SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. JENNIFER G. SCHECTER **PART** IAS MOTION 54EFM

Justice

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TWO RIVERS ENTITIES, LLC,

Plaintiff,

- v -

TACHO SANDOVAL,

Defendant.

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INDEX NO. 656906/2019

MOTION DATE

MOTION SEQ. NO. 001

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 001) 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26

were read on this motion to DISMISS.

Defendant Tacho Sandoval moves to dismiss the amended complaint (Dkt. 7 [the AC]). Plaintiff Two Rivers Entities, LLC (the Company) opposes the motion. The motion is granted.

Background

The Company, a New York LLC, is governed by an Amended and Restated Operating Agreement effective as of August 1, 2017 (Dkt. 19 [the Operating Agreement]). Its business is trading "commodity contracts, futures, currencies and options on futures or all derivative products as well as Trading Instruments … and Trading and taking positions in equity, options and OTC securities" (*id.* at 3).[1]

[1] Section 1.2 defines Trading Instrument to mean: "(i) any security as defined in Section 2(a)(1) of the Securities Act, (ii) any commodity, futures contract, forward contract, foreign exchange commitment, swap contract, exchange-for-physicals or spot (cash) commodity, (iii) any option, warrant or other right on or pertaining to the any of the foregoing, whether in the United States of

Sandoval is a Class A Member of the Company and has no management rights. He became a member after providing millions of dollars in financing to the Company beginning in 2016.

The Operating Agreement contains certain restrictions on Sandoval's investments in other companies and provides for recourse if he violates them. Specifically, section 5.7 provides:

> No Member, except for his investment in the Company, shall directly or indirectly invest in, or engage in any business **which engages in Trading Instruments or in any manner competes with the business of the Company**, except for an ownership interest **of less than 2%** in any publicly traded Company (*id.* at 21 [emphasis added]).

Section 7.3(a)(vii) states that Members, such as Sandoval, may have their membership terminated for Cause if they materially breach the Operating Agreement (*see id.* at 25-26). Other grounds for a for-cause termination include a Member's "negligence or misconduct in the course of his membership or in the performance of the Member's duties or responsibilities" or "embezzlement, fraud or dishonestly committed (or attempted) by the Member, or at his direction" (*see id.* at 26).

In October 2019, Sandoval agreed to restructure some of the financing he had provided to the Company. This was effectuated by an Amended and Restated Promissory Note dated November 1, 2019 (Dkt. 20 [The Note]). The Note sets forth the specifics of

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America or anywhere else throughout the world, or (iv) any other investment that is unrelated to the core business of the Company, which non-core business requires a majority vote of all Class A Members in order for the Company to make the investment" (*id.*).

the refinancing but does not address the Operating Agreement or Sandoval's obligations thereunder. Section 14 of the Note provides:

> Each party hereto unconditionally and irrevocably releases and discharges the other party and its respective affiliates, members, successors, assigns and agents (each, a "Released Party"), of and from, and hereby unconditionally and irrevocably waives, any and all claims, debts, losses, expenses, proceedings, covenants, liabilities, suits, judgments, damages, actions and causes of action, obligations, accounts, and liabilities of any kind or character whatsoever, known or unknown, contingent or unconditional, matured or unmatured, fixed or variable, suspected or unsuspected, in contract or tort, at law or in equity, direct or indirect, that such party ever had, now has or ever may have or claim to have against any Released Party, for or by reason of any matter, circumstance, event, action, inaction, omission, cause or thing whatsoever arising prior to the date hereof **in connection with this Note and the transactions described in the recitals hereto**; provided, however, that this release shall not affect any claims relating to the payment of this Note or any willful breach of this Note (*id.* at 6 [emphasis added]).

Prior to execution of the Note, between July 2017 and October 2018, Sandoval allegedly violated federal securities laws by inaccurately and untimely disclosing his acquisition of more than 10% of the stock of Clean Coal Technologies, Inc. (CCT), a publicity traded company that focuses on the environmental impacts of coal (*see* AC ¶¶ 21-49). Sandoval's alleged violations, which some claimed was market manipulation, allegedly dissuaded certain prospective investors from investing in the Company due to its affiliation with Sandoval (*see* ¶¶ 50-59). On October 16, 2019, prior to the Note's execution, the Company's manager asked Sandoval to correct his securities filings, but he allegedly refused to do so (*see* ¶¶ 60-63).

The Company commenced this action in November 2019. Its amended complaint includes two causes of action: (1) breach of the Operating Agreement; and (2) forfeiture of compensation under the faithless-servant doctrine. Sandoval moves to dismiss, arguing

that the release in the Note bars both claims. Even if it does not, he maintains that none of his alleged actions violate any provisions of the Operating Agreement and that he is not subject to the faithless-servant doctrine.

Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint and all reasonable inferences that may be gleaned from them (*Amaro v Gani Realty Corp.*, 60 AD3d 491 [1st Dept 2009]). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences from them, the complaint states the elements of a legally cognizable cause of action (*Skillgames, LLC v Brody*, 1 AD3d 247, 250 [1st Dept 2003], citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977]). If dismissal is sought based on documentary evidence, the motion will succeed only if such "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]).

