To Be Argued By:
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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

ROBERT SHAPIRO,

Plaintiff-Appellant,

—against—

GABRIEL ETTENSON and DAVID NEWMAN,

Defendants-Respondents.

BRIEF FOR PLAINTIFF-APPELLANT

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PRELIMINARY STATEMENT

Plaintiff-Appellant Robert Shapiro ("Shapiro") submits this brief in support of his appeal from the Decision, Order and Judgment dated August 16, 2015 and entered September 2, 2015 granting summary judgment to Defendants-Respondents David Newman ("Newman") and Gabriel Ettenson ("Ettenson").(RA 9).

In doing so, the lower court (the Hon. Kelly O'Neill Levy) made three basic errors. First, it resolved rather than merely identify, factual issues critical to the application of a novel legal issue important to the law on limited liability companies, namely, whether two years after the formation of the parties' limited liability company (ENS Health, LLC), organized and operated by them as three equal 1/3 owners without an operating agreement, Newman and Ettenson could unilaterally adopt and impose upon Shapiro, without notice, an Operating Agreement which (a) adversely affected him, (b) subjected him to provisions to which he did not agree including capital call requirements, dilution and expulsion, and (c) was contrary to the verbal agreement upon which the entity was formed and operated. Second, it erroneously ruled that, as a matter of law, Newman and Ettenson (as the majority in interest) could adopt the initial Operating Agreement two years later, and that the adoption of the initial Operating Agreement did not require a unanimous vote; and third, it resolved, rather than merely identify, factual

issues arising from conflicting provisions of the Operating Agreement, should the Operating Agreement have been validly adopted.

Newman and Ettenson acted to adopt and impose the Operating Agreement while they and Shapiro were discussing and attempting to reach unanimous agreement on an Operating Agreement. Moreover, the version of the Operating Agreement they adopted was different and more onerous than the version they had last proposed to Shapiro. They adopted a version never presented to or seen by Shapiro.

THE NATURE OF THE CASE

This action was brought by Shapiro challenging (1) the December 13, 2013 adoption of the ENS Operating Agreement, two years after its formation, by two out of three of them, without his consent and without any notice to him, (2) the October 14, 2014 rescinding of his salary by Newman and Ettenson as "managers" of the LLC while they continued to receive salary in contravention of Section 9.01 of the very Operating Agreement they adopted prohibiting "managers" from receiving "compensation" for their services and (3) the October 14, 2014 capital call by Newman and Ettenson, which they used to pay for their own salaries, purportedly pursuant to the Operating Agreement they adopted without Shapiro's consent. Shapiro claimed, inter alia, that these actions were a breach of fiduciary

duty by Newman and Ettenson and a breach of the verbal agreement upon which they formed and operated ENS.

QUESTIONS PRESENTED

1. Two years after the formation of a New York limited liability company, during which its business has been managed without an operating agreement and by unanimous vote, can two out of the entity's three equal interest owners adopt and impose the initial Operating Agreement upon the third, without notice and without his consent, binding him to provisions to which he did not agree?

The lower court answered this question in the affirmative.

2. Is it a breach of fiduciary duty or breach of the oral agreement by which the three formed and operated the entity, and acquired their interests in the entity, for the two to adopt and impose an Operating Agreement which is contrary to the oral agreement?

The lower court answered this question in the negative, even though the terms of the oral agreement were disputed.

3. Can two out of the entity's three equal owners adopt and impose an initial Operating Agreement requiring the third to make additional capital contributions or face threatened dilution, when they could not do so by an

amendment to an operating agreement without his consent, and when there was a "meeting of the minds" on requiring unanimity for additional capital calls?

The lower court answered this question in the affirmative, even though there was a conflicting provision in the paragraph adopted by the two owners which stated that no member was required to make an additional capital contribution.

4. Contrary to their unanimous agreement to pay salaries to each other and to their "meeting of the minds" on requiring unanimity on changing salaries, can two out of the entity's three equal owners rescind the third's salary and continue to pay salaries to themselves, when the initial Operating Agreement they imposed provided that no "compensation" would be paid to them for their services?

The lower court answered this question in the affirmative.

THE MATERIAL FACTS-DISPUTED AND UNDISPUTED

ENS is the exclusive distributor of the HyperVibe Whole Body Vibration Machine, which is used for exercise, therapeutic and performance enhancement purposes. (RA 412). It is undisputed that ENS was organized on January 11, 2012 by Shapiro as the sole organizer (RA 423); that, by verbal agreement of the parties, Ettenson and Newman joined with Shapiro so that each held an equal one-third ownership interest in ENS and they referred to themselves as equal one-third

"members"; and that ENS was formed by Shapiro as a "member-managed limited liability company" by virtue of the articles of organization he filed. (RA 13, 412).

