

At a Commercial Division, Part 1, of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at Civic Center, Brooklyn, New York, on the 10th day of May, 2007.

P R E S E N T:

HON. CAROLYN E. DEMAREST,
Justice.

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OUT OF THE BOX PROMOTIONS, LLC, and
PAUL HELLMAN,

Plaintiffs,

- against -

**DECISION
AND
ORDER**

Index No. 29586/06

AVI M. KOSCHITZKI, BREINDY KOSCHITZKI
and KOSCH DESIGN, LLC d/b/a OUT OF THE
BOX GROUP,

Defendants.

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The following papers numbered 1 to 5 read on this motion: Papers Numbered

Notice of Motion/Order to Show Cause/Petition/ Cross Motion and Affidavits(Affirmations)Annexed	1
Opposing Affidavits (Affirmations	3
Reply Affidavits(Affirmations)	4
Affidavits(Affirmations)	
Other Papers (Memoranda of Law)	2, 5

Defendants move pursuant to CPLR 3211(a) subdivisions (1), (3) and (7) for an order dismissing the verified complaint, contending that plaintiff Paul Hellman (“Hellman”) does not have standing to sue on behalf of Out of the Box

Promotions LLC (“Out of the Box”), because he is not a member of the LLC, and that, in any event, a member of a limited liability company has no right to bring a derivative action on behalf of the company.

BACKGROUND

The complaint alleges that in May 2003, Hellman and defendant Avi Koschitzki (“Koschitzki”) formed Out of the Box for the design, manufacture and sale of promotional products to various businesses. Hellman was to be primarily involved in the financial aspects of the business and Koschitzki would be primarily involved in operations and sales. The financial offices were to be located at 1123 McDonald Avenue, Brooklyn. Sales and operations were conducted at 4214 Glenwood Road, Brooklyn.

The complaint contains the following allegations: Between January 12, 2004 and August 17, 2004, Koschitzki used an Out of the Box Credit Merchant ID account to credit his personal debit card. Kotschitzki subsequently admitted the unauthorized use of the Merchant ID and promised to repay all stolen money. Company accounts were used to messenger items to Koschitzki’s home, ship furniture from China, and incur expenses at Home Depot and other retailers. Company employees were instructed to report to Koschitzki’s home to work there while it was under construction. Out of the Box employees threatened to quit after seeing lewd and graphic photographs of Kotschizki on the company computer. On January 1, 2006, to prevent further theft and illegal use of company resources, the space at Glenwood Road was downsized and most operations were consolidated to 1123 McDonald Avenue. Hellman was to continue Out of the Box with its current customers and Koschitzki agreed to continue with Out of the Box in a purely sales capacity, relinquishing control of all operational aspects.

The complaint further alleges the following: In February, 2006, Koschitzki formed defendant Kosch Design LLC d/b/a Out of the Box Group. In June 2006, Koschitzki took promotional orders for Out of the Box and charged the cost of the manufacture of the promotional items to Hellman's personal credit card without his knowledge and/or authorization. Koschitzki and his wife, Briendy Koschitzki, were receiving "kickbacks" from the Chinese manufacturers from whom Out of the Box was purchasing its promotional products. Between September 26, 2005 and January 12, 2006, there were various wire transfers made by Chinese manufacturers for Out of the Box to the personal JP Morgan Chase Bank account of Koschitzki and his wife. In July 2006 Koschitzki illegally entered the Glenwood Road location during non-business hours and took products intended for sales to Out of the Box customers. He changed the locks and deposited the new keys in Hellman's mailbox. On September 21, 2006, Hellman received notification from a current vendor of Out of the Box that a check from "Out of the Box Group" (Kosch Design, LLC) was returned for insufficient funds, resulting in a credit hold being placed on plaintiff Out of the Box. The complaint further alleges diversion of business from Out of the Box to Koschitzki's new company, Kosch Design, LLC d/b/a Out of the Box Group, and malicious efforts to destroy Out of the Box by informing customers that plaintiff is financially unsound and lacks resources to fill orders.

