SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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W. & M. OPERATING, L.L.C.,

Index No.: 651200/2015

Plaintiff,

DECISION & ORDER

-against-

JON BAKHSHI, FRANK PORCO, JOHN BEST, and TIMOTHY RUGISFORD,

Defendants.

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JON BAKHSHI, FRANK PORCO, and TIMOTHY RUGISFORD,

Third-Party Plaintiffs,

-against-

150 RFT VARICK CORP., LINA KAY, BARRY MULLINEAUX, JED STILLER, HIROKUNI SAI, G166NY LLC, LARRY HUGHES, and LDH INVESTMENTS LIMITED PARTNERHIP,

Third-Party Defendants.

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SHIRLEY WERNER KORNREICH, J.:

Motion sequence numbers 002 and 003 are consolidated for disposition.

Third-party defendants Lina Kay and Jed Stiller separately move, pursuant to CPLR 3211, to dismiss the claims asserted against them in the third-party complaint (the TPC). The third-party plaintiffs (defendants in the main action), Jon Bakhshi, Frank Porco, and Timothy Rugisford (collectively with defendant John Best, the Guarantors), oppose both motions and cross-move for leave to file a proposed amended third-party complaint (the ATPC). Kay and Stiller oppose. For the reasons that follow, the motions and cross-motion are granted in part and denied in part.

I. Factual Background & Procedural History

Since the instant motions, at heart, concern the pleading sufficiency of the ATPC (Dkt. 105),[1] the facts recited are taken from the ATPC and the documentary evidence submitted.

Plaintiff, W. &. M. Operating, LLC (Landlord), was the landlord of third-party defendant 150 Varick Corp. (the Company). *See* Dkt. 65 (original lease); Dkt. 68 (December 1, 2009 lease modification in which the Company became the tenant) (collectively, the Lease). The Company, a New York corporation, operated the "Greenhouse" nightclub at 150 Varick Street. The Company stopped paying rent in June 2012. In September 2013, Landlord commenced a nonpayment proceeding against the Company in Civil Court and, in November 2014, obtained a judgment against the Company in the amount of $521.294.59. *See* Dkt. 6. Landlord commenced this action on April 10, 2015, seeking to enforce the Guarantors' "Good Guy" guaranty of the Company's rent payments. *See* Dkt. 4 at 3 (the Guaranty). By order dated June 21, 2016, the court denied Landlord's motion for summary judgment, which was filed prior to the completion of discovery. *See* Dkt. 40. On March 15, 2018, the Appellate Division modified by directing the entry of judgment against Porco and Rugisford,[2] but affirmed the finding of questions of fact regarding Bakhshi's liability. *W. & M. Operating, L.L.C. v Bakhshi*, 2018 WL 1320137 (1st

[1] References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF).

[2] On November 9, 2017, Rugisford filed for bankruptcy in the Eastern District of New York. *See* Dkt. 123. The court notes, however, that while Rugisford's counsel was directed at oral argument on January 17, 2018 to e-file a notice of bankruptcy [*see* Dkt. 125 (1/17/18 Tr. at 6)], he did not do so until March 9, 2018 (and apparently did not notify the First Department prior to oral argument of the pending bankruptcy). In any event, while the automatic stay applies to the claims asserted in the main action by Landlord against Rugisford, it is undisputed that the automatic stay does not apply to Rugisford's claims in the third-party action. While the parties have not asked the court to withhold this decision, the implications of the automatic stay on discovery will be addressed at the next status conference scheduled herein.

Dept Mar. 15, 2018). Best's liability has not been adjudicated because he "was apparently never served." *See* Dkt. 79 at 8.

On February 7, 2017, Bakhshi, Porco, and Rugisford filed the TPC, which, simply put, seeks to hold the other shareholders of the Company liable for paying themselves distributions instead of paying the Company's rent, thereby leaving the Guarantors liable. *See* Dkt. 50. Kay and Stiller filed the instant motions to dismiss the TPC on May 1, 2017. On August 2, 2017, the third-party plaintiffs filed opposition and cross-moved for leave to file the ATPC. The ATPC asserts seven causes of action: (1) contractual indemnification, asserted by Bakhshi and Porco against all of the third-party defendants; (2) common law indemnification, asserted by the third-party plaintiffs against all of the third-party defendants; (3) constructive and intentional fraudulent conveyances under sections 273, 273-a, and 276 of the New York Debtor and Creditor Law (DCL), asserted by the third-party plaintiffs against all of the third-party defendants; (4) breach of the Lease, asserted by the third-party plaintiffs under a third-party beneficiary theory against all of the third-party defendants; (5-6) breaches of the Company's shareholders agreement, asserted by Porco against all of the third-party defendants; and (7) breach of fiduciary duty, asserted by Porco derivatively on behalf of the Company against the third-party defendants. The third-party plaintiffs also seek punitive damages.

