SCAN

SHORT FORM ORDER

SUPREME COURT : STATE OF NEW YORK
COUNTY OF NASSAU

PRESENT:
HON. IRA B. WARSHAWSKY,
Justice.

TRIAL/IAS PART 9

JOSEPH E. VERDERBER, JUDITH VERDERBER and VERBENCO, LLC,

Plaintiffs,

INDEX NO.: 007691/2009
MOTION DATE: 08/21/2009
MOTION SEQUENCE: 002 and 003

-against-

COMMANDER ENTERPRISES CENTEREACH, LLC, COMMANDER ENTERPRISES, LLC, BENCO, LLC, PEMBROKE PROPERTIES, LLC, LEONARD SHAPIRO and JOSEPH G. SHAPIRO,

Defendants.

The following papers read on this motion:

Notice of Motion, Affirmation & Exhibits Annexed 1
Memorandum of Law in Support of Plaintiffs' Motion to Dismiss Pursuant to CPLR Rule 3211(a)(1) and (7) 2
Order to Show Cause, Affidavit, Affirmation & Exhibits Annexed 3
Emergency Affirmation of Matthew F. Didora & Exhibit Annexed 4
Defendants' Memorandum of Law in Support of Motion to Stay Action and Compel Arbitration and for a Preliminary Injunction 5
Memorandum of Law in Support of Plaintiffs' Motion in Opposition to Motion to Compel Arbitration 6
Affirmation of Austin Graff in Opposition to Motion to Compel Arbitration & Exhibits Annexed 7

Motion by plaintiff to dismiss defendant Commander Enterprises' counterclaim for failure to state a cause of action is granted. Cross-motion by defendants to compel arbitration is

denied. Defendants' cross-motion for a preliminary injunction prohibiting plaintiff from transferring their interests in defendant Commander Enterprises Centereach is denied.

This is an action by minority members of a limited liability company seeking a declaration as to the operating agreement which governs the company. In the alternative, plaintiffs seek a declaration that the restriction on alienation contained in the more recent agreement is unenforceable. Plaintiff Joseph Verderber and his wife, plaintiff Judith Verderber, are real estate investors, who operated through a partnership, Pembroke Properties.[1] Defendant Joseph Shapiro, who was a friend of the plaintiffs for many years, is also a real estate investor.

In the spring of 1999, plaintiffs and Shapiro agreed to acquire jointly an office building located at 2100 Middle Country Road in Centereach. Rather than forming a new association for the venture, the parties agreed that title would be taken in the name of Pembroke Properties. Shapiro asserts that the transaction was structured in this manner so that plaintiffs could claim an "exchange of like kind property" and avoid recognizing a capital gain on a building which they had recently sold.[2] In any event, in anticipation of the transaction, Shapiro, acting through his limited liability company, defendant Benco, LLC, acquired an 80% interest in Pembroke Properties.

After Shapiro was admitted to the partnership, plaintiffs and Shapiro entered into a "conversion agreement," whereby Pembroke Properties, a Florida general partnership, was converted into Pembroke Properties, LLC, a New York limited liability company.[3] The conversion agreement provided that the ownership interests in the limited liability company would be in the same proportion as their ownership interests in the partnership, 80% would be owned by Benco, Joseph Verderber would own 18%, and Judith Verderber would own 2% of the

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[1]Affidavit of Joseph Shapiro at ¶ 6.

[2]Affidavit of Joseph Shapiro at ¶ 6. See also 26 U.S.C. § 1031. Since the agreements covering Pembroke Properties are lawful on their face, the court need not be concerned with the tax treatment (*Hilgendorff v Hilgendorf*, 241 AD2d 481 [2d Dept 1997]). However, the court expresses no opinion as to whether the transaction as ultimately concluded qualified as an exchange of like kind property.

