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Mizrahi v Cohen
2012 NY Slip Op 50030(U)
Decided on January 12, 2012
Supreme Court, Kings County
Demarest, J.
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Decided on January 12, 2012

Supreme Court, Kings County

Ronald Mizrahi, individually and as a 50% member of and in the right of 372-376 Avenue U Realty LLC, a New York limited liability company, Plaintiffs,

against

Ezra Cohen, Defendant

3865/10

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Carolyn E. Demarest, J.

Although not so captioned, in this case plaintiff Mizrahi ("plaintiff" or "Mizrahi") seeks the dissolution of a limited liability company, 372-376 Avenue U Realty LLC (the "LLC"), which was formed in December, 1999, as a real estate holding company for the purpose of constructing and operating a mixed-use building at the described location. The complaint also seeks an accounting, rescission of the Operating Agreement based upon defendant Cohen's ("defendant" or "Cohen") alleged failure to make capital contributions as allegedly required under the Agreement [FN1] and damages on behalf of both plaintiff and the LLC for breach of fiduciary duty based upon Cohen's alleged "embezzlement" of funds of the LLC and his failure to make his share of capital contributions. In his answer, Cohen counterclaimed that plaintiff was unjustly enriched, at the expense of the LLC and himself, due to his occupancy of space for which he was not paying a proportionate rent and by charging to the LLC excessive costs of building out his space without making reimbursement to the LLC.

FINDINGS OF FACT

An Operating Agreement was entered on April 11, 2000, between plaintiff, Ronald [*2] Mizrahi, a dentist, and his relative by marriage, Ezra Cohen, the defendant, who is an optometrist. The parties are 50/50 owners of the LLC and both are managing members. The members were to occupy commercial units within the building for their separate businesses; Mizrahi's dental practice occupies ñ4577 square feet on the second floor and Cohen has ñ2898.75 square feet on the ground floor with large street-level windows in which his optometry products are displayed. The LLC obtained financing for the purchase of the real property and construction of the building, secured by a mortgage, which was guaranteed personally by both of the members. In 2006, the original mortgage was refinanced in the sum of $4,700,000, most of which remains as a debt of the LLC at the present time. Apparently because the mortgagee required it, the Operating Agreement was quickly prepared by the attorney handling the real estate purchase and signed by both parties on the day of the

closing. Though plaintiff testified that he didn't read it prior to signing, the signatures of both members appear on the document and there is no doubt that it is binding on both parties. One is presumed to have read a document prior to execution and cannot thereafter be relieved of its effect, in the absence of actual fraud, merely due to carelessness. (*Metzger v Aetna Ins. Co.*, 227 NY 411,416 [1920]; *Cash v Titan Financial Services, Inc.*, 58 AD3d 785, 788 [2d Dept 2009]). There is no evidence of fraud here. Moreover, the Operating Agreement contains a merger clause (¶ 9.4), which precludes oral modification of the express provisions thereof.

Although the amount of each member's initial capital contribution is not listed, the Agreement does indicate that each member's interest is 50%. Both parties testified that the intention was to create a 50/50 ownership of the LLC in which the members would be equal participants. Plaintiff testified that he initially contributed $200,000 and was repaid by defendant for his 50% share. Paragraph 3.2 of the Operating Agreement provides:

No Additional Capital Contributions Required. No Member shall berequired to contribute any additional capital to the Company, unless

required by a vote of the Members holding one hundred (100%)

percent. No Member shall have any personal liability for any obligation

of the Company.

Paragraph 5.2.2 of the Agreement further provides that "the affirmative vote of [100% of the Members] shall be required to approve any matter coming before the Members".

The four-story structure, containing four residential and seven professional/commercial units (including those of the parties), was constructed and the parties took occupancy in or about March of 2006. The cost of the build-out of the parties' professional offices, as well as that for most of the other units, was born by the LLC using the proceeds of the mortgage and the capital contributions of the parties. In addition, the parties agreed to apply remaining mortgage proceeds, together with the rental income from other tenants of the building, to cover all expenses of the LLC so as to avoid the payment of rent on their own units. From the date of initial occupancy to January 2008, the parties were able to avoid paying rent on their respective units, partially due to capital contributions or loans made to the LLC by the

