Shapiro v Ettenson
2019 NY Slip Op 33793(U)
December 23, 2019
Supreme Court, New York County
Docket Number: 654641/2017
Judge: David Benjamin Cohen

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: I.A.S. PART 58

ROBERT SHAPIRO, individually and derivatively on behalf of ENS HEALTH, LLC,

Plaintiff,

- against -

GABRIEL ETTENSON, DAVID NEWMAN and ENS HEALTH, LLC,

Defendants.

DECISION AND ORDER

Index No. 654641/2017

DAVID B. COHEN, J.:

Plaintiff Robert Shapiro brings this action asserting direct and derivative claims for breach of contract and breach of fiduciary duty, among other causes of action, against defendants Gabriel Ettenson (Ettenson) and David Newman (Newman) (together, defendants) and ENS Health, LLC (ENS). In motion sequence no. 002, defendants move, pursuant to CPLR 3211 (a) (1), (3), (5) and (7), for pre-answer dismissal of the complaint and for an award of attorneys' fees. Plaintiff opposes the application and cross-moves, pursuant to CPLR 3025, for leave to amend the complaint. In motion sequence no. 003, plaintiff moves, pursuant to CPLR 3215, for a default judgment against ENS. Motion sequence nos. 002 and 003 are consolidated for disposition.

BACKGROUND

According to the complaint, plaintiff and defendants formed ENS in January 2012 as a New York limited liability company, in which each owned a one-third share, to distribute physical therapy equipment (NY St Cts Elec Filing [NYSCEF] Doc No. 38, affirmation of defendants' counsel, exhibit J, complaint ¶¶ 5-7). ENS operated without a written agreement until December 13, 2013, when defendants adopted an operating agreement (the Operating Agreement) without notifying plaintiff or obtaining his consent (*id.*, ¶ 42). A dispute over the validity of the Operating

Agreement formed the subject of a prior action between plaintiff and defendants titled *Shapiro v Ettenson*, Sup Ct, index No. 653571/2014 (*Shapiro I*) (*id.*, ¶ 54), and resulted in a declaration that the Operating Agreement was properly adopted and that its provisions were valid and binding upon ENS and its members (*see Shapiro v Ettenson*, 2015 NY Slip Op 31670 [U], *14 [Sup Ct, NY County 2015], *affd as mod* 146 AD3d 650 [1st Dept 2017], *lv denied* 29 NY3d 915 [2017]). On January 24, 2017, the Appellate Division, First Department, modified that part of the trial court's judgment declaring as valid the payment of salaries to ENS's members and the reduction of plaintiff's salary because those actions were "precluded by section 9.01 of the operating agreement" (*Shapiro*, 146 AD3d at 650).

Shortly thereafter, defendants invoked Article XIII of the Operating Agreement, which governs the disassociation of members, and voted to expel plaintiff from ENS. By letter dated January 31, 2017, defendants informed plaintiff of his termination pursuant to sections 13.03(a)(ii) and (iv) (NYSCEF Doc No. 32, affirmation of defendants' counsel, exhibit D at 1). The relevant portions of section 13.03(a) read, in part:

> "A Member may be expelled from the Company by a Majority of the Members if, in the reasonable determination of such Majority of the Members, and upon written notice provided, such Member (the 'Expelled Member') ... (ii) has failed or refused to perform his duties and responsibilities as a Member or Manager, and such failure to refusal is not cured by the Expelled Member within thirty (30) days after written notice thereof ... (iv) engages in unauthorized or other bad faith conduct which has a material adverse impact on the business or affairs of the Company"

(NYSCEF Doc No. 31, affirmation of defendants' counsel, exhibit C at 21-22). Section 13.03(b)(ii) provides that a termination under section 13.03(a)(iv) is effective upon the delivery of written notice to the member (*id.* at 22). In the event a member is expelled, sections 13.03(c) and (d) state, in relevant part:

> "(c) The Company shall completely redeem the Membership Interest of an Expelled Member by paying an amount equal to Fair Value Amount. The remaining Members and the Expelled Member shall endeavor in good faith to reach an agreement upon the Fair Value Amount and payment terms (the 'Expulsion Redemption Terms') by not later than thirty (30) days after the Expulsion Date.
>
> (d) Any dispute between or among an Expelled Member and Company and/or the remaining Members of the Company arising out of or related to the expulsion of a Member, including any dispute concerning the Expulsion Redemption Terms, shall be settled by final, binding arbitration ..."

(*id.* at 22-23).

