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

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ROBERT SHAPIRO,

Index No.: 653571/2014

Plaintiff,

-against-

GABRIEL ETTENSON and DAVID NEWMAN,

Defendants.

----------X

MEMORANDUM OF LAW IN FURTHER SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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PRELIMINARY STATEMENT

Plaintiff Robert Shapiro ("plaintiff" or "Shapiro") submits this memorandum of law in further support of plaintiff's motion for summary judgment in favor of plaintiff Robert Shapiro and against defendants Gabriel Ettenson and David Newman on the First and Second Causes of Action set forth in the complaint herein and dismissing all of defendants' counterclaims and in opposition to Defendants' Motion for Summary Judgment.

This dispute raises an issue of first impression. In the absence of an operating agreement, can two of three founding members of a New York limited liability company unilaterally impose an operating agreement at any time or beyond the ninety day statutory period, when it adversely affects the founding third member? Can they impose the operating agreement over his objections when the terms would subject him to personal liability and deprive the third member of his bargained for and expected benefits including salary and the non-dilution of his ownership interest? Can the two members impose a capital call upon the third member to fund the salaries of the two?

The Court is respectfully referred to the Plaintiff's Memorandum of Law in Support (the "Plaintiff's Memo in Support"), along with the facts set forth in the affirmation of James M. Felix dated March 12, 2015 (the "Felix Main Aff."), the affidavit of Robert Shapiro sworn to March 11, 2015 (the "Shapiro Aff.") and the affirmation in opposition of James M. Felix dated March 26, 2015 (the "Felix Opp. Aff."), the defined terms used therein are incorporated herein by reference. For the Court's convenience, those facts are more briefly set forth herein.

ARGUMENT

POINT I

DEFENDANTS' ACTIONS ARE IN VIOLATION OF THE NEW YORK LIMITED LIABILTY COMPANY LAW

A. The Purported Operating Agreement Is A Nullity

Defendants contend in Defendants' Memorandum in Support of Defendants' Motion for Summary Judgment ("Defendants' Memo of Law") that New York LLC Law § 402 (c)(3) permitted the defendants, as a majority in interest of the members to adopt the operating agreement some eleven (11) months after the formation of ENS. See Defendants' Memo of Law at pp. 11-12, Shapiro Aff. at ¶¶ 16-18.

As more fully set forth in Plaintiff's Memo in Support at Point I A., the LLC Law defines an operating agreement as "...any written agreement of the members concerning the business of a limited liability company and the conduct of its affairs and complying with section four hundred seventeen of this chapter." 102 (u) of LLC Law.

A review of New York cases does not reveal any cases which allow an operating agreement to be promulgated by any less than all the members of the subject limited liability company. In a sampling of cases decided on other issues, the Court notes that the subject operating agreement was signed by each and every member of the

particular limited liability company. See e.g. Matter of 1545 Ocean Ave., LLC, 72 AD3d 121, 123 (2d Dept. 2010) (two members, both signed the operating agreement); Matter of Spires v Lighthouse Solutions, LLC, 4 Misc. 3d 428, 430 (Sup. Ct. Monroe Cty. 2004) (three members, all three of whom signed the operating agreement).[1] Thus, by statute, an operating agreement is to be entered into by all but not less than all of the members, and certainly not just a majority. Respectfully, on this ground alone, no operating agreement can be entered into by less than all the members of a New York limited liability company.

Additionally, as set forth in the Felix Main Aff., it is the practice in New York to have all members sign operating agreements. That practice arises from the statute and from the understanding that in order to have an enforceable agreement that establishes and often curtails rights of investors/members, each and every member must memorialize each member's ascent to the manner in which the limited liability company will operate. See Felix Main Aff. at ¶¶ 6-7.

