2) the fifth cause of action is dismissed

3) the first, second, third, fourth, fifth, sixth, seventh, ninth and ~~tenth~~ tenth causes of action are dismissed against defendant Sheila Kaplowitz

4) The motion is DENIED in all other respects

5) Moving defendants are to serve and file an answer to the complaint within 20 days of service of a copy of this order with notice of entry

Dated: July 8, 2013

MELVIN L. SCHWEITZER, J.S.C.

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

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COM. DIV. PART 45

DAVID E. DANOVITCH and JOHN H. RILEY, Plaintiffs, - against - GERSTEN SAVAGE LLP, JAY KAPLOWITZ and SHEILA KAPLOWITZ as relief defendant, Defendants.	Index No. 650569/13 DECISION AND ORDER Motion Sequence No. 001

MELVIN L. SCHWEITZER:

Defendants Jay and Sheila Kaplowitz move, pursuant to CPLR 3211 (a) (7), to dismiss the complaint and all causes of action alleged therein with prejudice on the ground that the complaint fails to state any cause of action. Defendants also seek sanctions pursuant to 22 NYCRR § 130-1.1 against plaintiffs and their attorney.

In this action, two former partners of the law firm Gersten Savage LLP (the Firm) sue the now defunct law firm and one of its founding partners, Jay Kaplowitz, claiming that Kaplowitz misappropriated firm assets and denied compensation promised to partners. David E. Danovitch and John H. Riley claim that in the years leading up to the Firm's 2012 collapse, Kaplowitz used the Firm's money to cover personal expenses for he and his wife (co-defendant Sheila Kaplowitz), and made it look like the Firm was not profitable in order to deny partners their commissions and wages.

> "From at least as early as 2007, Jay Kaplowitz used the firm as his personal piggy bank, taking out whatever funds he needed for his and Sheila Kaplowitz's personal expenses during the time period up to the end of 2011 and into the beginning of 2012, and essentially using the firm's checking account as though it were his own personal checking account"

(Cmplt., ¶ 26).

Danovitch and Riley allege they were recruited in 2004 and 2005, respectively, to join the firm as "contract partners" who would earn a commission for legal services they provided to clients they originated (Cmplt., ¶¶ 13, 14). Riley alleges that he was recruited by Kaplowitz, and entered into an oral contract, whereby the Firm agreed to pay him a guaranteed draw of $150,000 plus 30% of any business he originated (*id.*, ¶¶ 14, 50; Riley 3/20/13 Aff., ¶ 2). In 2007, Kaplowitz "asked Danovitch to transition from a contract partner to an 'equity partner' whereby he would receive a percentage of the Firm's overall profits in addition to merely a percentage of the legal work which he performed or originated" (Cmplt., ¶ 15). Kaplowitz "represented to Danovitch that he would first be paid approximately 45% of his collections and, in addition, would thereafter share in the Firm's profits" (*id.*)

Once Kaplowitz's own practice and originations began to decline starting around mid-2009, the plaintiffs and other partners allegedly went for months at a time without receiving commission compensation or wages (Cmplt., ¶¶ 20-22) . However, during this time, Kaplowitz allegedly continued to take out hundreds of thousands of dollars from the Firm's accounts for his own benefit and instructed the Firm's back office staff to tell partners that there was no money left over to pay them after operational expenses (*id.*, ¶¶ 21-23, 36).

Allegedly Kaplowitz continued to falsely promise that he would personally front wages or commission payments owed to the partners in order to keep them from leaving the Firm. Kaplowitz also allegedly falsely promised the plaintiffs and other partners "that he was taking very little or no money by way of draw or profit from the Firm because of the lack of funds" (Cmplt., ¶ 33). In January 2012, plaintiff and other partners of the Firm allegedly confronted

Kaplowitz and demanded an accounting and access to the Firm's financial records (*id.*, ¶ 37). At this point in time, they claim to have gained access to some of the books of account and discovered that Kaplowitz and his wife had taken $950,000 from the Firm in 2011 alone (*id.*, ¶¶ 29, 37).

Plaintiffs allege that from late January through September 2012, Kaplowitz purported to give up control of the Firm and admitted to the plaintiffs and others that he "had misappropriated or otherwise wrongly taken money that was due them or had directed that it be paid to others," including his wife and Arthur Marcus, Kaplowitz's "equity partner and close friend of many years" (Cmplt., ¶¶ 38-39). Kaplowitz also allegedly promised that he would personally pay plaintiffs the compensation they were owed (*id.*).

