SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. JENNIFER G. SCHECTER** **PART 54**

Justice

--X

INDEX NO. 651598/2017

MOTION SEQ. NO. 003

ATLANTIS MANAGEMENT GROUP II LLC,

Plaintiff,

- v -

RAJAN NABE, RAHUL NABE, FARMERS PETROLEUM LLC, BRUCKNER PETROLEUM LLC,10TH AVENUE PETROLEUM LLC,138 PETROLEUM LLC,

Defendants.

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DECISION + ORDER ON MOTION & X-MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 003) 170, 171, 172, 173, 174, 175, 176, 178, 179, 180, 181, 182, 183, 184, 185, 186, 187, 188, 189, 190, 191, 192, 193, 194, 195, 196, 197, 198, 199, 200

were read on this motion to/for AMEND CAPTION/PLEADINGS.

Rajan Nabe, Rahul Nabe ("Managing Members"), Farmers Petroleum LLC, Bruckner Petroleum LLC, 10th Avenue Petroleum LLC and 138 Petroleum LLC (collectively the "Companies") move pursuant to CPLR 3025(b), for an order granting leave to amend their answer to assert eight additional counterclaims (third through tenth counterclaims) based on facts and circumstances occurring subsequent to the filing of their original answer. Plaintiff Atlantis Management Group II ("Atlantis" or "Investor Member") opposes the motion and cross-moves for an order granting it summary judgment on the remaining causes of action in the complaint.

The motion and cross-motion are granted in part.

Background

Plaintiff as "Investor Member" and defendants Rajan Nabe and Rahul Nabe as "Managing Member" entered into Operating Agreements ("OAs") for four New York companies. Each company operates a gasoline service station. The Nabes also issued personal guarantees to the Investor Members for "the full and prompt performance of each and every obligation" of the Managing Member under the OAs (*see, e.g.,* Dkt. 5 at 37-40).[1]

Beginning in 2008, under the OAs, which are substantially the same, the Companies made monthly profit distributions to Investor Member based on monthly profit and loss statements from gasoline and merchandise sales (Dkts. 181-84 [OAs]). Defendants allege that in 2011, the parties orally agreed (in the "Oral Agreement") that plaintiff would accept a fixed sum of $10,000 each month from the Companies and that defendants were no longer required to provide plaintiff with financial information. Plaintiff disputes whether any financial disclosure could be withheld and asserts that this payment arrangement was to continue merely until the Managing Members improved their accounting methodology for the Companies.

In or about 2012, a competing gasoline station near the station belonging to 10th Avenue Petroleum LLC (the "Company") closed and Investor Member contends that the Company's profits materially increased. In 2016, plaintiff verbally and in writing demanded financial statements and an accounting from the Companies, urging that it was entitled to its share of profits (Dkt. 180 [Complaint] ¶¶ 53-55). Managing Members

[1] References to "Dkt" followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF).

contended that, pursuant to the Oral Agreement, Investor Member waived its rights to a percentage of profits and to the Companies' books and records. Investor Member sent notices of default and notices to cure to Managing Members for violations of the OAs stemming from failure to provide access to books and records, failure to properly keep financial records, failure to use the designated accountants and failure to properly make profit distributions (Dkts. 185-186, 190-192 [Notices]). The Notices further provided that if the Managing Members failed to cure, the Investor Member would exercise its buy-back rights pursuant to the OAs (*see id.*; Complaint ¶ 109).

The OAs provide, in relevant part, that if, among other things, the Managing Members "[b]reach **any provision** of this [OA]" (OAs § 6.2 [emphasis added]), the Investor Member shall have the right "to Buy-Back all of the Membership Interests of the Managing Members in consideration for the sum of One ($1.00) Dollar U.S. . . ." (OAs § 6.3).

In 2017, plaintiff commenced this action asserting causes of action for (1) an accounting,[2] (2) breach of fiduciary duty against individual defendants, (3) breach of contract, (4) specific performance (based on the buy-back provision), (5) declaratory judgment (as to ownership of Companies) and (6) fraud.

Defendants move for leave to amend their answer to assert additional counterclaims based on breach of fiduciary duty relating to 2020 events. Plaintiff opposes the motion and cross-moves for summary judgment on its remaining causes of action.

[2] Plaintiff was awarded partial summary judgment on its accounting claim (*see* Dkts. 193, 194).

Analysis

Plaintiff's Cross-Motion for Summary Judgment

Plaintiff's cross-motion for summary judgment is for the most part denied and, after searching the record, some of its claims are dismissed.