The allegations pertinent to the third-party action are as follows. Bakhshi, Porco, and Best were shareholders of the Company in December 2009 when they, along with Rugisford, executed the Guaranty. In August 2010, the Company's shareholders executed a shareholders agreement. *See* Dkt. 71 (the Shareholders Agreement). The shareholders and their percentage equity is set forth in section 1.2. *See id.* at 3. Section 1.3 provides that the directors of the

Company were Bakshi, Porco, and third-party defendant Hirokuni Sai. *See id.* Bakhshi was the President and Treasurer, and Porco was the Secretary. *See id.*

The Shareholders Agreement was amended twice in 2011. *See* Dkts. 75 (The First Amendment) & 70 (the Second Amendment) (collectively, the 2011 Amendments). Section 1.2 of the Second Amendment sets forth the most current shareholder list: Best, Porco, non-party Merlin Bobb, and third-party defendants LDH Investment's Limited Partnership, Kay, Barry Mullineaux, G166NY LLC (G166NY), and Stiller. *See* Dkt. 70 at 2.[3] The directors were third-party defendant Larry Hughes, Mullineaux, Stiller, Porco, and Sai. *See id.* at 3. Mullineaux was the President, Stiller was the Vice President and Treasurer, and Porco was the Secretary. *See id.* As reflected in these recitals, and as set forth in section 2.3.4, Bakhshi was "no longer involved in the day to day management of the [Company]," was no longer a shareholder, and was no longer paid a salary. *See id.*[4]

Pursuant to the Second Amendment, when the Company stopped paying its rent in 2012, Mullineaux and Stiller managed the Company's nightclub and were responsible for making sure the Company paid its monthly rent. Allegedly, the reason the Company failed to pay its rent in 2012 was because "Mullineaux and/or Stiller refused to provide the consent necessary and required" for the Company to do so. *See* ATPC ¶ 35. This, as noted at the outset, resulted in Landlord commencing a non-payment proceeding and obtaining a judgment against the Company for unpaid rent, money Landlord seeks to collect from the Guarantors in this action.

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[3] "At all times on or after March 1, 2012, the Shareholders Agreement, as amended by the [Second] Amendment, was in full force and effect." ATPC ¶ 18. It should be noted that in a Stock Purchase Agreement dated August 25, 2010, the shareholders sold stock to G166NY. *See* Dkt. 74 (the SPA).

[4] That is why he, like Rugisford (who, as noted, was never a shareholder), cannot assert derivative claims or claims based on breach of the Shareholders Agreement.

According to the third-party plaintiffs, instead of paying the rent, the third-party defendants paid themselves from the Company's remaining cash and then shut down the nightclub. The third-party plaintiffs assert myriad contractual and common law theories as to why each third-party defendant, effectively, is liable to offset the third-party plaintiffs' liability to Landlord. On the instant motions, two of the third-party defendants – Kay and Stiller – seek dismissal of the third-party plaintiffs' claims. The court reserved on the motions after oral argument. *See* Dkt. 125 (1/17/18 Tr.).

II. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1st Dept 1992); *see also Cron v Hargro Fabrics, Inc.*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes

plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994). That said, leave to amend to cure pleading deficiencies "should be freely given, and denied only if there is prejudice or surprise resulting directly from the delay or if the proposed amendment is palpably improper or insufficient as a matter of law." *McGhee v Odell*, 96 AD3d 449, 450 (1st Dept 2012) (quotations marks and internal citation omitted).

III. Discussion

Kay and Stiller correctly argue that neither may be held liable for common law indemnification. "The principle of 'common law, or implied indemnification, permits one who has been compelled to pay for the wrong of another to recover from the wrongdoer the damages it paid to the injured party. The **party seeking indemnification must have delegated exclusive responsibility** for the duties giving rise to the loss to the party from whom indemnification is sought, **and must not have committed actual wrongdoing itself.**" *Tiffany at Westbury Condo. v Marelli Dev. Corp.*, 40 AD3d 1073, 1077 (2d Dept 2007) (emphasis added; internal citations and quotation marks omitted); *see generally D'Ambrosio v City of New York*, 55 NY2d 454, 461 (1982). "In the classic case, implied indemnity permits one held vicariously liable solely on account of the negligence of another to shift the entire burden of the loss to the actual wrongdoer." *17 Vista Fee Assocs. v Teachers Ins. & Annuity Ass'n of Am.*, 259 AD2d 75, 80 (1st Dept 1999). While there appears to be a Department split on the question of whether common law indemnification is available "in actions seeking recovery for purely economic loss resulting from the breach of contractual obligations,"[5] the court need not reach this issue.