It is also undisputed that no written operating agreement was adopted by them before, during or within 90 days after ENS' articles of organization were filed and that during the almost two year period from January 11, 2012 until December 13, 2013, the three of them operated and managed the business of ENS equally and made decisions unanimously. (RA 34). Although the parties referred to themselves as "members", they were not "members" under the New York Limited Liability Company ("LLC Law") until they signed an Operating Agreement. See LLC Law, §102(q) definition of "Member" means "a person who has been admitted as a member of a limited liability company in accordance with the terms and provisions of this chapter and the operating agreement and has a membership interest in a limited liability company with the rights, obligations, preferences and limitations specified under this chapter and the operating agreement"). This is consistent with the notion that parties are not bound as "members" to each other until they have all signed an Operating Agreement and with the LLC Law's requirement that "the members of a limited liability company shall adopt a written operating agreement." (Section 417(a), emphasis added).

Until they signed an Operating Agreement, Shapiro, Newman and Ettenson were akin to partners or joint venturers. Newman referred to the fact that they had

not yet done "our partnership agreement" (RA 98) and to "our relationship as partners." (RA 415). In any event, until they signed an Operating Agreement, the three of them operated and managed the business pursuant to a verbal arrangement. There is a factual dispute as to the content of that verbal arrangement. According to Shapiro, the parties agreed at the outset "that ENS would be member managed, that all material decisions would be made by unanimous vote of all the members, and that in the event that the members unanimously agreed to make a capital call, that no members inability or decision not to make any payment on account of a capital call, would result in any diminution of that member's membership interest." (RA 34). While Newman and Ettenson agree that there was a verbal arrangement, they dispute Shapiro's version of it. They contend that the parties' actual conduct in making the decisions unanimously during the two year period was not required, but rather because "we generally attempted to build consensus whenever possible." (RA 413, 415). In effect, they dispute the portion of their oral agreement which provided for unanimous consent, but enforce the portion pursuant to which they obtained their interests.

It is undisputed, however, that during the two year period, the parties operated ENS according to an oral agreement. It is undisputed that the parties relied upon such agreement in contributing time, money and effort. Newman and Ettenson acknowledged the relevance of their oral agreement by asserting that

Shapiro was not entitled to receive his salary because he did not abide by their view of his "responsibilities" to the Company, although they never specified the basis or nature of his alleged "responsibilities." (RA 419). Since it was not written, it could only be allegedly oral. According to Newman, "it was never agreed or contemplated that Plaintiff would be a passive investor in ENS and have no responsibilities to the Company. To the contrary, as our equal one-third membership interests, capital contributions, and management rights reflected, all of the members agreed to do our fair share of the work required to build and operate the Company." (RA 413). The point is that the parties' verbal agreement was the only agreement that established their rights in ENS and that the substance of that verbal agreement was disputed.

It is undisputed that on July 15, 2013, Newman suggested to Shapiro and Ettenson that the time had come for them to have an Operating Agreement prepared, and he asked "Bobby" (i.e. Shapiro) to "get Rosie on this." (RA 98). The reference to "Rosie" was to ENS' corporate counsel, Stephen M. Rosenberg, Esq. (RA 34).

It is undisputed that on September 19, 2013, Shapiro and Newman, in person and Ettenson, by telephone (Ettenson lives in Colorado), held a meeting at Rosenberg's office, with Rosenberg present. They discussed the terms of a possible operating agreement, worked off of a prior basic draft and suggested

changes that should be made thereto. Rosenberg, as counsel to ENS, was asked to prepare a new draft for consideration by the three of them. (RA 35, 415).

It is also undisputed that also discussed on September 19, 2013 was the issue of salaries for the 3 of them. It is undisputed that, at the time of the formation of ENS, the three had agreed that no salaries would be taken by any of them and that, as of September 19, 2013, no salaries had been paid to any of them. On September 19, 2013 they unanimously agreed that Ettenson and Newman would receive a salary at the annualized rate of $100,000/ year and Shapiro would receive a salary at the annualized rate of $50,000/year. (RA 13, 41, 415) which obviously reflected lesser expectations for Shapiro's involvement and that his participation would not be the same as theirs.

What is disputed, however, is the duration of the salary agreement. Shapiro avows that the salary agreement was for an initial period of 90 days, from October 1, 2013 to December 31, 2013, after which the three could extend or modify the salary agreement by unanimous consent. (RA 13, 41). Shapiro's version of the September 19, 2013 salary agreement is supported by the "Unanimous Written Consent of the Members of ENS Health LLC" drafted by ENS' corporate counsel, Rosenberg, who was present, to reflect the salary agreement reached and which he circulated on November 12, 2013 along with the revised draft of an Operating Agreement. (RA 427, 428).