Breach of Fiduciary Duty (second cause of action)

To the extent that plaintiff maintains there is a viable claim for breach of fiduciary duty independent of the OAs based on self-dealing (such as interest free loans and improper luxury expenses--*see* Dkt. 178 at 8), such derivative claims have not been unquestionably proven (and, to be sure, the claims for "violations of their duty of care, their duty of loyalty, their duty of honesty, and/or self dealing, with respect to their management" are derivative, not direct claims) and summary judgment on the second cause of action is denied.

Breach of Contract, Specific Performance and Declaratory Judgment Related to Buy-Back Provision (third, fourth and fifth causes of action; second counterclaim)

Plaintiff's breach of contract cause of action is based on alleged defaults listed in the Notices. As already made clear in previous decisions, there remain disputed questions of fact with respect to the Oral Agreement between the parties regarding profit distributions and the scope of any such agreement (Dkts. 193, 194). Resolution of this heavily-disputed issue will determine, in large part, plaintiff's alleged entitlement to damages, which can be calculated.

Plaintiff is, however, entitled to summary judgment on its claim for breach of § 13.1(D) of the OAs. In the decision and order dated October 1, 2018, this court determined

that plaintiff was "entitled to a copy of the books and records referred to in Limited Liability Company Law 1102 and Article 13 of the LLC Defendants' Operating Agreements" (Dkt. 193 at 6-7). Therefore, plaintiff's motion for summary judgment for breach of contract is granted as to liability only for breach of Section 13.1(D) of the OAs.

Despite the books-and-records breach or even any other provable breach of the OA's alleged, as a matter of law, plaintiff is not entitled to buy back defendants' interests for $1.

A penalty provision will not be enforced "if it is against public policy to do so and public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority" based on the principle of just compensation for loss (*Truck Rent-A-Ctr v Puritan Farms 2nd, Inc.*, 41 NY2d 420, 424 [1977]; *Beltway 7 Props., Ltd. v Blackrock Realty Advisors, Inc,* 167 AD3d 100, 106-107 [1st Dept 2018]; *Matter of Krodel v Amalgamated Dwellings Inc.*, 166 AD3d 412, 414 [1st Dept 2018] [parties may contract for attorneys' fees so long as they are not in the nature of a penalty or forfeiture]).

Where, as here, a clause is intended to "secure performance by the compulsion of the very disproportion" it is plainly unenforceable (*Truck Rent-A-Ctr.*, 41 NY2d at 424; *see also Trustees of Columbia Univ. in the City of NY v D'Agostino Supermarkets, Inc.*, 36 NY3d 69, 73 [2020] [penalty clauses that are disproportionate to a breach are unenforceable]).

In fact, disproportionate penalty provisions are practically no different from unenforceable liquidated damages clauses. "In interpreting a provision fixing damages, it

is not material whether the parties themselves have chosen to call the provision one for 'liquidated damages' . . . or have styled it as a penalty" (*Truck Rent-A-Ctr*, 41 NY2d at 425). "'A contractual provision fixing damages in the event of breach, will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced'" (*JDM Holding Corp. v Congress Financial Corp.*, 4 NY3d 373, 381 [2005], citing *Truck Rent-A-Ctr*, 41 NY2d at 425; *see also 172 Van Duzer Realty Corp. v Globe Alumni Student Assistance Assn., Inc.*, 24 NY3d 528, 536 [2014]; *Trustees of Columbia University in City of New York*, 36 NY3d at 731 [a party can show a liquidated damages clause is an unenforceable penalty by showing the amount of damages are grossly disproportionate to the actual damages]; *Free People of PA LLC v Delshah 60 Ninth, LLC,* 169 AD3d 622, 623 [1st Dept 2019] [under the circumstances and the nature of the contract, lease's rent-credits provision was an unenforceable penalty]; *Cuencana v ECC Leasing Co. Ltd*, 154 AD3d 501, 502 [1st Dept 2017] ["While the complaint is facially deficient and must be dismissed, we note that the court below identified that there are factual issues surrounding whether the $2.18 million, 'non-refundable' deposit was a valid liquidated damages provision or an unenforceable penalty"]).