The Note's release does not bar any of the claims in this action. Though its scope is broad and includes unknown claims, the release is unambiguously limited to claims "in connection with this Note and the transactions described in the recitals hereto." The Note does not address the Operating Agreement's prohibition on Sandoval investing in other companies and has nothing to do with the alleged securities violations that, based on the Company's own allegations, the parties were discussing in the month before the Note was executed. Had these sophisticated parties intended for the Note's release to cover these disputes, they would have ensured it expressly did so. Consequently, the claims asserted

by the Company in this action were not released (*see Fitzgerald v Fahnestock & Co.*, 48 AD3d 246, 247 [1st Dept 2008]).

Nonetheless, the Company has not stated a claim for breach of the Operating Agreement.

Section 5.7 does not prohibit Sandoval from investing in other companies, even for a stake greater than 2%, unless that company "engages in Trading Instruments or in any manner competes with the business of the Company." There is no indication in the AC or otherwise that CCT "engages in Trading Instruments or in any manner competes with the business of the Company." Thus, the Company has not stated a claim for breach of section 5.7.

Nor has it stated a claim for breach of section 7.3(a). Even assuming, without deciding, that section 7.3(a) may give rise to an independent claim for damages and that its subsections are not merely grounds to effectuate a for-Cause termination, the Company has still not stated a claim.

The Company has not stated a claim for breach of section 7.3(a)(ii) as it has not alleged Sandoval's "negligence or misconduct **in the course of his membership or in the performance of the Member's duties or responsibilities**." The alleged securities violations, which concern CCT, an unrelated company, have nothing to do with Sandoval's membership in or funding of the Company. Nor has the Company alleged a violation of any other subsection. Indeed, the AC does not explicitly allege in the breach-of-contract cause of action any specific violation of section 7.3(a). Rather, it is clear that this claim is focused on the erroneous contention that section 5.7 prohibits Sandoval from having a 2%

stake in any publicly traded company regardless of whether that company "engages in Trading Instruments or in any manner competes with the business of the Company." The 2% limit is clearly a safe harbor to these two prohibitions and not an independent limitation. The breach of contract claim is therefore dismissed.[2] Failure to state a claim for breach of section 5.7 or any other material breach of the Operating Agreement defeats recovery based on section 7.3(a)(vii), which requires a separate material breach.

Additionally, because the Company has not alleged any breach that would serve as a predicate for application of the faithless-servant doctrine, the second cause of action is dismissed as well.[3]

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[2] In opposition, the Company also suggests that Sandoval breached section 1.3, which requires "The Company, Members and Subsidiaries shall make all filings and disclosures required by, and shall otherwise comply with, all such laws and regulatory requirements" (*see* Dkt. 19 at 4). Read in context, this obligation clearly governs filings related to or on behalf of the Company and not those related to other companies. It is unreasonable to interpret this section to mean that all unrelated securities violations are breaches of the Operating Agreement. After all, the closest thing to a morals clause is section 7.3(a)(iii), but that provision requires a criminal conviction (*see id.* at 26). Thus, a mere allegation of criminal conduct is not enough to establish a breach. Likewise, section 7.3(a)(v), which covers "embezzlement, fraud or dishonestly committed (or attempted) by the Member, or at his direction," cannot reasonably be read to include misconduct unrelated to the Company (*see id.*). This provision clearly seeks to protect against direct harm to the company; unrelated securities fraud does not fit the bill. There is no reading of the Operating Agreement that would permit a for-cause termination simply based on reputational issues deriving from Sandoval's alleged misconduct that did not involve or directly harm the Company.

[3] Notwithstanding the conclusory invocations of the duties of loyalty and good faith (*see* AC ¶¶ 98-99), the Company only asserts breach-of-contract claims and not a separate cause of action for breach of fiduciary duty (likely because Sandoval is not a manager and the Operating Agreement does not contractually establish non-default fiduciary duties for him, and in any event, it seems unlikely that a securities violation unrelated to the Company would support such a claim). Plaintiff cites no authority for use of the faithless-servant doctrine to preclude recovery of loans. The doctrine is about equitable forfeiture of compensation for the services of a disloyal fiduciary (*see Feiger v Iral Jewelry, Ltd.*, 41 NY2d 928 [1977]). The obligation to repay a loan is purely a matter of contract that does not arise from a fiduciary relationship. The faithless-servant doctrine cannot be raised to recoup money that the Company repaid someone to satisfy its debt. Consequently, a

Accordingly, it is ORDERED that Sandoval's motion to dismiss the AC is granted and the Clerk is directed to enter judgment dismissing the action.

7/7/2020
DATE

JENNIFER G. SCHECTER, J.S.C.

CHECK ONE:	X	CASE DISPOSED			NON-FINAL DISPOSITION		
	X	GRANTED		DENIED	GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER			SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN			FIDUCIARY APPOINTMENT		REFERENCE

principal driver of this action–an affirmative attack on Sandoval's own separate lawsuit seeking repayment–is a non-starter.