In the first quarter of 2012, Kaplowitz allegedly represented that he was going to sell his townhouse and certain artwork owned by him and his wife in order to pay the plaintiffs and other Firm employees from the proceeds of that sale (Cmplt., ¶ 43). When Riley and others recently demanded that Kaplowitz provide them with some security interest in the townhouse, Kaplowitz allegedly refused and stated the proceeds of the sale of the townhouse would be used for his own benefit and the benefit of his wife and family (*id.*).

Both plaintiffs terminated their association with the Firm on or about August 31, 2012 (Cmplt., ¶¶ 2, 3). They contend that Kaplowitz "abandoned the Firm" in mid-September 2012, "taking certain tangible assets of the Firm with him, including but not limited to various artwork" (*id.*, 46).

Riley contends he is owed at least $162,919 in unpaid "commission compensation wages" for the years 2010, 2011 and 2012 (Cmplt., ¶ 54). Danovitch contends he is owed in

excess of $1 million in unpaid compensation (*id.*, ¶ 63). Plaintiffs also seek an order of attachment preventing Kaplowitz and his wife from divesting themselves of their $6.9 million Upper East Side townhouse listed for sale in September 2012, and now under contract, as well as a punitive damages award totaling $5 million for breach of contract, breach of the implied covenant of good faith and fair dealing, promissory and/or equitable estoppel, conversion and misappropriation, unjust enrichment, violation of New York's labor law, fraud and breach of fiduciary duty.

Relying on *Arnold v Arnold* (90 NY 580, 584 [1882]), Kaplowitz maintains that all of the complaint's causes of action must be dismissed because "partners cannot sue each other at law for anything relating to their partnership concerns unless there has been a settlement and balance struck and an express promise to pay . . . " (*see also Roberts v Astoria Med. Group*, 43 AD2d 138, 139 [1st Dept 1973]). Plaintiffs, however, contend that their complaint falls within the exception to the *Arnold* rule, i.e., "'where the alleged wrong involves a partnership transaction which can be determined without an examination of the partnership accounts'" (*Stark v Goldberg*, 297 AD2d 203, 204 [1st Dept 2002], quoting *Kriegsman v Kraus, Ostreicher & Co.*, 126 AD2d 489, 490 [1st Dept 1987]; *see also Le Bel v Donovan*, 96 AD3d 415, 416 [1st Dept 2012]).

The *Arnold* rule undoubtedly applies to all of the claims asserted by Danovitch, who was admittedly an equity partner of the Firm, and is suing for a percentage of the Firm's profits, which is "currently unknown" (*see* Cmplt., ¶¶ 15, 59, 63; *see also* Danovitch 3/20/13 Aff., ¶ 4 [the $1 million owed is "based on my alleged targeted percentage, against my own collections, Law Firm collections generally, and the amount that was actually paid to me"]). Because

Danovitch's claims seek monetary damages based on the partnership's earnings, and because those claims require an examination of the partnership's books and records for determination, his claims cannot be resolved without first having an accounting. Indeed, the very case plaintiffs rely on proves this point.

> "In the instant situation, respondent contends that the financial disputes between him and petitioner were caused by the latter's fraud, conversion, embezzlement, breach of the partnership agreement and breach of fiduciary duty. According to respondent, petitioner removed partnership files, books and records, altered partnership checkbooks, records and books, misappropriated funds, misrepresented facts concerning partnership income, profits and expenditures and concealed partnership profits. Therefore, the bulk of the allegations contained in the cross petition which comprises the claim for damages necessarily require inspection of the books, records and accounts of the partnership, and the validity of the charges against petitioner must be resolved by means of an action for an accounting."

(*Kriegsman v Kraus, Ostreicher & Co.*, 126 AD2d at 490).

Plaintiffs also contend that the *Arnold* rule does not apply, "because Kaplowitz was for all intents and purposes the alter ego of the Law Firm" and because "the Firm did not operate as a true partnership" (Pls. Memo. of Law, at 6). While it might be true that Kaplowitz controlled the Firm and took more than his fair share of the Firm's profits, that does not mean the Firm was not operated as a partnership or that an accounting is not required to resolve Danovitch's claims.

The *Arnold* rule has no relevance to Riley, however, who alleges that he was an employee of the Firm (Cmplt., ¶ 49), and that he received a guaranteed salary plus 30% of his collections, and had no equity interest in the Firm. His claims for payment of his salary and/or commissions can be calculated from his own origination billings without the need for a full accounting.

