Sims v Firstservice Corp.
2017 NY Slip Op 30104(U)
January 17, 2017
Supreme Court, New York County
Docket Number: 653238/2016
Judge: Anil C. Singh

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 45

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RANDALL SIMS, acting in his capacity as a shareholder, pursuant to BCL section 626, on behalf of 200 EAST 90TH STREET OWNERS CORP., a domestic corporation,

Plaintiff,

-against-

FIRSTSERVICE CORPORATION; and FIRSTSERVICE RESIDENTIAL NEW YORK, INC., a wholly-owned subsidiary of FIRSTSERVICE CORPORATION,

Defendants.

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DECISION AND ORDER

Index No. 653238/2016

HON. ANIL C. SINGH, J.:

Defendants move to dismiss the complaint pursuant to CPLR 1001, 1003, 3013, 3211(a)(1), (3), (7) and (10), and Business Corporation Law section 626, contending that the complaint fails to allege with sufficient particularity that plaintiff in this shareholder derivative action made a demand upon the corporation's board of directors to pursue the claim, nor does the complaint properly allege demand futility. Plaintiff opposes the motion and cross-moves for leave to amend the complaint pursuant to CPLR 3025(b).

The verified complaint alleges the following facts.

Plaintiff Randall Sims, an attorney who is self-represented in this matter, is a

lessee and shareholder of an apartment in a residential cooperative building at 200 East 90th Street in Manhattan. In addition to 165 apartment units, the building contains a large indoor and underground parking garage facility.

In 1980, the cooperative corporation (the "co-op") executed an agreement to lease the parking garage to a third-party to generate a stream of revenue for the co-op. By its terms, the lease would expire on June 30, 2015.

In 2012, the co-op entered into a management agreement with defendant First Service New York Residential, Inc. ("FSR"). Plaintiff contends that FSR is a wholly-owned subsidiary of defendant First Service Corporation ("FSC"), and FSR and FSC are essentially one and the same. Virginia Manning, an employee of FSR, was assigned to the co-op's account.

In 2011, the co-op created a business committee to analyze long-term capital needs and to assist the board of directors in long-term planning. In light of the fact that the lease for the parking garage was expiring in 2015, one means to increase revenue would be through a new garage lease at a higher rent. Accordingly, a search was begun for a new qualified garage operator.

In 2012, the co-op received garage lease proposal letters from Icon Parking Systems LLC, and Standard Parking, Inc.

As the Senior Property Manager for the building, Virginia Manning

participated in some discussions with the members of the co-op's business committee. Manning informed the committee and the board of directors that FSR had the expertise necessary to search for a qualified garage operator and negotiate a new lease agreement.

Relying on such representations, the co-op's board of directors delegated to FSR the conduct and management of the bid process from prospective garage operators and the negotiation of a new lease. Accordingly, Virginia Manning, with the assistance of other FSR employees, took control of: 1) the garage operator selection process; and 2) the negotiation of a new rent structure under a lease.

The complaint alleges that all further information about the new garage lease project flowing to the co-op's board of directors was controlled by people employed by the defendants, and it was selectively provided to the board of directors for purposes that were intended by the defendants to mislead the board of directors and to defraud the co-op corporation.

After a new operator had been selected and a new lease had been negotiated and signed by the co-op under the guidance of the FSR defendants, public statements were made to the shareholders informing them that the board had entered into a lease agreement with the bidder which had bid the highest amount of rent.

On May 26, 2015, the defendants distributed a memorandum to the shareholders notifying them that a new garage operator had been selected, a lease had been signed, and that the rent payable to the co-op was being significantly increased.

Through a memorandum dated June 4, 2015, to the shareholders, the defendants distributed the co-op corporation's audited financial statements for 2014. The independent auditor's cover letter to the 2014 financial statements was dated June 3, 2015.

The 2014 financial statements included several notes describing financial events that had occurred after 2014 and during 2015. Note 6 disclosed the new 15-year garage lease's rent structure as being:

Years 1-5	$315,000 per year;
Years 6-10	$350,000 per year; and
Years 11-15	$385,000 per year,

for a total aggregate rent of $5,250,000.

The annual shareholders meeting was held on June 8, 2015. A PowerPoint-type presentation prepared by the co-op's treasurer stated:

> Icon Parking was the clear winner by a significant margin, resulting in a rental increase of over $170,000/year versus the old contract, and this will escalate starting in year 6.

At the meeting, the treasurer stated that Icon was by far the highest bidder for

the garage.

On June 4, 2015, the board of directors consented to plaintiff's request to review the new garage lease at defendants' offices in Manhattan on June 8, 2015, in the afternoon before the annual shareholders meeting. When he arrived at defendants' reception area of defendants' offices that afternoon, he was kept in the reception area for more than an hour without being permitted to review the new garage lease. Virginia Manning and her assistant refused to come from their office to speak to him or to speak with him by telephone.

Plaintiff contends that the FSR defendants did not re-solicit written bids from all of the garage operators who were interested in leasing the garage. Plaintiff contends further that the August 12, 2014, competitor's lease rent proposal was significantly more lucrative to the co-op than the new lease that had actually been entered into by the co-op and Icon Parking.

