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

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FAVOURITE LIMITED, CLAUDIO GATELLI, GRAZIANO SGHEDONI, ALBERTO BRENTEGANI, SIRIO SRL, OILE SRL, and UPPER EAST SIDE SUITES, LLC,

Index No.: 652857/2016

DECISION & ORDER

Plaintiffs,

-against-

BENEDETTO CICO, CARLA CICO, 151 EAST HOUSTON ACQUISITION LLC, ABC CORPS. 1-20, and JOHN DOES 1-20,

Defendants.

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JENNIFER G. SCHECTER, J.:

Motion sequence numbers 009 and 010 are consolidated for disposition.

Defendants Benedetto Cico, Carla Cico (collectively, the Cicos), and 151 Houston Acquisition LLC (Acquisition) move to dismiss the first amended complaint (the FAC). Plaintiffs Favorite Limited, Claudio Gatelli, Sghedoni Graziano, Alberto Brentegani, Sirio SRL, Oile SRL (collectively, the Remaining Member Plaintiffs), and Upper East Side Suites, LLC (the Company) oppose and cross-move for leave to file a second amended complaint (the PSAC). Defendants oppose the cross-motion. The motions and cross-motion are granted in part and denied in part.

Background

While there have been more than ten motions in this 2016 case and multiple written decisions, a brief recap is warranted.

This case involves alleged improprieties by former managers (the Cicos) of a Delaware LLC (the Company) that owned a residential building located at 44-46 East End Avenue in Manhattan (the Building or the Property), which it used to operate a short-term rental business (like Airbnb). The Remaining Member Plaintiffs, along with others, collectively invested $4.75 million in the Company. That money is mostly (if not all) gone. While the Cicos are (as discussed herein) alleged to have caused some of the losses due to their acts of self-dealing and allegedly deficient management, a critical adverse event that affected the viability of the Company was that, after the Company purchased the Building, it became illegal in New York to operate the Company's short-term rental business.[1] This eventually resulted in the Building defaulting on its mortgage. Faced with foreclosure, the Cicos sold the Building and used most of the net proceeds of $1.1 million as a down payment on a more expensive building, located at 151 Houston Street (the New Building), which was to be owned by Acquisition, a New York LLC (*see* Dkt. 182).[2] Since the purchase price of the New Building was nearly $19 million (*see id.* at 3),[3] substantial additional investment was required to close the sale. To date, that

[1] "In about 2012, New York passed what Defendants have reported to investors as the 'anti-airb-n-b' law prohibiting the operation of the Property as a short-term rental operation, making such operation illegal" (PSAC ¶ 85). The Cicos informed the members of this issue at a telephonic meeting on May 15, 2013 (*see* Dkt. 201 at 3). The court notes that while a resolution was passed to explore the possible acquisition of another building, a definitive agreement to do so was not reached at that time (*see id.* at 4).

[2] References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF).

[3] The amount recited in the contract is greater than the amount the Cicos allegedly disclosed to plaintiffs ($11.8 million) and the amount plaintiffs claim was the actual sale price ($10 million). This issue of the actual sale price, however, is not material here. All that matters for purposes of

investment has not materialized and the proceeds from the sale of the Building supposedly remain in escrow.

Plaintiffs object to the proposed purchase of the New Building because, under their interpretation of the Company's operating agreement, dated October 31, 2007 (Dkt. 199) [the Operating Agreement]), the Company (1) was not permitted to acquire the New Building unless there was unanimous member consent; and, in any event, (2) the Company's business becoming illegal mandated dissolution. Because the Operating Agreement is ambiguous on these issues, plaintiffs' claims predicated on what was done with the sale proceeds survive dismissal. Plaintiffs also seek recovery from the Cicos for their other alleged breaches of the Company's operating agreement and their breaches of fiduciary duty. Before addressing the merits of plaintiffs' claims, a review of the somewhat atypical procedural history is in order.

Procedural History

On May 27, 2016, the Company, the Remaining Member Plaintiffs, and other members of the Company commenced this action by filing their original complaint – which ***did not*** assert any derivative claims (Dkt. 2). Rather, the members and the Company only purported to assert direct claims. Defendants filed motions to dismiss. Prior to those motions being decided, in April 2017, some of the members moved to withdraw their direct claims with prejudice. In May 2017, the Company's counsel was

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this motion is that it is undisputed that the purchase price of the New Building was millions of dollars more than the $1.1 million down payment.

relieved. Neither the withdrawing members nor the Company appeared or retained new counsel.