Defendants' January 31, 2017 letter noted there was no right to cure if the expulsion was predicated on plaintiff having engaged in unauthorized or other bad faith conduct under section 13.03(a)(iv) (NYSCEF Doc No. 32 at 3). They offered to pay plaintiff $76,900, or the fair value of his interest in ENS, within 60 days pending his agreement to that amount (*id.*). The letter also emphasized the "parties are required to endeavor in good faith to reach an agreement upon the Expulsion Redemption Terms by not later than thirty days of the date of this letter" (*id.*).

Plaintiff responded by letter dated February 24, 2017, calling the attempt to expel him "baseless" and "vindictive" (NYSCEF Doc No. 33, affirmation of defendants' counsel, exhibit E at 1). In addition to contesting the bases for his expulsion, plaintiff observed that defendants had yet to reimburse ENS for their salaries and expenses (*id.*). Plaintiff did not challenge the proposed fair valuation of his membership interest, nor did he propose an alternative amount.

By letter dated March 8, 2017, defendants advised plaintiff that the decision issued by the First Department did not require them to return their salaries (NYSCEF Doc No. 34, affirmation of defendants' counsel, exhibit F at 1). Defendants further observed that even if they reimbursed ENS, no distributions had ever been made to its members. Therefore, as a former member, plaintiff

cannot lay claim to any future distributions (*id.*). Lastly, because he did not provide a counteroffer for the fair value of his interest, he was bound to the valuation set forth in the January 31 letter.

Meanwhile, on March 20, 2017, the First Department denied plaintiff's application for a stay enjoining defendants from expelling him from ENS (NYSCEF Doc No. 35, affirmation of defendants' counsel, exhibit G at 1). On April 11, 2017, the First Department denied plaintiff's application for leave to reargue or for leave to appeal its January 24, 2017 decision to the Court of Appeals (NYSCEF Doc No. 36, affirmation of defendants' counsel, exhibit H at 1). On June 29, 2017, the Court of Appeals denied plaintiff's application for leave to appeal (NYSCEF Doc No. 37, affirmation of defendants' counsel, exhibit I at 2).

Plaintiff commenced the present action by filing a summons and complaint on July 5, 2017. The amended complaint pleads the following causes of action: (1) a derivative claim on behalf of ENS for breach of the implied covenant of good faith and fair dealing because defendants failed to return their salaries and expenses to ENS; (2) a direct claim for breach of contract for failing to submit the dispute concerning plaintiff's expulsion to arbitration, thereby depriving him of his pro rata share of distributions; (3) a direct claim for the impressment of a constructive trust on funds diverted from ENS; (4) a direct claim for fraudulent conveyance; (5) a direct claim for an accounting; (6) a direct claim for breach of fiduciary duty; and (7) a derivative claim for breach of fiduciary duty.

DISCUSSION

Motion Sequence No. 002

At the outset, plaintiff concedes that the third cause of action for a constructive trust is a derivative claim, as evidenced by his cross motion to amend his complaint. Thus, the court will not address the third cause of action as a "direct" claim.

A. CPLR 3211 (a) (7) (Failure to State a Claim)

Defendants submit that the complaint fails to plead direct claims for fraudulent conveyance and for an accounting and fails to plead direct and derivative claims for breach of fiduciary duty.

When a motion is brought under CPLR 3211 (a) (7), the court must "accept the facts as alleged in the complaint as true, accord the plaintiff the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994] [citations omitted]). The motion will be denied "if from its four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law" (*Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977]). Allegations that are ambiguous must be resolved in plaintiff's favor (*see JF Capital Advisors, LLC v Lightstone Group, LLC*, 25 NY3d 759, 764 [2015]). However, "the court is not required to accept factual allegations that are plainly contradicted by the documentary evidence or legal conclusions that are unsupportable based upon the undisputed facts" (*Robinson v Robinson*, 303 AD2d 234, 235 [1st Dept 2003]). "When documentary evidence is submitted by a defendant 'the standard morphs from whether the plaintiff stated a cause of action to whether it has one'" (*Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 [1st Dept 2014] [internal citation omitted]).