Newman and Ettenson dispute Shapiro's version of the September 19, 2013 salary agreement. They assert that there was no 90 day limit agreed upon and they did not sign the proposed Unanimous Written Consent prepared by Rosenberg. (RA 415). As Newman averred, "in recognition of our relationship as partners…Ettenson and I agreed to move forward on the basis of an agreement to pay salaries to all members, including Plaintiff" (RA 415). Yet, as shall be seen, one year later, despite this admitted agreement, Newman and Ettenson "reduced Shapiro's salary to zero."

On November 12, 2013 Rosenberg circulated to all parties a "revised LLC Operating Agreement… marked to show the changes from the last draft." (RA 428). He wrote that "I made the changes in the Operating Agreement discussed at the last meeting and provided a suggested list of items for which Unanimous approval of the members may be required." (RA 428).

One of the items Rosenberg suggested require unanimous approval was "Requiring or permitting additional Capital Contributions or loans by the Members of the Company" (Section 6.02(a) (i), RA 436). It is self-evident that a party cannot be required to make additional capital contributions unless he binds himself to an agreement allowing those additional capital calls to be made. Indeed, Section 417 (b) of the LLC Law provides that an Operating Agreement cannot be amended

"that increases the obligations of any member to make contributions" "without the written consent of each member adversely affected" to the amendment.

Another item Rosenberg suggested require unanimous approval was "changing or authorizing the salaries, benefits and other compensation to be paid to the Members, Managers or officers of the Company…" (Section 6.0(a) (ix), RA 437).

Consistent with this provision, his recollection of the September 19, 2013 salary agreement and the Unanimous Written Consent he circulated simultaneously with the revised draft Operating Agreement, Rosenberg proposed in Section 9.01 that "Unless approved by the unanimous consent of all the members, no compensation shall be paid for the services of the Members in arranging the transactions contemplated by the Company and continuing management of the Company." (RA 442).

Rosenberg also wrote that "I did not address the issue of expulsion since there is apparently no agreement of the Members on this point." (RA 428).

Finally, Rosenberg advised that as corporate counsel "I am obligated to point out to each of you that there may be potential conflicts of interest and that each of you should consider this and decide if you wish to consult independent counsel to advise you and give you legal advice." (RA 428).

At the end of the day on Monday, December 2, 2013, an attorney on behalf of Newman, Stephen Plotnick ("Plotnick"), introduced himself to Rosenberg and forwarded to Rosenberg a significantly revised draft of the Operating Agreement, although he characterized it as merely "incorporating some proposed edits to the operating agreement for ENS Health." (RA 128). He provided a red-lined version to show his changes. A mere review of the red-lined version (RA 159-194) shows the substantial extent of the proposed changes. Nevertheless, Plotnick also stated that he "included in the revised draft a couple of comments, and highlighted a few points, that will likely require some further discussion among the members" (RA 128), thus confirming that the terms of the Operating Agreement being discussed required the agreement of all members.

Most significantly, Plotnick did not disagree with the list of matters Rosenberg suggested require unanimous approval, including unanimous approval for "Requiring or permitting additional Capital Contributions" and for "changing or authorizing the salaries, benefits and other compensation authorized to be paid by the Company to the Members, Managers or employees of the Company." Plotnick's December 2, 2013 draft provided: "The following decisions respecting the conduct of the Company's business and affairs shall require the unanimous approval of all of the Members:

(a) Requiring or permitting additional Capital Contributions"

* * *

(j) changing or authorizing the salaries, benefits and other compensation authorized to be paid by the Company to the Member, Managers or employees of the Company."

(Section 6.03 (a), (j), RA 167, 168). Thus, it appeared that all three owners had a "meeting of the minds" and were in agreement on the list of matters requiring unanimous approval, including specifically additional capital calls and salary decisions.

On Thursday morning December 5, 2013, Rosenberg cordially responded as follows to Plotnick (RA 459):

> "Stephen:
>
> I have reviewed your draft Operating Agreement and have forwarded a copy to Robert Shapiro. I have assumed David and Gabriel have been provided with a copy by you.
>
> It appears that in addition to substantive changes, your draft has numerous versions which are intended to conform the draft to your firm's internal form of agreement. My concern is that these change [sic] may obscure the substantive changes which are intended and impede the Members' discussions. I would appreciate it if you could provide me with a brief summary of the substantive changes of the terms these revisions are intended to effectuate which the Members can then use to focus on which changes if any they object to. I would suggest that we then schedule a meeting of the Members for purposes of discussing the suggested changes.