Plaintiff alleges that defendants breached their fiduciary duties and their duties of loyalty and honesty as managing agent by engaging in mismanagement and deceit. Specifically, plaintiff contends that the FSR defendants conspired with a favored vendor to rig the bidding process for the garage. Plaintiff contends that the board of directors was duped by the defendants, resulting in a failure to award the garage lease contract to the highest bidder. As a result, the co-op received less

rental income than it could have received.

The complaint alleges three causes of action. The first cause of action alleges that the defendants breached their fiduciary duties and their duties of loyalty and honesty. The second cause of action seeks punitive damages in the sum of $30 million "as a public message for deterrent purposes to protect New York's homeowner residents" (Complaint, para. 126). The third cause of action seeks an award of reasonable attorneys' fees pursuant to section 626(e) of the New York Business Corporation Law.

Discussion

On a motion to dismiss pursuant to CPLR 3211(a)(7), the court accepts the complaint's factual allegations as true, according to the plaintiff the benefit of every possible favorable inference, and determining only whether the facts as alleged fit within any cognizable legal theory (Mill Financial, LLC v. Gillett, 122 A.D.3d 98, 103 [1st Dept., 2014]. However, bare legal conclusions, as well as factual claims either inherently or flatly contradicted by documentary evidence, are not presumed to be true and accorded every favorable inference (Biondi v. Beekman Hill House Apt. Corp., 257 A.D.2d 76, 81 [1st Dept., 1999], affd 94 N.Y.2d 659 [2000]). Where extrinsic evidence is submitted in connection with the motion, the appropriate standard of review is whether the proponent of the pleading has a cause

of action, not whether he has stated one (IIG Capital LLC v. Archipelago, L.L.C., 36 A.D.3d 401, 402 [1st Dept., 2007]).

If the documentary proof disproves an essential allegation of the complaint, dismissal pursuant to CPLR 3211(a)(1) is warranted even if the allegations, standing alone, could withstand a motion to dismiss for failure to state a cause of action (McGuire v. Sterling Doubleday Enters., L.P., 19 A.D.3d 660, 661 [1st Dept., 2005]). In other words, dismissal is warranted pursuant to CPLR 3211(a)(1) where the documentary evidence resolves all factual issues as a matter of law; conclusively disposes of the claim; and utterly refutes plaintiff's factual allegations (Fortis Fin. Serv. v. Fimat Futures USA, 290 A.D.2d 383 [1st Dept., 2002]).

The pleading requirements governing a shareholders' derivative cause of action were summarized in Taylor v. Wynkoop, 132 A.D.3d 843 [2nd Dept., 2015]). The Court wrote:

> In order to adequately plead a shareholders' derivative cause of action, in the complaint shareholders must set forth with particularity [their] efforts ... to secure the initiation of such action by the board or the reasons for not making such effort. Such demand is futile, and excused, when the directors are incapable of making an impartial decision as to whether to bring suit. Demand is excused because of futility when a complaint alleges with particularity (1) that a majority of the board of directors is interested in the challenged transaction, which may be based on self-interest in the transaction or a loss of independence because a director with no direct interest in the transaction is "controlled" by a self-interested director, (2) that the board of directors did not fully inform themselves about the challenged

> transaction to the extent reasonably appropriate under the circumstances, or (3) that the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment of the directors.

(Taylor, 132 A.D.3d at 844-45 (internal citations and quotation marks omitted)).

The demand requirement rests on "the basic principle of corporate governance that the decisions of a corporation – including the decision to initiate litigation – should be made by the board of directors or the majority of shareholders" (Kamen v. Kemper Financial Services, Inc., 500 U.S. 90, 101, 111 S.Ct. 1711, 1719, 114 L.Ed. 152, 167 [1991]). Accordingly, the demand requirement is a prophylactic device designed to weed out unnecessary or illegitimate shareholder derivative suits commenced by shareholders for personal gain rather than the benefit of the corporation (Barr v. Wackman, 36 N.Y.2d 371, 378 [1975]).

The complaint in the instant matter does not state that plaintiff ever made a pre-suit demand on the board of directors.

Plaintiff's communications with the board and the board's response are set forth at paragraphs 60, 61, 68 and 69 of the complaint. The complaint alleges that plaintiff posed various questions to the board of directors regarding the garage transaction; requested an opportunity to review documents pertinent to the transaction and bid procedures; and asked the board to meet and discuss facts

regarding the transaction. On June 4, 2015, the board consented to plaintiff's review of the garage lease at defendants' office on June 8, 2015. Plaintiff contends that Virginia Manning refused to meet with him when he showed up at her office.

The complaint asserts that during June 2015 the board members never responded in substance to questions plaintiff posed; did not allow any independent review of any relevant documents, despite plaintiff's standing requests for them; and said that the issue of disclosure, access and review would be raised at the July board meeting.