The fourth cause of action for fraudulent conveyance asserts a direct claim under Debtor and Creditor Law §§ 273 and 276. However, conclusory allegations, made upon information and belief, as is the case here, are inadequate to sustain the claims (see *Carlyle, LLC v Quik Park 1633 Garage LLC*, 160 AD3d 476, 477 [1st Dept 2018]; *RTN Networks, LLC v Telco Group, Inc.*, 126 AD3d 477, 478 [1st Dept 2015] [dismissing a Debtor and Creditor Law § 276 claim where the claim was not pled with particularity under CPLR 3016 (b)]; *NTL Capital, LLC v Right Track Rec.*,

LLC, 73 AD3d 410, 412 [1st Dept 2010] [dismissing a Debtor and Creditor Law § 273 claim where the complaint contained "only legal conclusions and no specific factual allegations"]). Plaintiff alleges upon information and belief that defendants paid themselves from ENS's account when ENS was insolvent or rendered insolvent, but allegations of bare legal conclusions are insufficient (*Caniglia v Chicago Tribune-N.Y. News Syndicate*, 204 AD2d 233, 233-234 [1st Dept 1994]). Additionally, the allegations show that ENS retained a positive balance in its bank account, thereby defeating any claim of insolvency. Thus, the fourth cause of action is dismissed.

The fifth cause of action seeks an accounting of the funds defendants diverted from ENS, and is dismissed, as discussed further below.

The sixth and seventh causes of action plead direct and derivative claims for breach of fiduciary duty. "A fiduciary relationship 'exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation'" (*see EBC I, Inc. v Goldman, Sachs & Co.*, 5 NY3d 11, 19 [2005] [internal citation omitted]). Therefore, to plead a breach of fiduciary duty, the plaintiff "must the prove the existence of a fiduciary relationship, misconduct by the other party, and damages directly caused by that party's misconduct" (*Pokoik v Pokoik*, 115 AD3d 428, 429 [1st Dept 2014]). Under the terms of the Operating Agreement, plaintiff and defendants each own an equal share in ENS and each serve as a managing member. As such, each owed a fiduciary duty to each other (*see* Limited Liability Company Law § 409 [a]), and contrary to defendants' contention, the duty does not run only from a managing member to a minority member (*see Jones v Voskresenskaya*, 125 AD3d 532, 533 [1st Dept 2015] [concluding that equal members of a limited liability company stand in a fiduciary relationship to each other and to the company]). However, a breach of fiduciary duty claim will be dismissed if it is duplicative of a breach of contract claim. Here, the fiduciary duty claims "are

premised upon the same facts and seek identical damages" as the breach of contract claims (*Chowaiki & Co. Fine Art Ltd. v Lacher*, 115 AD3d 600, 600 [1st Dept 2014]), and should be dismissed. The sixth cause of action is dismissed for the additional reason that the allegations concern harm sustained by ENS, which is a derivative claim, as discussed *infra*. Thus, the sixth and seventh causes of action are dismissed.

B. CPLR 3211 (a) (1) and (5) (Documentary Evidence, Res Judicata and Collateral Estoppel)

Defendants argue that the direct claims in the complaint are barred by res judicata and collateral estoppel. Submitted in support of the motion are copies of the complaint in *Shapiro I*, the judgment rendered in that action, and briefs filed by plaintiff in that action. The complaint reveals that plaintiff sought monetary damages for breach of contract, breach of the implied covenant of good faith and fair dealing and breach of fiduciary duty "in the amounts, if any, of any salary paid to defendants Ettenson and Newman which was in excess of any salary paid to plaintiff ... other than what was agreed to for the period October 1, 2013 through December 31, 2013" (NYSCEF Doc No. 39, affirmation of defendants' counsel, exhibit K at 11-12). Defendants maintain that the trial court dismissed plaintiff's claims for damages (*see Shapiro*, 2015 NY Slip Op 31670[U] *11-13), and this branch of the trial court's decision was not disturbed or modified on appeal (*see Shapiro*, 146 AD3d at 650).

Plaintiff argues that his direct claims are viable because the issue in *Shapiro I* concerned the validity of the Operating Agreement and the capital call, but in this action, he seeks "damages for Defendants' breach of same" (NYSCEF Doc No. 53, plaintiff's memorandum of law at 6).

Dismissal under CPLR 3211 (a) (1) is warranted "where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law" (*Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 [2002]). "[T]he paper's content must

be 'essentially undeniable and ... assuming the verity of [the paper] and the validity of its execution, will itself support the ground on which the motion is based" (*Amsterdam Hospitality Group, LLC v Marshall-Alan Assoc., Inc.*, 120 AD3d 431, 432 [1st Dept 2014] [citation omitted]). The court may dismiss a claim for res judicata or collateral estoppel under CPLR 3211 (a) (5).