Here, it is clear that the buy-back clauses--forfeiture for a dollar--are grossly disproportionate, unreasonable, unenforceable penalty provisions. By their terms, any breach "**of <u>any</u> provision**" however trivial triggers the draconian $1-buy-out consequence without regard to the magnitude of the breach or actual value of the interest surrendered

(OAs §§ 6.2[1] [emphasis added]; 6.3 [upon five days written notice, Investor Members shall have the right "to Buy-Back all of the Membership Interest of the Managing Members in consideration for the sum of One ($1.00) Dollar"]). Section 6.3 is "conspicuously disproportionate to [] foreseeable losses" (*JDM Holding Corp*, 4 NY3d at 380) because the same drastic remedy applies to an immaterial technical breach as it does a material one. By punishing any breach, however minor, with forfeiture of valuable interests in exchange for a mere dollar, the intent of the provision is purely punitive. In no way was it intended to remotely correspond with the magnitude of any loss or injury. Recovery must ultimately be "limited to actual damages proven" (*id.* at 380-81) and there is no reason it cannot be. After searching the record, the OAs' buy-back provisions (§ 6.3) are unenforceable penalty clauses as a matter of law. Plaintiff's motion for summary judgment for specific performance (fourth cause of action) is denied, the claim for entitlement to that relief is rejected, the cause of action is dismissed and a declaration against entitlement to that relief (fifth cause of action) is issued and summary judgment is awarded to defendants on the second counterclaim.

Fraud (sixth cause of action)

Plaintiff's motion for summary judgment on its fraud claim is denied and the claim is dismissed for failure to state a cause of action. Plaintiff asserts that "the complaint particularizes two claims for fraud, for fraudulent tax returns and fraudulent statements of intention to provide financial reporting" (Dkt. 178 at 27). As a matter of law, plaintiff has not pleaded much less proven, detrimental reliance on filings with tax authorities nor has it alleged any actual damages were suffered (*see* Dkt. 180 ¶ 92 [LLCs have been exposed

to "potential tax liabilities"], ¶ 94 [acts or omissions with respect to required tax reporting "have or may subject plaintiff to potential claims, liabilities, costs and expenses"]). The failure to provide an accounting, moreover, is insufficient for purposes of pleading a fraudulent inducement claim that is not duplicative of its breach of contract claim as plaintiff has not adequately alleged a promise collateral to the contract nor has it pled scienter or alleged facts showing any intent at the time of contracting not to perform (*see I.M.P. Plumbing & Heating Corp. v Munzer & Saunders, LLP*, 199 AD3d 569 [1st Dept 2021]; *Pate v BNY Mellon-Alcentra Mezzanine III, L.P.*, 163 AD3d 429, 430 [1st Dept 2018]; *Cronos Group Ltd. v XComlP, LLC*, 156 AD3d 54, 62 [1st Dept 2017]).

Affirmative Defenses

The first affirmative defense--failure to state a cause of action--is dismissed as plaintiff's have clearly stated a valid cause of action. Likewise, the sixth affirmative defense--statue of frauds--is dismissed as defendants (who are invoking an oral agreement) have not shown the defense's applicability by alleging which of plaintiff's claims could be barred by lack of a writing. The eighth affirmative defense (buyback is "unenforceable penalty") is dismissed as moot. The eleventh ("defendants did not breach any applicable duty") and twelfth ("defendants at all times acted in the lawful exercise of their proper authority") affirmative defenses are dismissed because they are not in fact affirmative defenses on which defendants have the burden of proof. The fourteenth affirmative defense, based on plaintiff's purported failure to mitigate, is dismissed because defendants fail to explain how plaintiff should have mitigated any contractual damages it allegedly suffered.

The remaining affirmative defenses may proceed for now as plaintiff has not met its heavy burden of establishing that they should be dismissed. The scope of sections of the OAs invoked by plaintiff as barring certain affirmative defenses cannot be determined as a matter of law and there are certainly questions of fact as to whether there was an executed oral agreement between the parties and whether their performance was unequivocally referable to any oral modification based on their years of dealings.

Defendants' Motion to Amend

As relevant, the Company's OA provides plaintiff with the right to designate the supplier of gasoline and to negotiate with respect to the Company's presence at the premises (Dkt. 183, §§ 6.4[5], 6.5[j]). The Company's operation of a BP gas station was subject to a Prime Lease between BP Products North America Inc. ("BP") and Gasateria Oil Corp ("Gasateria"). In 2008, a sublease between BP and the Company was executed by proposed counterclaim defendant Jose Montero on behalf of the Company ("Sublease"). Proposed counterclaim defendant Tumay Basaranlar entered into a lease for a Dunkin Donuts on the premises.