Based on these allegations, plaintiffs assert causes of action, inter alia, for violation of fiduciary duty, theft, embezzlement, "wrongful interference with contractual relations of Out of the Box," unfair competition, and self-dealing. Plaintiffs seek damages and injunctive relief including removal of Koschitzki as an officer/member and a declaration that plaintiff Hellman "have exclusive right

and title to all assets of Out of the Box.”

In support of dismissal, Koschitzki asserts that on May 27, 2003, he alone formed Out of the Box before he had any business relationship with Hellman and that he is the sole member of Out of the Box. Koschitzki points out that the Articles of Organization of Out of the Box make no mention of any other member aside from himself, and argues that Hellman has submitted no evidence that he ever became a member. According to Koschitzki, the relationship between himself and Hellman was limited to Hellman loaning money to Koschitzki’s business. Koschitzki submitted an email from the controller of Caretech Group Inc., Hellman’s company, which lists the funds Hellman invested in Out of the Box as loans.

In opposition to the motion to dismiss, Hellman asserts that he is a member of Out of the Box, and as such, he has the capacity to bring this action. He contends that there is evidence that a partnership existed, including tax returns filed by Out of the Box which list both Hellman and Koschitzki as members of Out of the Box, emails in which Koschitzki refers to Hellman as his partner, agreements which had been drafted by Koschitzki’s attorney which had never been finalized and interactions with customers by both Hellman and Koschitzki which led the customers to believe they were partners. Hellman further asserts that the complaint delineates wrongs done both to himself individually and to Out of the Box.

ANALYSIS

Motion to Dismiss the Complaint

In general, upon a motion to dismiss, a pleading must be afforded a liberal construction. Leon v. Martinez, 84 NY2d 83, 87 (1994); Casamassima v.

Casamassima, 30 AD3d 596 (2d Dep't, 2006). The court must determine whether the facts as alleged fit within any cognizable legal theory. 511 West 232nd Street Owners Corp. v. Jennifer Realty Co., 98 NY2d 144, 152(2002). When evidentiary material is considered, the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one. Guggenheimer v. Ginzburg, 43 NY2d 268(1977). A CPLR 3211 motion should be granted only where "the essential facts have been negated beyond substantial question by the affidavits and evidentiary matter submitted." Biondi v. Beekman Hill House Apartment Corp., 257 AD2d 76 (1st Dep't, 1999). Factual claims either inherently incredible or flatly contradicted by documentary evidence are not presumed to be true or accorded favorable inference. Biondi v. Beekman Hill House Apartment Corp., supra, citing Kliebert v McKoan, 228 AD2d 232, lv denied, 89 NY2d 802. However, unless it has been shown that a claimed material fact as pleaded is not a fact at all and that there exists no significant dispute regarding it, dismissal is not warranted. Guggenheimer v. Ginzburg, 43 NY2d 268(1977).

Defendants contend this action should be dismissed pursuant to CPLR 3211 (a)(3) because Hellman lacks standing as he is not a member of the LLC and, because a member of an LLC may not prosecute a derivative suit on behalf of the LLC, plaintiffs lack capacity to bring the action which, they argue, seeks recovery on claims belonging to the LLC. Defendants contend that this is conclusively established by documentary evidence; thus dismissal is likewise required pursuant to CPLR 3211 (a)(1). Defendants further contend that dismissal is warranted pursuant to CPLR 3211 (a)(7) for failure to state a cause of action because the law does not recognize a derivative cause of action on behalf of an LLC, and Hellman may not sue individually to redress wrongs suffered by the LLC. It is noted that

plaintiffs' complaint has not been framed as a derivative action although several of the claims demand relief on behalf of Out of the Box.

Standing as a Member

Evidentiary material submitted by defendants in support of their contention include the Articles of Organization of Out of the Box and documents of plaintiff's company, Caretech Group, showing money transferred from Caretech to Out of the Box as loans. However, plaintiff Hellman has submitted evidence which supports his position that he and Koschitzki were partners in Out of the Box. In view of the conflicting evidentiary submissions, there exists a significant dispute regarding the essential facts which defendants' documentary evidence does not negate beyond substantial question.