Defendants also seek dismissal of each of Riley's individual claims on the ground that they fail to state a viable cause of action.

The first cause of action alleges breach of an oral agreement to pay Riley his agreed-upon compensation. Although the complaint itself alleges that this agreement was between Riley and the Firm (Cmplt., ¶ 50), the complaint also alleges that Kaplowitz promised that he would personally pay Riley the wages he was due (*id.*, ¶ 39),[1] and that Kaplowitz and the Firm have breached their agreement with Riley (*id.*, ¶ 55). In addition, the complaint alleges that the Firm was the alter ego of Kaplowitz and that the Firm was effectively a sole proprietorship, of which Kaplowitz was the owner and manager, and who exercised sole dominion and control (*id.*, ¶ 5).

The third cause of action alleges that the Firm and Kaplowitz breached their implied duty of good faith and fair dealing with respect to their performance of the agreement regarding Riley's compensation (Cmplt., ¶ 68). This covenant requires that the parties will not take any action which may have the effect of destroying the rights of the other party to receive the benefits of the contract (*511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 153 [2002]; *Forman v Guardian Life Ins. Co. of Am.*, 76 AD3d 886, 888 [1st Dept 2010]). The cause of action is sufficiently pled, because it alleges that Kaplowitz, by his improper management of the Firm, deprived Riley of the benefit of their bargain. Specifically, Riley alleges that Kaplowitz misrepresented material facts about his own draw, instructed the Firm's back office to pay his family's personal bills from Firm accounts, and arranged to have Firm clients provide Sheila Kaplowitz with lavish gifts in lieu of payment for legal services (Cmplt., ¶¶ 23, 26, 32, 33, 35-36).

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[1] Defendants may not raise the Statute of Frauds or rely on documentary evidence for the first time in their reply papers as additional grounds for dismissal of the complaint (*see Dannasch v Bifulco*, 184 AD2d 415, 417 [1st Dept 1992]).

The fifth cause of action alleges that Kaplowitz "misappropriated and converted" the commission wages owed to Riley for his own benefit and for the benefit and enjoyment of his wife. "Conversion is an unauthorized assumption and exercise of the right of ownership over goods belonging to another to the exclusion of the owner's rights" (*Peters Griffin Woodward, Inc. v WCSC, Inc.*, 88 AD2d 883, 883 [1st Dept 1982]). While money can be the subject of a conversion action, Riley never had ownership, possession or control of his unpaid wages, even if characterized as commissions (*Colombo v Sharmas Realty*, 174 AD2d 985 [4th Dept 1991]), and, thus, this cause of action is dismissed.

In the seventh cause of action, Riley claims that the Firm and Kaplowitz, as its managing partner, was guilty of willful violation of Labor Law § 190 by failing to pay Riley his wages. He also seeks liquidated damages pursuant to Section 198 (1-a). Kaplowitz argues that the compensation Riley seeks for the years 2010 through 2012 are not "wages" for purposes a Labor Law claim.

Labor Law § 190 (1) defines "wages" as "the earnings of an employee for labor or services rendered, regardless of whether the amount of earnings is determined on a time, piece, commission or other basis." Although the term "does not encompass an incentive compensation plan" (*Matter of Dean Witter Reynolds v Ross*, 75 AD2d 373, 381 [1st Dept 1980]), if the compensation "is vested and mandatory as opposed to discretionary and forfeitable," it falls within the protections of the Labor Law (*Truelove v Northeast Capital & Advisory*, 268 AD2d 648, 649 [1st Dept], *affd* 95 NY2d 220 [2000]). Since nothing in the complaint suggests that Riley is asking for discretionary incentive compensation (*see* Cmplt., ¶ 14), and he alleges, in an affidavit submitted in opposition to this motion, that he was guaranteed $150,000 plus 30% of

any business he originated (Riley 3/20/13 Aff., ¶ 2), there is no basis to dismiss Riley's Labor Law claims.