In June 2016, Tumay Basaranlar, as "Managing Member" of the Company, executed a "First Modification and Extension of Sublease" extending its Sublease to the premises to August 3, 2020 (Dkt. 174 at 10-11; Basaranlar Aff. [Dkt. 195] at 1 [Basaranlar and Montero are co-managers of plaintiff]). Prior to the expiration of the Sublease extension, defendants sought to negotiate a further extension of the Sublease; however, plaintiff would not permit defendants to negotiate with BP for the extension (Dkt. 174 at 10; Dkt. 172 [Proposed Answer], Exs. B-N [Exhibits are contained in Proposed Answer]).

Nonetheless, Managing Members expressed their desire to extend the Sublease with BP, which BP and Gasateria were willing to do (Dkt. 174 at 11-12). Plaintiff later explained to Managing Members that it was having discussions with Gasateria, without providing any further information. The Sublease was not extended and the Company vacated the premises in August 2020 (Dkt. 174 at 15; Dkt. 172, Ex. O).

After vacating the premises, and effectively closing the business, the Managing Members learned that either plaintiff or an entity related to plaintiff ("Successor Company"), entered into a new lease for the premises. The Successor Company operated a Mobile gas station.

Defendants allege that plaintiff, Basaranlar and Montero breached their fiduciary duties to the Company by not negotiating for an extension of the Sublease and instead obtaining a new lease for plaintiff's Successor Company. Defendants move to amend their counterclaims to include (1) breach of fiduciary duty, (2) "knowing participation in Breach of Fiduciary Duty" (aiding and abetting breach of fiduciary duty), (3) conversion, (4) unjust enrichment, (5) constructive trust, (6) accounting, (7) punitive damages, and (8) attorneys' fees.

Plaintiff opposes any amendment urging that (1) it would be prejudiced by the delay because more discovery would be required, (2) the claims have no merit based on the OAs and because defendants defaulted and (3) the parties' business relationship ended upon defendants' default as plaintiff was entitled to exercise the buy-back provision.

CPLR 3025(b) provides that a party may amend its pleading "at any time by leave of court or by stipulation of all parties. Leave shall be freely given upon such terms as may be just . . ." However, where a proposed amendment clearly lacks merit, it will be denied as it would "serve no purpose but needlessly complicate discovery and trial" (*Thomas Crimmins Contracting Co., Inc. v City of New York*, 74 NY2d 166, 170 [1989]).

The events on which defendants base the amendments occurred after commencement of the action. While "a motion for leave to amend should not be granted if the nonmoving party would be prejudiced by the delay" as plaintiff argues, "the need for additional discovery does not constitute prejudice sufficient to justify denial of an amendment" (*322 West 47th Street HDFC v Tibaldeo*, 196 AD3d 411, 412 [1st Dept 2021], quoting *Jacobson v McNeil Consumer & Specialty Pharms*., 68 AD3d 652, 654 [1st Dept 2009]). Moreover, document discovery has not been completed, depositions have not been conducted nor has there been any expert discovery so defendants are not hijacking "the process of discovery" (Dkt. 178 at 20).

Plaintiff urges that pursuant to § 10.2 of the OA, it was specifically permitted to enter into a competitive business activity.[3] That ignores allegations that plaintiff did not merely enter into a competitive business; rather, it--a member of the Company--took a "corporate opportunity" for itself which, for all intents and purposes, ended the Company's business (*Alexander & Alexander of New York, Inc. v Fritzen*, 147 AD2d 241, 246 [1989] ["The doctrine of 'corporate opportunity' provides that corporate fiduciaries . . . cannot,

[3] The OA provides in § 12.3 that if the Company is *dissolved*, a member may elect to reconstitute the Company and operate as a successor company.

without consent, divert and exploit for their own benefit any opportunity that should be deemed an asset of the corporation"]; *see Richbell Information Services, Inc. v Juniper Partners, L.P.*, 309 AD2d 288, 302 [1st Dept 2003]; *see also Young v Chiu*, 49 AD3d 535, 536 [2d Dept 2008] [defendant diverted corporate opportunity by "secretly establishing a competing entity and acquiring the property at issue in which corporation (of which she was an officer) had a 'tangible expectancy'"]; *Stavroulakis v Pelakanos*, 58 Misc 3d 1221[A], at *11 [Sup Ct, NY County 2018] [corporate opportunity doctrine violated where director secretly forms new entity and transfers to it the corporation's entire business]).