[5] Compare *Lawrence Dev. Corp. v Jobin Waterproofing, Inc.*, 186 AD2d 634, 636 (2d Dept 1992) (With respect to [defendant's] claims for contribution ***and indemnification***, it is well settled that ***these*** remedies are not available in actions seeking recovery for purely economic loss

As to Kay, she is only alleged to have been a passive shareholder, and was not allegedly delegated the responsibility of paying rent. She, therefore, cannot be sued for indemnification. As to Stiller, this is an odd circumstance to be asserting a claim for indemnification, which is a creature of negligence liability. *See Glaser v M. Fortunoff of Westbury Corp.*, 71 NY2d 643, 646 (1988) ("The conceptual distinction between contribution and common-law indemnification claims has often been discussed and is by now familiar to most practitioners. In the classic indemnification case, the one seeking indemnity had committed no wrong, but by virtue of some relationship with the tortfeasor or obligation imposed by law, was nevertheless held liable to the injured party. In other words, **where one is held liable solely on account of the negligence of another**, indemnification, not contribution, principles apply to shift the entire liability to the one who was negligent.") (emphasis added; citations and quotation marks omitted). Even where the First Department has permitted indemnification for breach of contract, the contractual liability was based on a negligence claim. *See 17 Vista*, 259 AD2d at 81 ("[defendant] is seeking to hold [plaintiff] **liable for the negligence of another**, JB&B, to whom performance was fully delegated.") (emphasis added). The same is true of the instances where the other Departments have so ruled. *See Konrad Developers, LLC v Holbrook Heating, Inc.*, 158 AD3d 1202 (4th Dept 2018) (involving negligent construction), citing *Westbank Contracting, Inc. v Rondout Valley Cent. Sch. Dist.*, 46 AD3d 1187, 1189 (3d Dept 2007) (same).

This court is skeptical that a common law indemnification claim may be predicated on a breach of contract where the underlying liability does not arise from any negligence, such as in the case of a personal guaranty of a debt. Notably, the third-party plaintiffs do not cite any case

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resulting from the breach of contractual obligations") (emphasis added), with *17 Vista*, 259 AD2d at 81 ("That TIAA's underlying counterclaims sounded in breach of contract, rather than tort, does not defeat the indemnity claim.").

where an unconditional personal guarantor on a debt was permitted to seek indemnification from the party who caused the underlying event that triggered liability under the guaranty, and the court has found none.[6] The indemnification claim asserted against Stiller is dismissed. Likewise, as the third-party plaintiffs concede [*see* Dkt. 106 at 15], under CPLR 1401, a party may not seek contribution for monetary liability under a contract. *Lehr Assocs. Consulting Engineers, LLP v Daikin AC (Americas) Inc.*, 133 AD3d 533, 534 (1st Dept 2015) ("[P]urely economic loss resulting from a breach of contract does not constitute 'injury to property' within the meaning of [CPLR 1401]."), quoting *Bd. of Ed. of Hudson City*, 71 NY2d at 26.

Nor can the third-party plaintiffs assert a claim for breach of the Lease based on the theory that they are third-party beneficiaries. "A party asserting rights as a third-party beneficiary must establish (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for his benefit and (3) that the benefit to him is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate him if the benefit is lost." *State of California Pub. Employees' Ret. Sys. v Shearman & Sterling*, 95 NY2d 427, 434-35 (2000), quoting *Burns Jackson Miller Summit & Spitzer v Lindner*, 59 NY2d 314, 336 (1983). Additionally, "[t]he parties' intent to benefit the

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[6] That is because the party seeking common law indemnification cannot bear any amount of fault for the underlying liability on which it seeks indemnification. *See id.* at 80 ("a party who has itself actually participated to some degree in the wrongdoing cannot receive the benefit of the doctrine [of indemnification]."). Here, in the event they are held liable on the Guaranty, the third-party plaintiffs seek indemnification from Kay and Stiller. If the third-party plaintiffs are indeed held liable, they cannot then claim they bear no responsibility for the underlying liability and, therefore, cannot shift that liability to Kay and Sillier with a claim for indemnification. *See Rosado v Proctor & Schwartz, Inc.*, 66 NY2d 21, 25 (1985) (party seeking indemnification "must show that it **may not be held responsible in any degree**.") (emphasis added), accord *Cunha v City of New York*, 12 NY3d 504, 509 (2009). The touchstone of an unconditional guaranty is liability without regard for why the underlying obligation was breached, even, for instance, if there was fraud. *See W. & M. Operating*, 2018 WL 1320137, at *1, citing *Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v Navarro*, 25 NY3d 485, 494 (2015).

