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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DEBORA WARNER,

Plaintiff,

- v -

WILLIAM HEATH, DAVID KUZMANICH, ROBERT NUELL, KIM TABET, DAVID ROBINSON, DOES 1-10,

Defendants.

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INDEX NO. 654714/2018

MOTION DATE

MOTION SEQ. NO. 002

DECISION & ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 002) 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 83, 84, 85, 86, 87, 88, 89, 90, 93

were read on this motion to DISMISS.

Defendants William Heath, David Kuzmanich, Kim Tabet, Robert Nuell and David Robinson move to dismiss the second amended complaint (Dkt. 49 [the SAC]). Plaintiff Debora Warner opposes the motion. The motion is granted in part.

Introduction

The facts are drawn from the SAC and are assumed true for purposes of this motion to dismiss unless refuted by documentary evidence.[1]

Plaintiff is "a career fitness professional and running coach" who claims to have "developed the concept of a boutique fitness studio dedicated exclusively to running" (SAC

[1] In contrast, the factual averments in Heath's affidavit (Dkt. 57) may not even be considered (*see Basis Yield Alpha Fund (Master) v Goldman Sachs Grp., Inc.*, 115 AD3d 128, 134 [1st Dept 2014] [on motion to dismiss, defendant's "affidavit itself is not considered evidence; it merely serves as a vehicle to introduce documentary evidence to the court"]).

¶ 32).[2] In October 2012, she formed Mile High Run Club, LLC (Mile High or the Company) as a New York LLC. She then brought in Heath, Tabet, Nuell, and Robinson (collectively, the Co-Founding Members), who agreed to help raise funds for the Company so plaintiff "could focus on developing and managing [Mile High] as its CEO and face of the brand and would remain one of its largest shareholders" (¶ 33). The Co-Founding Members were collectively provided with 60% of the Company's membership interests without any consideration other than their promise to help procure other investors (*see* ¶ 100-101). The Co-Founding Members allegedly failed to procure any substantial investment in Mile High.

Mile High is governed by an amended operating agreement dated July 1, 2014 (Dkt. 58 [the Operating Agreement]). Plaintiff and the Co-Founding Members are defined as the Company's "Founding Members" (*id.* at 3). The Operating Agreement provides that Mile High's purpose "is to engage in any activity for which limited liability companies may be organized" and that its term "will continue until dissolved and wound-up in accordance with Section 12, or when the Company is otherwise terminated in accordance with applicable law" (*id.* at 5-6).

[2] "Prior to starting Mile High, Warner owned a fitness training business called The Total Movement, where she primarily trained runners of all levels outdoors. During a group run she was coaching in Central Park, Warner ended up losing someone who couldn't keep up with the pack. That's when Warner had the first spark about creating [an] indoor running studio. Warner thought it would be much better to have everyone work at their individual effort level on a treadmill, similar to the format of a spin class, with a professional trainer leading the class to optimize individual runners' performance. By bringing her training indoors, Warner believed she could train runners of different levels simultaneously, without losing any of them. Warner also had developed several individual treadmill programs for personal training clients that she thought could be applied to a group fitness format" (SAC ¶ 92).

Section 2(g) of the Operating Agreement governs members' rights to access the Company's books and records (*see id.* at 7). Section 4(a)(i) provides that the Company is to be governed a board composed of five Managers, "each of which must be a Founding Member" (*id.* at 12). Managers must cease serving on the board if and when they are removed (*see id.*). Section 3(b) ("Removal for Cause of Founding Members") governs removal of a Founding Member and provides that:

> The Board (excluding the vote or consent of the affected Member in all respects), at its sole discretion at any time, may remove or force a mandatory withdrawal from membership in the Company, the Board, any committee of the Board, as a Manager, as an officer, or as an agent, if applicable, **of any Founding Member for Cause if such Member meets any of the conditions for removal for Cause**. Upon the unanimous vote or consent of the Board (excluding the vote or consent of the affected Member in all respects), the Board may cause the mandatory withdrawal from membership in the Company and mandatory redemption at Book Value of the Interest of any Founding Member who has taken action or omitted to take any action **that would constitute Cause under this Agreement** (*id.* at 8 [emphasis added]).

Cause is extensively defined in the Operating Agreement to include numerous acts of malfeasance (*see id.* at 32).

Section 4(a)(v) governs how board vacancies may be filled and provides, except under certain delineated circulates, that a new Manager "may" be appointed (*see id.* at 13). An exception to this rule is that if plaintiff leaves the board "without Cause," the "resulting vacancy … **will be filled** by a nominee of [plaintiff] so long as [plaintiff] holds a majority of the Profit/Loss Percentage of the Company" (*id.* [emphasis added]).[3] Moreover, the

[3] It follows that the board can continue to function with the other four Members if plaintiff is removed for Cause. Indeed, since the board ordinarily may act without a meeting by Supermajority written consent (and otherwise by simple majority), the board can validly act without plaintiff even

board can remove plaintiff as CEO upon a unanimous vote of the other Managers (*see id.* at 14). Removal as CEO can occur "at any time" and, unlike removal from the board, is not predicated on a showing of Cause (*see id.*).

