SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 03M

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TNJ HOLDINGS, INC., INDIVIDUALLY AND ON BEHALF OF PROJECT VERTE, INC.

Plaintiff,

- v -

SARA RUBENSTEIN,

Defendant.

INDEX NO. 654120/2020

MOTION DATE 01/14/2021

MOTION SEQ. NO. 001

DECISION + ORDER ON MOTION

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HON. JOEL M. COHEN:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28

were read on this motion to DISMISS.

This legal malpractice action is the latest episode in a long-running, wide-ranging feud between opposing shareholder blocs in Project Verte, Inc. ("PV"), a closely-held corporation. Plaintiff TNJ Holdings, Inc. ("TNJ") represents one bloc, while Jane Gol, Amir Chaluts and several entities under their control (the "AJ Group") represent the other. Here, TNJ takes aim at a lawyer, Defendant Sara Rubenstein, who allegedly was employed by an AJ Group entity but also acted as counsel to PV and to TNJ. In a nutshell, TNJ alleges that throughout her representation, Rubenstein acted negligently and unfaithfully, for the benefit of the AJ Group and to the detriment of PV and to TNJ.[1]

[1] Previously, TNJ sued the law firm Troutman Pepper Hamilton Sanders LLP ("Troutman"), alleging that *Troutman* served as TNJ's counsel and committed malpractice by defecting to the AJ Group's side (*see Kahlon v Troutman Pepper Hamilton Sanders LLP*, 2021 WL 3666263 [Sup Ct, New York County 2021]). On August 18, 2021, this Court dismissed the Troutman action in its entirety (*id.*).

TNJ asserts derivative claims, on PV's behalf, for legal malpractice, breach of fiduciary duty, and constructive trust. In addition, TNJ asserts a direct claim for legal malpractice. Rubenstein moves to dismiss the complaint on several grounds, including lack of standing to pursue the derivative claims and failure to state a cause of action. For the reasons set forth below, Rubenstein's motion is granted and the complaint dismissed.

DISCUSSION

Under CPLR § 3211(a)(7), dismissal is warranted if the plaintiff "fails to assert facts in support of an element of the claim, or if the factual allegations and inferences to be drawn from them do not allow for an enforceable right of recovery" (*Connaughton v Chipotle Mexican Grill, Inc.*, 29 NY3d 137, 141-142 [2017] [internal citation omitted]). When determining a motion to dismiss, the Court must accept all factual allegations as true, afford the pleadings a liberal construction, and accord plaintiff the benefit of every possible favorable inference (*see Leon v Martinez*, 84 NY2d 83, 87-88 [1994]). However, allegations that are "bare legal conclusions" or that are "inherently incredible or flatly contradicted by documentary evidence," are not sufficient to withstand a motion to dismiss (*see JFK Holding Co., LLC v City of New York*, 68 AD3d 477, 477 [1st Dept 2009] [internal citation omitted]).

A. Derivative Claims

1. TNJ's Standing as a Derivative Plaintiff

The derivative claims TNJ purports to bring on behalf of PV are dismissed, in the first instance, for lack of standing. PV is a Delaware corporation, so TNJ's standing to bring derivative claims on PV's behalf is governed by Delaware law. And under Delaware law, "to qualify as a derivative plaintiff, an individual must not only continuously hold stock in the subject corporation, but also must 'qualif[y] to serve in a fiduciary capacity as a representative of

a class, whose interest is dependent upon the representative's adequate and fair prosecution'" (*Smollar v Potarazu*, CV 10287-VCS, 2016 WL 3635304, at *2 [Del Ch June 29, 2016] [quoting *Youngman v Tahmoush*, 457 A2d 376 [Del Ch 1983]; *see Priestley v Comrie*, 2007 WL 4208592, at *5 [SD NY Nov. 27, 2007]; *see also* Del. Ch. Ct. R. 23.1).