> Robert Shapiro will be out of town next week and I will be traveling December 16 and 17. Accordingly, please get back to me with convenient dates and times commencing with December 18 so that we can schedule a meeting and hopefully resolve these issues.
>
> Please call me with any comments or questions you may have.
>
> Stephen"

At the end of the day on December 5, 2013, Plotnick responded that "we're not inclined to provide a summary of the changes" but that he was willing to discuss "whatever questions or concerns" Rosenberg had the next afternoon, December 6, 2013. Plotnick wrote, "We don't want to wait until December 18 (or possibly later)." (RA 458).

On December 6, 2013, Rosenberg responded (RA 458):

> "I suggest that given that there are conflicting positions among the Members, that my Partner Richard Feldman represent Robert Shapiro with respect to the Operating Agreement so that we can move this along. I will of course need the consent of David and Gabriel. Richard is out of the office right now but I will check with him on his return if this is agreeable to your clients. Once the members have agreed to changes, I can implement them."

Over the next two days, the three parties exchanged emails discussing the desire to move forward with the discussions for an Operating Agreement (RA 463-466). Newman and Ettenson did not agree to allow Rosenberg's partner, Richard Feldman, to represent Shapiro to move it along. Accordingly, Shapiro wrote that

upon his return from vacation the following week, he would retain independent counsel to review the significantly revised draft. He pointed out that the parties had operated the business of ENS for about 2 years without an operating agreement and that he did not understand the "frenzied state to have it done yesterday." (RA 464). He wanted some time to get the advice of independent counsel on Newman and Ettenson's substantial "rewrite" of the agreement prepared by Plotnick. (RA 464) It is to be noted that Shapiro was first notified that Newman had retained independent counsel when Plotnick sent his email on December 2, so less than one week had passed.

Newman and Ettenson did not wait for Shapiro to retain independent counsel. On December 13, 2013, without notice to Shapiro, they adopted and imposed as "a majority in interest of the members" of ENS, an Operating Agreement that materially differed from even the draft forwarded by Plotnick on December 2, 2013 (RA 467, 471). Therefore, the Operating Agreement imposed was not even one which had been sent to Shapiro for review or comment by him or any counsel.

The most important differences between Plotnick's December 2, 2013 draft and the Operating Agreement adopted on December 13, 2013 was that Newman, Ettenson and Plotnick completely altered the section providing for matters to be determined by unanimous approval of the members. They removed from that

Section (Section 6.04) that unanimous approval would be required for "requiring or permitting additional Capital Contributions, "requiring or permitting loans by or to the Members," "the appointment and removal of Managers," "the making of any Distributions by the Company to Members," "incurring any loans, debts or obligations on behalf of the Company," "any financing of the Company's property," "granting or allowing any liens, mortgages or other encumbrances on the assets of the Company" and "changing or authorizing the salaries, benefits and other compensation authorized to be paid by the Company to the Members, Managers or employees of the Company." (Compare Plotnick 12/2/13 Draft Sections 6.03(a) – (m) (RA 167-168) with 12/13/13 Operating Agreement Section 6.04(a) – (e)(RA 479-480). They also made changes in Sections 2.02, 2.05, 6.07 – 6.10, 7.01, 7.03, 9.02, 11.04, Article 12, 13.04 and 15.08.

The Operating Agreement imposed on December 13, 2013 also significantly differed and deviated from the LLC Law in important respects. It contained provisions for the expulsion of a member (Sections 13.03 and 13.04), when the statute does not provide for expulsion. It contained provisions for the making of additional capital contributions (Section 7.01), when the statute does not provide for it (LLC Law, Article V). It contained a more restrictive provision on assignment of membership interests (Section 11.01) than is in the statute (LLC Law §603). It contained a narrower provision on conflicts of interest (Section

6.08) than is in the statute (LLC Law §411), by which Newman and Ettenson attempt to exclude themselves from the statutory protections on transactions by "interested managers."

The December 13, 2013 Operating Agreement adopted by Newman and Ettenson changed ENS from a "member-managed" LLC to one managed by Shapiro, Newman and Ettenson as "managers". On the two issues of capital calls and salaries for managers, the Operating Agreement had the following provisions. In Section 7.01, Newman and Ettenson provided (instead of their previous agreement to unanimous approval for additional capital calls) that "a majority of the members may determine if additional Capital Contributions are necessary to conduct the Company's business activity" but they added that "No Member shall be required to make Capital Contributions to the Company to eliminate Capital Account deficits or for any other purpose, either upon dissolution of the Company or at any other time." (RA 483). (emphasis added). While they removed "salary decisions" from the list of matters requiring unanimous approval, Newman and Ettenson retained Section 9.01 providing that "No compensation shall be paid to the Managers for their services in arranging transactions contemplated by the Company and managing the Company." (RA 485). The management of the Company was vested in the three of them as Managers (Section 6.01).