members. Beginning in January, 2008, it became necessary, however, for each party to pay rent, which was determined based upon the member's unilateral assessment, as no leases were created with the LLC and the court finds there was no express agreement between the parties regarding the rental value of the members' units. The court does not accept plaintiff's contention that the parties expressly agreed [*3]that Cohen would pay $30 per square foot and plaintiff would pay $25 per square foot as such numbers do not comport with what was actually paid by either party. There is no dispute that Cohen paid $7,500 monthly for his 2898.75 square feet at ground level. During his occupancy of his 4577 square feet of space on the second floor, Mizrahi contributed $15,000 each month until May of 2010, when, following commencement of this action, he reduced his monthly payment to $10,000 and directed the accountant to retroactively credit $5000 of his monthly payments to his capital account, rather than as rent, as previously recorded. Plaintiff contends that his rent was always $10,000 per month, and that he had made voluntary capital contributions or loans of an additional $5,000 monthly, which had been improperly reflected in the LLC's accounts as rent. This issue, which forms the substance of defendant's first counterclaim, and is relevant to plaintiff's claims to an entitlement to a greater than 50% membership in the LLC, is contested, as is defendant's contention that plaintiff's build out was more expensive than his own, resulting in unjust enrichment to plaintiff.

Between 2000 and 2003, several capital calls were made to fund various expenses, which were paid equally by both members. Notwithstanding the voting procedure set forth in the Operating Agreement, the practice between the parties, when additional funds were required, was that the bookkeeper, Claudia Mizrahi, plaintiff's sister and the office manager for his dental practice, would approach Cohen with the request for 50% of the needed amount and Cohen would supply such funds. However, at some point in 2003, Claudia made a request of Cohen that was not met. Plaintiff testified that he was told by Cohen that financial difficulties prevented him from meeting the particular demand, but the obligation to fund was not questioned. Plaintiff advanced the entire required sum. Thereafter, Cohen's contributions were sporadic and plaintiff frequently advanced sums to the LLC to prevent a default upon its obligations and the potential loss of the property.

On June 29, 2006, a check was issued to Cohen from the LLC account in the sum of $230,000, identified on its face as a "loan". This check is the basis for plaintiff's claim of "embezzlement" and breach of fiduciary duty. It is acknowledged that this sum has not been repaid to the LLC. Plaintiff testified that Cohen had asked him to borrow this sum from his

capital account in order to pay down a credit line for another business owned by Cohen, but that Mizrahi had declined because of insufficient funds available. Approximately a week later, upon receipt of the bank statement for the LLC, plaintiff learned that the funds had been taken. Claudia testified that she had drafted the check at Cohen's instructions without consulting her brother. Cohen's testimony that plaintiff consented to the loan is rejected in light of his evasive testimony and his acknowledgment on cross examination that he had lied in his affidavit when he claimed that the withdrawal of $230,000 was done "to equalize" the amounts of the capital contributions of the two members. In his testimony, Cohen also admitted that the tax returns for the LLC show a capital return to him of the $230,000, rather than a loan, and that plaintiff had invested more in the LLC than he had, although he did not "know" to what extent he had been "subsidized".

There is no real dispute that the LLC has been managed somewhat informally by both members, in disregard of the formal provisions of the Operating Agreement. Each party performed various tasks as the need arose, often in daily consultation with each other, at least during the early stages of their relationship and during construction. Plaintiff has provided [*4]bookkeeping and clerical services through his sister, who also manages his dental practice. Claudia testified to overseeing much of the construction and providing daily management of the building, which is not disputed, but Cohen also performed various routine management services. Plaintiff has sought to claim, as an element of his investment, the value of his sister's services going back to the beginning of the LLC's operation; however, there is insufficient evidence of any agreement between the parties that she would be compensated directly by the LLC and she is not a party to this action.[FN2] The evidence is that she has been paid a salary by plaintiff which is quite adequate. There is no evidence of any direct compensation paid to her from the LLC. The court finds that her services were provided as plaintiff's agent, as a part of his contribution, for which the LLC is not directly responsible (*see Birnbaum v Birnbaum,* 73 NY2d 461, 466[1989]). Nor is there any evidence of an agreement by the members to credit the value of personal services supplied to the LLC by a member as a capital contribution of that member. (*See, cf Matter of KSI Rockville, LLC v Eichengrun,* 305 AD2d 681[2d Dept 2003]). As both members have contributed their personal services to the operation of the LLC, without expectation of remuneration outside of sharing equally in the profits of the LLC and enjoying the benefits of their occupancy, and there is insufficient evidence of any agreement to pay Claudia, this element of plaintiff's claim is rejected.