third party **must be apparent from the face of the contract**." *LaSalle Nat'l Bank v Ernst & Young LLP*, 285 AD2d 101, 108 (1st Dept 2001) (emphasis added); *see U.S. Bank N.A. v GreenPoint Mortg. Funding, Inc.*, 105 AD3d 639, 640 (1st Dept 2013) (dismissing third-party beneficiary claim because of "the absence of any clear language on the face of the [contracts]").

Here, the third-party plaintiffs do not point to any provision of the Lease that evidences an intent to make them third-party beneficiaries. That they may be incidental beneficiaries is of no moment. *Grunewald v Metro. Museum of Art*, 125 AD3d 438, 439 (1st Dept 2015) ("Plaintiffs also lack standing to sue under the [lease] as third party beneficiaries because the benefit to them is incidental and not direct."); *Nasar v Trustees of Columbia Univ. in City of N.Y.*, 122 AD3d 449, 449 (1st Dept 2014) (no liability where no indication in grant agreement that plaintiff is intended rather than incidental beneficiary). All shareholders and guarantors of a corporate tenant may be incidental beneficiaries of its lease. But, as Stiller explains, New York courts have rejected the notion that shareholders and guarantors can sue under a lease between the company and its landlord. Dkt. 79 at 25-26 (collecting cases); *see Tsang v Berley*, 2014 WL 2990392, at *2-3 (Sup Ct, NY County 2014) (Rakower, J.) (guarantor "does not have independent standing to raise claims under the Lease."), citing *YL West 87th St., LLC v Arbor Realty Sr, Inc.*, 2010 WL 2150616 (Sup Ct, Nassau County 2010) (Bucaria, J.) (rejecting claim that personal guarantor is third-party beneficiary of underlying contract).[7] The third-party plaintiffs do not cite any authority for the proposition that personal guarantors of a lease have

[7] The third-party plaintiffs make no effort to distinguish the cases cited by Stiller and, instead, complain that "the Nassau County case that supposedly involved a guarantor of loans and [] does not appear in WestLaw." *See* Dkt. 106 at 21. This assertion is false. As indicated above, the Nassau County case (and the case in which it was cited positively by Justice Rakower) may indeed be found on Westlaw.

intended third-party beneficiary status absent specific language in the lease evidencing such intent. The third-party plaintiffs do not argue that any such language may be found in the Lease.

Next, Bakhshi and Porco claim that the written agreements in which Bakhshi either purchased or sold his Company stock between July 2008 and August 2010 contain provisions in which the third-party defendants agreed to expressly indemnify Bakhshi for his liability under the Guaranty. But as Kay and Stiller correctly contend, neither the TPC nor the ATPC cite any specific, applicable indemnity provision. With one exception, these pleadings, in conclusory fashion, simply allege the existence of such indemnity provisions. *See* ATPC ¶ 59 ("Section 3.4.7 of the Shareholders Agreement provided that there would be indemnification of selling shareholders, which include [Bakhshi and Porco], for any liabilities relating to the operation of [the Company] after the date of sale."). By contrast, Kay and Stiller submitted the actual agreements, which contain no such promise of indemnity. *See* Dkt. 72 (February 2008 Sales Agreement), Dkt. 73 (August 2008 Subscription Agreement), Dkt. 74 (the SPA). Kay contends that:

> **none of the sales agreements executed during that time frame include the putative indemnity provision**. In the February 2008 Sales Agreement, Bakhshi is purchasing, rather than selling, stock. The August 2008 Subscription Agreement involves a transfer of shares from Bakhshi to Kay but contains no indemnity. Lastly, the indemnity provisions in the [SPA] operate for the benefit of the buyer against the seller and vice versa. Here, both Bakhshi and Kay are selling their shares and thus no indemnity exists in favor of Bakhshi as against Kay in this agreement or any other agreement. Therefore, Bakhshi's contractual indemnification claim against Kay must fail.

Dkt. 76 at 13-14 (emphasis added).