According to the ENS tax returns filed by Newman in early 2014, the capital accounts of the parties as of December 31, 2013 were Shapiro ($53,613), Ettenson ($29,030) and Newman ($14,437) (RA 40, RA 246).

On October 14, 2014, Newman and Ettenson took two actions, without the consent of Shapiro, purportedly pursuant to the Operating Agreement. They "reduced the salary of Robert Shapiro to zero dollars ($0)" while continuing to pay their own salaries for managing the Company as managers. They also issued a capital call to each member for an additional $10,000 by November 21, 2014, declaring that "upon the failure of any Member to provide all or part of his proportionate share of such additional Capital Contribution," his participation interest shall be reduced proportionately. (RA 232, 233).

Shapiro filed this action on November 17, 2014 challenging these two actions and the adoption of the Operating Agreement.

THE COURT'S RULING

After the joinder of issue, all parties moved for summary judgment believing that there were no disputed issues of fact. However, as recited above, the parties' motion papers revealed material disputed issues of fact.

The lower court held that the Operating Agreement was validly adopted by Newman and Ettenson, as two out of the three owners, based upon Section 402(c)(3) of the LLC Law which provides:

"(c) Except as provided in the operating agreement, whether or not a limited liability company is managed by the members or by one or more managers, the vote of a majority in interest of the members entitled to vote thereon shall be required to:

(3) adopt, amend, restate or revoke the articles of organization or operating agreement, subject to the provisions in subdivision (e) of this section, subdivision (b) of section six hundred nine of this chapter and subdivision (b) of section four hundred seventeen of this article."

The lower court held that the capital call was validly issued pursuant to Section 7.01 of the Operating Agreement.

The lower court held that Newman and Ettenson, together, could reduce Shapiro's salary to zero and continue the salaries to themselves, based upon Section 411(e) of the LLC Law which provides that "Unless otherwise provided in the Operating Agreement, the managers shall have authority to fix the compensation of managers for services in any capacity." The lower court

interpreted Section 9.01 of the Operating Agreement prohibiting “compensation” to the managers for their services as not encompassing “salary”.

ARGUMENT

I. THE OPERATING AGREEMENT WAS NOT VALIDLY ADOPTED, AS IT REQUIRED A UNANIMOUS VOTE OF THE MEMBERS AND NOT A MERE MAJORITY

The LLC Law is premised upon the freedom of contract of the owners of the limited liability company (the "LLC") to tailor their business arrangements for the operation of the entity. The LLC Law requires the LLC to have a written operating agreement. See Section 417(a) ("the members of a limited liability company shall adopt a written operating agreement"). While it permits an operating agreement to be entered into before the entity's articles of organization are filed, it contemplates that the operating agreement will be entered into "within ninety days after the filing of the articles of organization." LLC Law, Section 417(c). There would be no other reason to state the 90 day period.

The LLC Law is premised upon the existence of a written operating agreement and upon "the members" complying with the mandate to have a written operating agreement. The very definition of a "member" under the LLC Law is one who has been admitted in accordance with "the operating agreement" and who has the rights and obligations specified in "the operating agreement." LLC Law, Section 102(q). Many of the provisions in LLC Law begin with the clause "Except as otherwise provided in the operating agreement…". This assumes the existence of an operating agreement. It means that if the members do not cover a particular

concept in their operating agreement, the relevant LLC Law default provision for such concept would then govern their entity. The phrase "Except as otherwise provided in the operating agreement" is not the same thing as saying "in the absence of an operating agreement."

Since the LLC is a creature of contract, the initial operating agreement must be adopted by all of the owners to make it binding upon them and as between each other. For example, could two out of three of the owners adopt an operating agreement requiring the third owner to arbitrate his disputes without his consent? Of course not.

The lower court erroneously focused on Section 402 (c) (3) of the LLC Law to hold that the initial ENS Operating Agreement could be imposed by just two out of the three ENS owners. That Section begins with the phrase "Except as provided in the operating agreement" which assumes there already is one. It provides for "the vote of a majority in interest of the members" but, as noted, a "member" under the LLC Law and, therefore, this provision is a person who already has been admitted in accordance with "the operating agreement" and has the rights and obligations specified in "the operating agreement." Section 102(q). Therefore, Section 402(c) already assumes that an operating agreement has been entered into.