Further, pursuant to § 417 (c) of the LLC Law, an operating agreement may be entered into by the members of the limited liability company before, at the time of or within ninety days after the filing of the articles of organization. Herein, no operating agreement was entered into by all the members of ENS, either before, at the time of or within the ninety day period after the filing of the articles of organization, or at any time thereafter. See Shapiro Aff. at ¶ 6. Failure of all the members to adopt a written operating agreement company before, at the time of or within ninety days after the filing of the articles of organization prohibits two out of the three members of ENS from

[1] Most of the New York cases involving operating agreements do not even consider the need to make reference to the fact that all the members executed the subject operating agreement, as that fact is implicitly inferred. See e.g. Verderber v Commander Enters. Centereach, LLC, 85 AD3d 771 (2d Dept. 2011).

promulgating the Purported Operating Agreement over eleven (11) months after formation and there is no support. Based upon the foregoing, respectfully, the Purported Operating Agreement is a nullity and of no legal force and effect.

B. No Statutory Provisions or Default Rights Allow For Defendants' Actions

In the instant Action, there has never been a written operating agreement executed by all the members. Assuming, arguendo, that all the members of ENS are bound by the default provisions in the LLC Law, no default provisions would permit defendants to promulgate the Purported Operating Agreement without the unanimous consent of all the members, as all members of ENS must enter into such an agreement within the ninety day period after the filing of the articles of organization. See § 417 (a) and (c) of the LLC Law. Additionally, unless the original operating agreement expressly provided for the right to amend, no amendment may be had. See § 417 (b) of the LLC Law. As there is no valid operating agreement, there is no right to amend what is not in existence in the first place.

In terms of the Purported Oct. 2014 Capital Call, there is no default provision contained in the New York's LLC Law relating to the liability of members for capital contributions and a member is only liable to contribute what that member agreed to contribute to the limited liability company. See § 502 (a) of the LLC Law. In fact, the only way a limited liability member may have that member's interest diluted is by expressly providing for dilution in a valid operating agreement signed by all the members, by unanimous consent of all the members or any amended operating agreement signed by the member against whom dissolution is sought. See § 502 (b), (c) and § 417 (b) of the LLC Law.

§ 502 (b) of the LLC Law requires that unless expressly provided for in a valid operating agreement, "the obligation of a member to make a contribution ... may be compromised only by consent of all the members." § 502 (c) of the LLC Law provides that a valid operating agreement may provide for dilution of the non-contributing member's interest in the subject LLC. However, in either case, there is no default provision in the LLC Law which would allow for dilution of any member's interest without the agreement of that member.[2]

One of the primary reasons for adopting a limited liability company is to insulate the members from personal liability for company obligations, which is obvious from the name of the act itself, the New York Limited Liability Company Law. This limited liability protection is found in part, in § 417 (b) of the LLC Law, which reads, in pertinent part, as follows:

> b) The operating agreement of a limited liability company may be amended from time to time as provided therein; provided, however, that, except as otherwise provided in the operating agreement or the articles of organization, without the written consent of each member adversely affected thereby, (i) no amendment of the operating agreement ...shall be made that (i) increases the obligations of any member to make contributions, (ii) alters the allocation for tax purposes of any items of income, gain, loss, deduction or credit, (iii) alters the manner of computing the distributions of any member or (iv) allows the obligation of a member to make a contribution to be compromised by consent of less than all the members.

Adopting an operating agreement more than ninety days after the formation of ENS that permits capital calls by votes of less than all members the majority has converted

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[2] Even assuming, arguendo, that defendants can promulgate an operating agreement after the ninety day period, the default provisions of the LLC Law would have governed and thus precludes the dilution of a member without the agreement of that member.

company obligations to personal ones, is prohibited by the LLC Law, including § 417 (b) of the LLC Law.

The need for a capital call is to meet the operational expenses of the company and is upon the individual members, thus they are now required to personal fund the company's debts, in violation of the statute. The Purported Oct. 2014 Capital Call at issue herein specifically provided that any Member who failed to make the $10,000 additional Capital Call would be diluted of that Member's interest to the extent that other Members covered all or part of the amount called for in the Capital Call. See Exhibit "N" to the Shapiro Aff. Clearly, the Purported Oct. 2014 Capital Call adversely affect the rights of plaintiff Shapiro, the non-signing member by increasing the obligations of any member to make contributions, alters the manner of computing distributions to plaintiff and allows the obligation of plaintiff, the non-consenting member, to be compromised by consent of less than all the members which is in direct conflict with and prohibited by the express language of the LLC Law. Therefore, respectfully Purported Oct. 2014 Capital Call is null and void ab initio.