Section 3(a) governs the members' fiduciary duty of loyalty to Mile High and provides:

> Each Founding Member acknowledges and agrees that he or she owes a fiduciary duty of loyalty, fidelity and allegiance to act at all times in the best interests of the Company and to do no act which would injure the business, interests, or reputation of the Company or any of its subsidiaries or Affiliates. In keeping with these duties, each Founding Member and Manager will make full and prompt affirmative disclosure to the Company of all business opportunities pertaining to the Company's business and will not appropriate for his or her own benefit business opportunities concerning the subject matter of the fiduciary relationship. …. (*id.* at 8)

Moreover, the Founding Members are prohibited from competing with the Company and soliciting its employees and customers during a Restricted Period (*see id.* at 11, 23). Section 10 prohibits disclosure of the Company's confidential information as well (*see id.* at 22). The Managers are exculpated from liability unless they act in bad faith (*see id.* at 15). They also are entitled to indemnification and advancement "in connection **with the defense** of any actual or threatened action … arising out of or incidental to the business … upon receipt by the Company of an undertaking by or on behalf of the Indemnitee to repay such amount if it is determined … that such Indemnitee is not entitled to be indemnified"

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if she was still a Manager (*see id.* at 13). That is because Supermajority is defined to mean a 75% vote (*see id.* at 31), which the Co-Founding Members had without plaintiff since she was one of five board members (*see id.* at 44-45 [Exhibit D to the Operating Agreement, listing the requisite votes required for various actions]). Plaintiff does not allege any action was taken without the requisite Founding Member Supermajority (*see id.* at 45), which is calculated based on their percentage interests (*see id*. at 34).

(*see id.* [emphasis added]). While former Managers also have indemnification rights, the scope of the indemnification is limited to actions against the Managers and it does not extend to lawsuits brought by the Managers (*see id.*).

Section 12 provides that the "Company will dissolve, and its affairs will be wound up, upon the earliest to occur of (i) the prior written consent of the board (ii) the affirmative vote or consent of a Founding Member Supermajority, or (iii) the entry of a decree of judicial dissolution under Section 702 of the [LLC Law]" (*see id.* at 23).

Upon dissolution, Warner is entitled to the intellectual property (IP) that she had contributed to the Company pursuant to a Subscription and Contribution Agreement dated June 13, 2013 (*see* Dkt. 87 [the Contribution Agreement]),[4] with the value of Mile High otherwise distributed to the members without accounting for the IP (Dkt. 58 at 26).

On July 3, 2018, Warner was removed as Mile High's CEO (SAC ¶ 46). Heath then became CEO (*id.*).

In the fall of 2018, plaintiff, who was represented by counsel, commenced this action. In the initial complaint, plaintiff sought dissolution of Mile High and asserted both direct and derivative claims (*see* Dkt. 4). She amended the complaint for the first time in November 2018 (Dkt. 6) .

By letter dated December 21, 2018, plaintiff was notified that, pursuant to a written consent, the Co-Founding Members removed her from the board (*see* Dkt. 66). The letter states that the board would determine at a later date if her "removal shall be deemed for

[4] Exhibit A to the Contribution Agreement is the assignment of plaintiff's intellectual property, which she refers to as the "IP Agreement" (*see* Dkt. 87 at 5).

Cause" (*see id.*). Plaintiff has objected, averring that section 3(b) of the Operating Agreement only permits her removal for Cause.[5]

After motion practice and comprehensive discovery conferences in which various issues were addressed (including demand-futility allegations), plaintiff filed the SAC on January 25, 2019 (Dkt. 49).

Significantly, the SAC does not assert any claims derivatively on behalf of Mile High. Plaintiff only seeks relief on her own behalf.

In the SAC, plaintiff claims that dissolution is warranted based on Mile High's precarious financial condition and on alleged wrongdoing by the Co-Founding Members.

For example, plaintiff complains that Heath caused Mile High to contract with DIBS Technology (DIBS), a company in which he has an interest, in violation of his fiduciary duty of loyalty and that the Co-Founding Members aided and abetted this breach (*see* SAC ¶¶ 54-65).[6] Plaintiff also alleges that the Co-Founding Members improperly decided to accept a loan from ClassPass on terms that hurt Mile High (*see* ¶¶ 66-74). A litany of other allegations, such as allegedly imprudently managing the Company's finances and divulging confidential information, are asserted as well (*see, e.g.*, ¶ 119).

[5] Plaintiff did not move for a preliminary injunction compelling the Co-Founding Members to put her back on the board.

[6] Allegations related to the Co-Founding Members' alleged misdeeds, for the most part, only give rise to derivative claims, which have been abandoned.

Plaintiff also pleads that Heath and Kuzmanich presented the board with a fake investment proposal to dissuade the other Managers from accepting a viable, rewarding offer. She alleges:

> As Mile High's prospect of finding investors faded, in early 2018 Mile High considered other options. In the course of this effort, Mile High received an offer by a well established fitness focused company ("Purchaser") to buy Mile High's brand and business.
>
> After lengthy negotiations, Purchaser made a lucrative offer for Mile High. Purchaser's offer was in the best interest of Mile High's investors because it would have allowed each investor to receive back their original investment, as well as make a lucrative and immediately payable cash return. In addition to the immediate cash payout, each investor would have received an additional and substantial return in Purchaser's equity. Finally, each investor would have had the potential for additional upside resulting from further payouts based on three earn-outs.
>
> In May 2018, Defendants Heath and Kuzmanich, presented Mile High's board and management team an elaborate supposed offer by an alleged investor named Jim Ellsworth. Heath claimed that Ellsworth was interested in investing several hundred thousand dollars in Mile High from his "consortium" of investors at a $10M valuation.
>
> It has now been discovered that Jim Ellsworth is not an institutional investor (and likely not even an accredited investor), and never promised to make any investments alone or in a consortium. On August 30, 2018, Mr. Ellsworth stated that he "was approached by someone at Mile High several months ago about making an investment in the company, but [he] declined as the terms weren't to [his] liking."
>
> Defendants Tabet, Nuell, and Robinson knew or should have known that Heath and Kuzmanich's supposed alternative to the Purchaser's offer was false and did not exist and that they were lying. The purported terms of the offer, described more fully above, were not credible, and on their face made no sense. In addition, the supposed valuation at which Ellsworth would invest was a moving target, as was their representation that Ellsworth could sell Mile High in a "fire sale" at $7 million if the business did not pan out.
>
> The fact that Heath and Kuzmanich would not even allow a meeting with Ellsworth (as Warner requested to discuss the offer) and would not identify