By order dated February 21, 2018, this court dismissed the complaint with respect to the various plaintiffs (Dkt. 110 [the February 2018 Decision]). First, the court, at their request, dismissed the withdrawing members' direct claims with prejudice (*see id.* at 3). Second, the court dismissed the Company's direct claims without prejudice for failure to retain counsel (*see id.* at 3-4). Finally, the court dismissed the Remaining Member Plaintiffs' direct claims without prejudice because the claims were derivative[4] and granted plaintiffs the opportunity to replead (*see id.*).[5]

On March 28, 2018, the Remaining Member Plaintiffs filed the FAC (Dkt. 114). On April 10, 2018, the Cicos moved to reargue and renew the February 2018 Decision. The Cicos argued that the Remaining Member Plaintiffs should not have been granted leave to amend to assert derivative claims because the Company was an inactive

[4] The court did not and does not fault plaintiffs for previously failing to plead derivative claims because, at the time this action was commenced, such claims were being prosecuted by the Company directly, and thus there was no need (and, indeed, no ability) to plead derivative claims. The posture of the action changed when the Company defaulted, thereby creating the need for the Remaining Member Plaintiffs to pursue the claims derivatively. We have now come full circle as the Company has now sought to take over its claims and assert them directly. Though defendants complain about this procedural maneuver, it is well settled Delaware law that the company can take over derivative claims and prosecute them how it sees fit so long as the company makes that decision through an independent committee (*Zapata Corp. v Maldonado*, 430 A2d 779, 784-89 [Del 1981]; *see In re Oracle Corp. Deriv. Lit.*, 808 A 2d 1206, 1210-12 [Del Ch 2002]). While this is not the classic case of a derivative plaintiff resisting losing control of the action (here, the defendants oppose the Company taking over), since derivative claims are assets of the company (*see Sciabacucchi v Liberty Broadband Corp.*, 2018 WL 3599997, at *10 [Del Ch July 26, 2018]), it would be wrong to prevent the Company from pursuing its own claims at the behest of the majority of its unconflicted members.

[5] The only claim the court found to be direct was fraud, which was and still is insufficiently pleaded (*see* February 2018 Decision at 3 n 5).

Delaware LLC and the decision of some of the Company's members to withdraw their claims precludes a finding of demand futility. The court rejected these arguments and denied the motion by order dated May 29, 2018 (Dkt. 195), explaining that the Company had been revived[6] and that the question of whether the Remaining Member Plaintiffs could plead demand futility had ***not*** been decided in the February 2018 Decision and was to be addressed on defendants' forthcoming motion to dismiss the FAC.

In the interim, the court issued an order dated May 14, 2018 (Dkt. 185), which required defendants to produce certain discovery, stayed all other discovery pending a decision on these motions and set a briefing schedule. That schedule contemplated the Remaining Member Plaintiffs cross-moving for leave to amend if they could procure the requisite member consents to be able to cause the Company to cure its default and to reassert its claims directly – thereby mooting the need for derivative claims (*see id.* at 2). It is undisputed that they have done so (*see* Dkt. 251).

On June 21, 2018, defendants made these motions to dismiss the FAC, and on July 23, 2018, plaintiffs cross-moved for leave file the PSAC. After the motions were fully briefed, by order dated August 13, 2018 (Dkt. 267), the court lifted the discovery stay.

[6] The court does not understand why defendants continue to raise this issue as it is undisputed that the Company is once again an active Delaware LLC and thus has standing to prosecute its claims (*see* Dkt. 187). As discussed at a previous conference, since the Cicos' plan was for the Company to get an interest in the New Building through Acquisition, the Company needed to remain an active LLC. Thus, defendants' complaints about the revival of the Company are baseless.