Similarly, upon the evidence presented, the court finds no merit in the defendant's counterclaims that plaintiff was unjustly enriched by a larger investment by the LLC in the construction of his office or that he has not paid his fair share of rent for the space he occupies. Defendant's admittedly incompetent speculation as to the rental value of space based exclusively on square footage and the amount of the mortgage, which covered both acquisition of the property and construction, did not provide proof of his claims. Moreover, both members testified that the LLC paid for the build out of all the units, other than a dental office in the lower level, and each of the members made a unilateral determination as to the amount of rent to be paid for his office space. The court credits the testimony of both parties that each paid an additional amount to finish the space for occupancy in accordance with his needs, as is appropriate for commercial occupancy. Cohen testified that Mizrahi had declined the ground floor space in favor of Cohen's optometry practice because he recognized the defendant's greater need for public exposure, for which Cohen expressed his gratitude. Although plaintiff does occupy approximately 58% more space than defendant, the photographs in evidence reveal the substantially greater aesthetic value of Cohen's space. It is noted that plaintiff was paying between a third more and twice as much rent for his space, depending on whether the additional $5000 incorporated in the monthly payments is treated as rent or capital contribution. Since the court finds that no specific rent had been established between the parties, but that both members had merely accepted the unilateral contribution of the other, it cannot now be said that the rents paid were inadequate.

As to whether plaintiff's capital account should be credited with the additional monthly [*5]payments of $5000, this court finds such sums are properly credited as rent, as reflected in the tax returns filed for 2008 and 2009, which were signed by plaintiff himself. He may not now take a position in this litigation inconsistent with those representations (*Mahoney-Buntzman v Buntzman*, 12 NY3d 415, 422 [2009]; *Stevenson-Misischia v L'Isola D'Oro SRL*, 85 AD3d 551, 552 [1st Dept 2011]). However, in light of the testimony of both parties that each had made his own decision regarding the payment of rent, and the fact that $10,000 appears to be a reasonable sum for the use and occupancy of plaintiff's space in comparison to the $7500 paid monthly by defendant, the court finds that plaintiff is not liable to the LLC for the additional $5000 per month which plaintiff ceased paying beginning in May 2010. However, plaintiff's attempt to retroactively recoup the alleged overpayments for the first four months of 2010 cannot succeed in light of plaintiff's own prior representations regarding the additional $5000 monthly payments. Finally, whatever the cost of the build out of the

members' suites, such investment was made by the LLC as a cost of business and the value added will ultimately inure to the benefit of the LLC. No sums are due from either member based upon the costs of construction.

The Operating Agreement contains a provision for resolution "on any matter" in which there is a deadlock between the members. Paragraph 5.6.1 of the Agreement states:

> When a vote is required on any matter under this Agreement,
>
> and insufficient votes to approve or disapprove of the matter are
>
> cast [100% required], then any member may, subject to ten(10)
>
> days notice to the other members, require that the matter be submitted
>
> to Rabbi Shlomo Churpa, or if Rabbi Michael Haber [i]s unavailable
>
> or unwilling to resolve the dispute to such person as shall be named
>
> [by?] The Safardic Rabbinical Counsel of Flatbush.

Evidence was adduced of Mizrahi's attempts to exercise this provision by demanding arbitration, which were rejected by Cohen as not being in compliance with the Agreement. Mizrahi contends that "The Safardic Rabbinical Counsel of Flatbush" does not exist. While many of the disagreements between the members might have been resolved through arbitration, thereby avoiding the disastrous consequences of dissolution, such relief has not been timely sought through the court and the current action seeking judicial dissolution of the LLC can only be determined by the court.

In the latter part of 2010, after the instant suit had been commenced, Mizrahi took over control of the LLC's bank account, transferring the funds of the LLC to a new account and preventing Cohen's access to those funds. It is undisputed that Cohen had paid no rent for the three months prior to trial. Cohen does not deny that he owes substantial sums to the LLC.