To that end, "a Court can and should examine any extrinsic factors, that is, outside entanglements which make it likely that the interests of the other stockholders will be disregarded in the prosecution of the suit" (*Youngman*, 457 A2d at 379). Delaware courts generally consider eight factors in assessing whether a derivative plaintiff will adequately represent the class of shareholders:

> (1) economic antagonisms between the representative and the class;
>
> (2) the remedy sought by plaintiff in the derivative litigation;
>
> (3) indications that the named plaintiff was not the driving force behind the litigation;
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> (4) plaintiff's unfamiliarity with the litigation;
>
> (5) other litigation pending between plaintiff and defendants;
>
> (6) the relative magnitude of plaintiff's personal interests as compared to her interest in the derivative action itself;
>
> (7) plaintiff's vindictiveness toward defendants; and
>
> (8) the degree of support plaintiff was receiving from the shareholders she purported to represent

(*Smollar*, 2016 WL 3635304, at *2-3).[2]

[2] "The requirement of adequate representation flows from the Due Process Clause of the United States Constitution and the protection it affords the non-parties on whose behalf the representative plaintiff purports to litigate. A judgment only can bind those non-parties if the named plaintiff has provided adequate representation 'at all times'" (*South v Baker*, 62 A3d 1, 21 [Del Ch 2012] [internal citations omitted]).

"A court need not find all of these factors to disqualify a Plaintiff from bringing a derivative suit. [O]ften a strong showing of one factor, which is actually inimical to the class can serve as grounds for dismissal of a derivative claim" (*Priestley v Comrie*, 07 CV 1361 (HB), 2007 WL 4208592, at *5 [SD NY Nov. 27, 2007]). At the same time, "[t]he fact that the plaintiff may have interests which go beyond the interests of the class, but are at least co-extensive with the class interest, will not defeat his serving as a representative of the class" (*Youngman*, 457 AD2d at 380). "Similarly, purely hypothetical, potential or remote conflicts of interests never disable the individual plaintiff" (*id.*). Ultimately, the party seeking to disqualify a plaintiff from bringing a derivative suit "must show a substantial likelihood that the derivative action is not being used as a device for the benefit of all the stockholders" (*Priestley*, 2007 WL 4208592, at *3 n.11 [citing *Youngman*, 457 A2d at 381]).

Cumulatively, the "extrinsic factors" surrounding this litigation compel TNJ's disqualification as a derivative plaintiff here. When a derivative plaintiff "operates under . . . a conflict of interest with the other stockholders," the Court "may look to that factor alone in determining that the plaintiff is not an adequate representative and lacks standing to prosecute the action" (*Smollar*, 2016 WL 3635304, at *3). PV is plagued by such conflict. Because the AJ Group in effect controls PV, the shareholder class purportedly represented by TNJ is mostly allied against TNJ (*see* Compl. ¶7 [noting TNJ currently holds "less than a 7% interest in project Verte"]). And the fissures between TNJ and the AJ Group raise concerns that TNJ will use the derivative action primarily as a cudgel against the AJ Group, rather than to benefit the corporation as a whole. This concern is magnified by the disparity between the value of TNJ's direct claim – seeking more than $14 million in damages (Compl. ¶¶7, 96) – and its derivative claim for unspecified "legal fees" and devaluation. Under the circumstances, TNJ is incentivized

to settle its direct claim even at the expense of the derivative claim (*see Scopas Tech. Co v. Lord*, 1984 WL 8266, at *2 [Del. Ch. Nov. 20, 1984] [finding that where there is an greater interest in personal claims than the derivative suit there are concerns regarding whether the plaintiff will actively represent the class in the litigation and "[i]t is for precisely this reason that a plaintiff might be disqualified"]).

Moreover, TNJ's position as a derivative plaintiff in this lawsuit may be constrained by its role in other litigation. For example, TNJ's principal, Julian Kahlon, is prosecuting an action *against PV*, seeking millions of dollars in recovery, arising out of some of the same governing documents at issue here (*see* NYSCEF 27 [Complaint, *Kahlon v Project Verte Inc.*, Case No. 20-cv-03774-MKV [SD NY]]). As a result, TNJ may be incentivized to litigate this action in a way that preserves Kahlon's action against PV, which could limit recovery for the shareholders here. In sum, the ongoing disputes intra-PV create economic antagonism between TNJ and the other PV shareholders (factor 1), and TNJ's role in those disputes suggest a disparity between the relative magnitude of TNJ's individual interests as compared to its interest in the derivative action (factor 6). Therefore, the Court finds that Rubenstein has shown "a substantial likelihood that the derivative action is not being used as a device for the benefit of all the stockholders" (*Priestley*, 2007 WL 4208592, at *3 n.11).