The PSAC

The PSAC (Dkt. 254) contains four causes of action: (1) breach of the Operating Agreement, asserted by the Company against the Cicos; (2) breach of fiduciary duty, asserted by the Company against the Cicos;[7] (3) fraud, asserted by the Remaining Member Plaintiffs against the Cicos; and (4) inspection of the Company's books and records, asserted by the Remaining Member Plaintiffs against the Cicos.[8]

Plaintiffs allege that the Cicos breached multiple provisions of the Operating Agreement. First are the provisions governing the propriety of use of the sale proceeds to invest in the New Building. Section 1.3 of the Operating Agreement provides:

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[7] The PSAC's ad damnum clause makes it clear that this claim is only being asserted by the Company (PSAC at 35 ["On Count Two, compensatory damages" to the Company).

[8] Though the causes of action listed in the PSAC are purportedly asserted by all plaintiffs, the court has relabeled them in a manner consistent with the February 2018 Decision. Because a books and records claim is inherently direct and the Remaining Member Plaintiffs indisputably have books-and-records rights under section 6.1 of the Operating Agreement (*see* Dkt. 199 at 22), the court permits this claim even though it was not contemplated by the February 2018 Decision. By contrast, the first cause of action seeking damages on behalf of the Remaining Member Plaintiffs is completely inconsistent with the February 2018 Decision and thus is not permitted. To be sure, there are components of the breach of contract claim that superficially appear to implicate the Remaining Member Plaintiffs' individual rights, such as their claim that the Company should have been dissolved and the proceeds of the sale distributed to them on a pro rata basis. However, the proceeds are now held by the seller on behalf of Acquisition, and thus there is nothing for the Company to distribute. Hence, the Company must seek to recover from the Cicos (or, in a best-case scenario, get the money back from the seller), and any money recovered would be distributed to the members on a pro rata basis. Accordingly, the Remaining Member Plaintiffs lack a claim to the proceeds that is distinct from the other members, which renders their claim classically derivative (*see Tooley v Donaldson, Lufkin & Jenrette, Inc.*, 845 A2d 1031, 1033 [Del 2004]; *accord NAF Holdings, LLC v Li & Fung (Trading) Ltd.*, 118 A3d 175, 180 [Del 2015]). Finally, while it is unclear what Acquisition did wrong, it is a necessary party since it constructively possesses the sale proceeds, which are being held in its name by the seller. The court does not, however, read the PSAC as seeking any other damages from Acquisition, especially since it appears the Company is (or should be) a member of Acquisition.

> The purpose of the Company is to ***acquire***, hold, manage, operate, finance, develop, maintain, and sell ***the Property and other real property*** and personal property related thereto. The Company shall have the authority to do all things necessary or convenient to accomplish its purpose and operate its business as described in this Section. ***The Company shall exist only for the purpose specified in this Section, and may not conduct any other business without the unanimous consent of the Members***. The authority granted to the Managers hereunder to bind the Company shall be limited to actions necessary, appropriate or convenient to this business (Dkt. 199 at 2 [emphasis added]). [9]

Plaintiffs claim that the Company's investment in Acquisition--another LLC--to acquire a beneficial interest in the New Building, which would be purchased, in part, with the sale proceeds of the Building, is not an acquisition of "other real property" within the meaning of section 1.3. Likewise, plaintiffs claim that since the Building was the Company's only asset, the sale proceeds should have been distributed to the Company's members pursuant to section 8.1(b), which states that the Company is to be dissolved upon "the sale of ***all of the Company's assets*** and the collection and distribution of all proceeds therefrom" (*see id.* at 24 [emphasis added]). Relatedly, section 8.1(d) provides that dissolution is required upon "the occurrence of any event ***which makes it unlawful for the business of the Company to be carried on***" (*see id.* [emphasis added]). As noted, after the Company purchased the Building, its short-term rental business became illegal. According to plaintiffs, the 2012 law rendering the Company's business illegal "triggered the obligation under [section 8.1] to dissolve [the Company]" (PSAC ¶ 87). Plaintiffs claim that, read in conjunction, sections 1.3 and 8.1 obligated the Cicos to distribute the

[9] While it appears undisputed that some of the members approved the sale, and while the minutes of the May 28, 2013 meeting state that there was unanimous approval (*see* Dkt. 202 at 2), the minutes reflect that only 62.1% of the members were present (*see id.* at 1). Thus, there does not appear to have been unanimous consent as required by section 1.3.

sale proceeds instead of using them to invest in another building for another business purpose.