> the alleged "consortium" to be brought in by Ellsworth, constituted significant red flags. It should have been readily apparent to people charged with acting in the best interest of Mile High's investors, as Defendants each were, that the supposed offer was not real. Instead of doing their job as Board members and managers the other Defendants closed an eye to Heath and Kuzmanich's false representations, asked no questions and mechanically voted to reject Purchaser's deal as they were asked to do by Heath, in violation of their fiduciary duties to Mile High and its members.
>
> It became clear from what happened next, that Defendants planned all along to place Mile High in dire financial straits in order to force sweeping changes to the [Operating Agreement], which they claimed were necessary for Mile High to receive the funds it needed to survive. Indeed, in the midst of crisis regarding Mile High's ability to keep its doors open, Defendants' priority was to strip Warner of her position, equity, and IP rights, while they seized complete control of the business (SAC ¶¶ 108-114).

The SAC contains 12 causes of action: (1) dissolution of the Company pursuant to LLC Law § 702 and "Enforcement of Warner's Right to Reversion of Mile High's IP"; (2) breach of fiduciary duty, asserted against the Co-Founding Members; (3) aiding and abetting breach of fiduciary duty, asserted against all defendants; (4) rescission of the Operating Agreement and the IP Agreement, asserted against the Co-Founding Members; (5) rescission of the Contribution Agreement, asserted against the Co-Founding Members; (6) breach of the Operating Agreement's confidentiality requirements, asserted against all defendants; (7) breach of Operating Agreement's undertaking requirements, asserted against all defendants; (8) breach of Operating Agreement's prohibition on removing plaintiff from the board without Cause and operation of the Company with a four-member board, asserted against the Co-Founding Members; (9) defamation, asserted against Heath; (10) tortious interference with business relations, asserted against Heath and Kuzmanich; (11) breach of plaintiff's indemnification and advancement rights under the Operating

Agreement, asserted against the Co-Founding Members; and (12) breach of plaintiff's books and records rights under the Operating Agreement and LLC Law § 1102.[7]

Defendants move to dismiss the SAC. They argue that plaintiff has not stated a claim for dissolution, that the bulk of the claims are derivative, that she has not properly pleaded the few claims that are indisputably direct, and that her request for punitive damages should be stricken.

Discussion

Legal Standard

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 that can be drawn 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 the defendant seeks dismissal of the complaint 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]).

[7] Plaintiff then sought to inspect the Company's books and records (*see* Dkts. 51, 52), and the court decided the scope of her access by order dated April 8, 2019 (Dkt. 68).

Dissolution (First Cause of Action)

The Operating Agreement provides that the Company may be dissolved pursuant to LLC Law § 702 and that, upon dissolution, plaintiff may reacquire the intellectual property she gave to the Company for $1. LLC Law § 702 states that an LLC may be dissolved "whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." While the LLC law is silent as to the meaning of "not reasonably practicable," case law has established that dissolution is not permitted pursuant to the statute unless "(1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible" (*Matter of 1545 Ocean Ave., LLC*, 72 AD3d 121, 131 [2d Dept 2010] [adopting Delaware rule], accord *Doyle v Icon, LLC*, 103 AD3d 440 [1st Dept 2013]; *see Barone v Sowers*, 128 AD3d 484, 485 [1st Dept 2015]).

Indeed, judicial dissolution--an "extreme" remedy--must be granted sparingly.

> [A] court will not dissolve an LLC merely because the LLC has not experienced a smooth glide to profitability or because events have not turned out exactly as the LLC's owners originally envisioned; such events are, of course, common in the risk-laden process of birthing new entities in the hope that they will become mature, profitable ventures. In part because a hair-trigger dissolution standard would ignore this market reality and thwart the expectations of reasonable investors that entities will not be judicially terminated simply because of some market turbulence, **dissolution is reserved for situations in which the LLC's management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business**, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill (*Matter of 1545 Ocean Ave.*, 72 AD3d at 130-31 [emphasis added], quoting *Matter of Arrow Inv. Advisors, LLC*, 2009 WL 1101682, at *2 [Del Ch Apr. 23, 2009]).

Even in the case of deadlock, dissolution is prohibited if the operating agreement provides a mechanism for resolving that deadlock (*see Matter of 1545 Ocean*, 72 AD3d at 131, accord *Belardi-Ostroy, Ltd. v American List Counsel, Inc.*, 2016 WL 1558850, at *6 [Sup Ct, NY County Apr. 14, 2016] ["There is no authority that permits a non-controlling member to seek dissolution of an LLC on the ground that a disagreement over strategy exists"]).

There is no deadlock here. Even if plaintiff were still on the board, she would simply be outnumbered. Her alleged wrongful removal from the board did not fundamentally alter the governance of the Company as dictated by the Operating Agreement (*see Doyle*, 103 AD3d at 440 ["Plaintiff's allegations that he has been systematically excluded from the operation and affairs of the company by defendants are insufficient to establish that it is no longer 'reasonably practicable' for the company to carry on its business … Indeed, the allegations show that the company has been able to carry on its business since the alleged expulsion of plaintiff in 2007"]). To the extent plaintiff had an urgent desire to resume influencing the Company's direction, she could have sought a preliminary injunction on her wrongful-removal claim. That she has not done so in the more than a year since her removal not only speaks volumes about the practical effect of her removal, but also shows that the Company is capable of fulfilling its stated purpose without her. After all, "dissolution is a remedy of last resort" (*Matter of Arrow*, 2009 WL 1101682, at *5; *see Matter of Klein*, 134 AD3d 450 [1st Dept 2015]). Wrongful removal should result in restoration of her position on the board, not dissolution of the LLC.