DISCUSSION

It is well-established that the court must look to the terms of the Operating Agreement to

determine the rules applicable to the operation of a particular LLC (*Matter of 1545 Ocean Ave., LLC*, 72 AD3d 121, 128 [2d Dept 2010](hereafter *1545 Ocean*); LLCL §417 (a)). Only where the Operating Agreement is ambiguous, contrary to law or does not contain any provision for the particular matter at issue, do the statutory provisions of the Limited Liability Company Law (LLCL) control (*1545 Ocean* at 129; *Chiu v Chiu*, 71 AD3d 646, 647 [2d Dept 2010]; *Matter of Spires v Lighthouse Solutions, LLC*, 4 Misc 3d 428, 436 [Sup Ct, Monroe Co., 2004](hereafter *Spires*); *cf Matter of KSI Rockville, LLC v Eichengrun*, 305 AD2d 681, 682 [2d Dept 2003]).

*[*6]Dissolution*

Mizrahi seeks dissolution of the LLC based primarily upon Cohen's failure to carry what Mizrahi contends is his fair share of the financial responsibility for the real estate business created under the Articles of Organization and defined in the Operating Agreement. As heretofore noted, both parties made their initial capital contribution of 50% of $200,000 and the Operating Agreement expressly states that no further capital contributions are required unless authorized by a 100% agreement between the members. Apparently there was a 100% agreement as to several early capital calls and it was only when Cohen determined that he did not have sufficient funds available that the informal consensus between the members broke down.

Although this Court finds that Mizrahi did not consent to Cohen's request to borrow $230,000 from his capital account, he was consulted in advance, Mizrahi's sister, in whom he had vested full authority to act with respect to the management of the LLC's finances, actually wrote the check and Mizrahi acknowledged that he became aware that the money had been removed from the bank account within approximately a week. Thus, it cannot be said that Cohen "embezzled" the funds as embezzlement involves fraud, which, in turn, involves deception. However, Cohen owed a fiduciary duty, both to his fellow member Mizrahi and the LLC itself, not to drain the LLC of finances necessary to its maintenance, thereby rendering the LLC insolvent. Cohen's misappropriation of the "loaned" funds, in disregard of the consequences to the LLC, may establish so egregious a breach of Cohen's duty to the LLC as to warrant dissolution.[FN3] Section 3.4 of the Operating Agreement provides that "no Economic Interest Holder shall have the right to receive any return of any Capital Contribution."[FN4] Thus, Cohen's removal of funds contributed to the LLC was unauthorized and in derogation of the rights of the LLC.

In any case, the outstanding loan of $230,000 stands as a debt to the LLC, and must be deducted, with interest at the statutory rate set forth in CPLR 5004, together with any other debts Cohen owes to the LLC, from any distribution due him upon the winding up of the LLC, in accordance with Article IV of the Operating Agreement. However, any compensation due for Cohen's breach of duty is owed to the LLC and does not provide plaintiff with an individual right of recovery (*cf. Abrams v Donati,* 66 NY2d 951, 953[1985]). The court finds that Mizrahi's failure to act promptly upon discovery of Cohen's appropriation of funds of the LLC constituted a ratification of the "loan", so as to preclude his own recovery of any damages to him personally. [*7]Thus, plaintiff's argument that he should be credited with sums owed to the LLC by Cohen so as to diminish Cohen's interest in favor of Mizrahi, in the absence of a provision for such relief in the Operating Agreement, cannot succeed. The issue before the Court is whether plaintiff has born his burden to demonstrate that it is impracticable to continue the operation of the LLC in light of Cohen's failure to provide needed financial support and his undermining of the LLC's financial integrity so as to warrant dissolution of the LLC.

At the commencement of trial and prior to opening statements, at the insistence of both counsel, a surprisingly acrimonious letter from defense counsel to plaintiff's counsel was read into the record in which the defense attorney offered to "stipulate" to dissolution and the appointment of a receiver to oversee the winding up of the business and the sale and distribution of its assets or, alternatively, an accounting in which the interests of each member would be determined, followed by "peacefully continu[ing] in business". Neither proposal having been accepted by plaintiff (nor by defendant, according to counsel's representation that he had "not yet agreed to anything"), following trial, defendant argues that the petition for dissolution should be dismissed because the Operating Agreement limits the conditions under which the LLC can be dissolved, prior to December 31, 2099, to written agreement of 100% of the members or "involuntary withdrawal", defined under Article I of the Operating Agreement, "with respect to Ron Mizrahi or Ezra Cohen only", as including the making of an assignment for the benefit of creditors, a voluntary petition in bankruptcy, adjudication of bankruptcy or insolvency, consent to appointment of a trustee or receiver, death, incapacity or adjudication as incompetent or "(iv) the Member files a petition seeking for the Member any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law or regulation".

