| **Schindler v Rothfeld** |
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| 2016 NY Slip Op 31959(U) |
| October 12, 2016 |
| Supreme Court, New York County |
| Docket Number: 653161/2015 |
| Judge: Eileen Bransten |
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 3

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HEATHER THOMAS SCHINDLER, JONATHAN SCHINDLER and MICHELLE MOORING DARAY,

Plaintiffs,

-against-

Index No. 653161/2015
Motion Seq. Nos. 008, 009
Motion Date: 5/25/2016

ERIC ROTHFELD, REI CAPITAL, LLC, RICHARD ROTHFELD, and THE RF TRUST,

Defendants,

-and-

TIMES THREE CLOTHIER, LLC,

Nominal Defendant.

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REI CAPITAL, LLC and TIMES THREE CLOTHIER, LLC,

Third-party Plaintiffs,

Index No. 595917/2015

-against-

WENDY HERMAN and FASHION 360, LLC,

Third-Party Defendants.

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**BRANSTEN, J.**:

Motion sequence nos. 008 and 009 are consolidated herein for disposition. In motion sequence no. 008, plaintiffs Heather Thomson Schindler, Jonathan Schindler, and Michelle Mooring Daray seek dismissal of the amended counterclaims brought by defendant REI, individually and on behalf of Times Three Clothier, LLC d/b/a Yummie

by Heather Thomson ("Yummie" or the "Company"), on the grounds that they fail to state a cause of action and are refuted by documentary evidence.

In motion sequence no. 009, defendants seek to modify the September 21, 2015 temporary restraining order (the "TRO") issued by the Court, which required two signatories to the Company's accounts – Eric Rothfeld and Wendy Herman. Plaintiffs cross-move for an order: (1) directing defendants to provide plaintiffs with full and complete access to the books and records of the Company; (2) directing defendants to provide plaintiffs with monthly financial statements; (3) granting plaintiffs the right to approve the hiring or firing of Yummie employees or consultants; and, (4) granting plaintiff Jonathan Schindler the power to approve all payments in place of Herman.

For the reasons set forth below, plaintiff's motion to dismiss is granted. With respect to motion sequence no. 009, both the motion and the cross-motion are denied.

## I. **Background**

Plaintiffs Heather Thomson Schindler, Jonathan Schindler, and Michelle Mooring Daray are the majority owners of Yummie. Defendant Eric Rothfeld, through defendant REI Capital, LLC ("REI"), loaned $1,000,000 to the Company. Pursuant to the Second Amended and Restated Limited Liability Company Operating Agreement (the "Operating Agreement"), Rothfeld was appointed the Company's manager. Under Section 8.1 of the

Operating Agreement, Rothfeld could be replaced as manager upon repayment of the loan, and REI's approval of the replacement manager was "not to be unreasonably withheld." (Affirmation of John Reichman Ex. 4 § 8.1.) Plaintiffs now allege that the loan has been repaid. Accordingly, they seek to replace Rothfeld with Wendy Herman, who served as president of the Company, over REI's allegedly unreasonable objections.

Defendants counter that the attempt to remove Rothfeld as manager was improper and in violation of Section 8.1 of the Operating Agreement. In addition, defendants claim that plaintiff Heather Schindler's appearance on the third season of a reality show television program violated Section 2.10(b) of the Operating Agreement, which required her to devote her full time services exclusively to the Company. While Heather Schindler entered into an agreement with the Company to allow her to participate for two seasons in the Real Housewives of New York ("RHONY") program, this so-called RHONY Agreement required Heather Schindler to pay a certain percentage her appearance fees to the Company. Since she allegedly failed to make the payments required for her first two seasons on the show, Defendants purportedly required that Heather Schindler enter into a new agreement with them in order to appear in a third season of the show. This new agreement required Heather Schindler to pay the Company its past-due share of her RHONY income, as well as pay the Company 50% of her income from the third RHONY

season. Heather Schindler disputes that she entered into this new agreement with the Company and therefore she did not make these payments.

A. *The Prior Motions*

Plaintiffs commenced this action by filing a verified complaint and order to show cause seeking a TRO appointing Herman as manager of the Company (motion sequence no. 001). On September 21, 2015, the Court issued a TRO directing the parties to maintain the status quo and ordering that all payments by the Company must be approved jointly by Herman and Rothfeld.