Kay and Stiller further argue that section 3.4.7 is inapplicable because they did not purchase their shares from third-party plaintiffs. *See* Dkt. 71 at 8 (Company and "purchasing party" must indemnify "Selling Shareholders" from liability incurred based on guaranty of

Company's debt). Kay purchased her shares from the Company, not Bakhshi; Stiller received his as payment for services in lieu of cash. Indeed, Kay is listed in the Shareholders Agreement as one of the sellers, and not as a purchaser. *See id.* at 2. Kay also is only listed as a seller in the SPA. *See* Dkt. 74 at 1. Stiller is not listed as a purchaser (though at the time he was not yet a shareholder). *See id.* And while Stiller is listed as a shareholder in the First Amendment, he is not defined as a purchaser (presumably because he never paid for the shares). *See* Dkt. 75 at 2. It is worth noting that section 3.4.7 was not changed in either of the 2011 Amendments.

In opposition, Bakhshi and Porco fail to meaningfully address any of these arguments. Rather, they take the position that these contracts do not qualify as documentary evince that "utterly refutes [their] factual allegations" under CPLR 3211(a)(1). *See Goshen*, 98 NY2d at 326. They are wrong. It is well settled that where, as here, the contract does not provide a provision alleged in the complaint, and where no relevant provision is shown to be ambiguous, dismissal under CPLR 3211(a)(1) is appropriate. *Whitebox Concentrated Convertible Arbitrage Partners, L.P. v Superior Well Servs., Inc.*, 20 NY3d 59, 63 (2012) ("The motion may be granted if documentary evidence utterly refutes [the] plaintiffs factual allegations, thereby conclusively establishing a defense as a matter of law. One example of such proof is an unambiguous contract that indisputably undermines the asserted causes of action.") (internal citations and quotation marks omitted); *see Chu v Klatskin*, 158 AD3d 500 (1st Dept 2018).

Kay and Stiller further argue that Porco has no basis to hold them personally liable for the Company's payment obligations under section 4.2 of the Shareholders Agreement. Under the First Amendment (which Porco signed), the Company's shareholders agreed that the payment obligations under section 4.2, which originally were to be made by Bakhshi, instead, would be

made by the Company. *See* Dkt. 70 at 3.[8] It is well settled that the shareholders of a corporation are ordinarily not liable for the corporation's financial obligations. *Joan Hansen & Co. v Everlast World's Boxing Headquarters Corp.*, 296 AD2d 103, 109 (1st Dept 2002). The third-party plaintiffs seek to avoid this rule by piercing the corporate veil.

"The concept of piercing the corporate veil is a limitation on the accepted principles that a corporation exists independently of its owners, as a separate legal entity, that the owners are normally not liable for the debts of the corporation, and that it is perfectly legal to incorporate for the express purpose of limiting the liability of the corporate owners." *Morris v NY State Dep't of Taxation & Finance*, 82 NY2d 135, 140 (1993). "The doctrine of piercing the corporate veil is typically employed by a third party seeking to go behind the corporate existence in order to circumvent the limited liability of the owners and to hold them liable for some underlying corporate obligation." *Id.* at 140-41. "In order to pierce the corporate veil, a plaintiff must show [1] that the dominant corporation exercised complete domination and control with respect to the transaction attacked, **and** [2] that such domination was used to commit a fraud or wrong causing injury to the plaintiff." *Fantazia Int'l Corp. v CPL Furs New York, Inc.*, 67 AD3d 511, 512 (1st Dept 2009) (brackets and emphasis added). In other words, the plaintiff must show *both* an abuse of the corporate form (the domination prong) *and* that such abuse was committed for the purpose of defrauding plaintiff (the fraud prong). *TNS Holdings, Inc. v MKI Secs. Corp.*, 92 NY2d 335, 339 (1998) ("Evidence of domination alone does not suffice without an additional showing that it led to inequity, fraud or malfeasance."); *see Cobalt Partners, L.P. v GSC Capital Corp.*, 97 AD3d 35, 40 (1st Dept 2012); *Damianos Realty Group, LLC v Fracchia*, 35 AD3d 344

[8] The specifics of section 4.2 and its previous iterations are discussed further, where pertinent, herein. That said, none of the iterations of section 4.2 ever required Porco's payments to be made by the third-party defendants. Bakhshi was the only shareholder to have had this obligation.

(1st Dept 2006) ("The mere claim that the corporation was completely dominated by the defendants, or conclusory assertions that the corporation acted as their 'alter ego,' without more, will not suffice to support the equitable relief of piercing the corporate veil").