[3]Defendants' ex. D.

company. Although defendants' copy of the conversion agreement is dated July 30, 1999, plaintiffs allege that it was actually entered into on July 2, prior to the real estate closing.[4]

On July 7, 1999, an entity known as Pembroke Properties, LLP took title to the property.[5] Financing for the transaction was provided by a mortgage party lender other than one of the parties. It appears that Pembroke Properties, LLP, the limited partnership which took title to the property, is a different entity from the general partnership or the limited liability company in which Shapiro had an interest. Whether Shapiro had a legal, as opposed to an equitable, interest in the limited partnership is unclear. Nevertheless, the mortgage lender was apparently aware of Shapiro's interest in the property.

At the real estate closing, plaintiffs and Shapiro entered into an operating agreement, governing Pembroke Properties, LLC.[6] In Sec. 9.2, the operating agreement provided that if any member desired to sell his interest in the LLC to a third party, he was required to give the other members an option to purchase the member's interest on the same terms as were contained in the third-party's offer. Shapiro alleges that this agreement was "put together hastily, largely to satisfy the requirements of the mortgage lender" and that an amended operating agreement was to be negotiated after the closing.[7]

However, before agreeing to an amended operating agreement covering Pembroke Properties, Shapiro and Joseph Verderber first agreed to an operating agreement covering another limited liability company in which Verderber was a minority member. In January 2000, Shapiro and Verderber executed an operating agreement covering Commander Enterprises Islandia II, LLC.[8] This operating agreement contains a provision that minority interests must be sold to

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[4]Plaintiffs' ex. E, complaint at ¶ 15.

[5]Affidavit of Joseph Shapiro at ¶ 10. In the complaint ¶ 21, plaintiffs allege, apparently erroneously, that "Defendant Commander" purchased the property.

[6]Plaintiffs' second ex. A (behind the conversion agreement). See also affidavit of Joseph Shapiro at ¶ 10.

[7]Affidavit of Joseph Shapiro at ¶ 10-11.

[8]Defendants' ex. F.

Benco. The agreement also contains a "buyout rate," for valuing the minority interest. According to this formula, the minority interest is valued based upon a purchase price for the entire company of 8.46 times the net operating income, minus the "present mortgage balance." This agreement also contained a provision that "In the event of any dispute that cannot be resolved between the members, it shall be referred to the company's then accountant and legal counsel for determination."

Defendant asserts that a similar agreement covering Pembroke Properties, and dated October 1, 2000, was executed by all parties on or about September 28, 2000.[9] Article III, Sec. 8 of the October 2000 agreement provides that in the event any member desires to transfer all or any part of his interest, it must be transferred to Benco.[10] Sec. 8 further provides that the membership interest must be sold "at the value set forth in Article VII." Article VII, entitled "death of a member," provides in sec. 4 that "The purchase price/buy out rate shall be determined by multiplying the net operating income by 8.80, and deducting the present mortgage balance. Such purchase price/buy out shall be paid over a term of five years in equal monthly installments."

Article III, Sec. 4 of the October 2000 agreement provides that each member may inspect and copy, at his own expense, for any purpose reasonably related to such member's interest ...all tax returns or financial statements of the company for three years immediately preceding his inspection, and other information regarding the affairs of this company as is just and reasonable."

Article VIII of the agreement provides that "In the event of any dispute that cannot be resolved between the members, it shall be referred to the company's then accountant and legal counsel for determination."

On November 28, 2001, Pembroke Properties, LLC filed a certificate of amendment with the Department of State, changing its name to Commander Enterprises Centereach, LLC.[11] There is no dispute that plaintiffs hold a 20% interest in that company. In the ensuing six years,

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[9]Defendants' ex. A.

[10]Defendants' ex. A.

[11]Defendants' ex. E.

Shapiro, as the holder of the majority interest, controlled the management of the company, operating through Benco.

