2014–2015 UPDATE ON BUSINESS ASSOCIATIONS

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CONTENTS

INTRODUCTION

In this year's *Survey* period, the New York Legislature made a significant change to the Limited Liability Company law.

Also in this *Survey* period, in *Jacobs v. Altorelli* (*In re Dewey & LeBoeuf L.L.P.*), the Bankruptcy Court for the Southern District of New York held that ex-partners of a bankrupt law partnership could be held liable for the return of compensation paid to them during the period prior to bankruptcy when the partnership was insolvent—a decision of interest to many lawyers in private practice.[1]

The Court of Appeals did not issue any decisions during this *Survey* period directly affecting the law of business associations. Thus, the *Survey* focuses on noteworthy decisions from the New York State Appellate Division and the Supreme Court.

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1. 518 B.R. 766, 771–72 (Bankr. S.D.N.Y. 2014).

I. LEGISLATIVE DEVELOPMENTS

A. Amendment to LLC Law

The single most significant development during the *Survey* period may well be the importation of section 630 of the New York Business Corporation law[2] (BCL section 630) into the Limited Liability Company (LLC) law.[3] Under BCL section 630, the ten holders of the largest economic interests in a New York corporation are held jointly and severally liable for debts, wages and salaries owed by the corporation to unpaid employees.[4] Section 11 of Assembly Bill 8106-C, effective February 27, 2015, added new subdivisions (c) and (d) to LLC section 609, with provisions similar, but not identical, to BCL section 630.[5]

Subdivision (c) provides that the ten members with the largest percentage ownership interest in a New York LLC shall have joint and several personal liability "for all debts, wages or salaries due and owing to any of its laborers, servants or employees."[6] To bring a claim against an LLC member, a laborer, servant, or employee must send written notice of the claim for payment to the LLC member within 180 days after the termination of services, and the action against the LLC member "shall be commenced within ninety days after the return of an execution unsatisfied against the limited liability company upon a judgment recovered against it for such services."[7] A member who pays more than his or her pro rata share under LLC section 609 may pursue other members who are among the ten largest percentage holders for their pro rata share of the payment.[8]

The Legislature's Act adding subdivisions (c) and (d) also contained several amendments to the Wage Theft Prevention Act for the purpose of "better ensur[ing] that all New York workers receive the wages they have rightfully earned."[9] The Wage Theft Prevention Act,

2. N.Y. BUS. CORP. LAW § 630 (McKinney 2003).

3. Act of December 29, 2014, ch. 537, § 11, 2014 McKinney's Sess. Law News of N.Y. 1353–54 (codified at N.Y. LTD. LIAB. CO. LAW § 609(c), (d) (McKinney 2016)).

4. N.Y. BUS. CORP. LAW § 630(a).

5. Act of December 29, 2014, ch. 537, § 11, 2014 McKinney's Sess. Law News of N.Y. 1353–54 (codified at N.Y. LTD. LIAB. CO. LAW § 609(c), (d)).

6. N.Y. LTD. LIAB. CO. LAW § 609(c) (as amended by the Act).

7. *Id.*

8. *Id.*

9. Memorandum of Support of Legislation, A8106C, Sponsor Assemb. Heastie (2014).

enacted in 2010,[10] requires that every employer in New York provide each employee with a written notice, at the time of hiring, containing relevant information such as "the rate or rates of pay and basis thereof, whether paid by the hour, shift, day, week, salary, piece, commission, or other."[11] The notice must be "in English and in the language identified by each employee as the primary language of such employee."[12]

When originally enacted, the notice was required to be given, not only at the time of hiring, but also on or before February 1 of each subsequent year.[13] This requirement for annual updates was removed in the same legislation that added subdivisions (c) and (d) to LLC section 609, perhaps as a legislative trade-off.[14]

New LLC sections 609(c) and (d) can be expected to generate controversy.[15] New York law already gives protection for workers' wages, such as New York Labor law section 191 (frequency of wage payments).[16] The value of LLC sections 609(c) and (d) is not readily apparent, considering that similar provisions of BCL section 630[17] have traditionally discouraged businesses from incorporating in New York.[18]

After the *Survey* period, the Legislature also amended BCL section 630 to apply to foreign (non-New York) corporations, for unpaid services performed in New York.[19] It remains to be seen whether New York can make out-of-state shareholders of a foreign corporation liable without fault or even knowledge.