"Res judicata or claim preclusion precludes successive litigation based on the same transaction or series of connected transactions if there is a valid and enforceable judgment and the party against whom the doctrine is invoked was a party to the previous action, or in privity with a party" (*Matter of Silvar v Commissioner of Labor of the State of N.Y.*, 175 AD3d 95, 103 [1st Dept 2019]). Because New York employs a transactional approach, whether a transaction or series of transactions forms a "factual grouping ... depends on how the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understandings or usage" (*Smith v Russell Sage Coll.*, 54 NY2d 185, 192-193 [1981], *rearg denied* 55 NY2d 878 [1982] [internal quotation marks and citation omitted]). As such, the doctrine bars claims that were actually litigated and those claims that could have been litigated (*Matter of Hunter*, 4 NY3d 260, 269 [2005]), and claims that are based on different theories or seek a different remedy (*O'Brien v City of Syracuse*, 54 NY2d 353, 357 [1981]). Res judicata, though, does not bar claims where "the requisite elements and proof required for the new claim vary materially from those of the claim in the prior action" (*Ginezra Assoc. LLC v Ifantopoulos*, 70 AD3d 427, 429 [1st Dept 2010] [internal quotation marks and citation omitted]). The doctrine also does not preclude claims that arise "*subsequent* to a prior action ... even if the new claim is premised on facts representing a continuance of the same course of conduct" (*UBS Sec. LLC v Highland Capital Mgt., L.P.*, 159 AD3d 512, 514 [1st Dept 2018], *lv dismissed* 32 NY3d 1080 [2018] [collecting cases]). The burden rests with the party seeking to

invoke the doctrine to show that res judicata precludes the subsequent action (*see Gomez v Brill Sec., Inc.*, 95 AD3d 32, 35 [1st Dept 2012]).

"Collateral estoppel, or issue preclusion, 'precludes a party from relitigating in a subsequent action or proceeding an issue clearly raised in a prior action or proceeding and decided against that party … whether or not the tribunals or causes of action are the same'" (*Ventur Group, LLC v Finnerty*, 80 AD3d 474, 475 [1st Dept 2011], quoting *Ryan v New York Tel. Co.*, 62 NY2d 494, 500 [1984]). The doctrine "applies only if the issue in the second action is identical to an issue which was raised, necessarily decided and material in the first action, and the plaintiff had a full and fair opportunity to litigate the issue in the earlier action" (*City of New York v Welsbach Elec. Corp.*, 9 NY3d 124, 128 [2007] [internal quotation marks and citation omitted]). The burden rests with the party seeking to invoke the doctrine "to demonstrate the identicality and decisiveness of the issue, while the burden rests upon the opponent to establish the absence of a full and fair opportunity to litigate the issue in [the] prior action or proceeding" (*Ryan*, 62 NY2d at 501]).

Here, the second cause of action regarding salary payments are duplicative of the claims in *Shapiro I*. In *Shapiro I*, plaintiff sought monetary damages based on the salaries paid in excess of the parties' verbal agreement (NYSCEF Doc No. 39, ¶¶ 31, 36, 40, 45). As noted earlier, the dismissal of the damages portion of the trial court's decision was not the subject of the appeal. Therefore, the claims concerning the payment of defendants' salaries arose of out of the same transaction as in *Shapiro I*, and are "grounded on the same gravamen of the wrong" (*Smith*, 54 NY2d at 192 [internal quotation marks and citation omitted]), and were actually litigated. Likewise, the issue of defendants' legal fees and expenses related to ENS's business should have been raised earlier, because sections 9.01 and 9.02 of the Operating Agreement appear to cover

those payments.[1] Thus, defendants have demonstrated that the claims related to the payment of defendants' salaries, legal fees and expenses are precluded by res judicata or collateral estoppel. Plaintiff's attempt to distinguish these damages is unavailing. Merely rephrasing his demand to plead claims for different or additional damages is inadequate because the trial court in *Shapiro I* denied and dismissed his damages predicated on breach of contract and fiduciary duty theories.

To the extent plaintiff argues that it is impermissible for defendants to rely on the pleadings filed in *Shapiro I*, the argument is without merit. Not only may the court take judicial notice of the verified complaint in *Shapiro I* (*see Curry v Hundreds of Hats, Inc.*, 146 AD3d 593, 593-594 [1st Dept 2017]), but the complaint in that action constitutes a judicial admission (*see Performance Comercial Importadora E Exportadora Ltda v Sewa Intl. Fashions Pvt. Ltd.*, 79 AD3d 673, 674 [1st Dept 2010]). Furthermore, plaintiff has not challenged the authenticity or veracity of the Operating Agreement or the letters annexed to defendants' motion, having referenced those same documents extensively in his complaint in the present action. Thus, that part of the second cause of action predicated on the payment of salaries, legal fees and business-related expenses must be dismissed under CPLR 3211 (a) (5).