Subsequently, plaintiffs filed a verified amended complaint and an order to show cause (motion sequence no. 003), seeking a preliminary injunction to enforce the TRO and prohibit defendants from interfering with Herman's day-to-day running of the Company. Defendants then filed their own motions seeking a preliminary injunction to prohibit both violations of the TRO and interference with Rothfeld's management of the Company (motion sequence no. 004). In addition, Defendants sought dismissal of the verified amended complaint (motion sequence no. 005).

On February 5, 2016, the Court: (1) denied plaintiffs' motion for a preliminary injunction but continued the TRO in place, (2) denied defendants' motion for a preliminary injunction, and (3) largely denied defendants' motion to dismiss, only

dismissing Heather Schindler's Labor Law claim and the two derivative claims on the ground that demand futility had not been adequately pleaded.

B. *The Counterclaims*

In December 2015, defendants filed counterclaims against plaintiffs, as well as third-party claims against Herman and Fashion 360, LLC ("Fashion 360"), an entity owned by Herman. After plaintiffs sought dismissal of the counterclaims, defendants then served the following amended counterclaims, which are the subject of the instant motion to dismiss: breach of the Operating Agreement and the RHONY Agreement; breach of fiduciary duty; and, a request for a permanent injunction.

C. *Recent Events*

By letter dated February 11, 2016, Heather Schindler and Daray resigned from the Company. A little over one week later, Herman provided the 90-day notice of her resignation required by her consulting agreement.

On April 26, 2016, this Court so-ordered the parties' stipulation, modifying the TRO so that Jimmy Yao replaced Herman as a required signatory on Company accounts. The Court further ordered that, in all other respects, the TRO would continue, pending the hearing and determination of the within motions.

II. **Discussion**

A. *Motion to Dismiss Counterclaims (Motion Sequence No. 008)*

Plaintiffs now seek dismissal of each of the amended counterclaims. For the reasons that follow, plaintiffs' motion is granted.

1. Motion to Dismiss Standard

On a motion to dismiss for failure to state a cause of action, all factual allegations must be accepted as truthful, the complaint must be construed in a light most favorable to the plaintiffs and the plaintiffs must be given the benefit of all reasonable inferences. *Allianz Underwriters Ins. Co. v. Landmark Ins. Co.*, 13 A.D.3d 172, 174 (1st Dep't 2004). "We . . . determine only whether the facts as alleged fit within any cognizable legal theory." *Leon v. Martinez,* 84 N.Y.2d 83, 87-88 (1994). This Court must deny a motion to dismiss, "if from the pleadings' four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law." *511 W. 232nd Owners Corp. v. Jennifer Realty Co.,* 98 N.Y.2d 144, 152 (2002) (internal quotation marks and citations omitted).

However, on a CPLR 3211(a)(1) motion, "[i]t is well settled that bare legal conclusions and factual claims, which are either inherently incredible or flatly contradicted by documentary evidence . . . are not presumed to be true on a motion to

dismiss for legal insufficiency." *O'Donnell, Fox & Gartner v. R-2000 Corp.*, 198 A.D.2d 154, 154 (1st Dep't 1993). The Court is not required to accept factual allegations that are contradicted by documentary evidence or legal conclusions that are unsupported in the face of undisputed facts. *See Zanett Lombardier, Ltd. v. Maslow*, 29 A.D.3d 495, 495 (1st Dep't 2006) (citing *Robinson v. Robinson*, 303 A.D.2d 234, 235 (1st Dep't 2003)). Ultimately, under CPLR 3211(a)(1), "dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Leon*, 84 N.Y.2d at 88.

2. Fraud and Breach of Fiduciary Duty (Third and Fifth Counterclaims)

In support of their fraud counterclaim, defendants allege that Daray breached the Operating Agreement by: (1) refusing to assist Rothfeld in determining markdown values for company inventory and failing to sell such inventory (Am. Counterclaims ¶¶ 209-211); (2) telling Rothfeld that the information he was demanding was counterproductive, time consuming and unreasonable (*id.* ¶ 215), and (3) refusing or countermanding Rothfeld's instructions (*id.* ¶¶ 221-225). In essence, defendants assert that Daray "concealed" from Rothfeld "massive" inventory which Rothfeld could have sold for a higher price had he known about it earlier.