In January 2008, a dispute arose, the precise nature of which is not disclosed. In the wake of the dispute, plaintiffs proposed that Shapiro buy out their interest, and Shapiro readily agreed to their proposal. However, Shapiro asserted that the buyout price was covered by the amended operating agreement covering Pembroke Properties dated October 1, 2000. In a letter to Joseph Verderber dated February 5, 2008, Shapiro enclosed a copy of the October 2000 agreement, or at least the provision governing the buyout price.[12] In March 2008, the parties, represented by counsel, began negotiating with regard to the terms of the buyout.[13]

On January 14, 2009, plaintiffs purported to assign their interests in Commander Enterprises Centereach to their own limited liability company, Verbenco LLC.[14] Defendants promptly objected to the assignments as being in violation of the membership agreement. On January 27, 2009, plaintiffs, acting through counsel, demanded "mediation" of the dispute by the company's accountant and legal counsel "pursuant to Article VIII of the operating agreement."[15] Nevertheless, on February 10, 2009, counsel for plaintiffs wrote to counsel for the company, claiming that plaintiffs had been unaware of the October 2000 operating agreement and had understood the July 1999 agreement to be controlling.[16]

The present action was commenced on April 21, 2009. In the first cause of action, plaintiffs seek a declaratory judgment that plaintiff Joseph Verderber holds an 18% interest in defendant Commander Enterprises Centereach, LLC and plaintiff Judith Verderber holds a 2% interest in the company. Since defendants concede that plaintiffs are members of CEC and hold

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[12]Defendants' ex. H.

[13]Defendants' ex. I.

[14]Defendants' ex. C (second document in the exhibit).

[15]Defendants' ex. C.

[16]Defendants' ex. I.

their respective interests, there is no justiciable controversy as to this issue.[17] Accordingly, the court may not issue a declaratory judgment with respect to the first cause of action (See CPLR § 3001).

In the second cause of action, plaintiffs seek a declaration that the July 1999 operating agreement controls Commander Enterprises Centereach and the October 2000 agreement is "a nullity." Although the October 2000 agreement purports to be signed by all parties, plaintiffs allege that the signature page was fraudulently "slipped in" and is actually "part of a different document."[18] In the third cause of action, plaintiffs seek an alternative declaration that the restriction on alienation contained in the October 2000 agreement is "void as a matter of law." In the fourth cause of action, plaintiffs seek an alternative declaration that the buyout provision in the October 2000 agreement applies only upon the death of a member.

In the fifth cause of action, plaintiffs assert a claim for breach of fiduciary duty, alleging that defendants misled them with respect to the operating agreement and denied plaintiffs "access to the premises to conduct an appraisal." In the sixth cause of action, plaintiffs assert a claim for fraud, alleging that defendants "falsely identified the [October 2000 operating agreement] as the governing document."

In defendants' original answer, defendant Commander Enterprises Centereach asserted a counterclaim for breach of an agreement to pay CEC its costs and expenses related to producing and duplicating financial documents at plaintiffs' request. In defendants' amended answer, this counterclaim is asserted on behalf of defendant Commander Enterprises, LLC.

Plaintiffs move pursuant to CPLR 3211(a)(7) to dismiss the counterclaim for failure to state a cause of action. Plaintiffs argue that they did not enter into any agreement with Commander Enterprises and defendants are barred from changing the party on whose behalf the counterclaim is asserted by the doctrine of "judicial estoppel."

Defendants cross-move pursuant to CPLR § 7503 to compel "arbitration" of plaintiffs' claims pursuant to Article VIII of the October 2000 operating agreement. Defendants further

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[17]See defendants' memorandum of law at 2 and affidavit of Joseph Shapiro ex. D.

[18]Plaintiffs' ex. E, complaint at ¶ 109.

move pursuant to CPLR § 6301 for a preliminary injunction, prohibiting plaintiffs from transferring their membership interests "pending final disposition of this action." The court will begin by considering the motion to compel arbitration.

CPLR § 7503(a) provides that a party aggrieved by the failure of another to arbitrate may apply for an order compelling arbitration. Where there is no substantial question whether a valid agreement was made or complied with, and the claim is not barred by the statute of limitations, the court shall direct the parties to arbitrate (CPLR § 7503). Where any such question is raised, it shall be tried forthwith in said court (Id).

New York has a "long and strong public policy favoring arbitration" (*Stark v Molod Spitz DeSantis & Stark*, 9 NY3d 59, 66 [2007]). Arbitration is to be encouraged as a means of conserving the time and resources of the contacting parties and the courts (Id). Thus, the court should "interfere as little as possible" with the freedom of the parties to submit disputes to arbitration" (Id).