Separate and apart from the claims concerning the New Building, the Cicos allegedly violated multiple provisions of the Operating Agreement by, among other things: (1) failing to make mandatory distributions under section 4.1 (*see id.* at 9); (2) engaging in interested transactions in violation of section 5.5(b) without procuring the requisite unanimous consent under section 5.7 (*see id.* at 16-17); (3) providing false information regarding the sale proceeds in violation of section 5.13(ii) (*see id.* at 18); and (4) failing to provide the financial records required by sections 6.2 and 6.3 (*see id.* at 23).

The Cicos, moreover, are alleged to have breached both their fiduciary duties of loyalty and care. They allegedly beached their duty of loyalty by engaging in conflicted transactions (i.e., triggering entire fairness scrutiny) by, among other things: (1) causing the Company to borrow money from the Cicos at an excessive interest rate;[10] and (2) paying marketing fees to a company called USABound, an entity owned by the Cicos, because the Cicos' compensation is capped by section 5.8 (*see* Dkt. 199 at 17).[11] They allegedly beached their duty of care, for instance, by using the sale proceeds as a down

[10] *See* PSAC ¶ 90 (alleging Carla and an LLC controlled by the Cicos loaned money to the Company "on terms still not fully known to Plaintiffs but, which, on information and belief, were taken at 10% annual interest at a time when interest rates were a small fraction of that rate").

[11] Defendants contend that USABound's role was disclosed during the May 15, 2013 call (*see* Dkt. 206 at 15-16). But USABound is not mentioned in the minutes (*see* Dkt. 201 at 1-4).

payment on the New Building without having procured nearly enough financing to close, thereby risking forfeiture of the down payment.[12]

The Cicos also allegedly committed fraud at the outset by lying about their intentions of making distributions and later by misrepresenting the status of the sale proceeds.[13]

Threshold & Moot Issues

Defendants argue that this court lacks subject matter jurisdiction over this action because plaintiffs' claims concern the internal affairs of a Delaware LLC (*see* Dkt. 233 at 14). While they recognize that "the Operating Agreement does not have a forum selection clause" (*id.*), they contend that since the Operating Agreement is governed by Delaware law, Delaware courts have exclusive jurisdiction over the case (*see id.* at 14-15). Defendants are wrong. Disputes concerning the internal affairs of Delaware LLCs

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[12] Plaintiffs allege "[o]ther examples of the Cicos' waste of assets, mismanagement, and breaches of fiduciary duty, much of which was only recently disclosed for the first time by Defendants in this litigation, include[ing] … "numerous New York City building department and other violation penalties, interest, and expenses on the Property," "overdue debts to contractors and vendors for the Property" and "excessive, unjustified alleged expense reimbursements to Benedetto Cico without adequate back-up" (*see* PSAC ¶ 119). The 38-page PSAC contains extensive factual detail concerning the Cicos' alleged malfeasance. Since not all of the factual allegations are addressed by defendants in opposition to plaintiffs' cross-motion for leave to amend, in the interest of brevity, the court will not do so either. Omission of such detail should not be taken as an indication of the relative importance of such allegations. Discussion of these allegations is simply not necessary to determine whether leave to amend should be granted.

[13] For instance, plaintiffs allege that the Cicos made numerous misrepresentations, including that "The sales price of the [Building] was $11.8 million, when in fact it was $10 million;" that the Company "was in possession of the proceeds of the sale of the [Building] and other assets totaling over $3 million, when in fact [the Company] had less than $750,000 and was in possession of none of it;" and that "a bank in Riga, Latvia was in possession of over $3 million of [the Company's] assets, when in fact this was completely false and appears to be based on a document purporting to be a wire confirmation email from the Latvian bank that was forged by Mr. Cico and sent to certain investors" of the Company (*see* PSAC ¶ 127).

are routinely litigated in New York (*see, e.g., Estate of Calderwood v ACE Grp. Int'l LLC*, 157 AD3d 190, 194 [1st Dept 2017]; *Wandel v Dimon*, 135 AD3d 515, 515-16 [1st Dept 2016] [assessing whether demand futility is properly pleaded under Delaware law]). To be sure, there are certain types of actions, such as dissolution proceedings, that must be brought in Delaware (*see Otto v Otto*, 110 AD3d 620 [1st Dept 2013]). However, unlike claims concerning the status of an LLC, claims between members concerning the LLC's internal affairs may be brought in New York (*see Capone v Castleton Commodities Int'l LLC*, 2016 WL 1222163, at *3-6 [Sup Ct, NY County Mar. 29, 2016], *affd* 148 AD3d 506 [1st Dept 2017]).