a. **Duplicative Claims**

Assuming for the sake of argument that Daray breached the Operating Agreement, those breaches nonetheless could not form the basis for a fraud or breach of fiduciary claim. It is a well-established that breach of contract is not a tort "unless a legal duty independent of the contract itself had been violated." *Clark-Fitzpatrick, Inc. v. Long Is. R.R. Co.*, 70 N.Y.2d 382, 388 (1987); *see also Caniglia v. Chicago Tribune-N.Y. News Syndicate*, 204 A.D.2d 233, 234 (1st Dep't 1994) ("It is well settled that a cause of action for fraud does not arise, where, as here, the only fraud alleged merely relates to a contracting party's alleged intent to breach a contractual obligation"). "A fraud claim may coexist with a breach of contract cause of action only where the alleged fraud constitutes the breach of a duty separate and apart from the duty to abide by the terms of the contract." *Verizon N.Y., Inc. v. Optical Communc'ns Group, Inc.*, 91 A.D.3d 176, 179-180 (1st Dep't 2011).

Similarly, a breach of fiduciary duty claim cannot be founded upon the breach of an employment agreement and/or the duty of loyalty owed an employer. *See Western Elec. Co. v. Brenner*, 41 N.Y.2d 291, 295 (1977). "A cause of action for breach of fiduciary duty which is merely duplicative of a breach of contract claim cannot stand." *William Kaufman Org. v. Graham & James*, 269 A.D.2d 171, 173 (1st Dep't 2000); *see also Chowaiki & Co. Fine Art Ltd. v. Lacher*, 115 A.D.3d 600, 600 (1st Dep't 2014)

(breach of fiduciary duty claim dismissed as "duplicative of the breach of contract claim, since the claims are premised upon the same facts and seek identical damages").

Here, defendants' counterclaims are based upon an alleged, intentional violation of the Operating Agreement. Indeed, as defendants alleged in their initial counterclaims, "Ms. Daray and Ms. Herman had the *contractual* and fiduciary duty" to disclose information to him. (Am. Counterclaims ¶ 253). A party cannot transform a breach of contract claim into a tort claim by saying that a breach was intentional. *Steinberg v. DiGeronimo*, 255 A.D.2d 204, 204 (1st Dep't 1998). However, this is precisely what REI is attempting to do here.

In opposition to the motion, defendants contend that the fraud and breach of fiduciary duty claims are independent of the Operating Agreement because the "third counterclaim, unlike the breach of contract counterclaims focuses" on Daray allegedly falsifying inventory reports. *See* Defs.' Br. at 12. This argument completely lacks merit, as Rothfeld has repeatedly argued that Daray had a contractual duty to disclose the supposedly falsified information to Rothfeld. For example, in their briefing, defendants claim that Daray breached the contract by refusing to follow Rothfeld's instructions and that those instructions supposedly consisted of putting slow selling inventory into a phaseout report. *See* Defs.' Br at 7. In their amended counterclaims, defendants also repeatedly allege that Daray had contractual obligations to mark down and sell inventory

and to follow Rothfeld's instructions in this regard. Daray allegedly breached the Operating Agreement by: (1) refusing to assist Rothfeld in determining markdown value for company inventory and failing to sell such inventory (Am. Counterclaims ¶¶ 209-211); (2) telling Rothfeld that the information he was demanding was counterproductive, time consuming and unreasonable (*id.* ¶ 215); and, (3) refusing or countermanding Rothfeld's instructions (*id.* ¶¶ 221-225). These allegations belie defendants'a ssertion that the fraud and fiduciary duty claims are independent of the breach of contract claim.

Moreover, it is clear that the failure of an employer to perform assigned tasks does not give rise to an action for fraud or breach of fiduciary duty. *Cerciello v. Admiral Ins. Brokerage Corp.*, 90 A.D.3d 967, 968 (2d Dep't 2011). "Rather, the employee's misuse of the employer's resources to compete with the employer is generally required." *Id.* at 968. There is no such allegation here.

b. **Damages**

Finally, REI's third and fifth counterclaims also fail because REI has not alleged a cognizable damage theory. While REI claims that if Rothfeld would have sold the concealed inventory at a higher price had he known about it earlier, this theory is foreclosed by the out-of-pocket rule. Under this rule, "[d]amages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for

what they might have gained. Under the out-of-pocket rule, there can be no recovery of profits which would have been realized in the absence of fraud." *Lama Holding Co. v. Smith Barney*, 88 N.Y.2d 413, 421 (1996) (internal citations omitted).