10. Act of December 10, 2010, ch. 564, 2010 McKinney's Sess. Law News of N.Y. 1446 *ff*.

11. Act of December 10, 2010, ch. 564, § 3(1)(a), 2010 McKinney's Sess. Law News of N.Y. 1446 *ff* (codified at N.Y. LAB. LAW § 195(1)(a) (McKinney 2015)).

12. *Id.*

13. *Id.*

14. Act of December 29, 2014, ch. 537, § 1(a), 2014 McKinney's Sess. Law News of N.Y. 1348 (codified at N.Y. LAB. LAW § 195(1)).

15. N.Y. LTD. LIAB. CO. LAW § 609(c), (d) (2016).

16. N.Y. LAB. LAW § 191 (McKinney 2015).

17. N.Y. BUS. CORP. LAW § 630(a), (b) (McKinney 2003).

18. *See, e.g.*, Comment, *Shareholder Liability for Wages: Section 630 of the New York Business Corporation Law*, 30 FORDHAM L. REV. 471, 474 (1962) (citing JOINT LEGISLATIVE COMMITTEE TO STUDY REVISION OF CORPORATION LAWS, N.Y. LEG. DOC. NO. 17, at 32 (1957) ("It was a known fact that section 71 [the predecessor statute to BCL section 630] was one of the more substantial reasons why New York enterprises eschewed incorporation under New York law.")).

19. Act of November 20, 2015, ch. 421, 2015 McKinney's Sess. Law News of N.Y. 737 (codified at N.Y. BUS. CORP. LAW § 630(a)).

B. Other

Geology was added to the list of professions that require licenses from the New York Education Department,[20] effective November 21, 2016.[21] On the effective date, geology will be one more profession for which a professional service corporation may be organized under the BCL.[22]

II. AGENCY

Pasquarella v. 1525 William St., L.L.C. outlines what a party must show in order to succeed on a claim of apparent authority.[23] In *Pasquarella*, the defendant appealed from an order granting the plaintiffs' summary judgment motion for specific performance in a dispute arising out of a contract for the sale of a parcel of real property.[24] The transaction had been negotiated over a two-year period by Roger Pasquarella, the nominal plaintiff, acting as agent on behalf of 2030 Elmwood Avenue, Inc.,[25] and by Zvi Sultan ("Sultan"), who presented himself as the president-principal of the defendant, a limited liability company, together with the parties' attorneys.[26] "Throughout the negotiations, defendant's attorney acted as if Sultan had authority to negotiate on defendant's behalf."[27] The contract was finalized in April 2012.[28] Then the transaction took an unexpected turn:

> Sultan, in executing the contract on behalf of defendant, indicated that he was defendant's manager, and defendant's attorney accepted plaintiffs' deposit of $7500.00. When plaintiffs' attorney sought the documents that, pursuant to the contract, defendant was obligated to provide prior to closing, defendant declined to provide them and refused to schedule a closing date. Defendant sought to return plaintiffs' deposit after this action was commenced, using the services of a different attorney. Defendant contended that Sultan had no authority to bind defendant because, shortly before the contract was signed, Sultan sold a controlling interest in defendant to his son, and the operating agreement between the two provided that a sale of

20. Act of November 21, 2014, ch. 475, 2014 McKinney's Sess. Law News of N.Y, 3810–D (to be codified at N.Y. EDUC. LAW § 7204-b) (will take effect in November 2016).
21. *Id.*
22. N.Y. BUS. CORP. LAW § 1501(g) (McKinney Supp. 2016).
23. 120 A.D.3d 982, 983, 990 N.Y.S.2d 760, 761 (4th Dep't 2014).
24. *Id.* at 982, 990 N.Y.S.2d at 761.
25. *Id.* at 982–83, 990 N.Y.S.2d at 761.
26. *Id.*
27. *Id.* at 983, 990 N.Y.S.2d at 761.
28. *Pasquarella*, 120 A.D.3d at 983, 990 N.Y.S.2d at 761.