The eighth cause of action is based on the theory that the Kaplowitzes were unjustly enriched at the expense of Riley. Defendants move to dismiss this claim on the ground that it is precluded by Riley's breach of contract claim. While the existence of a valid contract generally precludes such a quasi-contract claim (*see IDT Corp. v Morgan Stanley Dean Winter & Co.*, 12 NY3d 132, 142 [2009]), in support of his motion to dismiss, Kaplowitz denies that he ever agreed to be personally responsible to pay Riley's compensation and never entered into any contract with Riley (Kaplowitz 3/25/13 Aff., ¶¶ 4, 5). At this stage of the litigation, and until Riley's breach of contract and alter ego claims are resolved, it would be error to dismiss Riley's quasi-contract claim against Kaplowitz.

Although the complaint seeks to hold Sheila Kaplowitz jointly and severally liable for all of the ten claims for relief, the only cause of action actually pled against her is unjust enrichment (*see* Cmplt., ¶¶ 120- 121). Sheila Kaplowitz allegedly was having her personal expenses paid directly by the Firm's back office every month, even at such times when her husband "was not producing any income or billings and was otherwise incapacitated" (*id.*, ¶ 120). Since unjust enrichment does not require that the party enriched take an active role in obtaining the benefit (*Georgia Malone & Co. v Rieder*, 86 AD3d 406, 414 [1st Dept 2011]), this claim is sufficiently plead against Sheila Kaplowitz to the extent Riley can prove that she was unjustly enriched by the Firm's payment of her personal expenses. All other claims against Sheila Kaplowitz are dismissed.

The ninth cause of action alleges fraud by Kaplowitz. The complaint alleges that:

> "[Kaplowitz], at the time he represented to each of the Plaintiffs that they were going to be paid in accordance with their respective compensation agreements, falsely and fraudulently made those representations knowing, at the time he made the representations, that the would not compensate the Plaintiffs as promised."

(Cmplt., ¶ 124). "A cause of action for fraud does not arise when the only fraud charged relates to a breach of contract. To plead a viable cause of action for fraud arising out of a contractual relationship, 'the plaintiff must allege a breach of duty which is collateral or extraneous to the contract between the parties'" (*Krantz v Chateau Stores of Canada*, 256 AD2d 186, 187 [1st Dept 1998], quoting *Mastropieri v Solmar Const. Co.*, 159 AD2d 698, 700 [2d Dept 1990]; *see also Financial Structures Ltd. v UBS AG*, 77 AD3d 417, 419 [1st Dept 2010]). Thus, the above-quoted language is insufficient to support a fraud claim against Kaplowitz. However, the complaint also alleges that Kaplowitz made other misrepresentations that are collateral to the terms of Riley's compensation agreement. Kaplowitz is accused of making the following misrepresentations to induce Riley to stay with the Firm and not take action to collect the monies owed to him: (1) that Kaplowitz had substantially reduced the amount of his draw to ensure that all Firm expenses were paid, (2) that he had loaned the Firm enough money to pay everyone's wages; (3) that he would personally pay the plaintiffs the money they were owed; and (4) that he would use the proceeds from the sale of his townhouse and certain artwork for this purpose. Since Riley alleges falsity, materiality, reliance and injury with respect to these representations by Kaplowitz, the complaint states a claim for fraud.

The tenth cause of action alleges that Kaplowitz breached his fiduciary duty to Riley and the other employees of the Firm. This claim is neither duplicative of Riley's contract claims, nor

too conclusory or speculative. The complaint alleges such conduct on the part of Kaplowitz, such as the payment of personal expenses from Firm coffers, that would constitute a breach of his fiduciary duty to the other partners of the Firm (*see Lemle v Lemle*, 92 AD3d 494, 497 [1st Dept 2012]).

Defendants' request for sanctions against plaintiffs and their attorney, pursuant to 22 NYCRR § 130-1.1, is denied.

Conclusion

Accordingly, it is

ORDERED that the motion of defendants Jay and Sheila Kaplowitz to dismiss the complaint and for sanctions is granted to the following extent:

-- the claims asserted by plaintiff David E. Danovitch are dismissed as premature, with leave to replead a claim for an accounting;

-- the fifth cause of action is dismissed;

-- the first, second, third, fourth, fifth, sixth, seventh, ninth and tenth causes of action are dismissed against defendant Sheila Kaplowitz;

and the motion is denied in all other respects; and it is further

ORDERED that the moving defendants are directed to serve and file an answer to the complaint within twenty (20) of service of a copy of this order with notice of entry.

Dated: July 8, 2013

ENTER:

J.S.C.

MELVIN L. SCHWEITZER

A Preliminary Conference is scheduled for 8-26-13 at 11AM at 26 Broadway 10th Floor