Equally baseless is defendants' continued contention that plaintiffs lack standing because the Company was an inactive LLC. That is no longer the case (*see* Dkt. 187); thus, plaintiffs have standing (*see Capone v LDH Mgmt. Holdings LLC*, 2018 WL 1956282, at *7, *13 [Del Ch Apr. 25, 2018]).

Next, defendants' arguments concerning the pleading sufficiency of the derivative claims in the FAC are moot as the Company will be asserting these claims directly. Demand futility and issues related to whether plaintiffs are adequate representatives are therefore inapposite.

Defendants also argue that the court's prior dismissal of the direct claims of the Company and the Remaining Member Plaintiffs precludes the Company from curing its default and reasserting its direct claims. Again, defendants are wrong. The only claims dismissed with prejudice were the direct claims of two of the Company's members,

Anchor Holdings Ltd. and AFIL, Srl (February 2018 Decision at 5). The rest of the claims were explicitly dismissed ***without*** prejudice (*see id.*).[14]

Leave to Amend

Leave to amend should be granted freely unless the proposed amendment is palpably devoid of merit or would cause undue prejudice (*McGhee v Odell*, 96 AD3d 449, 450 [1st Dept 2012]).[15] With one exception, the causes of action in the PSAC do not clearly lack merit.[16]

To begin, the parties dispute whether section 1.3, which authorizes the Company to acquire "other real property," allowed the Cicos to pursue the proposed transaction involving the New Building. While the New Building is obviously real property, section 1.3 cannot be read in insolation (*Kuhn Const., Inc. v Diamond State Port Corp.*, 990 A2d 393, 396-97 [Del 2010] ["We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the contract mere surplusage"];

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[14] Defendants also refer to a nonexistent "default judgment" that supposedly must be vacated before the Company can reassert its claims (*see* Dkt. 264 at 11). No judgment has been entered in this action, nor have defendants sought the entry of judgment (even against the plaintiffs whose claims were dismissed with prejudice). There is good cause, moreover, for the Company to have sought to reassert its claims now that the requisite member consents have been procured.

[15] In keeping with their propensity for advocating clearly erroneous legal arguments, defendants contend that submission of a proposed meritorious pleading is not enough, but that plaintiffs were required to submit an affidavit of merit and supporting proof (*see* Dkt. 264 at 12). It is now settled law in the First Department such contentions are wrong (*Hickey v Kaufman*, 156 AD3d 436 [1st Dept 2017]; *see Boliak v Reilly*, 161 AD3d 625 [1st Dept 2018] ["Plaintiffs were not required to submit an affidavit of merit or make any other evidentiary showing in support of their motion"]).

[16] Because leave to amend is granted, there is no need to address whether the FAC should be dismissed. In deciding whether the claims in the PSAC have merit, the court considers the arguments in defendants' opening briefs on their motions to dismiss, as they directly bear on the validity of the proposed claims.

see Chicago Bridge & Iron Co. N.V. v Westinghouse Elec. Co. LLC, 166 A3d 912, 927 n.61 [Del 2017] [collecting cases]). Rather, it must be read in conjunction with section 8.1(d), which requires dissolution of the Company if its business becomes illegal – ***which occurred prior to the sale of Building***.

To be sure, even assuming that section 8.1(d) did not require an immediate dissolution, the Cicos' contention that section 1.3 definitively authorizes the Company's investment in the New Building is incorrect. The Cicos did not merely have the Company purchase another building. Rather, they used the sale proceeds as a down payment on the New Building, the purchase of which requires millions of additional dollars of funding from new investors. In essence, the Cico were signing the Company and its members up for a new venture in which they would be minority stakeholders in Acquisition. This is hardly a routine real estate transaction, as the very nature of the members' investment was fundamentally changing. The Company's members would be forced into a new business with new investors and have different rights. Plaintiffs reasonably contend that this is impermissible under section 1.3 absent unanimous member consent.