There is also no basis pleaded in the SAC to compel dissolution because continuation of Mile High is financially unfeasible. Plaintiff alleged in the SAC--more than a year ago--that the Company was about to financially implode (*see* SAC ¶ 117 [alleging the Company "has no assets to cover its liabilities, or even to keep its doors open" and therefore "there is no possible basis for the business to continue"]). She was wrong. Plaintiff does not dispute that the Company "continues to own and operate indoor treadmill studios and has opened a third studio during the pendency of this litigation" (Dkt. 54 at 15). While the Company may well have long term financial concerns, plaintiff has not plausibly alleged that continuation of the business is truly financially unfeasible.

Plaintiff's contention that the Company "is insolvent under any definition of that term" does not save her claim (*see* Dkt. 84 at 13). Many newer companies will have a debt load far in excess of its assets. Indeed, it is not uncommon for businesses to survive long periods of unprofitability with the long-term goal of gaining significant market share, developing valuable technology or potential synergies with other companies to make it an attractive acquisition target. Selling the Company has, in fact, been a major focus for the last few years. It is not for the court to force closure of newer businesses simply because its principals don't agree particularly, where, as here, there is an operating agreement that governs. So long as the Company appears to be able to run its business and there is no indication that rent, invoices, and salaries are systematically unpaid, the court will not shut it down.

Dissolution may well be required if the Company's financial situation significantly worsens in the future.[8] As pleaded in the SAC, however, this is simply a classic case where the Company "has not experienced a smooth glide to profitability" and where "events have not turned out exactly as [plaintiff] originally envisioned" (*Matter of Arrow*, 2009 WL 1101682, at *2).[9] If the Company is truly worthless, the only real utility of dissolution for plaintiff is recoupment of her IP. While she indisputably has that bargained-for right, it is expressly conditioned on meeting the requirements of § 702. That she may well have been treated inequitably by the Co-Founding Members is no basis to loosen the standards of § 702.

Fiduciary Duty Claims (Second Cause of Action)

"In order to distinguish a derivative claim from a direct one, the court considers (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders individually) (*Serino v Lipper*, 123 AD3d 34, 40 [1st Dept 2014], quoting *Yudell v Gilbert*, 99 AD3d 108, 114 [1st Dept 2012]; *see Tooley v Donaldson, Lufkin & Jenrette, Inc.*, 845 A2d 1031, 1033 [Del 2004]). "Even where an individual harm is claimed, if it is confused with or embedded in the harm to the corporation, it cannot separately stand" (*Serino*, 123 AD3d at 40). Thus, "allegations of mismanagement or

[8] It is unclear whether current events have rendered continuation of Mile High unfeasible but that is outside the scope of the SAC.

[9] Plaintiff's allegations that defendants breached their fiduciary duty of loyalty do not justify dissolution (*see Matter of 1545 Ocean Ave.*, 72 AD3d at 132 [dissolution cannot be based on claim of self-dealing]).

diversion of assets by officers or directors to their own enrichment, without more, plead a wrong to the corporation only, for which a shareholder may sue derivatively but not individually" (*Abrams v Donati*, 66 NY2d 951, 953 [1985]). Though corporate malfeasance may adversely affect the value of an investor's equity, it is well settled that "the lost value of an investment in a corporation is quintessentially a derivative claim by a shareholder" (*Serino*, 123 AD3d at 41).

With one exception, plaintiff's breach of fiduciary duty claims (including those concerning DIBS, ClassPass, Braintrace, as well as her general allegations of mismanagement) are derivative because they all seek redress for harm to Mile High for which she is not uniquely aggrieved (*see Shyer v Shyer*, 170 AD3d 577 [1st Dept 2019] ["The cause of action for breach of fiduciary duty asserted directly against the individual defendants must be dismissed because it alleges mismanagement and diversion of corporate assets, which are wrongs to the corporation"]). The parties' disputes over whether the claims are properly pleaded with sufficient particularity and whether the business judgment rule (and possibly the Operating Agreement's exculpatory clause) immunize defendants from these claims are academic. Plaintiff cannot pursue these claims directly anyway.

That plaintiff uniquely has the potential right to obtain the IP does not change the analysis. Even if defendants planned to sabotage Mile High to induce plaintiff to give up her IP, the harm would still be to the Company as all of its members equally suffer. The ultimate result of the harm, according to plaintiff, is the Company's failure; but in that case, she gets her IP back. As of now, she still has her reversionary right to the IP, so any harm

defendants have thus far caused to the Company would have harmed all members equally. She has not been specially or directly harmed. Moreover, plaintiff's consent is required before she gives up any IP rights. There simply is no plausible basis to conclude that plaintiff suffered unique damages by virtue of the allegations concerning the management of the Company.

By contrast, when management has an opportunity to sell a company in a transaction that would involve divestiture of control, the managers have direct fiduciary duties to the shareholders in connection with the potential sale.[10] Here, plaintiff claims that Heath and Kuzmanich presented the board with a fake investment proposal to dissuade the other Managers from accepting a real offer (*see* SAC ¶¶ 110-114).[11] Plaintiff further alleges that Heath and Kuzmanich wanted to scuttle the sale because they "stood to lose an approximately $30,000 finder's fee that they claimed they were entitled if they successfully raised funds for Mile High" (¶ 233). Fraudulently inducing the board to reject a sale that a fully informed and unconflicted board would conclude is in the best interests of all

[10] New York has not formally adopted *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc.* (506 A2d 173, 182 [Del 1986] ["The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit"]; *see* 4C N.Y .Prac., Com. Litig. in New York State Courts § 94:26 [4th ed.]). The claim, however, is necessarily direct because an entity itself is indifferent about whether it is sold; it is the shareholders that stand to lose if managers fail to get the best possible price or forgo a sale to entrench themselves (*see Gatz v Ponsoldt*, 925 A2d 1265, 1277 [Del 2007]; *see also El Paso Pipeline GP Co., L.L.C. v Brinckerhoff*, 152 A3d 1248, 1266 [Del 2016] [Strine, C.J., concurring]). Because the company itself is not harmed, the claim is direct.