The same rationale, though, does not apply to the claim concerning the monies paid in July 2017 to nonparty Elixinol LLC (Elixinol), a supplier of cannabidiol oil products (NYSCEF Doc No. 38, ¶¶ 36, 66 and 71), or for expenses unrelated to ENS's business (*id.*, ¶ 28). The complaint alleges that defendants worked for Elixinol and ENS at the same time and that defendants transferred funds to ENS after *Shapiro I* had concluded. Additionally, the payment of expenses unrelated to ENS's business was not raised in the prior action, although it is unclear when these

[1] Section 9.02 in the Operating Agreement, titled "Expenses," states that "[t]he Managers may be reimbursed by the Company for any direct out-of-pocket expenses incurred by the Managers on behalf of the Company in connection with the performance of their duties thereunder" (NYSCEF Doc No. 31 at 15).

payments occurred. Thus, plaintiff's claim seeking to recover these funds would have been premature (*see UBS Sec. LLC*, 159 AD3d at 513-514). Consequently, dismissal of the second cause of action pertaining to the money transferred to Elixinol or paid for unrelated business on the grounds of res judicata or collateral estoppel is denied.

C. CPLR 3211 (a) (3) (Legal Capacity to Sue)

The first cause of action pleads a derivative claim for breach of contract. Defendants contend that the second cause of action for breach of contract, third cause of action for a constructive trust, and fifth cause of action for an accounting also plead derivative, as opposed to direct, claims. Because plaintiff was expelled from ENS and failed to pursue the arbitration mandated in the Operating Agreement, defendants maintain that plaintiff waived his right to arbitration and can no longer challenge his expulsion or the valuation of his membership interest. As such, he lacks standing to assert any derivative claims.

Plaintiff, in response, posits that the derivative claims are viable. As to the first cause of action, he alleges that defendants breached the Operating Agreement by paying themselves a salary in contravention of the express terms of that agreement and reimbursing themselves for unrelated business expenses and their legal fees from ENS's funds. These same actions form the crux of the second, third, and fifth causes of action. He rejects the theory that an accounting claim may be pled only against managing members. A demand for an accounting is premised on the existence of a fiduciary relationship, and he and defendants owed each other a fiduciary duty. Lastly, plaintiff argues that defendants waived their right to arbitrate these issues by participating in this litigation.[2]

[2] The complaint alleges that the arbitration provision is unconstitutional (NYSCEF Doc No. 38, ¶ 107), but this issue was not raised on this motion. Even if plaintiff had raised it, the time to challenge that provision arose at the time he litigated *Shapiro I*, and therefore, he cannot now contest its validity. The court further notes that plaintiff had raised the constitutionality of the Operating Agreement in his briefs submitted to the

A motion brought under CPLR 3211 (a) (3) concerns a party's legal capacity to sue, which is premised "purely on the litigant's status" (*Security Pac. Natl. Bank v Evans*, 31 AD3d 278, 279 [1st Dept 2006], *appeal dismissed* 8 NY3d 837 [2007]).

"[M]embers of a limited liability company (LLC) may bring derivative suits on the LLC's behalf, even though there are no provisions governing such suits in the Limited Liability Company Law" (*Tzolis v Wolff*, 10 NY3d 100, 102 [2008]). A plaintiff asserting a derivative claim must have been a member of the limited liability company when the action is commenced (*see Kaminski v Sirera*, 169 AD3d 785, 787 [2d Dept 2019]; *MFB Realty LLC v Eichner*, 161 AD3d 661, 662 [1st Dept 2018]), and must maintain its status as a member to continue the litigation (*see Jacobs v Cartalemi*, 156 AD3d 605, 607 [2d Dept 2017]; *Herman v Herman*, 122 AD3d 506, 507 [1st Dept 2014]; *Cordts-Auth v Crunk, LLC*, 815 F Supp 2d 778, 786-787 [SD, NY 2011], *affd* 479 Fed Appx 375 [2d Cir 2012] [citing New York law that the plaintiff must have been a member at the time of the alleged wrong]).

Regarding corporations, while an individual shareholder cannot bring an action in his or her own name for a wrong committed against a corporation (*General Motors Acceptance Corp. v Kalkstein*, 101 AD2d 102, 105-106 [1st Dept 1984], *appeal dismissed* 63 NY2d 676 [1984]), the shareholder may maintain a direct claim if "the wrongdoer has breached a duty owed to the shareholder independent of any duty owing to the corporation wronged" (*Abrams v Donati*, 66 NY2d 951, 953 [1985]). In that event, the shareholder seeks redress for an injury personal to him or her (*see Yudell v Gilbert*, 99 AD3d 108, 113 [1st Dept 2012]). In determining whether a claim is a derivative or direct claim, the "court should consider '(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any

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First Department (NYSCEF Doc No. 42, affirmation of defendants' counsel, exhibit N, ¶¶ 19-21) and to the Court of Appeals (NYSCEF Doc No. 43, affirmation of defendants' counsel, exhibit O at 22).