Yet, even if defendants' interpretation of section 1.3 were more persuasive, the court cannot resolve the parties' competing interpretations on a motion to dismiss, let alone on a motion for leave to amend (*Fortis Advisors LLC v Stora Enso AB*, 2018 WL 3814929, at *3 [Del Ch Aug. 10, 2018] [dismissal permitted only if defendant's interpretation of the contract "is the *only* reasonable interpretation"]; *see Calderwood*,

157 AD3d at 196 ["ambiguity exists when the provisions in controversy are fairly susceptible of different interpretations or may have two or more different meanings"], quoting *Nicholas v Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 83 A3d 731, 735 [Del 2013]). Accordingly, plaintiffs' claim that the Cicos violated section 1.3 is not clearly devoid of merit.[17]

Defendants, moreover, have not established that plaintiffs' other breach-of-contract claims are entirely without merit.[18] Rather, they merely argue that the breach-of-

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[17] The Cicos further argue that, especially in light of the ambiguity, their decision to invest the sale proceeds in the New Building cannot give rise to liability under the Operating Agreement's exculpatory clause in section 5.10(b) (*see* Dkt. 199 at 17-18). However, in light of the allegations that the Cicos lied on multiple occasions about the status of that deal and the amount in escrow, plaintiffs have raised a question of whether the Cicos acted in bad faith (*see id.* at 18 [managers exculpated only if they acted in "good faith"]). Indeed, under Delaware law, operating agreements cannot exculpate managers for bad faith (*Wood v Baum*, 953 A2d 136, 141 [Del 2008]). It is unclear that the exculpatory clause provides them with a defense and the claim is not clearly devoid of merit. Likewise, defendants have not demonstrated that plaintiffs' claims are barred by the statute of limitations. While defendants argue that Delaware's three-year limitations period applies, they do not address when any of the claims specifically accrued (*see* Dkt. 261 at 14). They merely state in a footnote, in conclusory fashion, that all of the claims "arose more than three years ago" (*see id.* n 7). While this is not a sufficient basis to procure a statute of limitations dismissal, it bears mentioning that defendants, initially, erroneously suggested that the limitations period is to be calculated from February 21, 2018, when the court dismissed the complaint (*see id.*). But then defendants themselves recognize that the relation-back doctrine (see CPLR 203[f]) would render the claims timely because this action was originally commenced in May 2016 (*see id.* n 8; *see also* Dkt. 262 at 5-6 [claims also are timely under CPLR 205(a)]). While many of the events allegedly occurred after May 2013, the PSAC clearly takes issue with the Cicos' conduct going back to the outset of the parties' relationship in 2007. Nonetheless, because defendants failed to specifically explain which claims are supposedly time-barred by setting forth their accrual dates, the court will not do so *sua sponte*. Defendants are free to plead a statute-of-limitations affirmative defense and later move for summary judgment.

[18] Defendants attempt to do so by proffering their own version of facts about, for instance, the money available for distribution. But since plaintiffs do not have complete financial transparency, defendants have not shown the claims to be entirely be without merit. After discovery, defendants can revisit this issue on summary judgment.

contract claims are duplicative of the breach of fiduciary duty claims. Defendants are only partially correct.

Under Delaware law, which applies to the Operating Agreement (*see* Dkt. 199 at 28) and governs the internal affairs of the Company (*see Davis v Scottish Re Group Ltd.*, 30 NY3d 247, 253 [2017]), claims for express breaches of an operating agreement are properly pleaded as breaches of contract while claims that a managing member breached his duties of care and loyalty may be separately pleaded as breaches of fiduciary duty (*see AM Gen. Holdings LLC v Renco Grp., Inc.*, 2013 WL 5863010, at *10 [Del Ch Oct. 31, 2013]). The claims will be considered duplicative if they arise from the same set of facts, but not if the facts underlying the fiduciary duty claims are broader so long as the contract itself does not expressly govern the issues (*MHS Capital LLC v Goggin*, 2018 WL 2149718, at *8 [Del Ch May 10, 2018]; *see Nemec v Shrader*, 991 A2d 1120, 1129 [Del 2010]).