While defendant contends that there has been no "involuntary withdrawal", arguably, the

filing of the instant petition for dissolution of the LLC may effectively constitute an "involuntary withdrawal" sufficient to supply an event triggering dissolution under Article VII as, contrary to defendant's argument, under the Operating Agreement, involuntary withdrawal may occur when a member files a petition seeking "for the member . . . dissolution, or similar relief under any statute, law, or regulation" and is not limited to a proceeding against the member, but may also occur when a member seeks affirmative relief. The only saving provision in the Operating Agreement to avoid dissolution upon involuntary withdrawal by one of the members requires that, within 180 days of an involuntary withdrawal, "remaining Members holding two-thirds or more of the Percentages then held by Members" elect to continue the business.[FN5] Upon such an interpretation of the Operating Agreement, since Mizrahi filed the petition, thus involuntarily withdrawing from the LLC, the only remaining Member would be defendant Cohen who apparently has not "elected" to continue the business within 180 days of the filing of the petition on February 16, 2010. Under such circumstances, the Operating Agreement mandates [*8]dissolution.[FN6]

Neither party has advanced such argument, however, and defendant's position is actually that "no member involuntarily withdrew". Rather, defendant argues that, based upon the Operating Agreement, without the unanimous consent of the members, the court is without authority to dissolve the LLC at all prior to the expiration of its duration, as set forth in the Operating Agreement, on December 31, 2099, well beyond the expected lifespans of both of the members. This specious argument is rejected. Such interpretation of the law would void the statutory provision for judicial dissolution pursuant to Section 702 of the LLCL in any situation in which an operating agreement provided for dissolution only on consent or at the end of a definite term of duration for the LLC, and would thus thwart the obvious legislative intent of LLCL §702, to provide a mechanism to equitably terminate a business relationship that is disfunctional or abusive, without the consent of all of the members.

Alternatively, defendant argues that plaintiff has failed to sustain his burden of proof under LLCL §702. In *1545 Ocean,* the Second Department Appellate Court held that judicial dissolution of an LLC pursuant to LLCL §702 requires the petitioning member to "establish, in the context of the operating agreement or articles of incorporation, that (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". Defendant contends plaintiff has failed to satisfy this standard.

At trial, Joshua Silberberg, the certified public accountant who has acted as the accountant for the LLC since its inception, and previously had been Cohen's personal accountant, as well as serving as the personal accountant for Mizrahi and for his dental practice to the present, testified that the LLC has consistently operated at a loss from its beginning. The first year that the building was occupied, 2006, the LLC sustained a loss of $390,252.94; in 2007, the loss was $415,264.61; in 2008, the loss was $165,104.25; in 2009, it lost $61,877.42; in 2010, the loss was $113,370.98; and for the first five months of 2011, through the end of May, the loss was $235,727. These figures are without consideration for depreciation and are actual cash losses. Mr. Silberberg explained that this loss, totaling $1.168 million, was covered by application of the mortgage proceeds to the day to day operation of the LLC and by capital contributions from the members, which prevented foreclosure on the property.

Mr. Silberberg testified that from the initiation of the LLC through May 12, 2011, Cohen's capital contributions totaled $295,500, after deduction of the $230,000 withdrawal, and Mizrahi's capital contributions totaled $1,191,586.99, without crediting the $140,000 that Mizrahi claims was improperly entered in monthly increments as rent instead of capital contributions (Plaintiff's Exhibit 11).[FN7] This evidence is substantially undisputed. It is Cohen's [*9]position, however, that, because of a real property tax reduction of approximately $30,000 a year, for which he claims credit in achieving, and which is not disputed, the LLC will actually have a net income, based upon current rent rolls and projected expenses, of $7600 per month. Cohen thus contends that the LLC is viable and that plaintiff has not met his burden.