Here, even assuming the domination prong is sufficiently pleaded, the third-party plaintiffs have not pleaded the fraud prong. The only wrongdoing that supposedly constitutes fraud or injustice is the very breach of contract claims alleged in the ATPC on which third-party plaintiffs seek to pierce the corporate veil. *See* Dkt. 106 at 17 ("Here, at the time that rent went unpaid at 150 Varick Street, the owners dominated [the Company], and **that domination was used to commit the wrong of not paying the rent** and then ignoring the [] Judgment for $521,294.59 in unpaid rent under the Lease.") (emphasis added). It is well settled that veil piercing must be based on wrongdoing independent of the underlying breach of contract. *See Skanska USA Bldg. Inc. v Atl. Yards B2 Owner, LLC*, 146 AD3d 1, 12 (1st Dept 2016) ("a simple breach of contract, without more, does not constitute a fraud or wrong warranting the piercing of the corporate veil."), quoting *Bonacasa Realty Co. v Salvatore*, 109 AD3d 946, 947 (1st Dept 2013). Moreover, the fraud or injustice must relate to the alleged corporate form abuse. *See Bd. of Managers of 325 Fifth Ave. Condo. v Cont'l Residential Holdings LLC*, 149 AD3d 472, 475 (1st Dept 2017) ("[t]he party seeking to pierce the corporate veil must establish that the *owners*, **through their domination**, abused ... the corporate form to perpetrate a wrong or injustice against that party such that a court in equity will intervene." (italics in original; bold added for emphasis), quoting *ABN AMRO Bank, N.V. v MBIA Inc.*, 17 NY3d 208, 229 (2011). Here, the alleged wrongdoing is the payment of distributions instead of rent – allegations that form the basis of the breach of contract claims. The fraud prong of the veil piercing claim, therefore, is

not properly pleaded. Absent a valid basis to pierce the corporate veil, there is no basis to hold Kay and Stiller personally liable for the Company's alleged breach of contract.

Porco, however, has stated a claim for intentional *and* constructive fraudulent conveyance under the DCL based on the distributions. As a threshold matter, unlike the other third-party plaintiffs (whose status as creditors is addressed further herein), Porco is a creditor within the meaning of DCL § 270 because he is allegedly owed money by the Company. *See* DCL § 270 ("'Creditor' is a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent."). As discussed, in section 4.2 of the Shareholders Agreement, Bakhshi originally agreed to guaranty a $25,000 *monthly* payment to Best, Porco, and Bobb ("Guaranteed Payment"). *See* Dkt. 71 at 10.[9] In exchange for the Guaranteed Payment, Bakhshi obtained the rights to Best's, Porco's, and Bobb's share of the Company's profits. *See id.* However, in paragraph F of the First Amendment, section 4.2 of the Shareholders Agreement was amended so that ***the Company***, instead of Bakhshi, would be obligated to make the Guaranteed Payment and retain Best's, Porco's, and Bobb's share of the profits. *See* Dkt. 75 at 3. This change was unaffected by the Second Amendment. *See* Dkt. 70 at 2. In the ATPC, Porco asserts a claim for breach of section 4.2 against the Company, seeking his profit share due to non-payment of the Guaranteed Payment. *See* Dkt. 105 at 20-21.

Porco alleges, and it is undisputed by Kay and Stiller on this motion, that when the Company failed to pay its rent in June 2012, and at all times thereafter, the Company was insolvent within the meaning of DCL § 271, which provides: "A person is insolvent when the

[9] While the word "monthly" is not used in the first paragraph of this section, the second paragraph makes it clear it is a monthly (as opposed to a one-time) payment. The second paragraph provides: "The parties acknowledge that the Guaranteed Payment will be $12,500.00 for the months of April, May, June, October, November and December of 2008." Dkt. 71 at 10. This paragraph, addressing which months the Guaranteed Payment is cut in half, would make no sense if section 4.2 dealt with a one-time $25,000 payment.

present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured." It is well settled that payments to company insiders (such as Kay and Stiller) that either render the Company insolvent or are made when the Company already is insolvent are presumptively considered to be in bad faith and qualify as constructive fraudulent transfers under DCL §§ 273 and 273-a. *CIT Group/Commercial Servs., Inc. v 160-09 Jamaica Ave. Ltd. P'ship*, 25 AD3d 301, 303 (1st Dept 2006); *see Am. Media, Inc. v Bainbridge & Knight Labs., LLC*, 135 AD3d 477, 478 (1st Dept 2016) ("An insider payment is not in good faith, regardless of whether or not it was paid on account of an antecedent debt."), citing *EAC of N.Y., Inc. v Capri 400, Inc.*, 49 AD3d 1006, 1007 (3d Dept 2008) ("The requirement of good faith is not fulfilled through preferential transfers of corporate funds to directors, officers or shareholders of a corporation that is, or later becomes, insolvent, in derogation of the rights of general creditors.").