Plaintiff maintains that the board's delay in responding to the requests for information was deliberate stonewalling until after July 1, 2015, at which time Icon Parking would begin its operations at the garage pursuant to the new lease.

The Court finds that the complaint on its face fails to plead a proper demand.

BCL 626(c) does not provide any specific instruction for making demand. Accordingly, New York courts have held that the "[d]emand to sue need not assume any particular form nor need it be made in any special language" (Ripley v. International Railways of Central America, 8 A.D.2d 310, 317 [1st Dept., 1959], judgment aff'd, 8 N.Y.2d 430 [1960] (holding that discussions between shareholders, their attorneys, and corporate officials concerning facts of derivative claim were sufficient); Syracuse Tel. v. Channel 9, Syracuse, 51 Misc.2d 188 [Sup.

Ct., Onondaga County, 1966] (holding that memorandum written by plaintiff and given to each director detailing grounds for demand was sufficient); Jones v. Jones, 223 A.D.2d 483 [1st Dept., 1996] (holding that plaintiff's forwarding copy of complaint along with demand letter to the directors was sufficient)). Nevertheless, the demand must be made in "earnest, not a simulated effort ... [which] must be made apparent to the court" (O'Brien v. King, 258 A.D. 504, 505 [1st Dept., 1940]).

Here, the complaint does not state that an oral demand was ever made to the board. Nor does that complaint plead that a written demand was made to the board identifying the alleged wrongdoers; describing the factual basis of the alleged wrong and the harm caused to the corporation; requesting that the directors bring suit; providing the directors with sufficient time to consider and act upon the demand; and indicating that litigation would result from an improper refusal to sue.

In light of the Court's finding that the shareholder plaintiff's complaint fails to plead that a demand was made, we turn to the issue of whether the complaint properly pleads demand futility.

Before shareholders may commence a derivative action, they must make a demand upon the corporation to commence the action, unless such demand would be futile (Marx v. Akers, 88 N.Y.2d 189 [1996]). Under the rule that the plaintiff may commence a derivative action only after demanding that the board of directors

initiate a suit, a demand will be considered futile if the complaint alleges with particularity: 1) that the majority of the directors are interested in the transaction; 2) that the directors failed to inform themselves to a degree reasonably necessary about the transaction; or 3) that the directors failed to exercise their business judgment in approving the transaction (id.).

"Under the business judgment rule, which applies to the directors of residential cooperative corporations, absent a showing of discrimination, self-dealing or misconduct by board members, corporate directors are presumed to be acting in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes" (Jones v. Surrey Coop. Apts., 263 A.D.2d 33, 36 [1st Dept., 1999] (internal citation and quotation marks omitted)). "Thus, without a showing of a breach of fiduciary duty to the corporation, judicial inquiry into the actions of corporate directors is prohibited, even though 'the results show that what [the directors] did was unwise or inexpedient'" (id.).

A cooperative board owes a fiduciary duty to further the collective interests of the cooperative (40 W. 67th St. v. Pullman, 100 N.Y.2d 147, 150 [2003]). The business judgment rule prohibits judicial inquiry into the actions of the board of directors of a cooperative undertaken in good faith and in furtherance of the cooperative's business (id.).

The complaint in the instant action does not allege that the board of directors participated in and authorized any wrongdoing in violation of their fiduciary duty. Rather, plaintiff alleges that it was the defendant managing agent for the building – not the board of directors – that violated its fiduciary duty by rigging the bidding process for the garage lease.

The complaint alleges that the board delegated the search for a new garage operator and the negotiation of the lease agreement to the managing agent, and the complaint asserts no specific facts that the board acted improperly in deciding to delegate that task to the managing agent, especially in light of the managing agent's representation that it had expertise in such matters. Because it can be inferred from these allegations that the board acted in a reasonable manner under the circumstances, it follows that the complaint does not allege with particularity that the challenged transaction was so egregious on its face that it could not have been a product of the sound business judgment of the directors.

Accordingly, the Court finds that the complaint fails to allege demand futility.

Plaintiff cross-moves for leave to amend the complaint to assert the additional facts that he sent a pre-filing draft of the complaint to a corporate officer of one of the defendants and the defendants' counsel for discussion, and they (the

defendants) in turn forwarded a copy of the proposed complaint to members of the co-op's board of directors for their review. Plaintiff contends that this would serve to detail the board's prior knowledge of this contemplated shareholder's derivative action (if the board did not on its own take appropriate action).

The cross-motion for leave to amend must be denied as plaintiff failed to submit appropriate substantiation in the form of a proposed pleading accompanied by an affidavit of merit (Liberty Mut. Ins. Co. v. K.O. Medical, P.C., 142 A.D.3d 875 [1st Dept., 2016]; McBride v. KPMG Intern., 135 A.D.3d 576, 581-581 [1st Dept., 2016]).

Accordingly, it is

ORDERED that the motion to dismiss the complaint is granted, and the complaint is dismissed without prejudice; and it is further

ORDERED that the cross-motion to amend the complaint is denied.

The foregoing constitutes the decision and order of the court.

Date: January 17, 2017
New York, New York

Anil C. Singh