[11] The business judgment rule does not warrant dismissal on a motion to dismiss where, as here, board members allegedly engaged in fraud and self-dealing (*Fletcher v Dakota, Inc.*, 99 AD3d 43, 48 [1st Dept 2012]; *see Matter of Kenneth Cole Prods., Inc., Shareholder Litig.*, 122 AD3d 500, 501 [1st Dept 2014], *affd* 27 NY3d 268 [2016]).

members is a direct claim because the harm affects the members and not the Company (*see Citigroup Inc. v AHW Inv. Partnership*, 140 A3d 1125, 1127 [Del 2016] ["Before evaluating a claim under *Tooley*, 'a more important initial question has to be answered: does the plaintiff seek to bring a claim belonging to her personally or one belonging to the corporation itself?"]; *see also Gatz*, 925 A2d 1277 [recognizing direct breach of fiduciary duty claims]).

On the merits, defendants have not articulated a valid basis for dismissal of the sale-related fiduciary breach claim. Aside from urging that all of the alleged fiduciary duty claims are really direct, they also argue--ironically, very generally-- that all such claims are not pleaded with sufficient particularity and that they impermissibly duplicate the breach of contract claims. Allegations related to sale of Mile High are sufficiently pleaded (SAC ¶¶ 110-114). Plaintiff has put defendants on notice of the conduct on which the claim is based, which satisfies CPLR 3016(b) (*see Sargiss v Magarelli*, 12 NY3d 527, 530 [2009]).

Nor is this claim duplicative of plaintiff's breach of contract claims as neither plaintiff nor defendants aver that a particular provision of the Operating Agreement governs this issue. On the contrary, defendants' default fiduciary duties control (*see Pokoik v Pokoik*, 115 AD3d 428, 429 [1st Dept 2014]).[12] The Operating Agreement's exculpatory

[12] There is no basis to conclude that breach of fiduciary duty claims are converted into contract claims simply because the Operating Agreement reaffirms that the Co-Founding Members have the usual fiduciary duties subject to their liability being limited to instances of bad faith.

provisions, moreover, would not apply to the alleged fraud (since fraud, as discussed below, requires scienter and thus is incompatible with good faith).[13]

Kuzmanich, however, was not on the board and is not otherwise alleged to be a managing member. He does not have direct fiduciary duties to plaintiff (*see SSA Holdings LLC v Kaplan*, 120 AD3d 1111 [1st Dept 2014]). Thus, his liability is limited to aiding and abetting a breach.

Aiding & Abetting Breach of Fiduciary Duty (Third Cause of Action)

The only viable underlying breach of fiduciary claim that can anchor aiding and abetting liability is plaintiff's direct claim related to stymying the sale of Mile High. Though Kuzmanich, a non-board member, can be the subject of an aiding and abetting claim on the facts pleaded (he is alleged to have worked with Heath to defraud the board and there are sufficient facts pleaded as to actual knowledge and substantial assistance [*see*

[13] To the extent plaintiff pleads that defendant board members (all of them but Heath) "should have known about the false representations" and that "they simply sit there to say 'yes' or 'no' to whatever Heath commands them to do," they might be exculpated from such alleged negligence (SAC ¶¶ 201, 235; *see Deckter v Andreotti*, 170 AD3d 486, 487 [1st Dept 2019]). While the failure to make fully-informed votes can implicate both the duties of care and loyalty (*see Matter of Santa Fe Pac. Corp. Shareholder Litig.*, 669 A2d 59, 67 [Del 1995]), it is not necessarily the case that all such breaches amount to more than ordinary negligence (*see Matter of Zale Corp. Shareholders Litig.*, 2015 WL 6551418, at *3 [Del Ch Oct. 29, 2015]). Though plaintiff pleads, in a conclusory fashion, that defendants engaged in gross negligence (*see, e.g.*, SAC ¶ 188), she does not plead any facts suggesting conduct tantamount to intentional misconduct (*see Sommer v Fed. Signal Corp.*, 79 NY2d 540, 554 [1992] ["Gross negligence, when invoked to pierce an agreed-upon limitation of liability in a commercial contract, must smack of intentional wrongdoing"]; *see also Madison Sullivan Partners LLC v PMG Sullivan St. LLC*, 2018 WL 372223, at *7-8 [Sup Ct, NY County Jan. 11, 2018], *affd* 173 AD3d 437 [1st Dept 2019]). While plaintiff pleads detailed facts suggesting Heath and Kuzmanich engaged in intentional misconduct, the others appear only to have allegedly been asleep at the wheel. Dismissal on this basis at this stage as against the Co-Founding Members, however, is unwarranted and was not sought by defendants in their moving brief. Plaintiff may need discovery to raise questions of bad faith on summary judgment.

Goldin v TAG Virgin Islands, Inc., 149 AD3d 467, 468 (1st Dept 2017)]), the board-member defendants are already subject to the actual breach of fiduciary duty claim itself. The aiding and abetting cause of action against them would therefore be duplicative and is dismissed as to everyone except Kuzmanich.

Rescission (Fourth & Fifth Causes of Action)

Plaintiff seeks to rescind the Operating Agreement, IP Agreement, and Contribution Agreement based on allegedly fraudulent misrepresentations made by the Co-Founding Members (*see J.P. Morgan Sec. Inc. v Ader*, 127 AD3d 506, 507-08 [1st Dept 2015] ["a defrauded party to a contract may elect to either disaffirm the contract by a prompt rescission or stand on the contract and thereafter maintain an action at law for damages attributable to the fraud"]). "The elements of a cause of action for fraud [are] a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages" (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). The claim must be pleaded with particularity pursuant to CPLR 3016(b) (*see id.*).