Likewise, Porco alleges that these distributions were made in intentional violation of section 4.1 of the Shareholders Agreement, thereby satisfying the element of scienter. *Wall St. Assocs. v Brodsky*, 257 AD2d 526, 529 (1st Dept 1999). He claims this was done to defraud the Company's creditors (Landlord on the rent; Porco on the Guaranteed Payments). While certain badges of fraud also are present here [*see id.* at 529], even if they were not, a reasonable inference of scienter can be inferred from the ATPC's allegations. Fraudulent intent may be inferred from the allegation that the third-party defendants received the last of the Company's cash when, contractually and under the DCL, that money first should have been paid to Landlord. *Machado v A. Canterpass, LLC*, 115 AD3d 652, 654 (2d Dept 2014) (upon "defendants' failure to proffer any legitimate explanation for the conveyances, the defendants' actual fraudulent intent is readily inferrable, and the plaintiff is entitled to a judgment setting

those conveyances aside under [DCL § 276]."); *see Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009) ("CPLR 3016(b) is satisfied when the facts suffice to permit a 'reasonable inference' of the alleged misconduct."); *Aozora Bank, Ltd. v J.P. Morgan Secs. LLC*, 144 AD3d 440, 441 (1st Dept 2016) (complaint must include "sufficient facts to support the reasonable inference of fraud and scienter."). Porco may seek to set aside these conveyances so that he may be made whole on his claims against the Company.

By contrast, Bakhshi and Rugisford lack standing to plead a claim that the challenged distributions are fraudulent conveyances under the DCL because they are not creditors within the meaning of DCL § 270. The PTAC does not allege they are owed any money by the Company; the claims against the Company for breach of the Shareholders Agreement are only asserted by Porco. *See* Dkt. 105 at 20-21. As discussed, the claims for breach of the Lease based on a third-party beneficiary theory are infirm.

Bakhshi and Rugisford do not meaningfully respond to these arguments, focusing instead on whether the elements of §§ 273, 273-a, or 276 are otherwise properly pleaded (an issue on which the court need not and will not opine). *See* Dkt. 121 at 18-22. Construed liberally, the only sentence in their brief that comes close to addressing the issue is as follows: "Because of application of piercing the corporate veil law, [the third-party defendants] are debtors; and because of the 'Good Guy' Guarantees with respect to the rent payments owed to the Landlord, Third-Party Plaintiffs become *de facto* creditors." *See id.* at 19 (italics in original). As previously discussed, the third-party plaintiffs have not properly pleaded a veil piercing claim.

Also, the argument that a guarantor is a de facto creditor of the party whose debt it guaranteed is not supported within any controlling authority.[10]

Porco also has stated a claim for breach of section 4.1 of the Shareholders Agreement. That section provides that "[t]he Shareholders agree that rent due each month will be paid directly to the Corporation's landlord before any profits are distributed to the Shareholders." *See* Dkt. 71 at 10. Kay and Stiller argue that they cannot be held liable for accepting distributions from the Company after the Company stopped paying rent in June 2012 because Mullineaux, not they, was the shareholder responsible for deciding to make distributions instead of rent payments. Nonetheless, in section 4.1, *the shareholders agreed not to receive* distributions until the rent was paid. By accepting distributions from Mullineaux, Kay and Stiller breached section 4.1. Had they not received distributions, that money could (and should) have been paid to Landlord, thereby decreasing the amount of the Guarantors' liability. Porco is uniquely aggrieved by this breach,[11] and thus may pursue this claim as a direct cause of action against his fellow shareholders.[12] Hence, he may be able to offset his liability under the Guaranty by

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[10] The cases cited by third-party plaintiffs appear inapposite. *See, e.g., Gio, Buton & C., S.p.A. v Mediterranean Importing Co.*, 125 AD2d 638 (2d Dept 1986) (affirming dismissal of DCL claims because claims governed by Italian law and subject to Italian forum selection clause). The court declines to thoroughly review a lengthy federal district court case cited without a pin citation (or explanation in the brief), which decision, for the most part, is irrelevant to this case (e.g., statute of limitations). *See Lippe v Bairnco Corp.*, 225 BR 846 (SDNY 1998), *on reargument in part*, 229 BR 598 (SDNY 1999), *aff'd*, 99 FApp'x 274 (2d Cir 2004).

[11] Bakhshi was not a shareholder in 2012 and lacks standing to assert this claim.