> corporate property must be approved by all members.[29]

The court granted the summary judgment motion because the plaintiffs had "demonstrated that they 'substantially performed [their] contractual obligations and w[ere] willing and able to perform [their] remaining obligations.'"[30] On the other hand, the defendants had "failed to raise a triable issue of fact whether Sultan lacked apparent authority to bind defendant contractually."[31]

Citing considerable precedent, the court stated:

> 'Essential to the creation of apparent authority are words or conduct of the principal, communicated to a third party, that give rise to the appearance and belief that the agent possess authority to enter into a transaction. The agent cannot by his own acts imbue himself with apparent authority. Rather, the existence of apparent authority depends upon a factual showing that the third party relied upon the misrepresentation of the agent because of some misleading conduct on the part of the principal not the agent.' Here, we conclude that the plaintiffs reasonably relied on, inter alia, their prior course of dealing with Sultan in his capacity as president, principal and manager of defendant.[32]

The court noted that defendant also allowed its attorney:

> [T]o act in a manner consistent with Sultan's continued authority, and defendant [that is, the LLC, acting through its attorney] accepted the deposit that plaintiffs provided to that attorney in conjunction with the signing of the contract, thus 'giv[ing] rise to the appearance and belief that [Sultan] possesse[d] authority to enter into [the] transaction.'[33]

Thus, defendant was properly precluded from later denying Sultan's authority.[34]

Finally, the court observed how apparent authority is addressed in

29. *Id.*

30. *Id.* (alteration in original) (quoting EMF Gen. Contracting Corp. v. Bisbee, 6 A.D.3d 45, 51, 774 N.Y.S.2d 39, 44 (1st Dep't 2004); Pesa v. Yoma Dev. Grp., Inc., 18 N.Y.3d 527, 530–31, 965 N.E.2d 228, 229–30, 942 N.Y.S.2d 1, 2–3 (2012)).

31. *Id.*

32. *Id.* at 983–84, 990 N.Y.S.2d at 761–62 (quoting Hallock v. New York, 64 N.Y.2d 224, 231, 474 N.E.2d 1178, 1181, 485 N.Y.S.2d 510, 513 (1984) (deciding that client gave attorney apparent authority to approve settlement agreement); N.X. v. Cabrini Med. Ctr., 97 N.Y.2d 247, 252 n.3, 765 N.E.2d 844, 847 n.3, 739 N.Y.S.2d 348, 351 n.3 (2002); Benderson Dev. Co. v. Schwab Bros. Trucking, Inc., 64 A.D.2d 447, 456, 409 N.Y.S.2d 890, 896–97 (4th Dep't 1978); Fed. Ins. Co. v. Diamond Kamvakis & Co., 144 A.D.2d 42, 47, 536 N.Y.S.2d 760, 763 (1st Dep't 1989)).

33. *Pasquarella*, 120 A.D.3d at 984, 990 N.Y.S.2d at 762 (last four alterations in original) (quoting *Hallock*, 64 N.Y.2d at 231, 474 N.E.2d at 1181, 485 N.Y.S.2d at 513).

34. *Id.* at 983, 990 N.Y.S.2d at 762.

the New York Limited Liability Company Law:

> [U]nless the articles of organization of a limited liability company provide that management shall be vested in a manager or managers, every member is an agent of the limited liability company for the purpose of its business, and the act of every member, including the execution in the name of the limited liability company of any instrument, for apparently carrying on in the usual way the business of the limited liability company, binds the limited liability company, unless (i) the member so acting has in fact no authority to act for the limited liability company in the particular matter and (ii) the person with whom he or she is dealing has knowledge of the fact that the member has no such authority.[35]

The court continued:

> A nearly identical subsection provides that, where management of an L.L.C. is vested in a manager, the acts of the manager are binding upon the L.L.C. unless the manager at issue has in fact no authority to act for the L.L.C., and the person with whom he or she is dealing knows that the manager lacks such authority.[36]

Thus, the court concluded that:

> [W]hether Sultan was acting as a manager of defendant, as reflected by his signature on the contract, or as a member of defendant . . . he had apparent authority to act and his acts were binding upon defendant unless, inter alia, plaintiffs had "knowledge of the fact that [Sultan] ha[d] no such authority."[37]

And with that, the court elegantly explained the doctrine of apparent authority applied to the facts at issue.

35. *Id.* at 984, 990 N.Y.S.2d at 762 (quoting N.Y. LTD. LIAB. CO. LAW § 412(a) (McKinney 2016)). Section 412 makes no reference to a reasonable-belief standard, but rather states that the third party must have actual knowledge that the agent has no authority. The distinction between whether the third party has a reasonable belief that the agent has authority, as opposed to whether the third party has actual knowledge that the purported agent lacks authority, made no difference in *Pasquarella*. The distinction could be tested in future cases.