Likewise, there is no default provision in the LLC Law which allows for a majority of the members to agree to pay themselves a salary and at the same time to not pay another member a salary. Further, any majority agreement providing for the unequal payment of salary is expressly prohibited by § 417 (b) of the LLC Law, as that would necessarily alter the allocation for tax purposes of any items of income, gain, loss, deduction or credit and the manner of computing the distributions of any member. See Shapiro Aff. at ¶¶ 33-35. Thus, the Purported Operating Agreement, Purported Oct. 2014 Capital Call and any unequal payment of salary are, respectfully, each a nullity and of no legal force and effect.

POINT II

NO MANDATORY CAPITAL CALL OR UNEQUAL SALARY PAYMENTS ARE PERMITTED

As more fully set forth in Plaintiff's Memo in Support, the LLC Law specifically prohibits a member or manager from benefiting from transactions which favor a manager or group of managers over other managers or members. See Plaintiff's Memo in Support at Point II A. Neither defendant Ettenson or defendant Newman are able to vote in favor of paying himself or any other manager salary that is not approved by all of the disinterested managers. As plaintiff has not and will not approve salary for any of the defendants, while not being paid any salary, defendants should be precluded from terminating plaintiff's salary or paying themselves any salary. See Shapiro Aff. at ¶ 44.

Notwithstanding the prohibitions imposed by the New York LLC Law, in connection with the formation of ENS, plaintiff Shapiro, defendant Ettenson and defendant Newman expressly agreed that ENS would be member managed and that all material decisions would be by unanimous vote of all the members. See Shapiro Aff. at ¶ 4. Initially, the 3 ENS Members agreed that no salaries would be taken by any of the members. Thereafter, defendants and plaintiff discussed then unanimously agreed that salaries would be paid to the 3 ENS Members and that each member would receive the same salary. See Shapiro Aff. at ¶¶ 40-41.

On September 19, 2013, at a meeting of the 3 ENS Members, it was unanimous agreed by the 3 ENS Members that for a period of 90 days, October 1, 2013 to December 31, 2013, defendant Ettenson and defendant Newman would receive a salary at the annualized rate of $100,000/year and plaintiff Shapiro, would receive a salary at the annualized rate of $50,000/year. Also agreed at the Sept. 19, 2013 Meeting of 3 ENS Members was that at the end of said ninety day period, that being

December 31, 2013, the agreement as to salaries would expire and could be extended or modified only by unanimous consent of the Members. After January 1, 2014, there has been no modification or extension of the unanimous agreement as to salary. See Shapiro Aff. at ¶ 42-44.

The agreement reached by the 3 ENS Members that ENS would be member managed and that all material decisions would be by unanimous vote of all the members and the unanimous agreement in September of 2013 are binding agreements or contracts between the parties. "To establish the existence of an enforceable agreement there must be "an offer, acceptance of the offer, consideration, mutual assent, and an intent to be bound (22 NY Jur 2d, Contracts § 9)." Kowalchuk v Stroup, 61 AD3d 118 (1st Dept. 2009). Here, plaintiff has set forth all the elements of the formation of an enforceable contract when the LLC was formed. See Shapiro Aff. at ¶¶ 3-5.

The existence of a contract, while oral, can also be established by the conduct of the parties. Herein, as established in the Shapiro Aff., from the inception of ENS until October, 2014, ENS was being operated by plaintiff and both defendants with all of the 3 ENS Members participating in the operations of the business of ENS and neither defendant Ettenson or defendant Newman overtly took any significant action in the operations of the business that was based upon any claim under the Purported Operating Agreement to the exclusion of or at the express objection of plaintiff. See Shapiro Aff. at ¶¶ 6, 26. Instead of countering the facts, Defendants proffer that the oral agreement is somehow negated by either the default provision of the LLC Law or the Purported Operating Agreement.