Appellant recognizes the seeming incongruity of Section 402(c) (3) providing that a majority in interest of the members may "adopt, amend, restate or

revoke the articles of organization or operating agreement…" However, the word "adopt" can and should be read as limited to the adoption of the articles of organization since the operating agreement may be entered into before the articles of organization are filed. Applying the word "adopt" to the initial "operating agreement" does not make sense in context and is inconsistent with the rest of the LLC Law. For example, Section 417(b) of the LLC Law prohibits an amendment to the operating agreement, adversely affecting a member's various specified financial interests, "without the written consent of each member adversely affected thereby." It would make no sense to prohibit Newman and Ettenson from taking those actions proscribed by Section 417(b) by amendment without the consent of Shapiro, but to allow them to take those proscribed actions by "adopting" the initial operating agreement without his consent.

No case has been found, and the lower court did not cite to any, where a court held that a mere majority of ownership interests could enter into the initial operating agreement binding upon all owners. The only two LLC cases cited by the lower court (Matter of 1545 Ocean Ave., LLC, 72 A.D. 3d 121 (2d.Dept. 2010) and Matter of Spires v. Lighthouse Solutions, LLC, 4 Misc. 3d 428 (Sup. Ct. Monroe Co. 2004) both involved situations where there was an operating agreement, the operating agreement did not address a certain topic and the relevant

LLC Law provision applied by default. That is not the situation here. The instant case presents an issue of first impression.

Until the LLC owners come to an agreement and enter into the initial operating agreement, they are governed by the oral agreement upon which they formed and have been operating the LLC. Here, the terms of the oral agreement are disputed issues of fact, although they had a "meeting of the minds" on the matters which would require unanimous approval. Regardless, the owners of the LLC owe a fiduciary duty to each other. E.g., Pokoik v. Pokoik, 115 A.D. 3d 428 (1st Dept. 2014). It was both a breach of fiduciary duty, and a breach of the parties' oral agreement here, for Newman and Ettenson to impose upon Shapiro an initial Operating Agreement which was materially different from the one they had last prepared and were negotiating, and to do so in response to Shapiro's notice that he would obtain independent counsel.

Here, Newman and Ettenson imposed upon Shapiro an initial Operating Agreement which was materially different from the one being negotiated and last sent by Newman and Ettenson for his review. The consequences of the Court's ruling is that Newman and Ettenson did not even need to present a draft operating agreement for Shapiro's consideration. Under the Court's ruling, they could have chosen just to adopt and impose an Operating Agreement upon Shapiro, with no preceding discussions whatsoever. The LLC Law cannot contemplate that result.

II. THE CAPITAL CALL PROVISION OF THE OPERATING AGREEMENT WAS NOT VALIDLY ADOPTED, AS IT INCREASED SHAPIRO'S OBLIGATION TO MAKE A CONTRIBUTION WITHOUT HIS CONSENT, AND THE OCTOBER 2014 CAPITAL CALL REQUIRING SHAPIRO TO MAKE AN ADDITIONAL CONTRIBUTION OR SUFFER DILUTION WAS IN CONTRAVENTION OF SECTION 7.01 OF THE OPERATING AGREEMENT

For two years, the three owners of ENS managed it by unanimous agreement. Shapiro avers that unanimity on material decisions was one of the terms of their oral agreement. Newman and Ettenson dispute that, averring that decisions were merely made "by consensus." In any event, whether unanimity on material decisions was a term of their oral agreement was a material issue of fact not addressed by the lower court.

It is not disputed that in Rosenberg's November 12, 2013 draft of an Operating Agreement he suggested that unanimity be required for "Requiring or permitting additional Capital Contributions" and that, in their December 2, 2013 re-draft, Newman and Ettenson agreed that unanimous approval would be required for "Requiring or permitting additional Capital Contributions." It was only in the December 13, 2013 Operating Agreement that they unilaterally deleted this item as requiring unanimous approval. At the same time, they inserted into the Capital Contributions section (Section 7.01) a conflicting provision that "No Member shall be required to make Capital Contributions to the Company to eliminate Capital

Account deficits or for any other purpose, either upon dissolution of the Company or any other time."

On October 14, 2014, Newman and Ettenson issued the capital call for additional capital contributions of $10,000 by November 21, 2014, threatening Shapiro with dilution of his interest if he did not make the contribution, contrary to the provision just quoted. The lower court's observation that Shapiro was not "required" to make the capital call, but merely "requested" to make it, is not well founded. (RA 21). In granting summary judgment on the validity of this capital call, the lower court ignored the inherent conflict in the provision adopted by Newman and Ettenson and the factual issues created by this conflict. This provision was drafted by Newman and Ettenson and must be construed against them.