36. *Id.* (citing N.Y. LTD. LIAB. CO. LAW § 412(b)(2)(A), (b)(2)(B) (McKinney 2016)).

37. *Id.* (alterations in original) (citing N.Y. LTD. LIAB. CO. LAW § 412(a)(i), (b)(2)(B)).

III. PARTNERSHIPS

A. Jacobs v. Altorelli (In re Dewey & LeBoeuf L.L.P.)

Under the New York Partnership Law (NYPL), any unfinished business of a dissolved partnership is an asset of the partnership. A partner taking work begun, but unfinished, by the dissolved partnership must account for the profits from the business to the dissolved partnership[38]—or, in the case of a partnership in bankruptcy, to the bankruptcy trustee.[39] The New York Court of Appeals' decision of *In re Thelen L.L.P.* held that a dissolved law firm partnership's "unfinished business" does not include ongoing hourly matters that a partner of the dissolved law firm takes from the dissolved law partnership to a new law firm.[40]

The problems of a former partner of a bankrupt law firm, however, are hardly over. The question presented in *Jacobs v. Altorelli* (*In re Dewey & LeBoeuf L.L.P.*), a decision of the Bankruptcy Court applying New York law, is whether a payment to a partner, made when the firm is insolvent, constitutes a fraudulent conveyance recoverable by the bankruptcy trustee, despite the partner showing that the payment was made in exchange for the partner's services.[41] The answer depends upon the New York Debtor and Creditor Law (DCL)[42] and the NYPL.[43]

In *Jacobs*, Dewey & LeBoeuf LLP ("Dewey"), a law firm which

38. Geron v. Seyfarth Shaw, L.L.P. (*In re* Thelen L.L.P.), 24 N.Y.3d 16, 28, 20 N.E.3d 264, 270, 995 N.Y.S.2d 534, 540 (2014). For further discussion on *In re* Thelen, see Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2013–14 Survey of New York Law*, 65 SYRACUSE L. REV. 641, 647–48 (2015).

39. Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld L.L.P. (*In re* Coudert Bros.), 480 B.R. 145, 156, 174–75 (Bankr. S.D.N.Y. 2012) (citing N.Y. P'SHIP LAW § 73 (McKinney 2015); Kirsch v. Leventhal, 181 A.D.2d 222, 225, 586 N.Y.S.2d 330, 332 (1992)). *See also* Sandra S. O'Loughlin and Christopher J. Bonner, *Business Associations, 2011–12 Survey of New York Law*, 63 SYRACUSE L. REV. 560, 577–83 (2013) for further discussion on *In re* Coudert, a decision effectively reversed by *In re* Thelen. *See In re* Thelen, 24 N.Y.3d at 33, 20 N.E.3d at 274, 995 N.Y.S.2d at 544. *In re* Thelen included certified questions to the New York Court of Appeals from the Court of Appeals for the Second Circuit in *In re* Coudert, including the question whether an hourly-rate matter was "unfinished business." *In re* Coudert Bros. L.L.P., 2013 U.S. App. LEXIS 26016, at *4–5 (2d Cir. Dec. 2, 2013). The New York Court of Appeals held that it was not. *In re* Thelen, 24 N.Y.3d at 33, 20 N.E.3d at 274, 995 N.Y.S.2d at 544.

40. 24 N.Y.3d at 28, 33, 20 N.E.3d at 274, 995 N.Y.S.2d at 541, 544 (quoting Verizon New Eng., Inc. v. Transcom Enhanced Servs., Inc., 21 N.Y.3d 66, 72, 990 N.E.2d 121, 124, 967 N.Y.S.2d 883, 886 (2013)).

41. 518 B.R. 766, 771 (Bankr. S.D.N.Y. 2014).

42. N.Y. DEBT. & CRED. LAW (McKinney 2012).

43. *Jacobs*, 518 B.R. at 787–91 (interpreting N.Y. P'SHIP LAW §§ 50, 51, 40(6) (McKinney 2015)).

had registered as a limited liability partnership (LLP) with the New York Department of State,[44] filed for relief under the federal Bankruptcy Code on May 29, 2012.[45] Alan M. Jacobs, as Liquidating Trustee (the "Trustee") for Dewey, brought claims against certain former partners of Dewey to recover or "claw back" compensation payments made to them during the period before the bankruptcy filing when Dewey was allegedly insolvent.[46] The Trustee based one of his claims on DCL section 277 ("Section 277"), which provides:

> Every conveyance of partnership property and every partnership obligation incurred when the partnership is or will be thereby rendered insolvent, is fraudulent as to partnership creditors, if the conveyance is made or obligation is incurred,
>
> a. To a partner, whether with or without a promise by him to pay partnership debts, or
>
> b. To a person not a partner without fair consideration to the partnership as distinguished from consideration to the individual partners.[47]

If the Trustee were successful, the defendants would be required to return 100% of the compensation paid to them while the partnership was insolvent. In return, the defendants would have unsecured claims against the bankruptcy estate.[48]

The opinion in *Jacobs* regarding the Trustee's claims, and the defenses to those claims, involves the similarities and differences among three different kinds of "partnerships" under New York law. There are (1) general partnerships, governed by Articles 1 through 7 of the NYPL;[49] (2) limited partnerships, which are partnerships expressly organized under either the New York Uniform Limited Partnership Act (ULPA), adopted in 1922 and currently in effect,[50] or the New York Revised Limited Partnership Act (RULPA), effective since 1991;[51] and (3) registered limited liability partnerships (LLPs), registered under Article 8–B of the New York Partnership Law.[52] Generally speaking,

44. *Id.* at 772. A New York limited liability partnership is a "partnership without limited partners . . . registered under section 121–1500 of [New York Partnership Law] . . . ." N.Y. P'SHIP LAW § 2 (McKinney 2015).

45. *Jacobs*, 518 B.R. at 772.

46. *Id.* at 771.

47. N.Y. DEBT. & CRED. LAW § 277 (McKinney 2012).

48. 11 U.S.C. § 501(a) (2012).

49. N.Y. P'SHIP LAW §§ 1–82 (McKinney 2015).

50. *Id.* §§ 90–119 (McKinney 2015).

51. *Id.* § 121 (McKinney 2015).

52. *Id.* § 121–1500 (McKinney 2015).

(1) a partner in a general partnership is liable for all debts and obligations of the partnership;[53] (2) a limited partner in a limited partnership is liable only to the extent he or she agreed to contribute to the limited partnership;[54] and (3) a partner of an LLP is liable for his or her own negligence and for the professional negligence of any person under his or her direct supervision and control.[55]

The defendants in *Jacobs* argued that partners in an LLP should be treated as "person[s] not [] partner[s]" within the meaning of Section 277(b), and thus be entitled to a defense based upon the exchange of "fair consideration" to the partnership.[56] The "fair consideration" consisted of their work for Dewey:

> According to the Defendants, their services to Dewey, in the form of billable hours worked, business generated, fees collected, marketing, and client and practice development, were "property" conveyed to Dewey that, in turn, provided "value" for creditors that should necessarily be considered.[57]

The defendants' argument that they were not "partners" within the meaning of Section 277 went as follows: When Section 277 was enacted in 1925, LLPs did not exist.[58] At that time, only "general partnerships" and "limited partnerships" existed;[59] and consequently, the Legislature meant for Section 277(a) to apply only to general partners and not to limited partners.[60] Further, the 1994 amendments to the NYPL authorizing LLPs created a "limited liability shield for LLP partners,"[61] particularly new section 26(b), which provides in relevant part:

> (b) Except as provided by subdivisions (c) [*malpractice*] and (d) [*majority vote*] of this section, no partner of a partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise), for any debts, obligations or liabilities of, or chargeable to, the registered limited liability partnership or each other, whether

53. *Id.* § 26(a) (McKinney 2015).

54. N.Y. P'SHIP LAW §§ 96, 106(a) (limited liability under ULPA); *id.* §§ 121-303, 121-502 (McKinney 2015) (limited liability under RULPA).

55. *Id.* § 26(c) (McKinney 2015).

56. Jacobs v. Altorelli (*In re* Dewey & LeBoeuf L.L.P.), 518 B.R. 766, 774 (Bankr. S.D.N.Y. 2014) (alteration in original).

57. *Id.*

58. *Id.* at 779.

59. *Id.* The Legislature authorized LLPs in 1994. Act of July 26, 1994, ch. 576, 1994 McKinney's Sess. Laws of N.Y. 1347.

60. *Jacob*, 518 B.R. at 779.

61. *Id.* at 780.