[12] While ordinarily Porco could seek to assert a derivative claim based on demand futility, here, he was directly and uniquely harmed by not being afforded *pari passu* treatment when it came to making distributions (which he is owed if he is not paid the Guaranteed Payment), and also was uniquely harmed due to his personal liability for unpaid rent not being shared with the other shareholder third-party defendants. Under these circumstances, his claims are direct. *Cortazar v Tomasino*, 150 AD3d 668, 671 (2d Dept 2017) ("While 'allegations of mismanagement or diversion of assets by officers or directors to their own enrichment, without more, plead a wrong

recovering all distributions received by the other shareholders since June 2012. To the extent Kay and Stiller suggest this claim is duplicative of the third-party plaintiffs' claim for breach of fiduciary duty – the reverse is true. A claim for breach of fiduciary duty based on a contractual violation is considered duplicative and should be dismissed. *Kaminsky v FSP Inc.*, 5 AD3d 251, 252 (1st Dept 2004).[13]

Finally, the punitive damages demand is stricken. Punitive damages are only permitted "in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives." *Walker v Sheldon*, 10 NY2d 401, 405 (1961). It is not enough for the wrongdoing to be intentional; defendant must "evince a high degree of moral turpitude and demonstrate such wanton dishonesty as to imply a criminal indifference to civil obligations." *Ross v Louise Wise Servs., Inc.*, 8 NY3d 478, 489 (2007), quoting *Walker,* 10 NY2d at 405. "Mere commission of a tort, even an intentional tort requiring proof of common law malice, is insufficient; there must be circumstances of aggravation or outrage, or a fraudulent or evil motive on the part of the defendant." *Hoeffner v Orrick, Herrington & Sutcliffe LLP*, 85 AD3d 457, 458 (1st Dept 2011). Then too, "[p]unitive damages are not recoverable for an ordinary breach of contract as their purpose is not to remedy private wrongs **but to vindicate public rights**." *Rocanova v Equitable Life Assur. Soc. of U.S.*, 83 NY2d 603, 613 (1994). "Thus, a

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to the corporation only,' and a shareholder may not recover in his or her individual capacity for wrongs against the corporation, **an exception to that rule exists where the shareholder has sustained a loss disproportionate to that sustained by the corporation**.") (emphasis added), quoting *Abrams v Dontai*, 66 NY2d 951, 953-54 (1985); *see Venizelos v Oceania Mar. Agency, Inc.*, 268 AD2d 291 (1st Dept 2000). Proceeding on a derivative basis would not afford him any additional relief since his proportionate interest in a derivative recovery would be the same as his direct recovery (i.e., the amount of distributions paid to the other shareholders since June 2012, which should have been paid to Landlord and which Porco can use to offset his liability under the Guaranty).

[13] This renders the parties' statute of limitations dispute academic, as the applicable limitations period is six years. CPLR 213(2).

private party seeking to recover punitive damages must not only demonstrate egregious tortious conduct by which he or she was aggrieved, but also **that such conduct was part of a pattern of similar conduct directed at the public generally**." *Id.* (emphasis added)

Here, the alleged conduct of the third-party defendants is nowhere near egregious enough to warrant the imposition of punitive damages, nor is such conduct alleged to have been part of a pattern of wrongdoing aimed at the public. The subject lawsuit is merely a dispute between current and former shareholders of a corporation that implicates its internal affairs and the parties' contractual rights. Accordingly, it is

ORDERED that the TPC is dismissed in its entirety and its punitive damages demand is stricken with prejudice; and it is further

ORDERED that *only* Porco is granted leave to amend and *only* to the extent that, within one week of the entry of this order on NYSCEF, he may file a first amended third-party complaint with the following *direct* causes of action: (1) constructive fraudulent conveyance against all of the third-party defendants; (2) intentional fraudulent conveyance against all of the third-party defendants; (3) breach of section 4.2 of the Shareholders Agreement (as amended by the 2011 Amendments) against the Company; and (4) breach of section 4.1 of the Shareholders Agreement against all of the third-party defendants; and it is further

ORDERED that if Porco files an amended pleading, the third-party action shall bear the following caption:

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FRANK PORCO,

Third-Party Plaintiff,

-against-

150 RFT VARICK CORP., LINA KAY, BARRY

MULLINEAUX, JED STILLER, HIROKUNI SAI, G166NY LLC, LARRY HUGHES, and LDH INVESTMENTS LIMITED PARTNERHIP,

Third-Party Defendants.
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And it is further

ORDERED that Bakhshi and Rugisford are denied leave to amend, and their claims that were asserted in the TPC are dismissed with prejudice; and it is further

ORDERED that the parties shall jointly call the court within three weeks of the entry of this order on NYSCEF.

Dated: March 29, 2018

ENTER:

J.S.C

SHIRLEY WERNER KORNREICH
J.S.C