At trial, Cohen admitted that Mr. Silberberg was "very accurate" and the court fully credits his testimony regarding prior losses of the LLC and the disparate status of the members' capital contributions. While it is true that Mr. Silberberg had no knowledge of the current rent roles for the building, Mizrahi, who is currently managing all aspects of the finances of the LLC, approximated the present monthly rental income from both residential and commercial units at $39,000 and further testified that the LLC has $70,215 in delinquent accounts payable. Such numbers are not significantly contradicted by defendant. Bookkeeping records in evidence reveal that for the month of May, 2011, the mortgage payment, without escrow for taxes, totalled $29,491.16 in interest and amortization. Other maintenance expenses for the month exceeded $4800. The tax escrow, not yet reduced for the tax adjustment, was $17,324.55. The total of monthly expenses for May 2011, over $51,000,

far exceeds the monthly rent roll. Cohen's contention that the LLC will, "going forward", actually show a significant profit appears to be based on speculation and wishful thinking. Even adjusting for the reduction in taxes, given the significant losses sustained over the years, which were covered by plaintiff, it is not plausible that continuing the LLC, as presently constituted, is feasible.

In *1545 Ocean,* the Appellate Court cautioned that "[d]issolution is a drastic remedy", not to be lightly ordered merely based upon disagreement, or even deadlock, among the members of the LLC, but that "where the economic purpose of the limited liability company is not met, dissolution is appropriate"(72 AD3d at 129-131). In the case here, the agreed purpose of the LLC is the development and management of a mixed-use building, presumably for the economic benefit of its members. That purpose was achieved by the construction and occupancy of the building, but the expected profit has not been realized and the building does not support the costs of its maintenance, including payment of the mortgage taken to finance the project. The deficit has consistently been financed unilaterally by plaintiff, who, under the terms of the Operating Agreement, cannot be liable for the debts of the LLC (Section 3.2). Defendant not only has failed to contribute equally in meeting the losses, but has affirmatively undermined the financial integrity of the LLC by withdrawing a substantial portion of his capital contributions, thus evidencing his inability or unwillingness to permit or promote the purpose of the LLC. Under these circumstances, it is only a matter of time, should plaintiff choose to exercise his right to refrain from making additional capital contributions or loans to the LLC, before the LLC will default upon its mortgage and the mortgage will be foreclosed, thus eliminating the sole purpose of the LLC. Accordingly, plaintiff has established that continuing the LLC is financially unfeasible and that the LLC should be dissolved. (*See Mehraban v McIntosh,* 2011 WL 486101, p.3 [Sup St, Nassau Co., 2011]).

Plaintiff's Damages Claim

Plaintiff also seeks damages against Cohen for breach of his contractual duty to fund the LLC and for breach of his fiduciary duty in withdrawing $230,000 from the funds of the LLC. Although LLCL §502 makes members liable for capital contributions, and provides, among other possible penalties, that a defaulting member's interest may be reduced, the statute expressly [*10]defers to the operating agreement for the authority for such action. The Operating Agreement here, in addition to expressly not requiring additional capital

contributions except upon the unanimous vote of the members (of which there is no evidence), states: "No Economic Interest Holder shall be obligated to restore a Negative Capital Account" (Section 4.2.2). This provision is expressly referable to liquidation and dissolution. Thus, plaintiff may not recover damages for breach of the Operating Agreement in failing to make capital contributions, as the Agreement has not been breached in that regard. Although Cohen characterized his withdrawal of $230,000 as a loan, and expressed his intent to repay the loan (no interest rate has been suggested), it was treated on the books of the LLC as a withdrawal of capital. According to the Operating Agreement, upon dissolution, Cohen is not required to restore the funds withdrawn if treated as a reduction in capital.[FN8] Whether treated as a loan or a capital withdrawal, however, the amount of any distribution to Cohen upon the winding up of the LLC must be reduced by the amount of this withdrawal, with interest, as the money belonged to the LLC and, under the Operating Agreement, Cohen was not permitted to withdraw his capital contribution.

There is no question that Cohen's withdrawal of $230,000 from the account of the LLC under the circumstances established at trial exacerbated the LLC's insolvency and constituted a breach of his fiduciary duty, as a manager, to both the LLC and plaintiff (*see Out of the Box Promotions, LLC v Koschitzki,* 55 AD3d 575, 578 [2d Dept 2008]; *Cottone v Selective Services, Inc.,* 68 AD3d1038, 1039 [2d Dept 2009]). Defendant argues, however, that the claim for money damages must be dismissed as barred by the applicable three-year statute of limitations because the breach occurred on June 29, 2006, and this action was not commenced until February 18, 2010. Defendant is correct (*see* Chiu v Chiu, 71 AD3d 621, 623 [2d Dept 2010]). Plaintiff's cause of action for damages for defendant's breach of fiduciary duty is, accordingly, dismissed. It is further noted that there is no factual basis for recovery of punitive damages here in that, while defendant did place his own interests ahead of those of plaintiff and the LLC in taking the "loaned" funds, such act was not so egregious, wanton or morally culpable as to warrant such damages (*see Fioramonti v McGrath,* 83 AD3d 658 [2d Dept 2011], *citing Borkowski v Borkowski,* 39 NY2d 982, 983 [1976]).