For example, in *Starr Foundation v. American International Group, Inc.*, 76 A.D.3d 25 (1st Dep't 2010), plaintiff's primary asset was publicly-traded shares in defendant AIG. Plaintiff alleged that AIG's misrepresentations caused it to hold onto its shares longer than it otherwise would have otherwise. *Id.* at 26. In affirming the dismissal of the complaint, the First Department stated that the plaintiff's claim was "virtually the paradigm of the kind of claim barred by the out-of-pocket rule." *Id.* at 28. The Court identified several "cumulative layers of uncertainty," which together "take the claim out of the realm of cognizable damages." These "layers of uncertainty" included: (1) whether the plaintiff would have sold the shares absent the misrepresentations; (2) the time frame for the supposed sale or sales of the shares; and (3) in the event of a sale (or sales) how many shares the plaintiff would have sold. *Id.* at 29-30.

There are similar layers of uncertainty to REI's damage claim. Thus, it is completely speculative as to whether: (1) the Company would have sold the allegedly excess inventory; (2) the time frame (or time frames) during which the excess inventory would have been sold; and (3) how much inventory would have been sold, and at what

price. Consequently, REI's damages claims are barred by the out-of-pocket rule. Accordingly, the third and fifth counterclaims must be dismissed.

3. Breach of Contract Claim (First Counterclaim)

In its first counterclaim, REI alleges that Heather Schindler breached the Operating Agreement by appearing in the third season of the Real Housewives program without fulfilling the conditions imposed by the Company for her appearance. As already noted, Section 2.10(b) of the Operating Agreement requires Heather Schindler to devote her full time services "exclusively" to the Company as long as (1) the REI loan remains outstanding and (2) she accepts a consulting fee or salary from the Company. *See* Affirmation of John H. Reichman Ex. 4 at § 2.10. According to REI, Schindler sought the Company's permission to appear for a third season of the show and thus not devote her efforts full time to the Company. This permission was granted with certain conditions. Among the alleged conditions was the requirement that Schindler pay the Company 50% of the income she received for the third season. As REI states in its amended counterclaims, this permission – and the conditions imposed – constituted the granting of an "exception to her obligation to provide her services on a full time basis exclusively to the Company under Section 2.10(b) of the Operating Agreement." (Am. Counterclaims ¶ 233.)

Nevertheless, such an amendment to the terms of the Operating Agreement could only be done with the written consent of the Company's Members. *See* Operating Agreement § 14.1. REI does not allege any such written amendment. Moreover, the RHONY Agreement, which provided the "exception" to the Operating Agreement allowing for Heather Schindler's first two seasons on the Real Housewives program, explicitly only applies to those two seasons and not the third season at issue here. *See* Reply Affidavit of Eric Rothfeld Ex. M at 3 (attached as Exhibit 2 to the Affirmation of Donald S. Zakarian) ("Based upon you and Jonathan [Schindler] signing and returning a copy of this letter ... [the Company] hereby approves your participation in the [Real Housewives] series ... for the Initial Cycle and one Additional Cycle only."). Therefore, the RHONY Agreement fails to provide a basis for REI's breach claim.

Accordingly, the first counterclaim is dismissed.

4. Breach of Contract (Second Counterclaim)

In the second counterclaim for breach of contract, REI alleges that all plaintiffs breached "Article VIII" of the Operating Agreement by seeking to replace Rothfeld with an "unqualified" manager and by not following his instructions. However, REI fails to identify any specific provision in Article VIII that was breached.

It is well established that "[i]n order to plead a breach of contract cause of action, a complaint must allege the provisions of the contract upon which the claim is based" *Atkinson v. Mobil Oil Corp.*, 205 A.D.2d 719, 720 (2d Dep't 1994); *see also Matter of Sud v. Sud*, 211 A.D.2d 423, 424 (1st Dep't 1995). Defendants fail to allege which provision in Article VIII of the Operating Agreement that each of the plaintiffs allegedly breached. Article VIII includes many different provisions, including plaintiffs' right to replace Rothfeld as manager.

Defendants respond that plaintiff have "misrepresented" their counterclaim, and that the alleged breach of Article VIII consists of: (1) failing to comply with notice and meeting requirements in the Operating Agreement when they sought to remove Rothfeld as Manager; and (2) not following Rothfeld's instructions.

The notice and meeting requirements, however, are set forth in Article VI of the Operating Agreement – not Article VIII. Further, this Court has already rejected the claim that plaintiffs did not follow the notice and meeting requirements in the course of denying defendants' motion for a preliminary injunction:

> Accordingly, the Court concludes that Section 6.9 does not contradict Section 8.1(e) and merely provides for an "Information Action" waiving the meeting requirements as long as a majority of the Members agreed on the action to be taken. As a result plaintiff's exercise of the removal rights was proper.