[redacted]

recovery or other remedy (the corporation or the stockholders, individually)'" [*id.* at 114] [internal citation omitted]). This analysis applies equally to limited liability companies (*see Scott v Pro Mgt. Servs. Group, LLC*, 124 AD3d 454, 454 [1st Dept 2015]; *Najjar Group, LLC v West 56th Hotel LLC*, 110 AD3d 638, 638 [1st Dept 2013]). A complaint that confuses a shareholder's derivative and individual rights, though, will be dismissed (*see Abrams*, 66 NY2d at 953; *Serino v Lipper*, 123 AD3d 34, 40 [1st Dept 2014] [dismissing the plaintiff's individual claims because they were "embedded in the harm to the corporation"]).

At the outset, the court finds that the second cause of action pleads a direct claim because plaintiff seeks to vindicate his individual rights. To prevail on a cause of action for breach of contract, a plaintiff must prove the existence of a contract, the plaintiff's performance, the defendant's breach, and damages (*see Harris v Seward Park Hous. Corp.*, 79 AD3d 425, 426 [1st Dept 2010]). The complaint alleges that defendants failed to follow the disassociation procedures in the Operating Agreement (NYSCEF Doc No., ¶¶ 104-105, 108 and 110). In that regard, although plaintiff cannot recover any salary due to him (*see Shapiro*, 146 AD3d at 650), any judgment in his favor for an alleged breach would be personal to him, not ENS.

Defendants, though, have demonstrated that the fifth cause of action for an accounting is a derivative claim because any recovery would inure to the benefit of ENS, not plaintiff individually (*see Abrams*, 66 NY2d at 953 [finding that an allegation a director has diverted corporate assets for his or her own benefit pleads a derivative claim]; *Gordon v Credno*, 102 AD3d 584, 585 [1st Dept 2013] [stating that a diversion of assets to another corporation is a derivative claim]). An accounting claim is predicated upon a fiduciary relationship (*see Castellotti v Free*, 138 AD3d 198, 210 [1st Dept 2016]), and members of an LLC stand in a fiduciary relationship to each other (*see Jones*, 125 AD3d at 533). Although the accounting claim rests on a breach of that fiduciary

duty (*see Jacobs*, 156 AD3d at 608), any potential recovery would benefit ENS. Because the accounting claim was pled as a direct claim, it must be dismissed (*see Berardi v Berardi*, 108 AD3d 406, 407 [1st Dept 2013], *lv denied* 22 NY3d 861 [2014]).

Consequently, whether plaintiff may maintain the first and third causes of action turns on his expulsion from ENS. Based on the language contained in Article XIII of the Operating Agreement, arbitration is the proper forum in which plaintiff may challenge his expulsion, and defendants move for dismissal on that ground. But, "'[a]n agreement to arbitrate is not a defense to an action' and, thus, 'it may not be the basis for a motion to dismiss'" (*Carbon Capital Mgt., LLC v American Express Co.*, 88 AD3d 933, 940 [2d Dept 2011], quoting *Allied Bldg. Inspectors Intl. Union of Operating Engrs., Local Union No. 211, AFL-CIO v Office of Labor Relations of City of N.Y.*, 45 NY2d 735, 738 [1978]; *Ogoe v New York Hosp.*, 99 AD2d 968, 969 [1st Dept 1984] [stating that "[t]he mere existence of an arbitration clause in the contract would not authorize dismissal of the action"]). Therefore, the fact that the dispute over plaintiff's expulsion should have been arbitrated, standing alone, is no defense to plaintiff's complaint.

Defendants' argument that plaintiff failed to pursue arbitration is unpersuasive. It is a "long-standing rule that an arbitration clause in a written agreement is enforceable, even if the agreement is not signed, when it is evident that the parties intended to be bound by the contract" (*God's Battalion of Prayer Pentecostal Church, Inc. v Miele Assoc., LLP*, 6 NY3d 371, 373 [2006]). To that end, a written agreement must be construed according to the parties' intent (*see Greenfield v Philles Records*, 98 NY2d 562, 569 [2002]), and the words given their plain meaning (*see Ellington v EMI Music, Inc.*, 24 NY3d 239, 244 [2014]). Counter to defendants' assertion, section 13.03(d) does not place the burden of pursuing arbitration solely upon plaintiff. Rather, section 13.03(d)(i) provides, in relevant part, that the "remaining Members … and the Expelled