Accounting

Both parties seek an accounting with respect to the other. As both plaintiff and defendant owe a fiduciary duty to the LLC and to each other, this relief is granted (*Cottone,*

68 AD3d at 1039; *AHA Sales, Inc. v Creative Bath Prods., Inc.*, 58 AD3d 6, 23 [2d Dept 2008]).

Winding Up and Distribution of Assets

Relying on *Matter of Superior Vending, LLC*, 71 AD3d 1153 [2d Dept 2010], petitioner contends that, upon dissolution, he should be allocated a greater than 50% interest in the LLC [*11]proportional to his capital contributions and should be permitted to buy-out Cohen's diminished interest. *Superior Vending* involved a limited liability company formed to acquire and operate a vending machine company. The business had been originated by one of the members through his own corporation and was expanded to a second company through investments made by the other member three years later. No operating agreement was ever executed and the relationship of the llc members terminated after two years, but the llc continued to operate under the management of the original member. An initial effort to dissolve Superior Vending was abandoned by the departing member, but a new petition was brought three years later to recover his share of the assets and interim distributions. Unlike the case here, the members consented to dissolution and had severed their mutual operation of the business years prior to the litigation. Because one member had continued to operate, and had expanded, the business in the intervening years, the court found it appropriate, after determining the departing member's right to recovery on his investment, to permit the remaining member to purchase, or buy-out, the other member's interest for that sum, notwithstanding the absence of a provision for such relief in the LLCL. As is apparent from the stated facts of that case, the equities of the *Superior Vending* case differ from the circumstances at bar in which both members have remained active in the operation of the LLC and there has been no hiatus in their joint participation, other than that created by plaintiff's removal of the bank account from access by defendant.

Moreover, as defendant argues, the Operating Agreement contains an express Procedure for Winding Up and Distribution upon dissolution (Section 7.2). The Agreement requires that the assets be "first" distributed to creditors, which may include members who are creditors (for example, based upon a loan), in satisfaction of all liabilities of the LLC, and only then to members according to their ownership interests, pursuant to Section 4.4.[FN9] This requirement precludes the possibility of the buy-out suggested by plaintiff, and justifiably so, since both plaintiff and defendant are liable personally on the mortgage for the premises, which must be satisfied in order to relieve the members of their exposure to personal liability,

consistent with Section 3.2 of the Operating Agreement. Furthermore, in light of the dissolution of the primary obligor, the bank is entitled to have the debt satisfied. Thus, enforcing the contractual terms of the Operating Agreement, as mandated (*see 1545 Ocean),* the LLC must be wound up in accordance with Section 7.2. That section states that the members of the LLC shall wind up the affairs of the LLC upon dissolution, however, LLCL §703 approves such procedure "except for a dissolution pursuant to [§ 702] of this article", indicating that when the Supreme Court winds up the affairs of the company upon application of a member, a receiver "may" be appointed. The appointment of a receiver would appear to be appropriate where, as here, there is distrust among the members, however, this court will defer such decision pending an accounting. The building shall continue to be managed by plaintiff who clearly has the greater stake in maintaining it.

In light of the confidence reposed in the LLC's accountant, Joshua Silberberg, by both members, initially the accounting shall be performed by Mr. Silberberg at the expense of the [*12]LLC. A report shall be prepared and submitted to the court and both counsel, within 60 days of service upon Mr. Silberberg of a copy of this decision, containing an assessment of each member's present interest, consistent with this decision, and reflecting the current financial condition of the LLC, including a list of all creditors. Whereas Section 3.3 of the Operating Agreement states that "Economic Interest Holders shall not be paid interest on their Capital Contributions", neither plaintiff nor defendant is entitled to be credited with interest on such contributions. Section 3.7 of the Operating Agreement provides that loans may be made by members "on those terms as approved by a majority in interest of the other members". Since there is no evidence of any agreement regarding interest on the funds advanced to the LLC by plaintiff, no interest may be added. However, crediting the sums advanced by plaintiff to his capital account would work an inequitable result in that the Operating Agreement prevents the return of a Capital Contribution. Therefore, that portion of the Capital Contributions of plaintiff that exceed those of defendant shall be treated as a loan and shall be repaid to plaintiff, as a debt of the LLC, prior to any distributions of remaining assets to the members based upon their percentage of ownership.