In terms of the Purported Operating Agreement, there is no basis to find, as a matter of law or otherwise, that a preexisting oral agreements between all of the members is extinguished as a result of the two defendants signing the Purported Operating Agreement. By attempting to enforce the Purported Operating Agreement in a manner that is in conflict with the oral agreements is, a breach of those oral agreements and negates any provision conflicting therewith. See Noise In Attic Productions, Inc. v. London Records, 10 A.D.3d 303, 782 N.Y.S.2d 1 (1st Dept. 2004) (a cause of action for breach of contract are (1) formation of a contract between plaintiff and defendant, (2) performance by plaintiff, (3) defendant's failure to perform, and (4) resulting damage.).

In terms of the default provisions, as established above and in Plaintiff's Memo in Support, neither the Purported Capital Call or unequal salary by majority vote can survive the prohibitions set in § 502 (a), (b), (c) and § 417 (b) of the LLC Law. Further, defendants have confirmed the agreement not to allow for other than unanimously agreed to salaries when they promulgated and signed the Purported Operating Agreement on December 13, 2013, as that document expressly forbids salary to be paid to any managers or members. More particularly, Section 9.01 of the Purported Operating Agreement reads as follows:

> Section 9.01 Management Fees. No compensation shall be paid to the Managers for their services in arranging transactions contemplated by the Company and managing the Company.

See Exhibit "K" to the Shapiro Aff. at p. 15. Thus, according to defendants, no compensation can be paid to plaintiff or defendants for their services in managing the Company or in providing services for the Company relating to the business of selling the Company's products.

While the language in Section 9.01 is clear, defendants are proposing, in the Defendants Memo of Law, that

> ... the salaries paid to the parties are plainly not "Management Fees" under § 9.01, as evidenced by the fact that they were approved at the September 2013 Meeting – three months *before* the Company had any managers at all (it was still member-managed) or an Operating Agreement.

Defendant's Memo at p. 20, fn. 11. Respectfully, there is nothing plain about the attempt to not pay plaintiff any salary while paying the other two members, salary. First, at the September 2013 Meeting, all of the members agreed to pay salaries to all of the members at unanimously agreed amounts. See Shapiro Aff. at ¶ 42-43. That could have happened with or without any operating agreement, as the decision was unanimous for the period of October 1, 2013 to December 31, 2013. Id.

Now, Defendants are proposing that salary to defendants, as "managers" would not be in abrogation of § 9.01 of the Purported Operating Agreement, as somehow, a salary paid to a "manager" is not compensation to managers for "their services in arranging transactions contemplated by the Company and managing the Company." See § 9.01 of the Purported Operating Agreement. Respectfully, by their own language, Defendants have confirmed the oral agreement of the members of ENS and should not be permitted to abrogate plaintiff's statutory and contractual rights, by the mere stroke of a pen by less than all the members and by an absence of any member that has statutorily protected rights under the LLC Law.

POINT III

PLAINTIFF HAS VAILID CLAIMS NOT SUBJECT TO ANY MOTION FOR SUMMARY JUDGMENT

Plaintiff seeks only summary judgment for declaratory relief sought in the First and Second Causes of Action set forth in plaintiff's complaint and dismissing all of defendants' counterclaims. The balance of the claims set forth in plaintiff's complaint require establishment of facts which defendants contest and no request for summary judgment has been made on behalf of plaintiff. Instead, plaintiff has requested that the third, fourth and fifth causes of action should be severed and permitted to proceed to determine damages. See Felix Main Aff. at ¶ 2.

Defendants are moving for summary judgment, not only on all of the causes of action in defendant's complaint, but also to dismiss all of plaintiff's claims as a matter of law. In seeking summary dismissal of all of Plaintiff's claims, defendants claim that the decision to make a capital call and cut off any salary to plaintiff were

> At best, they are "business disagreements" which under the business judgment rule "should not be questioned by the courts where, as here, there is no evidence of bad faith or self-dealing on the part of the individual defendants." *See Van Der Lande v. Stout,* 786 N.Y.S.2d 515,516 (I" Dep't 2004); *see also Auerbach* v *Bennett,* 47 N.Y.2d 619,630-31 (1979) ("[B]y definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility. Thus, absent evidence of bad faith or fraud (of which there is none here) the courts must and properly should respect their determinations.").