> arising in tort, contract or otherwise, which are incurred, created or assumed by such partnership while such partnership is a registered limited liability partnership, solely by reason of being such a partner . . . .[62]

Thus, the defendants argued, exclusion of partners in an LLP from the term "partner" in Section 277 was necessarily required for consistency with limitation as to liability for partnership debts.[63]

In response, the court in *Jacobs* stated: First, liability under Section 277, which addresses the liability to return "transfers the partnership made directly to" partners, is not analogous to general liability for partnership debts under NYPL section 26.[64] In fact, if a general partner's liability for partnership debts under NYPL section 26 included liability for potentially excessive transfers from the partnership to the general partner, then Section 277 would have been completely superfluous and there would have been no reason to adopt Section 277 in the first place.[65]

Rather, Section 277 was adopted by New York in 1925 and was based on section 8 of the Uniform Fraudulent Conveyance Act (UFCA).[66] In 1984, the National Conference of Commissioners on Uniform State Laws proposed to revise the UFCA, in the form of the new Uniform Fraudulent Transfer Act (UFTA).[67] UFTA proposed to eliminate section 277.[68] A prefatory note to the UFTA explained that, under the uniform state law equivalent of section 277,

> any transfer made or obligation incurred by an insolvent partnership to a partner is fraudulent without regard to intent or adequacy of consideration. So categorical a condemnation of a partnership transaction with a partner unfairly prejudice[s] the interests of a partner's separate creditors.[69]

Significantly, New York did *not* adopt the UFTA, nor eliminate section 277.[70]

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62. N.Y. P'SHIP LAW § 26(b) (McKinney 2015).

63. *Jacobs*, 518 B.R. at 779–80.

64. *Id.* at 780–81 (citing N.Y. DEBT. & CRED. LAW § 277 (McKinney 2012); N.Y. P'SHIP LAW § 26(b)).

65. *Id.* at 781.

66. *Id.* at 780.

67. *Id.* at 781.

68. *Jacobs*, 518 B.R. at 781.

69. *Id.* (Nat'l Conference of Comm'rs on Unif. State Laws, *Uniform Fraudulent Transfers Act*, UNIFORM L. COMMISSION, http://www.uniformlaws.org/ (last visited May 23, 2016)).

70. *Id.* at 781.

In 1991, the New York Legislature adopted the Revised Limited Partnership Act, codified as Article 8–A of the New York Partnership Law.[71] Under that Act, a limited partner is liable only "for transfers made to a limited partner when the limited partnership was or was thereby rendered insolvent and the limited partner *knew* at the time that the partnership was insolvent."[72] The court observed that:

> While the Legislature chose to limit the liability of limited partners for transfers from insolvent limited partnerships when it enacted Article 8–A of the NYPL, it did not adopt any comparable limitation on the liability of LLP partners when it adopted Article 8–B, the Registered Limited Liability Partnership Act, and other LLP-related amendments, only three years later in 1994.[73]

Thus the court contrasted the Legislature's differing treatment under Section 277 of limited partners compared to LLP partners.[74] The court then contrasted New York to Maryland, a jurisdiction with a similar statute to New York's Section 277, which addressed the liability of LLP partners when it adopted LLP provisions in 1997.[75] Maryland expressly allows:

> "partner[s]" to prove "fair consideration" by way of "services provided or to be provided by the partner to the partnership and the services are provided or will be provided within 120 days before or after the date the conveyance is made or the obligation is incurred."[76]

The court concluded that Maryland, with a statute similar to New York's Section 277, considered LLP partners to be "partners" for purposes of the Maryland equivalent of Section 277, and had amended its equivalent of Section 277 to achieve the results that the defendants in *Jacobs* desired under New York law.[77]

Then the court cited instances where the New York Legislature, when it adopted the LLP provisions, continued to refer to partners in an LLP as general partners.[78] NYPL section 40(1) provides in relevant part that "'except as provided in subdivision (b) of section twenty-six of this chapter'"—section 26(b) is the basis liability shield of LLP partners—

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71. N.Y. P'SHIP LAW § 121-101 (McKinney 2015).

72. *Jacobs*, 518 B.R. at 781 (citing N.Y. P'SHIP LAW §§ 121-607(a)–(b) (McKinney 2015)) (emphasis by court).

73. *Id.* at 782.

74. *Id.* at 781–82.

75. *Id.* at 782 (citing Limited Liability Company Reform Act of 1997, 1997 Md. Laws ch. 659).

76. *Id.* (quoting MD. CODE ANN., COM. LAW § 15–208(a)(1) (West 2015)).