Defendants correctly contend that this claim suffers from a host of pleading problems, most notably that plaintiff does not allege any specific misrepresentation by a particular defendant made with the requisite intent to defraud (*RKA Film Fin., LLC v Kavanaugh*, 171 AD3d 678 [1st Dept 2019]; *see Cronos Grp. Ltd. v XComIP, LLC*, 156 AD3d 54, 72 [1st Dept 2017] ["where a fraud claim is based upon an alleged false promise, the plaintiff is required to plead specific facts from which it may be reasonably inferred that the defendant did not intend to keep the promise when it was made"]). Rather, she

simply claims that defendants never intended to raise any money for the Company or fund specific accounts and that they always intended to try to steal her equity (*see Jonas v National Life Ins. Co.*, 147 AD3d 610, 612 [1st Dept 2017], citing *New York Univ. v Continental Ins. Co.*, 87 NY2d 308, 318 [1995] ["General allegations that defendant entered into a contract while lacking the intent to perform it are insufficient to support the claim"]; *see also Perella Weinberg Partners LLC v Kramer*, 153 AD3d 443, 449 [1st Dept 2017]). Her allegations to this effect are conclusory (*see Fried v Lehman Bros. Real Estate Assocs. III, L.P.*, 156 AD3d 464, 465 [1st Dept 2017]). The SAC lacks any specific facts supporting these allegations and there is no basis in the pleading for any reasonable inference that the allegations are true (*see id.*). Nowhere in the SAC does plaintiff allege any facts indicating that, at the time she executed the agreements, the Co-Founding Members intended to defraud her. That defendants failed to adequately perform the tasks for which they were given equity and which justified plaintiff agreeing to the terms of the subject agreements does not mean they never intended to do so from the outset (*see Cronos*, 156 AD3d at 72, citing *Lanzi v Brooks*, 54 AD2d 1057, 1058 [3d Dept 1976] ["any inference drawn from the fact that the expectation did not occur is not sufficient to sustain the plaintiff's burden of showing that the defendant falsely stated his intentions"], *affd* 43 NY2d 778 [1977]). Her claims for rescission based on fraud are therefore dismissed.

Confidentiality & Undertaking Requirements (Sixth & Seventh Causes of Action)

Plaintiff's allegations that defendants improperly disclosed Mile High's confidential information and failed to provide the requisite undertaking state claims for harm to the Company and not any of its members uniquely. It is the Company that suffers if its

confidential information is wrongfully disclosed or if it is not repaid, and it is the Company that would obtain recovery for these wrongs. The claims are derivative and are therefore dismissed.

Removal of Plaintiff from the Board (Eighth Cause of Action)

Defendants aver that the other board members may remove plaintiff without Cause and that the only implication of a for-Cause removal is that she can be compelled to be bought out at book value (*see* Dkt. 54 at 27-28). Section 3(b) of the Operating Agreement, however, could not be clearer. It provides that the other board members may only remove a Founding Member from the board "if such Member meets any of the conditions for removal **for Cause**" (Dkt. 58 at 8 [emphasis added]). Defendants ignore this provision and instead focus on section 4(a)(iii), which lists the term of a Manager's service on the board, which may end when she "is removed from office by a Board Supermajority" (*see* Dkt. 89 at 17).[14] While that provision applies generally to Managers, section 3(b) expressly requires Cause to remove a Founding Member from the board (*see Muzak Corp. v Hotel Taft Corp.*, 1 NY2d 42, 46 [1956] ["Even if there was an inconsistency between a specific provision and a general provision of a contract … the specific provision controls"]).[15] Unlike with respect to her position as CEO, the Operating Agreement does not provide the board with the right to remove plaintiff from the board without Cause.

[14] Supermajority is ordinarily the vote threshold required for this sort of matter (*see* Dkt. 58 at 45).

[15] To go one step further and compel redemption of a Founding Member's interest in the Company the vote must be unanimous, though removal only requires a Supermajority (*see id.*).

Defendants, moreover, do not claim that there is Cause for Warner's removal. Nothing in the Operating Agreement permits her removal from the board without Cause and an open-ended threat to maybe, one day, decide that the removal was for Cause plainly does not satisfy the requirement. The eighth cause of action thus survives.

Defamation (Ninth Cause of Action)

The SAC does not state a claim for defamation. "Defamation is the making of a false statement about a person that tends to expose the plaintiff to public contempt, ridicule, aversion or disgrace, or induce an evil opinion . . . in the minds of right-thinking persons, and to deprive [plaintiff] of their friendly intercourse in society" (*Frechtman v Gutterman*, 115 AD3d 102, 104 [1st Dept 2014]). "The elements are a false statement, published without privilege or authorization to a third party, constituting fault as judged by, at a minimum, a negligence standard, and it must either cause special harm or constitute defamation per se" (*id.*). "A statement is defamatory on its face when it suggests improper performance of one's professional duties or unprofessional conduct" (*id.*).

The SAC alleges that Heath sent an email to at least one investor in which he falsely claimed that (1) plaintiff was fired due to her "lack of alignment and discord with the board"; (2) she was pushing [the members] to sell [Mile High] to Purchaser for a price and terms that did not make sense"; and (3) such prospective deal "would have barely given you your initial invested capital back up front" and that "all upside in the deal was tied up in [Purchaser's] stock and a cash earn-out over several years" (SAC ¶¶ 263-264). These statements were made in an email sent by Heath on July 15, 2018 (Dkt. 62). Plaintiff did not attach this email to the SAC or quote it in its entirety. Had she done so, it would have

been apparent that Heath was not defaming her, as he begin the email by stating that he was "**thankful** for [plaintiff's] **unwavering commitment** to [the Company]" (*see id.* [emphasis added]). These opening remarks put the later statements into context and show that no reasonable reader of the email would believe Heath was impugning plaintiff's professional integrity.