The cases cited by defendants on their face provide grounds for denial of defendants attempt to summarily decide plaintiff's claims for breach of contract. Clearly, the decision to cut off plaintiff's salary and have a capital call to fund their own salaries can reasonably be considered to be bad faith, self-dealing or fraudulent on the part of

the defendants, as expressly prohibited by Frist Department in the Van Der Lande case and by the Court of Appeals in the Auerbach v Bennett case.

In Pokoik v Pokoik, 115 A.D.3d 428, 982 N.Y.S.2d 67 (1st Dept. 2014), miscited by defendants on other grounds, the Court held that the business judgment rule does not protect fiduciaries when their decisions are affected by inherent conflict of interest. Id. 115 A.D.3d at 430. The First Department went on to state that "[t]he business judgment rule . . . permits review of improper decisions, as when the challenger demonstrates that the board's action . . . deliberately singles out individuals for harmful treatment" (*Barbour v Knecht*, 296 AD2d 218, 224 [1st Dept 2002] [internal quotation marks omitted]). Id. 115 A.D.3d at 430. Here, the facts do not permit summary dismissal based upon the business judgment rule.

Further, the claim of breach of fiduciary duty is not summarily dismissible despite the inapposite case law cited by Defendants. There is no authority in New York which supports dismissal of a breach of fiduciary claim by one member against other members of a New York LLC. In Pokoik v Pokoik, 115 A.D.3d 428, 982 N.Y.S.2d 67 (1st Dept. 2014), while the claim was against the managing member, there was no holding that the breach of fiduciary duty would have not been valid if against a member that was not a managing member. In fact, in the two cases cited by the Court in Pokoik in support of the breach of fiduciary claim, both do not require that the breach be by a managing member. See Salm v Feldstein, 20 AD3d 469, 470 (2d Dept 2005) (as the managing member of the company and as a comember with the plaintiff, the defendant owed the plaintiff a fiduciary duty); Tzolis v Wolff, 39 AD3d 138, 146 (1st Dept 2007), *affd* 10 NY3d 100 92008) (25% member able to bring derivative claim and breach of fiduciary claim), see also § 409 (a) of the LLC Law.

In a footnote, defendants make the bold statement applying the holding in a New York Federal Southern District case, Marino v. Grupo Mundial Tenedora, S.A., 810 F.Supp.2d 601, 608-609 (S.D.N.Y. 2011), to the case herein, that plaintiff would be prohibited from suing defendants on a breach of fiduciary claim because neither defendants is holds over 50 % of the voting interests in ENS. See Defendants' Memo at pp. 21-22, fn 12. However, the Court in the Marino v. Grupo Mundial case specifically applied Delaware limited liability law to the breach of fiduciary duty claim and not New York law. See Marino v. Grupo Mundial Tenedora, S.A., 810 F.Supp.2d 601, 608-609 (S.D.N.Y. 2011) wherein the Court specifically held that the subject limited liability company was "a Delaware limited liability company and, therefore, Delaware law governs the fiduciary duty claim asserted here." Id. 810 F.Supp.2d at 607. The law is New York is clear, a breach of fiduciary claim can be made by a member, against another member or manager, regardless of what percentage of ownership the parties hold. Respectfully, the third, fourth and fifth causes of action brought by plaintiff should be severed and permitted to proceed to determine liability and damages.

CONCLUSION

For all the foregoing reasons, and based upon the accompanying and previously filed affidavit, affirmations and Memorandum of Law In Support, plaintiff respectfully requests that this Court grant plaintiff's motion for summary judgment on the first and second causes of action in the complaint, sever plaintiff's remaining causes of action for full hearing on the merits and deny defendants' motion for summary judgment, along with such other and further relief as this Court deems just and proper.

Respectfully submitted,

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