77. *Jacobs*, 518 B.R. at 782.

78. *Id.* at 783.

"'each partner must contribute toward the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.'"[79] NYPL section 121–1500(d) provides, "'[a] partnership without limited partners that has been registered as a registered limited liability partnership is for all purposes the same entity that existed before the registration and continues to be a partnership without limited partners under the laws of this state.'"[80] Section 121–101(j–1) of New York's RULPA states that an LLP is a species of general partnership: "'Other business entity' means any person other than a natural person, *general partnership (including any registered limited liability partnership* or registered foreign limited liability partnership) or domestic limited partnership.'"[81]

Thus the court concluded that partners of an LLP were subject to recovery of their compensation under Section 277.[82]

The defendants also tried to protect their compensation as "reasonably equivalent value" for their services, under section 548(a)(1)(B)(i) of the Bankruptcy Code.[83] Here the defendants encountered a second problem under NYPL: the "no compensation rule," namely, that "'[n]o partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.'"[84] The court emphasized that the no compensation rule is only a default rule and that a partnership agreement is free to provide otherwise.[85] Dewey's partnership agreement allowed for specific compensation agreements with individual partners, but those contracts were not being considered in the motion before the court.[86]

Jacobs concluded that Dewey's bankruptcy Trustee could, as a general proposition, pursue former Dewey partners for compensation paid while Dewey was technically insolvent but before Dewey filed its bankruptcy petition.[87]

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79. *Id.* (emphasis omitted) (quoting N.Y. P'SHIP LAW § 40(1) (McKinney 2015)).

80. *Id.* (alteration in original) (quoting N.Y. P'SHIP LAW § 121-1500(d) (McKinney 2015)).

81. *Id.* (quoting N.Y. P'SHIP LAW § 121-101(j–1) (McKinney 2015)).

82. *Jacobs*, 518 B.R. at 784.

83. *Id.* (citing 11 U.S.C. § 548(a)(1)(B)(i) (2012)).

84. *Id.* at 787 (alteration in original) (quoting N.Y. P'SHIP LAW § 40(6) (McKinney 2015)).

85. *Id.*

86. *Id.*

87. *Jacobs*, 518 B.R. at 790.

B. Other

In *Fasolo v. Scarafile*, the plaintiffs sued the defendant for breach of an oral partnership agreement.[88] At issue was whether the plaintiffs and the defendant were partners with regard to the development and sale of residential property,[89] a venture in which the plaintiffs had suffered losses.[90] The trial court granted summary judgment to the defendant.[91] The appellate division subsequently listed several factors germane to its decision that the defendant was not a partner with the plaintiffs: (1) the defendant submitted the deposition testimony and tax returns of one of the plaintiffs, showing that the parties did not file tax returns as a partnership and that one of the plaintiffs had reported the income and losses from the business on his personal tax return; (2) the supposed partnership had no partnership name, bank account, assets, or capital contributions; (3) the plaintiffs were sole legal owners of the residential property involved; (4) one of the plaintiffs admitted that the defendant had never actually agreed to share the plaintiffs' losses on the property; and (5) the plaintiffs controlled the development and sale of the property.[92]

On the other hand, the plaintiffs' evidence showed that, on several earlier occasions, the plaintiffs and the defendant had shared profits when they had worked together on home sales.[93] The appellate division opinion noted that, while sharing of profits is "prima facie evidence of the existence of a partnership,"[94] the opinion also stated that "[n]o one factor is determinative [but, rather,] it is necessary to examine the parties' relationship as a whole,"[95] and "all of the elements of the relationship must be considered."[96]

Levine v. Seven Pines Associates L.P. was a dissenter's rights proceeding in connection with the merger of a New York limited partnership named Seven Pines Associates Limited Partnership ("Seven

88. 120 A.D.3d 929, 929, 991 N.Y.S.2d 820, 821 (4th Dep't 2014). David B. Cabaniss, Esq., a former colleague of the authors, represented the defendant in this case.

89. *Id.*

90. *Id.* at 930, 991 N.Y.S.2d at 822.

91. *Id.* at 929, 991 N.Y.S.2d at 821.

92. *Id.* at 930, N.Y.S.2d at 822.

93. *Fasolo*, 120 A.D.3d at 931, 991 N.Y.S.2d at 823.

94. *Id.* (citing N.Y. P'SHIP LAW § 11(4) (McKinney 2015)).