Member shall mutually agree upon and designate an arbitrator not later than forty five (45) days following the Expulsion Date" (NYSCEF Doc No. 31 at 23). Plaintiff's February 24, 2017 response to his expulsion should have alerted defendants to his intent to contest the issue, and under the plain reading of section 13.03(d), plaintiff and defendants were obligated to mutually select an arbitrator. Even though plaintiff did not submit a counteroffer on the value of his interest, nothing in section 13.03(d) precluded defendants from proposing a prospective arbitrator. Furthermore, if plaintiff rejected the arbitrator nominated by defendants, then section 13.03(d)(i) provides that "any party may apply to the American Arbitration Association, or any successor thereto, to designate a single arbitrator" (NYSCEF Doc No. 31 at 23). Defendants do not dispute that they failed to avail themselves of this provision.

Defendants' argument that plaintiff's waiver of arbitration precludes him from maintaining this action is equally unconvincing. New York strongly favors arbitration (*see Matter of Nationwide Gen. Ins. Co. v Investors Ins. Co. of Am.*, 37 NY2d 91, 95 [1975]), and that "a right to arbitration may be modified, waived or abandoned" (*Cusimano v Schnurr*, 26 NY3d 391, 400 [2015] [internal quotation marks and citation omitted]). A "party who commences an action may generally be assumed to have waived any right it may have had to submit the issues to arbitration" (*De Sapio v Kohlmeyer*, 35 NY2d 402, 405 [1974]). Thus, plaintiff's actions in commencing this proceeding and opposing defendants' motion to dismiss may constitute a waiver (*see Volpe v Interpublic Group of Cos., Inc.*, 2013 NY Slip Op 31784[U], *9-10 [Sup Ct NY County 2013], *affd* 118 AD3d 482 [1st Dept 2014], *lv denied* 24 NY3d 905 [2014]). However, such waiver operates only to foreclose plaintiff from affirmatively pursuing his claim in an arbitral forum, not whether plaintiff is entirely foreclosed from seeking redress in any venue, as is suggested. The court notes that the arbitration provision does not contain any language stating that arbitration was

the parties' exclusive or sole remedy (*see Island Cash Register v Data Term. Sys.*, 244 AD2d 117, 118 [1st Dept 1998] [dismissing the plaintiff's complaint challenging the defendant's for-cause termination of a dealership agreement where the parties had agreed that arbitration was the plaintiff's exclusive remedy and where the plaintiff failed to serve a demand for arbitration within the 60-day time frame set in their agreement]).

Similarly, defendants have not demonstrated that plaintiff cannot contest his expulsion because he failed to timely pursue arbitration. In the event of a deadlock between the parties on the selection of an arbitrator, section 13.03(d)(i) imposed a 45-day deadline for either plaintiff or defendants to request that the American Arbitration Association designate an arbitrator (*id.*). While plaintiff admittedly did not perform, it is also not disputed that defendants failed to request the appointment of arbitrator within the time prescribed in section 13.03(d)(i). Hence, given their own inactivity, defendants may have arguably waived their right to pursue arbitration as well.

Nevertheless, the issue of whether plaintiff's status as a member of ENS is more properly determined in arbitration (*see Blatt v Sochet*, 199 AD2d 451, 453 [2d Dept 1993]), but neither party has moved to compel arbitration or for a stay of this proceeding (*see* CPLR 7503). Accordingly, the motion insofar as it seeks dismissal of the first, second, third and fifth causes of action based on CPLR 3211 (a) (3) is granted to the extent of dismissing only the fifth cause of action.

D. Attorneys' Fees

Defendants also seek an award of their attorneys' fees under section 13.03(d)(iv) of the Operating Agreement, which states that "[t]he prevailing party in any arbitration ... shall be entitled to an award of all reasonable costs and legal fees incurred by that party (NYSCEF Doc No. 31 at 25). It is well settled that "attorney's fees are incidents of litigation and a prevailing

party may not collect them from the loser unless an award is authorized by agreement between the parties, statute or court rule" (*Hooper Assoc. v AGS Computers*, 74 NY2d 487, 491 [1989] [citations omitted]). The court denies defendant's request for attorneys' fees because this judicial proceeding does not constitute an arbitration.

E. Plaintiff's Cross Motion to Amend His Complaint

Plaintiff cross-moves for leave to serve a second amended verified complaint to plead a derivative claim for the impressment of a constructive trust instead of a direct claim.