In addition, the lower court upheld the validity of the capital call because it upheld the imposition of the Operating Agreement by Newman and Ettenson. It is clear under Section 417(b) of the LLC Law that Newman and Ettenson could not have increased Shapiro's obligation to make additional capital contributions by an amendment to an operating agreement without his consent. Section 417(b) states, in relevant part, that "without the written consent of each member adversely affected thereby… no amendment of the operating

agreement…shall be made that (i) increases the obligations of any member to make contributions…"

Of course, as explained earlier, the LLC Law (including this provision) assumes that the parties have already complied with the statutory mandate to have a written operating agreement. It makes no sense that Newman and Ettenson could increase Shapiro's obligation to make additional contributions by adopting an Operating Agreement without his consent, when they could not do so by an amendment without his consent. Section 417(b) expresses the important legislative policy that no member may be required to make additional capital contributions without his assent to an operating agreement providing for such additional capital calls.

III. THE OCTOBER 2014 SALARY ACTION BY NEWMAN AND ETTENSON VIOLATED SECTION 9.01 OF THE OPERATING AGREEMENT AND SECTION 411 OF THE LLC LAW

On September 19, 2013, when ENS was a "member-managed" LLC, the "members" unanimously agreed that salaries would be paid to all of them. While Shapiro claims that this salary arrangement was only for 90 days from October 1, 2013 – December 31, 2013. Newman and Ettenson claim that it had no time limitation. As Newman averred, "Ettenson and I agreed to move forward on the basis of an agreement to pay salaries to <u>all</u> members including Plaintiff" (RA 454).

In their December 2, 2013 re-draft of an Operating Agreement, Newman and Ettenson agreed that unanimous approval would be required for "changing or authorizing the salaries, benefits and other compensation authorized to be paid by the Company to the Members, Managers or employees of the Company." It was only in the December 13, 2013 Operating Agreement that they unilaterally deleted this item as requiring unanimous approval, although the salaries continued to be paid to all three as "managers" after January 1, 2014 by everyone's consent.

The salary action taken by Newman and Ettenson on October 14, 2014 was as "managers" of ENS (RA 232). Their reduction of Shapiro's salary to zero, and their decision to continue to pay themselves a salary as "managers" without paying a salary to Shapiro, was a breach of their agreement to act unanimously on salary decisions and a breach of their September 19, 2013 agreement, acknowledged by Newman, to pay the agreed upon salary to all members, including Shapiro.

Ignoring the September 19, 2013 agreement and the December 2, 2013 agreement to unanimity on salary decisions, the lower court relied upon Section 411(e) of the LLC Law to hold that the October 2014 salary action by Newman and Ettenson was valid. Section 411(e) states that "Unless otherwise provided in the operating agreement, the managers shall have authority to fix the compensation of managers for services in any capacity." But, the Operating Agreement does provide otherwise. It states in Section 9.01, "No compensation shall be paid to the

Managers for their services in arranging transactions contemplated by the Company and managing the Company." As long as all three were receiving the agreed upon salaries, there was no reason for Shapiro to complain about Section 9.01. However, once Newman and Ettenson took away his salary and continued to pay their own, Section 9.01's prohibition against "compensation" to the Managers for their services is triggered.

The lower court construed the prohibition against "compensation" as not including "salary." (RA 22). There is nothing in Newman's or Ettenson's affirmations that supports that interpretation or contradicts the ordinary meaning of "salary" as included as part of "compensation." The provision was drafted by Newman and Ettenson and must be construed against them. In any event, the interpretation of "compensation" was, at best, a factual issue which the Court erred in resolving on summary judgment.

The October 14, 2014 salary action also violated Section 411(a) because the action was taken by Newman and Ettenson as "interested managers." They continued to receive the personal benefit of paying themselves a salary. The lower court did not rule that Section 411(a) did not apply. It erroneously held that defendants did not derive a personal benefit from the salary action. (RA 21).

CONCLUSION

For all of the reasons set forth above, the Decision, Order and Judgment granting summary judgment to Defendants-Respondents should be reversed and vacated.

Dated: September 6, 2016

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION: FIRST DEPARTMENT

ROBERT SHAPIRO,

Plaintiff-Appellant,

-against-

GABRIEL ETTENSON and DAVID NEWMAN,

Defendants-Respondents.

New York County
Index No.: 653571/2014

PREARGUMENT STATEMENT

1. **TITLE OF ACTION:** As set forth in caption.

2. **FULL NAMES OF ORIGINAL PARTIES AND ANY CHANGE IN THE PARTIES:** As set forth in caption.