A New York Limited Liability Company is formed by filing articles of organization with the Secretary of State. LLCL §203, 209. LLCL §203(c) provides that, at the time of its formation, a limited liability company must have at least one member but there is no requirement that all members of the LLC be set forth in the articles of organization (LLCL §203[e]). Defendants have submitted no documentation that would unequivocally establish that Hellman was not a member either on the effective date of the initial articles of organization under LLCL §602(a)(1), or subsequently through one of the avenues set forth in LLCL §602(b).

It is not disputed that no operating agreement was signed, but there is evidence that Koschitzki considered Hellman to be a member. The tax documents submitted by plaintiffs show that Hellman and Koschitzki considered and held themselves out to be 50% owners of Out of the Box. See, 2005 IT-204-ATT (Exhibit A to plaintiffs' affidavit in opposition to motion to dismiss). Therefore,

defendants' contention that the absence of Hellman's name on the Articles of Organization conclusively demonstrates that he is not a member, is not supported by the evidence in light of the provisions of the LLC Law. See Man Choi Chiu v. Chiu, 38 AD3d 619 (2d Dep't, 2007) (Tax returns constituted documentary evidence of membership, in absence of LLC records required by LLCL §1102(a)(2)). Accordingly, dismissal for lack of standing as a member of the LLC pursuant to CPLR 3211(a)(3) and (7) is denied.

Capacity to Bring the Action

Defendants further contend that even if Hellman was a member of Out of the Box, it is well settled that, in the Second Department, members of a limited liability company may not sue derivatively on behalf of the company, citing Hoffman v. Unterberg, 9 AD3d 386, 388-89 (2d Dep't, 2004). Defendants maintain that this Court is required to follow the Second Department decision in Hoffman, notwithstanding conflicting authority from the federal courts and in the First Department. Defendants further argue, citing LLCL §408(b), that even if a derivative action is permitted, a majority vote of the members would be required to bring such an action.

Limited Liability Company Law § 408(b) only applies if the articles of organization provide that the management of the LLC shall be vested in a manager or managers. See LLCL §408(a). Since the Articles of Organization of Out of the Box do not provide for managers, and there has been no operating agreement submitted or any claim that an operating agreement was ever executed, the default provisions of the LLCL apply. See Spires v. Lighthouse Solutions, LLC, 4 Misc.3d 428(Sup. Ct, Monroe Co., 2004); Lio v. Mingyi Zhong, 10 Misc.3d 1068(A) (Sup. Ct, NY Co., 2006); McKinneys Practice Commentaries, 32A

Limited Liability Company Law, p. 4 Section 1.A (Rich, 2005).

Pursuant to LLCL §401, in the absence of a specific contrary provision, management is vested in all the members as in a general partnership. See, 1 NY Prac, NY Limited Liab Companies and Partnerships §6:9. Applying the default provisions of LLCL §402, members vote in proportion to their respective interests. See NY Jur. Business Relationships §2067. According to the 2005 tax returns for Out of the Box Promotions LLC, submitted as Exhibit A to the affidavit in opposition, plaintiff Hellman and defendant Koschitzki each own fifty percent of the capital of the company and are each entitled to fifty percent of the profits. Therefore, any attempt to obtain majority approval to act on behalf of the LLC would be impossible in the circumstances. As plaintiff points out, citing L.W. Kent and Co. v. Wolf, 143 AD2d 813, 814(2d Dep't, 1988), "it could hardly be expected that if approval . . . were sought, [Koschitzki] who controlled 50% . . . would have authorized the action against himself." Defendants' argument that the instant suit is precluded by the failure to obtain approval of a majority of the LLC members is unavailing.