(Affirmation of David Yeger Ex. 8 at 11.) This ruling constitutes the law of the case, and the issue therefore cannot be relitigated. *Chanice v. Fed. Express Corp.*, 118 A.D.3d 634, 635 (1st Dep't 2014).

In addition, in making the argument that plaintiffs breached Article VIII by not following Rothfeld's instructions, they still fail to specify which provision of Article VIII was breached. *See Sud*, 211 A.D.2d at 423.

Accordingly, the second counterclaim for breach of contract must be dismissed.

5. Breach of Fiduciary Duty (Fourth Counterclaim)

In its fourth counterclaim, REI alleges that Ms. Schindler breached her fiduciary duty to the Company by seeking "to impose an unqualified manager," and attempting to seize managerial control, in violation of the Operating Agreement. However, as previously discussed, a breach of fiduciary duty claim must be based upon conduct that is independent of the conduct constituting a breach of contract. Here, defendant's breach of fiduciary duty counterclaim is based solely on an alleged breach of the Operating Agreement.

Accordingly, the fourth counterclaim is dismissed as well.

6. Injunctive Relief (Sixth Counterclaim)

Since each of the other substantive counterclaims has been dismissed, the sixth counterclaim seeking the imposition of a permanent injunction is likewise dismissed. *See, e.g., Weinreb v. 37 Apartments Corp.*, 97 A.D.3d 54, 58-59 (1st Dep't 2012) ("[I]njunctive relief is simply not available when the plaintiff does not have any remaining substantive cause of action against those defendants. An injunction is a remedy, a form of relief that may be granted against a defendant when its proponent establishes the merits of its substantive cause of action against that defendant.").

B. *Motion to Modify TRO (Motion Sequence No. 009)*

In light of the resignations submitted by Heather Schindler, Daray, and Herman, defendants now seek to modify the TRO so to eliminate both the dual-signature requirement and the restriction on the authority of Rothfeld to terminate employees.

As an initial matter, defendants' request to eliminate the dual-signature requirement is denied as moot. On April 26, 2016, the parties stipulated to a modification of the TRO, replacing Herman with Jimmy Yao. *See* NYSCEF No. 336. Further, defendants' request to remove the restriction on Rothfeld's ability to fire employees is also denied. This Court is reluctant to change the status quo, especially in light of the fact

that counsel for defendants represented during oral argument that the company is profitable and being well run. *See* 5/11/16 Oral Arg. Tr. at 34:21-24.[1]

Plaintiffs' cross-motion likewise is denied. Jonathan Schindler's request for the power to approve payments in place of Herman is denied as moot, given Yao's appointment as signatory. Plaintiffs' request for access to the books and records of the Company, as well as the Company's monthly financial statements, is also denied as moot, as, during oral argument, defendants represented that they would fully comply with both of these requests.[2] *See* 5/11/16 Oral Arg. Tr. at 36:14-20.

Finally, the Court denies plaintiffs' request for the right to approve the hiring or firing of Yummie employees or consultants. This request is denied for the same reason that defendants' request to eliminate the restriction on termination was denied. *See supra.* The Court seeks to preserve the status quo during the pendency of this litigation.

The Court has considered the remaining arguments and finds them to be without merit.

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[1] The May 11, 2016 Oral Argument Transcript is available on NYSCEF as document no. 364.

[2] After this motion was argued, plaintiffs filed a motion to compel, arguing that defendants persisted in their refusal to allow plaintiffs full access to the Company's books and records notwithstanding defendants' statements on the May 11, 2016 record,. The Court granted plaintiff's motion to compel on October 5, 2016. *See* Decision and Order on Motion Sequence 010.

III. **Conclusion**

Accordingly, it is

ORDERED that plaintiffs' motion to dismiss the amended counterclaims (motion sequence no. 008) is granted, and the amended counterclaims are hereby dismissed; and it is further

ORDERED defendants' motion and plaintiffs' cross-motion to modify the September 15, 2015 temporary restraining order (motion sequence no. 009) are both denied; and it is further

ORDERED that the remainder of the action shall continue.

Dated: New York, New York
October 12, 2016

**ENTER**

Hon. Eileen Bransten, J.S.C.