In that regard, the Company has stated a claim against the Cicos for breaching their fiduciary duties to the Company while they served as its managers. It well settled that, unless expressly disclaimed in an operating agreement, an LLC's managers owe the company default fiduciary duties of care and loyalty (*CSH Theatres, L.L.C. v Nederlander of San Francisco Associates*, 2018 WL 3646817, at *21 [Del Ch July 31, 2018], citing *Auriga Capital Corp. v Gatz Properties*, 40 A3d 839, 851 [Del Ch 2012], *affd* 59 A3d 1206 [Del 2012]). The Operating Agreement expressly reaffirms the Cicos'

fiduciary duties (*see* Dkt. 199 at 18). The alleged fiduciary breaches, which the Cicos' have not disproven on this motion, are not clearly without merit.[19]

Nevertheless, the claim against the Cicos for lending the Company money at an egregious interest rate is duplicative. Section 3.3 of the Operating Agreement expressly governs the interest rate that the Cicos could charge the Company (*see* Dkt. 199 at 8). It provides the Cicos discretion on the interest rate; thus, they were obligated to set that rate in good faith (6 *Del C* § 18-1101[e] ["a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing"]; *see Morris v Spectra Energy Partners (De) GP, LP*, 2017 WL 2774559, at *17 [Del Ch June 27, 2017]; *Auriga*, 40 A3d at 851). However, since the express terms of section 3.3 and the implied covenant will determine the propriety of the terms of the loan, a separate fiduciary duty

[19] Unless they prove that the allegedly conflicted transactions were approved by a majority of the unconflicted members (*see Matter of Cyan, Inc. Stockholders Litig.*, 2017 WL 1956955, at *7 [Del Ch May 11, 2017], citing *Corwin v KKR Fin. Holdings LLC*, 125 A3d 304, 308 [Del 2015]), the Cicos must prove that such transactions were entirely fair to the Company (*Kahn v Lynch Commc'n Sys., Inc.*, 638 A2d 1110, 1115 [Del 1994]; *Matter of Straight Path Communications Inc. Consol. Stockholder Litig.*, 2018 WL 3120804, at *14 [Del Ch June 25, 2018] ["Conflicted transactions include those in which the controller stands on both sides of the deal"]; *see Matter of Kinder Morgan, Inc. Corp. Reorganization Litig.*, 2015 WL 4975270, at *10 [Del Ch Aug. 20, 2015] ["If conflicted fiduciaries make the determination, entire fairness typically applies"], *affd sub nom. The Haynes Family Tr. v Kinder Morgan G.P., Inc.*, 135 A3d 76 [Del 2016]; *see also Oliver v Boston Univ.*, 2006 WL 1064169, at *18 [Del Ch Apr. 14, 2006] ["The entire fairness inquiry has two basic aspects: (1) fair dealing or fair process and (2) fair price"]; *Ross Holding & Mgmt. Co. v Advance Realty Grp., LLC*, 2014 WL 4374261, at *17 [Del Ch Sept. 4, 2014]). The Cicos contend that section 5.6(a) of the Operating Agreement permits them to engage in competing ventures (*see* Dkt. 199 at 16). They are correct only to the extent that their operation of USABound was not, in and of itself, wrongful. The Operating Agreement, however, does not expressly permit the Cicos to unilaterally cause the Company to enter into conflicted transactions with their competing companies. Rather, section 5.7 requires prior consent of all of members (*see* Dkt. 199 at 17). Absent such consent, the Cicos' compensation is capped by section 5.8 (*see id.*).

claim on this issue is not viable (*see AM Gen. Holdings*, 2013 WL 5863010, at *10). Likewise, the claim that the Cicos contracted with USABound turns on whether they procured unanimous member approval in accordance with section 5.7. This allegation too cannot support a duplicative fiduciary duty claim.

The remainder of the breach-of-fiduciary-duty claims (*see* Dkt. 260 at 19-20) are not duplicative, as they seek redress for alleged wrongs not expressly prohibited by the Operating Agreement, which are inconsistent with the Cicos' duties of care and loyalty (*see Perella Weinberg Partners LLC v Kramer*, 153 AD3d 443, 450 [1st Dept 2017], citing *PT China LLC v PT Korea LLC*, 2010 WL 761145, at *7 [Del Ch Feb. 26, 2010]).