Plaintiff Hellman relies on the First Department decision in Tzolis v. Wolff, ___ AD3d ___, 2007 NY Slip Op. 01190 (1st Dept, 2007), reversing 12 Misc.3d 1151(A)(Sup. Ct, NY Co., 2006), to support his right to bring a derivative action. Defendants insist that this Court is constrained to follow Hoffman v. Unterberg, supra, a decision rendered in 2004 by the Appellate Division, Second Department, in which an inter-familial claim for diversion and misappropriation of funds belonging to the family-owned limited liability company, which was not a party to the action, was dismissed based upon the absence in the LLCL of an express statutory authorization to a member to bring a derivative suit. More recently, the

Second Department acknowledged this prior holding rendered “without elaboration” in Hoffman, but proceeded to find a right in an individual condominium owner to act on behalf of the entire condominium to bring a derivative action in the absence of statutory authority. Caprer v. Nussbaum, 36 AD3d 176, 189 (2d Dep’t, 2006). The compelling rationale set forth by Justice Spolzino in Caprer, recognizing the common law origins of the right to bring a derivative action as an equitable remedy, suggests, however, that a member of a limited liability company should similarly be accorded such relief.

In Weber v. King, 110 F. Supp. 2d 124, 131 (EDNY, 2000), taking note of the fact that an LLC, by statute, is an independent entity bearing characteristics of both a partnership and a corporation, in which the ownership interests of both forms have a statutory right to bring a derivative suit, Judge Mishler found it “peculiar” that the New York State legislature had chosen not to similarly provide such course of action to the members of an LLC. While recognizing the legislative history, citing to the Second Circuit’s recognition of the right of limited partners to sue derivatively prior to enactment of legislation in Klebanow v. New York Produce Exchange, 344 F.2d 294(2d Cir., 1965), Judge Mishler nevertheless concluded: “We do not believe that the legislature’s failure to include a derivative action provision in the LLCL prevents us from recognizing such a right at common law.” Accord, Bischoff v. Boar’s Head Provisions Co., Inc., 436 F. Supp.2d 626, 632(SDNY, 2006), in which Judge Chin rejected the reasoning applied in Hoffman that statutory omission precluded the exercise of common law derivative rights, finding that “the common law can only be displaced by a statement of ‘clear and specific legislative intent’,” citing Hechter v. New York Life Ins. Co., 46 NY2d 34, 39 (1978). Judge Chin took note of the lack of any

discussion of a common law right in Hoffman and further observed that, in debate on the subject proposed legislation, the Assembly had been assured that an LLC member would have a common law right to bring a derivative action even if no statutory provision therefor was made.

Based upon the cogent analysis set forth by the Second Department Appellate Court in Caprer, it seems at least possible that this Department may be prepared to reconsider its holding in Hoffman in light of the convincing logic set forth in the First Department decision in Tzolis v. Wolf, supra, which tracks the above-cited reasoning of the federal courts.

Finally, although not previously considered in the context at bar, this Court notes that LLCL §610 provides:

A member of a limited liability company is not a proper party to proceedings by or against a limited liability company, **except where the object is to enforce a member's right against or liability to the limited liability company.**(Emphasis supplied)

While not characterized as the right to bring a derivative action per se, a close reading of this provision suggests that plaintiff Hellman has initiated the instant action in full compliance with the statute by bringing suit both for himself individually, “to enforce a member’s right,” and by joining the limited liability company as a plaintiff in order to “enforce a member’s [Koschitzki’s] liability to the limited liability company.” Thus, it appears that the complaint does state a cause of action on behalf of both plaintiffs and should not be dismissed as an improper derivative action. Cf. Zulawski v. Taylor, 11 Misc. 3d 1058(A)(Sup. Ct, Erie Co., 2005). The motion to dismiss the complaint in its entirety pursuant to CPLR 3211(a)(7) is denied.

The Complaint

The complaint asserts ten causes of action. The first, claiming breach of fiduciary duty to Out of the Box, seeks removal of Koschitzki as “an officer/member” of Out of the Box and the award to Hellman of exclusive right and title to all assets. The second, third, fourth and ninth causes of action assert damages to the business and to Hellman personally, as a result of defendants’ breach of fiduciary duty, theft, embezzlement, waste, mismanagement and self-dealing depriving Hellman of his right to financial benefits. The fifth, sixth, eighth and tenth causes of action, claiming wrongful interference with contractual relations, unfair competition and solicitation of the customers of Out of the Box through false statements of the financial instability of the company, are wholly derivative. The seventh cause of action alleges “prima facie tort” premised upon all of the other claims.