Yet, even if the three statements are considered on their own it is clear they are not defamatory as a matter of law. The first is not false (*see Stepanov v Dow Jones & Co.*, 120 AD3d 28, 34 [1st Dept 2014] ["Because the falsity of the statement is an element of the defamation claim, the statement's truth or substantial truth is an absolute defense"]). The second is a matter of opinion (*Brian v Richardson*, 87 NY2d 46, 51 [1995] ["Since falsity is a *sine qua non* of a libel claim and since only assertions of fact are capable of being proven false, we have consistently held that a libel action cannot be maintained unless it is premised on published assertions of fact"]; *see Pecile v Titan Capital Grp., LLC*, 96 AD3d 543, 544 [1st Dept 2012]).[16] And the third, even if false, is not defamatory (*see Thomas H. v Paul B.*, 18 NY3d 580, 584 [2012] [false statement must tend "to expose a person to public contempt, hatred, ridicule, aversion or disgrace"]). Plaintiff does not cite any authority suggesting that falsely articulating or implying that a colleague has an incorrect view of a business matter is defamatory. If such a statement were defamatory, countless routine work conversations would give rise to defamation claims and the effect would be

[16] Plaintiff does not argue that any of the statements constitute a "mixed opinion," nor could they reasonably be construed as such (*see Steinhilber v Alphonse*, 68 NY2d 283, 289-90 [1986]).

to utterly chill business communications. Not every false statement is defamatory (*see Franklin v Daily Holdings, Inc.*, 135 AD3d 87, 92 [1st Dept 2015]).

The SAC also asserts that Heath made many other allegedly false statements in a letter dated December 21, 2018 (Dkt. 65), in which he claimed that: (1) plaintiff "has extraordinarily extensive noncompete" – which is substantially true (*see Birkenfeld v UBS AG*, 172 AD3d 566 [1st Dept 2019]) and at most "extraordinarily extensive" is an opinion; (2) plaintiff "had discussions with Purchaser in February, and that Mile High knew nothing further of any other discussion with Purchaser" – which may well be false but is not defamatory; (3) the Company did "not know that Warner became employed by Purchaser after she was fired by Heath as Mile High's CEO" – which also may well be false but also is not defamatory; (4) plaintiff "is subject to extraordinary restrictive covenants as a former employee and manager and as a founding member of Mile High" – which, again, is substantially true; and (5) "Warner is bound by restrictive covenants that are unlimited geographically and temporally" – which, again, is substantially true and in any event could easily be clarified to a prospective employer by plaintiff with the Operating Agreement so is not plausibly capable of causing damage (*see* SAC ¶ 277).[17] The letter also allegedly misrepresented "the nature and terms of Warner's contractual commitment," casted plaintiff "in a false light with her new employer," falsely claimed "that in order for Warner to be able to continue employment with her new employer, Mile High needed to receive

[17] Most, if not all, of the claims do not qualify as defamation per se, so the failure to plead special damages also is a problem (*see Sandals Resorts Intl. Ltd. v Google, Inc.*, 86 AD3d 32, 39 [1st Dept 2011]).

'written assurances,'" and that plaintiff and the Company "have 'certain on-going issues'" (*see id.*). These alleged statements are either too imprecise to sustain a claim for defamation (e.g., the actual misrepresented terms of the contract are not alleged) (*see Shawe v Kramer Levin Naftalis & Frankel LLP*, 167 AD3d 481, 483 [1st Dept 2018] ["the complaint does not allege, as required, that the words of which plaintiff complains are defamatory"]) or are substantially true (e.g., the parties most certainly have "on-going issues") (*see Birkenfeld*, 172 AD3d at 566) or do not tend to impugn plaintiff.

For these reasons, the defamation claims are dismissed.

Tortious Interference with Business Relations (Tenth Cause of Action)

To state a claim for tortious interference with business relations the plaintiff must plead "1) that it had a business relationship with a third party; 2) that the defendant knew of that relationship and intentionally interfered with it; 3) that the defendant acted solely out of malice or used improper or illegal means that amounted to a crime or independent tort; and 4) that the defendant's interference caused injury to the relationship with the third party" (*Amaranth LLC v J.P. Morgan Chase & Co.*, 71 AD3d 40, 47 [1st Dept 2009]). This claim is derivative to the extent it relies on predicate torts[18] that the court has found to be derivative. To the extent the predicate tort is the direct claim that Heath and Kuzmanich lied about Ellsworth to scuttle the potential deal with the Purchaser (*see* SAC ¶¶ 288-289), the claim fails since that alleged wrong did not plausibly interfere with plaintiff's business relationships with third parties, as the only result was the loss of the

[18] Plaintiff does not (and could not) plausibly plead that defendants acted solely out of malice since plaintiff herself pleads the economic motivations for their actions.

opportunity to receive compensation for her equity. The claim, moreover, also cannot be based on her now-dismissed defamation claim.

Indemnification & Advancement (Eleventh Cause of Action)

Section 4(g) of the Operating Agreement only provides former Managers, such as plaintiff, with indemnification rights for costs "incurred in connection with the **defense** of any actual or threatened" lawsuit (*see* Dkt. 58 at 15 [emphasis added]). Plaintiff is not entitled to indemnification for her affirmative claims in this action (*cf. G2 FMV, LLC v Thomas*, 135 AD3d 421, 422 [1st Dept 2016]).[19]

Books & Records (Twelfth Cause of Action)

The court has already determined that plaintiff has the right to inspect the Company's books and records and the scope of that inspection (*see* Dkt. 68). Dismissal of the claim is therefore denied.