During the 60-day period during which the accounting shall take place, the real property of the LLC shall be appraised by an independent appraiser to determine its fair market value. Applying the procedures set forth in Section 4.4 of the Operating Agreement, counsel for the parties are directed to confer regarding the selection of such appraiser and shall notify the court of their recommendation within 15 days of the date of this decision. Upon failure of the

parties to agree, this court will make the appointment, or the parties may request that the procedure set forth in Section 6.5 of the Operating Agreement be followed.

CONCLUSION

Consistent with the decision herein, it is hereby Ordered:

Plaintiff's application for dissolution is granted and the LLC is hereby declared to be dissolved. The plaintiff is directed to file a certified copy of this Order of Dissolution, in compliance with LLCL §702 within 30 days of entry.

Plaintiff's fourth cause of action for damages for defendant's breach of fiduciary duty is dismissed.

An accounting shall be performed by Joshua Silberberg, at the expense of the LLC, within 60 days as indicated herein.

The parties shall select an independent appraiser and notify the court of an agreed choice within 15 days. The appraisal shall be promptly performed within 60 days of the appraiser's appointment.

A conference shall be held before the court on April 2, 2012 at 10 a. m. Both parties must appear with counsel.

This constitutes the Decision and Order of the Court.

CAROLYN E. DEMAREST

Justice of the Supreme Court

Footnotes

Footnote 1: The cause of action for rescission was withdrawn at the pre-trial conference.

Footnote 2: The tax returns submitted in evidence reflect capital accounts of members of plaintiff's family other than Claudia. These individuals and trusts are neither members in the LLC nor employees. Defendant has not contested plaintiff's standing to bring this action, but

it is unclear from these returns just what plaintiff's present capital account is.

Footnote 3: However, plaintiff's reliance upon *Fuiaxis v 111 Huron Street, LLC*, 58 AD3d 798 [2d Dept 2009], to support his contention, that Cohen's failure to provide additional capital funds as requested constituted a breach of Cohen's fiduciary duty to the LLC, is misplaced, as in *Fuiaxis* , the operating agreement expressly provided that members were required to make additional cash contributions and failure to do so authorized the purchase of such member's interest by other members pursuant to a formula set forth in the operating agreement, unlike the agreement at bar which expressly indicates that no additional cash contributions would be required except on consent.

Footnote 4: According to the definitions set forth in the Operating Agreement, a Member would necessarily also be an Economic Interest Holder.

Footnote 5: This is in contrast to LLCL §701(b) which expressly provides that a limited liability company shall continue following an event which terminates the membership of a particular member unless a majority vote or agree in writing to dissolve within 180 days of such event. *See Matter of Horning v Horning Construction, LLC*, 12 Misc 3d 402, 408 [Sup Ct, Monroe Co, 2006].

Footnote 6: The court notes that, were plaintiff's petition treated as an involuntary withdrawal, Section 6.4 of the Agreement would authorize a buy-out of his interest by defendant, the converse of what plaintiff is seeking.

Footnote 7: Mizrahi's capital contributions are credited to four different individuals, apparently his family members, who are not members of the LLC. This procedure has not been challenged and those itemized contributions have been attributed to Mizrahi.

Footnote 8: As has become apparent, the Operating Agreement appears to have been drafted upon the unrealistically optimistic premise that the building could not fail to be profitable and that the circumstances presented here would never occur. There are provisions that protect the individual members from the consequences of economic loss to the LLC without providing a mechanism to adjust for such loss without destroying the LLC and both of the members' interests. The court is well aware that the result of dissolution as ordered will be the loss to both members of their professional offices unless a negotiated solution can be found.

Footnote 9: Section 4.4 .2 of the Operating Agreement requires that even if assets are distributed "in kind", which would be the case in the buy-out suggested by plaintiff, such assets must be assessed at fair market value by an independent appraiser and taken by all Economic Interest Holders entitled to participate in the distribution as tenants-in-common.

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