It is well-established that the elements of prima facie tort are (1) intentional infliction of harm (2) which results in special damages (3) without justification (4) by actions otherwise lawful. Curiano v. Suozzi, 63 NY2d 113, 117 (1984); Burns Jackson Miller Summit & Spitzer v. Lindner, 59 NY2d 314, 332(1983). Critical to the pleading of a cause of action for prima facie tort is that the claimed wrongful behavior be solely motivated by malice. See Curiano at 117. Such is clearly not the case here where the true gravamen of plaintiffs’ action is the breach by defendants of a duty to plaintiffs resulting in financial loss to them and financial benefit to defendants. There is not even a credible suggestion that defendants’ purpose was actually malicious. Defendants’ objective was clearly economic gain and their actions in furtherance thereof would therefore not constitute a prima facie tort. See Burns at 333. As the Court of Appeals stated in Curiano (at 118), a prima facie tort is not a “catch-all” cause of action made viable merely by the

assertion of a malicious purpose. Moreover, the means alleged to have been employed by defendants in diverting the assets of plaintiffs to their own use would constitute a breach of fiduciary duty and conversion, neither of which could be characterized as lawful. The seventh cause of action is deficient and is dismissed.

The fourth cause of action, predicated upon all of the claims set forth in the previous three causes of action, alleging that Koschitzki's actions constitute "theft, embezzlement, waste, mismanagement and self-dealing," is merely duplicative of the three prior causes and is therefore dismissed.

With regard to the first cause of action to remove Koschitzki as a member of Out of the Box, LLCL §606(1) provides that unless an operating agreement provides otherwise, a member may not withdraw from a limited liability company prior to the dissolution and winding up of the limited liability company. Absent any contrary provision in an operating agreement or in the articles of organization, a limited liability company may be dissolved by court decree upon a finding that it is not reasonably practicable to carry on the business in conformity with its operating agreement. LLCL §702. See Spires v. Lighthouse Solutions, LLC, *supra*, 4 Misc.3d 428, 437-438. Since Hellman is allegedly a member of Out of the Box, he has standing to bring an action for dissolution pursuant to LLCL §702, a pre-requisite to removal of a member absent contrary provisions in organizational or operating documents. See Spires at 438. However, plaintiff has not sought relief pursuant to LLCL §702 for dissolution of the company. The relief requested, transfer of all assets directly to Hellman, is unavailable under the law and the first cause of action must, accordingly, be dismissed for failure to state a cause of action.

Addressing the complaint insofar as it alleges damages to Hellman

individually, courts have recognized a common law and statutory right of members of an LLC to bring an action for breach of fiduciary duty against other members. Nathanson v. Nathanson, 20 AD3d 403 (2d Dep't, 2005); Salm v. Feldstein, 20 AD3d 469, 470 (2d Dep't, 2005); Lio v. Mingyi Zhong, 10 Misc.3d 1068(A) (Sup. Ct, NY Co., 2006); Zulawski v. Taylor, supra, 11 Misc.3d 1058(A). The relationship among LLC members is analogous to that of partners, who, as fiduciaries of one another, owe a duty of undivided loyalty to the partnership's interests. See Willoughby v. Webster, 13 Misc.3d 1230(A) (Sup. Ct, Nassau Co., 2006), citing Birnbaum v. Birnbaum, 73 NY2d 461, 466 (1989). "A partner, and by analogy, a member of a limited liability company, has a fiduciary obligation to others in the partnership or limited liability company which bars not only blatant self-dealing, but also requires avoidance of situations in which the fiduciary's personal interest might possibly conflict with the interests of those to whom the fiduciary owes a duty of loyalty." Willoughby v. Webster, supra, at ***4.