Finally, plaintiff argues that § 15.7 of the OA limits its liability "with respect to any of the provisions in the [OA]" to $25,000 multiplied by the number of years remaining under the "initial term of the Sublease, exclusive of any options, renewals or extensions" effectively making plaintiff's liability zero (Dkt. 174 at 23; Dkt. 183 at 26). Nonetheless, "an explicitly discretionary contract right may not be exercised in bad faith so as to frustrate the other party's right to the benefit under the agreement" (*Richbell,* 309 AD2d at 302). Even assuming the applicability of § 15.7 (which applies to "disputes arising under [the] Operating Agreement" or the exercise of buy-back rights), there can be no limitation of a bad-faith breach of fiduciary duty or one involving intentional misconduct (*see* Limited Liability Company Law § 417[a][1]).

Based on defendants' allegations, the third proposed counterclaim for breach of fiduciary duty is viable.

Defendants' fourth proposed counterclaim for aiding and abetting the breach of fiduciary duty, however, is not. Generally, claims of aiding and abetting the breach of

fiduciary duty are brought against individuals or entities assisting those who owe a fiduciary duty. Here, there is no allegation that an outside party assisted in Basaranlar and Montero's alleged breach. Defendants' allegations are wholly directed against Basaranlar and Montero, managing members of the company, for their purported direct breaches.

Likewise, amendment is denied with respect to defendants' proposed fifth and sixth counterclaims seeking recovery for conversion and unjust enrichment as they merely restate defendants' breach of fiduciary duty cause of action (*see Bavers v Shepherd*, 189 AD3d 606 [1st Dept 2020]).

Defendants' proposed seventh and eighth counterclaims seeking a constructive trust and an accounting of the Successor Company also fail. Defendants have an adequate remedy at law for taking a corporate opportunity (damages stemming from any breach of fiduciary duty) thus there is no basis for a constructive trust (*AQ Asset Mgt. LLC v Levine*, 154 AD3d 430, 431 [1st Dept 2017] [equitable remedy of constructive trust dismissed because there was an adequate remedy at law]). Additionally, defendants have no right to an accounting of the Successor Company (*see Atlantis Management Group II LLC v Nabe*, 117 AD3d 542 [1st Dept 2019] [defendants owed plaintiff a fiduciary duty and had no adequate remedy at law making an accounting appropriate]; *Gottlieb v Northriver Trading Co.*, 58 AD3d 550 [1st Dept 2009] [members of an LLC may seek an equitable accounting]; *Unitel Telecard Distribution Corp. v Nunez*, 90 AD3d 568, 569 [1st Dept 2011] [there must be a fiduciary duty and no adequate remedy at law to support a claim for an accounting]).

Finally, although defendants may be entitled to attorneys' fees (*see* BCL § 626[e]) and punitive damages (*see Vandashield Ltd. v Isaacson*, 146 AD3d 552, 555 [1st Dept

2017] ["the requirement of conduct directed at the general public does not apply to punitive damages for breach of fiduciary duty"], citing *Don Buchwald & Assocs., Inc. v Rich*, 281 AD2d 329, 330 [1st Dept 2001]), these claims may not be maintained as separate causes of action (*La Porta v Alacra, Inc.*, 142 AD3d 851, 853 [1st Dept 2016]).

The parties' remaining arguments have all been considered and are unavailing.

Accordingly, it is

ORDERED that defendants' motion for leave to amend is granted with respect to the third proposed counterclaim and with the potential for recovery of punitive damages and attorneys' fees, and is denied in all other respects, and an amended answer consistent with this decision shall be filed within one week; and it is further

ORDERED that plaintiff's cross-motion is denied except that plaintiff is granted summary judgment on liability for breach of Section 13.1(D) of the Operating Agreements and the first, sixth, eighth, eleventh, twelfth and fourteenth affirmative defenses are dismissed; and it is further

ORDERED that pursuant to CPLR 3212(b) plaintiff's fourth and sixth causes of action are dismissed; and it is further

DECLARED and ADJUDGED that section 6.3 of the OAs is an unenforceable penalty and the fifth cause of action and second counterclaim are severed; and it is further

ORDERED that the action shall continue in accordance with the determinations made in this decision; and it is

ORDERED that the parties are to proceed with mediation promptly.

Counsel are directed to meet and confer and provide an email status update (including on the progress of mediation) to ktouaf@nycourts.gov on February 16, 2022.

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2/3/2022
DATE

JENNIFER SCHECTER, J.S.C.

CHECK ONE: [ ] CASE DISPOSED [X] NON-FINAL DISPOSITION
[ ] GRANTED [ ] DENIED [ ] GRANTED IN PART [X] OTHER