3. **NAME, ADDRESS AND TELEPHONE NUMBER OF COUNSEL FOR APPELLANT:**

   Kilhenny & Felix
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4. **NAME, ADDRESS AND TELEPHONE NUMBER OF COUNSEL FOR RESPONDENTS:**

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   Two Wall Street
   New York, New York 10005
   (212) 732-3200

5. **COURT AND COUNTY FROM WHICH APPEAL IS TAKEN:** Supreme Court, New York County, Index No.: 653571/2014

   Decision, Order & Judgment (one paper) dated August 16, 2015 and entered in the office of the Clerk of New York County on September 2, 2015 and notice of entry was also filed on September 2, 2015.

6. **THE NATURE AND OBJECT OF THE CAUSE OF ACTION:**

   Plaintiff's Complaint asserts five causes of action for declaratory judgment and damages based upon alleged breaches of contract, fiduciary duties, and the covenant of good faith and fair dealing. Plaintiff

and the two defendants are equal members in a New York Limited Liability company named ENS Health LLC ("ENS"). The members did not adopt an operating agreement within the ninety days of the formation of ENS and thereafter, almost one year after the formation of ENS, defendants, without seeking or obtaining the consent of plaintiff, purportedly adopted an operating agreement which provided a majority of the members the right to unilaterally defeat the rights of the minority member without any consent of the minority and in abrogation of the agreement between the members. Plaintiff seeks a declaration that the operating agreement and capital call relied upon by defendants are null and void and a declaration that no member of ENS may receive a salary unless consented to by all of ENS's members, and damages for prior unequal treatment and related damages. In their answer, defendants assert five counterclaims for declaratory judgment, seeking declarations that the operating agreement, an amendment to ENS's articles of organization, and a capital call are valid and binding upon ENS and its members. Defendants also seek a declaration regarding the applicability of New York's Limited Liability Company Law (LLC Law) in the absence of a valid operating agreement, ENS's ability to pay salaries to its members and defendants' authority to reduce Shapiro's salary by majority vote.

7. **RESULT REACHED IN THE COURT BELOW:**

In the Decision and Order, the lower Court granted defendants' motion for summary judgment seeking declaratory judgment and dismissing plaintiff's complaint and granted plaintiff's motion of partial summary judgment seeking declaratory judgment and denied plaintiff's claims for damages. The Court held that defendants were authorized to adopt a limited liability operating agreement for ENS over eleven months after the formation of ENS without the consent of one of its members holding a thirty three and one-third ownership in ENS. The Court also found, contrary to the declaratory relief sought by plaintiff, that defendants were authorized to amend the Certificate of Amendment of Articles of Organization of ENS, that the default provisions of the New York LLC law were binding on ENS and its members absent any controlling provision of any written operating agreement, that defendants were authorized to issue a Call for Additional Capital to fund their unauthorized salary and further to reduce plaintiff's salary to zero dollars ($0.00).

8. **GROUNDS FOR APPEAL:**

The court below erred in granting defendants' motion for summary judgment and in dismissing plaintiff's complaint. The court below also erred in finding that plaintiff was not entitled to declaratory judgment in plaintiff's favor declaring the purported operating agreement, purported amendment to the articles of organization, purported capital call and purported unequal payment of salary were null and void based upon the plain meaning of the relevant statutory provisions governing New York limited liability companies and upon case law and

application of the facts to the law. Defendants did not have the authority to unilaterally adopt an operating agreement beyond the ninety day statutory period, when it adversely affects the equal third member, plaintiff herein and was contrary to the agreed upon and bargained for benefits, including salary and non-dilution of plaintiff's ownership interest. Further, the court below erred in finding that the termination of plaintiff's salary did not violate the statutory prohibition against interested managers favoring one group, the defendants, over another, herein, plaintiff. Additionally, the court below erred in finding that defendants' payment of salary to themselves did not, in fact, violate their own agreement to not pay managers for their services. Still further, defendants had no standing to raise any claims on behalf of ENS.

The court below also erred in alternatively finding that the default provisions of the relevant statute provided authority for the actions taken by defendants, as each action taken is not permitted under the statute or any default provision thereof. The court below also erred in finding that plaintiff was not entitled to damages as a matter of law, as evidence sufficient to grant summary judgment in favor of plaintiff was presented, including clear evidence of breach of contract and breach of fiduciary duties providing a basis for either summary judgment or leaving questions of fact requiring denial of defendants' motion for summary judgment. The court below also made clearly erroneous findings of fact.

9. **RELATED CASES:**

None.

10. **OTHER APPEALS PENDING:** There are no other appeals pending in this action.

Dated: New York, New York
September 30, 2015

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