Like arbitration, alternative dispute resolution procedures are favored by the court as an alternative to litigation (*FCI Group v New York*, 54 AD3d 171, 175 [1st Dept 2008]). Thus, a party aggrieved by the failure of another to pursue an alternate dispute resolution procedure may seek to compel alternate resolution pursuant to CPLR § 7503 (*Con Ed v Electric Ins. Co.*, 269 AD2d 288 [1st Dept 2000]). Under an alternative dispute resolution agreement, the resolver of the dispute need not be a neutral arbitrator and may even be an employee of one of the contracting parties (*Thomas Crimmins Contracting Co. v Cayuga Construction Co.*, 74 NY2d 166, 171 [1989]). For example, designated individuals, such as architects or engineers, may be granted power to make binding decisions as to factual disputes falling within their particular expertise (Id).

However, a party will not be denied judicial resolution of a controversy unless it falls within the meaning of the alternate dispute resolution provision (*FCI Group v New York*, supra, 54 AD3d at 175). "An alternate dispute resolution agreement, like an arbitration agreement, must be clear, explicit and unequivocal and must not depend upon implication or subtlety" (*Thomas Crimmins Contracting Co. v Cayuga Construction Co.*, supra, 74 NY2d at 171).

The fact that Joseph Verderber agreed to alternate dispute resolution in the operating

agreement covering Commander Enterprises Islandia is strong evidence that plaintiffs agreed to alternative resolution of disputes arising from the Centereach company. Moreover, by demanding "mediation" pursuant to Article VIII, plaintiffs in effect conceded that they are bound by the October 2000 operating agreement. Thus, Shapiro's reference in his letter of February 5, 2008 to "the initial buying" of the property must have been understood as relating to the fifteen month time period following the actual closing. The court concludes that plaintiffs explicitly agreed to alternate dispute resolution by the accountant and counsel to the company.

However, "like contract rights generally, a right to arbitration may be modified, waived or abandoned" (*Stark v Molod Spitz DeSantis & Stark*, supra, 9 NY3d at 66). "[A] litigant may not compel arbitration when its use of the courts is clearly inconsistent with its later claim that the parties were obligated to settle their differences by arbitration" (Id). "The crucial question is what degree of participation by the defendant in the action will create a waiver of a right to stay the action. In the absence of unreasonable delay, so long as the defendant's actions are consistent with an assertion of the right to arbitrate, there is no waiver. However, where the defendant's participation in the lawsuit manifests an affirmative acceptance of the judicial forum, with whatever advantages it may offer in the particular case, his actions are then inconsistent with a later claim that only the arbitral forum is satisfactory" (Id).

"[N]ot every foray into the courthouse effects a waiver of the right to arbitrate. Where urgent need to preserve the status quo requires some immediate action which cannot await the appointment of arbitrators, waiver will not occur (Id at 67). A "purely defensive action," such as interposing an answer, or entering a stipulation to extend the time to answer, will not constitute a waiver of the right to arbitration (*De Sapio v Kohlmeyer*, 35 NY2d 402, 405 [1974]). By contrast, contesting the merits through a motion for summary judgment will constitute a waiver (Id). Utilization of judicial discovery procedures, such as obtaining an order to take a deposition, constitutes affirmative acceptance of the judicial forum (Id at 406). Similarly, interposing a cross claim against a codefendant who is not a party to the arbitration agreement, is inconsistent with asserting the right to arbitrate (Id).