The Remaining Member Plaintiffs, however, have not stated a claim for fraud.[20] To do so, they must plead, with particularity (*see* CPLR 3016[b]), "a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance … and damages" (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). The Remaining Member Plaintiffs' claim that, at the outset, the Cicos lied about their intention to pay a particular return on their investment is infirm because the Operating Agreement expressly provides if, when, and how much of a return they are entitled to (Dkt. 199 at 9-13; *see Perrotti v Becker, Glynn, Melamed & Muffly LLP*, 82 AD3d 495, 498 [1st Dept 2011] ["a party claiming fraudulent inducement cannot be said to have justifiably relied on a representation when that very representation is

[20] The parties assume that the fraud claim is governed by New York law (*see* Dkt. 206 at 28). Though the court is unconvinced (*see Access Am. Fund, LP v Oriental Dragon Corp.*, 2016 WL 6459510, at *2 [Sup Ct, NY County Oct. 31, 2016]), the parties' failure to point to any conflict of law permits application of New York law here (*see TBA Global, LLC v Proscenium Events, LLC*, 114 AD3d 571, 572 [1st Dept 2014]).

negated by the terms of a contract executed by the allegedly defrauded party"]; *see also Pacnet Network Ltd. v KDDI Corp.*, 78 AD3d 478, 479 [1st Dept 2010] ["since the language of the contract [] contradicts plaintiff's allegations that it relied on defendant's predictions ..., those allegations are not presumed to be true"]). At most, this is a claim about the Cicos being insincere about their intention of abiding by the Operating Agreement (*see Perella*, 153 AD3d at 449 ["General allegations of lack of intent to perform are insufficient; rather, facts must be alleged establishing that the adverse party, ***at the time of making the promissory representation***, never intended to honor the promise"] [emphasis added]).[21] The Remaining Member Plaintiffs do not allege any specific facts from which it can be reasonably inferred that the Cicos fraudulently induced their investment. Rather, they merely claim that, years later, the Cicos engaged in malfeasance. Under these circumstances, a reasonable inference of scienter cannot be inferred (*see Aozora Bank, Ltd. v J.P. Morgan Secs. LLC*, 144 AD3d 440, 441 [1st Dept 2016]).

Finally, the Remaining Member Plaintiffs' claim that the Cicos lied about the status of the sale proceeds is derivative because the proceeds belong to the Company.

[21] There are other problems with this claim, such as the failure to allege loss causation (*see Basis PAC-Rim Opportunity Fund (Master) v TCW Asset Mgmt. Co.*, 149 AD3d 146, 149 [1st Dept 2017]). Simply put, it is apparent that the principal reason the Company lost money was due to its business becoming illegal *after* everyone's investment, thereby impairing the Company's ability to pay off its mortgage. This, of course, does not excuse the Cicos' other alleged bad acts, which allegedly caused losses in addition to those caused by the failure of the Company's business (and the fact that after October 2007 the real-estate market crashed).

Thus, even assuming each of the elements of fraud are well pleaded,[22] the claim is duplicative of the breach of fiduciary claim (*Pai v Blue Man Group Pub., LLC*, 151 AD3d 456, 457 [1st Dept 2017]; *see* Dkt. 260 at 20 [identifying misrepresentations regarding the New Building as part of fiduciary duty claim]).[23]

Defendants' remaining arguments are either moot or clearly lack merit and are rejected. Accordingly, it is

ORDERED that plaintiffs' cross-motion for leave to amend is granted only to the extent that, within one week of entry of this order, plaintiffs shall e-file a second amended complaint containing only the PSAC's first and second causes of action asserted on behalf of the Company (the latter of which is to exclude claims concerning the loans from the Cicos and the fees paid to USABound) and the fourth cause of action asserted on behalf of the Remaining Member Plaintiffs; and it is further

ORDERED that defendants shall respond to the second amended complaint within three weeks after it is filed; and it is further

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[22] Plaintiffs have not pleaded any "out-of-pocket" loss because the alleged misrepresentations occurred after the funds were put in escrow (*see Connaughton v Chipotle Mexican Grill, Inc.*, 135 AD3d 535, 538 [1st Dept 2016], *affd* 29 NY3d 137 [2017]).

[23] Carla does not, on this motion, seek dismissal for lack of personal jurisdiction or based on *forum non conveniens* (*see* Dkt. 233 at 2). However, the court reiterates that such arguments would lack merit because the PSAC's allegations concern her role as manager of an LLC that owned real property in New York (*see* February 2018 Decision at 5 n 9).

ORDERED that that defendants' motions to dismiss the first amended complaint are denied for the reasons stated in this decision.

Dated: October 30, 2018

ENTER:

Jennifer G. Schecter, J.S.C.