It is well settled that a motion for leave to amend the pleadings should be freely granted unless there is prejudice or surprise from the delay or if the amendment is "palpably insufficient or patently devoid of merit" (*see JPMorgan Chase Bank, N.A. v Low Cost Bearings NY Inc.*, 107 AD3d 643, 644 [1st Dep't 2013], quoting *MBIA Ins. Corp. v Greystone & Co., Inc.*, 74 AD3d 499, 500 [1st Dept 2010]). The court must examine the sufficiency of the merits of the proposed amendment and is not required to accept plaintiff's allegations as true (*see Bag Bag v Alcobi*, 129 AD3d 649, 649 [1st Dept 2015]). The party moving to amend its pleadings need not prove the facts (*see Daniels v Empire-Orr, Inc.*, 151 AD2d 370, 371 [1st Dept 1989]), but must tender an affidavit of merit or an offer of evidence similar to that used to support a motion for summary judgment (*see Matthews v City of New York*, 138 AD3d 507, 508 [1st Dept 2016]). The party opposing the motion bears a heavy burden of showing prejudice (*see McGhee v Odell*, 96 AD3d 449, 450 [1st Dept 2012]) or demonstrating that the facts as alleged are unreliable or insufficient to support the motion (*see Peach Parking Corp. v 346 W. 40th St., LLC*, 42 AD3d 82, 86 [1st Dept 2007], citing *Daniels*, 151 AD3d at 371]). Given defendants' failure to establish whether plaintiff lacks standing to pursue the constructive trust claim, as discussed earlier, the cross motion is

granted, and plaintiff shall serve a second amended complaint in the form annexed to his moving papers as exhibit C.

Motion Sequence No. 003

Plaintiff also moves for a default judgment against ENS for its failure to answer or otherwise appear in this action. The motion is supported by a copy of the complaint and an affidavit of service showing that ENS was served through the Secretary of State in accordance with CPLR 311-a.

CPLR 3215 (a) reads, in part, that "[w]hen a defendant has failed to appear, plead or proceed to trial ... the plaintiff may seek a default judgment against him." In order to obtain a default judgment, a moving party must submit proof of jurisdiction, a default, and "proof by affidavit made by the party of the facts constituting the claim" (*Joosten v Gale*, 129 AD2d 531, 534 [1st Dept 1987] [internal quotation marks and citation omitted]; *see also* CPLR 3215 [f]). The motion must be made within one year of the default (*see* CPLR 3215 [c]).

Plaintiff has demonstrated proof of service of the supplemental summons and amended complaint upon ENS (*see Paez v 1610 St. Nicholas Ave. L.P.*, 103 AD3d 553, 553-554 [1st Dept 2013] [stating that service of process upon a limited liability company is complete upon delivery of the summons and complaint to the Secretary of State]), and ENS's failure to answer with the time prescribed by CPLR 320 (a). Plaintiff, though, has not demonstrated proof of the facts constituting his claim. It is well settled that "a complaint verified by someone or an affidavit executed by a party with personal knowledge of the merits of the claim" shall suffice (*Beltre v Babu*, 32 AD3d 722, 723 [1st Dept 2006]). Here, plaintiff relies upon a complaint verified by his attorney, making "it hearsay and devoid of evidentiary value" (*Utak v Commerce Bank Inc.*, 88 AD3d 522, 523 [1st Dept 2011]; *Beltre*, 32 AD3d at 723).

Accordingly, it is

ORDERED that the motion of defendants Gabriel Ettenson and David Newman to dismiss the complaint (motion sequence no. 002) is granted to the extent that so much of the second cause of action predicated on the salaries, legal fees, and business-related expenses paid by defendant ENS Health, LLC, the fourth cause of action for fraudulent conveyance, the fifth cause of action for an accounting, the sixth cause of action for breach of fiduciary duty, and the seventh cause of action for breach of fiduciary duty are dismissed, and the motion otherwise denied; and it is further

ORDERED that plaintiff's cross motion for leave to amend the complaint herein (motion sequence no. 002) is granted to the extent of granting plaintiff leave to amend the third cause of action to plead a derivative claim for the impressment of a constructive trust; and it is further

ORDERED that the second amended complaint in the proposed form annexed to the cross-moving papers as Exhibit C shall be deemed served upon service of a copy of this order with notice of entry thereof; and it is further

ORDERED that the defendants Gabriel Ettenson and David Newman shall each serve an answer to the second amended complaint or otherwise respond thereto within 20 days from the date of said service; and it is further

ORDERED that plaintiff's motion for leave to enter a default judgment against defendant ENS Health, LLC (motion sequence no. 003) is denied.

Dated: 12-23-2019

ENTER:

J.S.C.

HON. DAVID B. COHEN
J.S.C.