2. Failure to State a Cause of Action

Alternatively, even if TNJ had standing to bring its derivative claims, it fails to state viable causes of action. The claim for breach of fiduciary duty is "premised on the same facts and seek[s] the identical relief sought in the legal malpractice cause of action," and therefore "is redundant and should be dismissed" (*Weil, Gotshal & Manges, LLP v Fashion Boutique of Short Hills, Inc.*, 10 AD3d 267, 271 [1st Dept 2004]). For the constructive trust claim, TNJ fails to

plead the elements required for imposition of the equitable remedy. The "transfer" underpinning the claim is compensation from a third party, Continental Ventures (an entity controlled by the AJ Group), to Rubenstein (Compl. ¶106); there is no alleged transfer of any PV or TNJ asset to Rubenstein. Therefore, "there is no reason to impose a constructive trust" (*Estate of Calderwood v ACE Group Intl. LLC*, 157 AD3d 190, 199 [1st Dept 2017] [noting constructive trust claim is "an equitable remedy, the purpose of which is the 'prevention of unjust enrichment'"]).

As for the derivative claim alleging legal malpractice, TNJ fails to adequately allege negligence or proximate causation. "Recovery for professional malpractice against an attorney requires proof of three elements: (1) the negligence of the attorney; (2) that the negligence was the proximate cause of the loss sustained; and (3) proof of actual damages" (*Ulico Cas. Co. v Wilson, Elser, Moskowitz, Edelman & Dicker*, 56 AD3d 1, 10 [1st Dept 2008]). "To prove malpractice, a client must establish, among other things, that the attorney failed to exercise that degree of care, skill and diligence commonly possessed by a member of the legal profession" (*Schafrann v N.V. Famka, Inc.*, 14 AD3d 363, 364 [1st Dept 2005]).

TNJ's allegations of negligence here are conclusory. TNJ generally alleges that Rubenstein "delayed" transactions, "withheld" information, and "assisted" with the convertible notes and a "freeze-out," but does not plead what she specifically did that was negligent. The Complaint does not allege, for example, which provisions of the SFNTA she "misleadingly" revised, what was misleading about the revisions, or what she did with respect to the convertible notes or any other transaction document that was purportedly negligent. These kinds of non-specific allegations are insufficient to sustain a legal malpractice claim (*see Mid-Hudson Val. Fed. Credit Union v Quartararo & Lois, PLLC*, 155 AD3d 1218, 1219–20 [1st Dept 2017), *aff'd*, 31 NY3d 1090 [2018]). Rather more broadly, TNJ infers that if it suffers any loss in connection

with PV, it must be because of Rubenstein's negligence (*see, e.g.*, Compl. ¶92 ["The only way that TNJ and Kahlon could possibly owe *anything* on the notes is if Rubenstein did not properly prepare [them]"]). This is an argument that assumes its own conclusion and thus adds nothing of substance to the claim.

To the extent TNJ pleads negligence, it does not sufficiently allege "but for" proximate cause because it fails to explain how Rubenstein's alleged negligent actions resulted in any actual damages to PV (or to TNJ, for that matter). The First Department has explained the element of proximate cause in malpractice cases this way:

> In order to establish proximate cause, plaintiff must demonstrate that but for the attorney's negligence, plaintiff would have prevailed in the matter in question or would not have sustained any ascertainable damages. Stated another way, plaintiff is required to prove a 'case within a case.' The failure to establish proximate cause mandates the dismissal of a legal malpractice action, regardless of the negligence of the attorney.

(*Reibman v Senie*, 302 AD2d 290, 290-91 [1st Dept 2003] [citations omitted]).

To begin with, TNJ's theory of causation in this case appears to conflict with the theory asserted in the *Troutman* action, where TNJ blamed other counsel for the same damages to itself and to PV (*see, e.g.*, Troutman compl. ¶¶160, 178 [Index No. 654257/2020]). But in any event, TNJ's assertions of causation are conclusory. TNJ alleges that PV suffered damages consisting of (i) "attorneys[sic] fees related to the transactions where Rubenstein was acting on behalf of the AJ Group [and] (ii) the devaluation of the Corporation associated with the issuance of convertible debt" (*id.* ¶¶7, 98). The former damage was allegedly caused by Rubenstein's "conflicted advice" and Plaintiff does not specify the cause of the later (*id.*). These generic assertions are insufficient to sustain a cause of action for malpractice (*Heritage Partners, LLC v Stroock & Stroock & Lavan LLP*, 133 AD3d 428, 428 [1st Dept 2015] ["unsupported factual

allegations, speculation and conclusory statements failed to sufficiently show that but for defendant's alleged failure" plaintiff would not have experienced loss]).