[19] Plaintiff, however, may seek advancement if defendants counterclaim. In opposition, plaintiff correctly notes that fees incurred dealing with a threatened claim could be subject to advancement, but she does not identify any such fees (Dkt. 84 at 24; *see* SAC ¶ 306). Nor are the potential fees listed in SAC ¶ 307 a basis for advancement because they appear to relate to third-party discovery costs that plaintiff may have to defray in connection with her own claims. But even if plaintiff had stated a claim for advancement, that claim would have to be asserted against the Company, not the defendants (*see* Dkt. 58 at 15 [providing that indemnification and advancement is provided "by the Company"]). Plaintiff would need to name the Company as a defendant if she amends her complaint in the event circumstances warranting advancement occur. Indeed, if she later seeks to amend her dissolution claim, she may choose to name the Company as a nominal defendant. While LLC Law § 702 is silent on this issue, BCL § 1106(a) requires the corporation to be noticed in a dissolution petition, and it would seem that the same requirement ought to exist in an LLC's dissolution proceeding since the rights of the LLC stand to be equally adversely affected. Then again, since an LLC is merely an unincorporated entity governed by an agreement among its members, perhaps the Legislature intentionally omitted this requirement for LLCs. It is unclear.

Punitive Damages

Punitive damages are recoverable on breach of fiduciary duty claims irrespective of the otherwise applicable requirements of moral turpitude and harm aimed at the public (*Briarpatch Ltd., L.P. v Frankfurt Garbus Klein & Selz, P.C.*, 13 AD3d 296, 298 [1st Dept 2004]; *see Indosuez v Barclays Bank PLC*, 181 AD2d 447 [1st Dept 1992], citing *Belco Petroleum Corp. v AIG Oil Rig, Inc.*, 164 AD2d 583, 587 n 3 [1st Dept 1991] ["the requirement of a public wrong may be dispensed with when the parties are in a fiduciary relationship"]). Because the fiduciary duty claim concerning the prospective sale of the Company survives, it is premature to dismiss the possibility that punitive damages are recoverable. The other surviving claims for breach of contract, however, are purely private commercial disputes that do not give rise to punitive damages (*Macy's Inc. v Martha Stewart Living Omnimedia, Inc.*, 127 AD3d 48, 57 [1st Dept 2015]; *see Rocanova v Equitable Life Assur. Soc. of U.S.*, 83 NY2d 603, 613 [1994]).

Leave to Amend

Plaintiff's unelaborated request for leave to amend is denied. It is not supported by a proposed amended pleading or an explanation for how such pleading would correct the identified deficiencies (Dkt. 84 at 27; *see Moore Charitable Foundation v PJT Partners, Inc.*, 178 AD3d 433, 434 [1st Dept 2019]). Because this is the first time the court has formally ruled on plaintiff's claims, the court will not dismiss any of the claims with prejudice, except that plaintiff cannot seek to further pursue any of the derivative claims by once again bringing direct claims. To the extent plaintiff seeks leave to amend, absent a stipulation to the proposed amendments, she must do so by formal motion and at that

time the court will assess whether the proposed claims are devoid of merit or would unduly prejudice defendants (*see McGhee v Odell*, 96 AD3d 449, 450 [1st Dept 2012]).

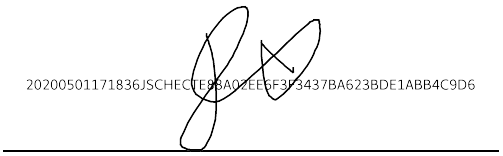
In conclusion, the only viable claims for monetary damages here relate to the allegedly sabotaged sale of Mile High. The wrongful-removal claims involving injunctive relief should be easily resolvable on summary judgment. The books and records issues have largely been resolved. The parties are again urged--especially in light of recent developments and despite their prior repeated unsuccessful efforts--to settle this case as any other outcome will simply result in more substantial expense and uncertainty. While the parties most certainly have grievances against each other, a business divorce remains the only sensible approach. The sooner it happens, the less the parties will spend on litigation allowing them to pursue more constructive endeavors. Plaintiff wants out and defendants want to be able to sell the Company without being encumbered by her and her potential claim to the IP. The parties are therefore directed to again engage in good-faith settlement efforts prior to the discovery conference, and if they do not report to the court that they expect to settle, the court will lift the discovery stay and a formal discovery schedule will be set.[20]

Accordingly, it is

[20] Plaintiff is currently representing herself. She has indicated that, if the case continues, she wants to retain new counsel (and she would be required to do so if derivative claims are asserted). Should she wish to retain new counsel, which is highly encouraged as this is a complex commercial matter, the court will afford her reasonable time to do so before proceeding with discovery. If that is plaintiff's intention, she should email the court copied to counsel prior to the scheduled conference so that it may be adjourned to a date that would provide enough time for replacement counsel to get up to speed.

ORDERED that defendants' motion to dismiss the SAC is granted to the extent that all claims are dismissed except: (1) the portion of the second cause of action asserted against the Co-Founding Members for breach of fiduciary duty concerning the offer by Ellsworth and the vote against the sale by the Purchaser and the portion of the third cause of action against Kuzmanich for aiding and abetting this alleged breach of fiduciary duty; (2) the eighth cause of action for breach of contract based on plaintiff's removal from the board without Cause; (3) the twelfth cause of action for books and records; and (4) the punitive damages demand on the remaining breach of fiduciary duty claim; and it is further

ORDERED that a telephonic status conference will be held on June 5, 2020 at 2:30 p.m., and the parties shall e-file and email the court a joint letter at least one week beforehand.



5/1/2020
DATE

JENNIFER G. SCHECTER, J.S.C.

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