Although defendants served plaintiff Joseph Verderber with a notice of deposition for

July 16, 2009, it is not clear that the deposition was actually conducted.[19] However, the defendants asserted a counterclaim for sums due for document production at plaintiffs' request. In the amended answer, the counterclaim is asserted on behalf of Commander Enterprises, LLC, which is not a party to the arbitration agreement. However, in the initial answer, the counterclaim was asserted on behalf of Commander Enterprises Centereach, the company which is the subject of the present action. Moreover, the counterclaim appears to be based on Article III, section 4 of the October 2000 agreement which obligates the member to pay for requested tax returns and financial statements. Since there is no compulsory counterclaim rule in New York, there was no need for defendants to assert their counterclaim for breach of the operating agreement in the present action (*67-25 Dartmouth Street Corp. v. Syllman*, 29 AD3d 888 [2d Dept 2006]). Although plaintiffs requested dispute resolution by the company's accountant and counsel on January 27, 2009, defendants do not appear to have responded to plaintiffs' request. The court concludes that defendants waived their right to submit the present dispute to alternate dispute resolution. Defendants' cross-motion to compel arbitration is denied.

In order to be entitled to a preliminary injunction, defendants must show a likelihood of success on the merits, danger of irreparable injury in the absence of an injunction, and a balance of the equities in their favor (*Aetna Ins. Co. v Capasso*, 75 NY2d 860 [1990]). As discussed above, the October 2000 agreement is the operating agreement covering CEC. The agreement contains a provision requiring that minority interests be sold to Benco, the controlling member, at a price determined by the buyout formula. To establish a likelihood of success on the merits, defendants must show that this restriction on alienation is enforceable.

A provision in a certificate of incorporation requiring a shareholder to give a "first option" to the corporation or the other shareholders to purchase the stock, at an agreed price or then-existing book value, before offering it to outsiders is ordinarily enforceable (*Allen v Biltmore Tissue Corp.*, 2 NY2d 534, 541 [1957]). However, the option must be for a limited period. "[O]wnership of property cannot exist in one person and the right of alienation in another" (Id at 542). "An effective prohibition against transferability itself" is not enforceable

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[19]Affirmation of Austin Graff, Esq. at ex. G.

(Id). A limited liability company bears resemblance to a close corporation, at least as to the limited liability feature. Thus, it appears that an operating agreement covering a limited liability company may contain a first option provision, but it may not prohibit a member from selling his interest to a third party. In any event, defendants have not shown a likelihood of success on the merits with respect to the enforceability of the provision restricting transfer of plaintiffs' membership interest.

Furthermore, defendants assert that there is a danger of irreparable harm because "any transfer of the plaintiffs' interest to a party other than Benco will result in a fundamental shift in the management and control of CEC...." However, Limited Liability Company Law § 603(a)(2) provides that "an assignment of a membership interest does not dissolve a limited liability company or entitle the assignee to participate in the management and affairs of the limited liability company." Thus, defendants have failed to show a danger of irreparable injury if a preliminary injunction is not granted. Defendants' motion for a preliminary injunction prohibiting plaintiffs from transferring their interests in Commander Enterprises Centereach, LLC pending final disposition of the action is denied.

To assert a claim for breach of contract, plaintiff must be a party to the contract or an intended third-party beneficiary (*Kings Choice Neckwear, Inc. v DHL Airways*, 41 AD3d 117 [1st Dept 2007]). Pursuant to Article III, Sec. 4 of the October 2000 operating agreement, plaintiffs' obligation to pay for reproduction costs is clearly intended to benefit Commander Enterprises Centereach, the party who would otherwise incur the expense. Had defendants erroneously asserted the counterclaim on behalf of Commander Enterprises, the court would have granted defendants leave to name the counterclaim plaintiff correctly. Leave to amend shall be freely given, and plaintiffs clearly received notice of the transaction (CPLR 3025[b]). However, as noted above, it appears that in the amended answer defendants deliberately asserted the counterclaim on behalf of Commander Enterprises, a stranger to the dispute resolution agreement, in an effort not waive their right to alternative dispute resolution.

The court notes that defendants have not requested leave to replead the counterclaim on behalf of defendant Commander Enterprises Centereach in the event that the motion to dismiss the counterclaim is granted. Since Commander Enterprises is not a party to the operating

agreement or a third party beneficiary, plaintiffs' motion to dismiss the counterclaim for failure to state a cause of action is granted.

This shall constitute the decision and order of the court.

Dated: October 15, 2009

J.S.C.