B. Direct Claim for Legal Malpractice

"In assessing the adequacy of a claim of . . . attorney malpractice, a court must first look to the relationship of the parties" (*AG Capital Funding Partners, L.P. v State St. Bank and Tr. Co.*, 5 NY3d 582, 595 [2005]). "[A]bsent an attorney-client relationship, a cause of action for legal malpractice cannot be stated" (*Fed. Ins. Co. v N. Am. Specialty Ins. Co.*, 47 AD3d 52 [1st Dept 2007]). Generally, "New York courts impose a strict privity requirement to claims of legal malpractice" (*Lavanant v Gen. Acc. Ins. Co. of Am.*, 164 AD2d 73, 81 [1st Dept 1990] *aff'd*, 79 NY2d 623 [1992]). But "absent privity, plaintiff must set forth a claim of fraud, collusion, malicious acts or other special circumstances in order to maintain a cause of action" (*AG Capital*, 5 NY3d at 595 [internal citations omitted]).

Here, TNJ fails to allege either privity of contract with Rubenstein or "other special circumstances" to support an attorney malpractice claim (*Griffith v Med. Quadrangle, Inc*., 5 AD3d 151, 152 [1st Dept 2004] [attorney "retained by the [corporation] to represent them and [was] not in privity with plaintiff []"]). Start with privity. While TNJ acknowledges there was no written or formal attorney-client relationship with Rubenstein, it argues that Rubenstein nonetheless "formed an attorney-client relationship" with TNJ "by words and actions" (NYSCEF 24 at 12). But "a party cannot create the relationship based on his or her own beliefs or actions" (*Pellegrino v Oppenheimer & Co., Inc.*, 49 AD3d 94, 99 [1st Dept 2008]). And the Complaint does not sufficiently allege "words and actions" that created an objectively reasonable expectation of an attorney-client relationship between Rubenstein and TNJ. Instead, the

Complaint speaks in conclusory terms about Rubenstein having legal "responsibilities" in connection with PV (Compl. ¶26), and that TNJ "relied upon the advice that Rubenstein rendered" (*id.* ¶29). Those kinds of generic statements, without "an explicit undertaking to perform a specific task" (*Terio v Spodek*, 63 AD3d 719, 721 [2d Dept 2009], do not adequately plead an attorney-client relationship.

Nor does TNJ allege facts sufficient to show "special circumstances" extending liability beyond the bounds of privity. TNJ does not allege that it was a "foreseeable third-party beneficiary" to any "relationship" between Rubenstein and PV. Rubenstein served as attorney for a company comprised, from the beginning, of two shareholder blocs with competing interests. Because of the potential for conflict in that context, it was not "foreseeable" that Defendant would serve her role for the corporation and also benefit TNJ directly. In *Good Old Days Tavern, Inc. v Zwirn*, 259 AD2d 300 [1st Dept 1999], by contrast, the court held that the *sole* shareholder of a company, which had a contractual relationship with an attorney, was a foreseeable third-party beneficiary of his company's contract. Finally, as the First Department held in analogous circumstances, Plaintiff's allegations that Defendant "colluded with defendant corporate board members . . . to defraud minority shareholders such as themselves . . . [are] not pleaded in sufficient detail" to invoke the fraud exception to the privity rule (*Griffith*, 5 AD3d at 152).

In sum, Plaintiff lacks standing to pursue its malpractice claim directly, and the claim is therefore dismissed.

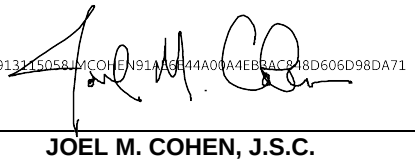
* * * *

Accordingly, it is

ORDERED that Defendant's motion to dismiss is **GRANTED**, and the Complaint is dismissed; and it is further

ORDERED that the Clerk of the Court enter judgment dismissing the Complaint with prejudice and disposing this action.

This constitutes the Decision and Order of the Court.



9/13/2021
DATE

JOEL M. COHEN, J.S.C.

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