In Nathanson v. Nathanson, supra, 20 AD3d 403, 404, quoting LLCL §409 (a), the Appellate Division reiterated that the defendant had a statutory duty to perform his duties "in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances." The plaintiff's allegations that the defendant engaged in self-dealing were sufficient to state a cause of action for breach of fiduciary duty. Similarly, in Salm v. Feldstein, 20 AD3d 469, the defendant was held to owe the plaintiff a fiduciary duty to make full disclosure of all material facts. In Hoffman v. Unterberg, supra at 388, the Court held that plaintiff had a cause of action against another LLC member for misappropriation of distributions to which plaintiff was entitled as an owner of the LLC.

Hellman asserts that Koschitzki used an Out of the Box Credit Merchant ID account to credit his personal debit card seventy-six times in an amount exceeding \$56,000. In emails sent to Hellman on August 19, 2004 and August 20, 2004, Kotschitzki admitted such unauthorized use and promised to repay the money. Company accounts were used to messenger items to Koschitzki's home, ship furniture from China, and incur expenses at Home Depot and other retailers. Company employees were allegedly instructed to report to Koschitzki's home to work there while it was under construction. In June, 2006, Koschitzki allegedly took promotional orders using the name Out of the Box Promotions, LLC and charged the cost on Hellman's personal credit card without Hellman's knowledge or approval. Hellman asserts that he learned recently that Koschitzki and his wife, Briendy Koschitzki, were receiving "kickbacks" from the Chinese manufacturers from whom Out of the Box was purchasing its promotional products. Between September 26, 2005 and January 12, 2006, various wire transfers were made by Out of the Box vendors to the personal JP Morgan Chase Bank account of Koschitzki and his wife. The complaint alleges that Koschitzki informed customers that Out of the Box would not continue in business, was financially unsound and lacked resources to fill orders so as to divert business to his own competing business, defendant Kosch Design, LLC. These allegations of dishonesty, theft and self-dealing sufficiently allege interference with Hellman's rights as a member of the LLC and a violation of Koschitzki's duty of undivided loyalty to both plaintiffs.

Accordingly, the complaint sets forth facts sufficient to allege a cause of action for breach of the fiduciary duty owed to plaintiff Hellman. The motion to dismiss the second, third, ninth and tenth causes of action as pleaded on behalf of

Hellman individually is denied.

As a practical matter, most of the claims brought personally by plaintiff Hellman as a fifty percent owner-member of the company against the only other member of the company, also possessed of an equal right of ownership, are inextricably related to the rights of the company to the assets alleged to have been diverted by defendants. The damages caused by any misappropriation by defendants, other than the use of Hellman's personal accounts, resulting in the diminution of the value of the company accrue equally to plaintiff Hellman and defendant Koschitzki. Thus, although the availability of a derivative action by a member of an LLC on behalf of the company is presently in dispute, the dismissal of those claims brought on behalf of plaintiff Out of the Box would have no salutary purpose and would only deprive both plaintiffs of a vehicle to redress the wrongs committed by defendants. Since plaintiff Hellman has clearly alleged serious breaches of fiduciary duty owed by member Koschitzky both to himself and the company, this Court declines to dismiss the remaining causes of action as asserted on behalf of plaintiff Out of the Box.

Accordingly, the motion to dismiss the second, third, fifth, sixth, eighth, ninth and tenth causes of action is denied. The motion to dismiss is granted with respect to the first, fourth and seventh causes of action. The motion to dismiss the complaint as against Briendy Koschitzki, the wife of member Koschitzki, is granted as to all causes of action except the third and the ninth causes of action, alleging acceptance of "kickbacks" into the Koschitzki's personal bank account, as recited in paragraphs 21 and 23 of the complaint, since the only allegations against Briendy Koschitzki concern her receipt of such financial benefit.

The Preliminary Conference Order is signed herewith as amended and the

parties are directed to proceed with discovery as set forth in the Order. Defendants shall serve and file their answer within 30 days of the date of this decision. Mediation having been requested, the parties are to communicate with chambers so that a mediation date may be scheduled. A compliance conference will be held before the Court on July 19, 2007 at 10 a.m.

This constitutes the decision and order of the Court.

E N T E R

J.S.C.