95. *Id.* at 930, 991 N.Y.S.2d at 822 (quoting Kyle v. Ford, 184 A.D.2d 1036, 1037, 584 N.Y.S.2d 698, 699 (4th Dep't 1992)).

96. *Id.* at 931, 991 N.Y.S.2d at 823 (quoting Blaustein v. Lazar Borck & Mensch, 161 A.D.2d 507, 508, 555 N.Y.S.2d 776, 777 (1st Dep't 1990)).

Pines").[97] Seven Pines's sole asset was an apartment building.[98] The general partner of Seven Pines proposed reorganizing Seven Pines by merging it with a new limited partnership, and gave the limited partners the alternatives of either receiving a cash payment of $650,000 per old limited partnership unit, or trading in the old limited partnership interest and a payment of $10,000 for a new membership interest in the reorganized limited partnership.[99] In response, Robert Levine, representing the owner of one-half of a limited partnership interest, sent notice of dissent from the merger.[100]

Seven Pines's counsel sent Levine an offer to pay the fair value of the interest he represented.[101] Seven Pines considered the merger price, or $325,000 for a one-half interest, to be fair value.[102] Levine and Seven Pines did not reach an agreement on the value, and Levine petitioned for a court determination of the fair value of his interest under section 121–1105(b) of the partnership law.[103] This section incorporates by reference the dissenter's rights procedures of paragraphs (h)–(k) of section 623 of the BCL.[104]

The court issued two important procedural holdings regarding the dissenter's petition. First, the court stated that BCL section 623(h)(4) "clearly suggests that an evidential bench trial is permitted, and necessary, to assist the court in determining fair market value where

97. No. 151958/2014, 2015 N.Y. Slip Op. 30138(U), at 1, 2 (Sup. Ct. N.Y. Cty. 2015).

98. *Id.*

99. *Id.*

100. *Id.* Section 121-1102(b) of the Partnership Law provides that a limited partner may send a notice of dissent from a merger. N.Y. P'SHIP LAW § 121-1102(b) (McKinney 2015). The similar notice under section 623(a) of the Business Corporation Law for a shareholder dissenting from a merger is titled an "objection" and "shall include a notice of his election to dissent, his name and residence address, the number and classes of shares as to which he dissents and a demand for payment of the fair value of his shares if the action is taken." N.Y. BUS. CORP. LAW § 623(a) (McKinney 2003).

101. *Levine*, No. 151958/2014, 2015 N.Y. Slip Op. 30138(U), at 2. Section 121-1105(a) of the Partnership Law states that "[w]ithin ten days after the occurrence of an event described in section 121-1102 of this article [*including a merger*], the surviving or resulting limited partnership shall send to each dissenting former limited partner a written offer to pay in cash the fair value of such former partner's interest." N.Y. P'SHIP LAW § 121-1105(a) (McKinney 2015). The fact that the notice was on the sixteenth day, rather than on or before the tenth day, does not seem to have raised any issue. *Levine*, No. 151958/2014, 2015 N.Y. Slip Op. 30138(U), at 2.

102. *Levine*, No. 151958/2014, 2015 N.Y. Slip Op. 30138(U), at 2.

103. *Id.*; *see also* N.Y. P'SHIP LAW § 121-1102(b) (McKinney 2015).

104. *Levine*, No. 151958/2014, 2015 N.Y. Slip Op. 30138(U), at 2–3 n.1 (citing N.Y. BUS. CORP. LAW § 623(h)–(k) (McKinney 2003)).

there is a dispute as to the value, as there is here."[105] Second, section 623(h)(4) "also permits the court to order pretrial disclosure, including experts' reports relating to the fair value of the shares, whether or not intended for use at the trial."[106] The court ordered Seven Pines to provide specified financial statements and to produce a witness having knowledge of a specific valuation issue raised by Levine.[107]

Levine demonstrates a trial court's willingness to provide the statutory dissenter's rights of appraisal in a limited partnership merger, which is comforting in view of the holding by the Court of Appeals in *Appleton Acquisition, L.L.C. v. National Housing Partnership* regarding the exclusivity of the statutory appraisal remedy.[108]

IV. CORPORATIONS

Vivir of Li, Inc. v. Ehrenkranz is a piercing-the-corporate veil case.[109] John and Andra Ehrenkranz obtained a jury verdict in their favor against Opus Vivir, Inc., also known as Vivir of Li, Inc. ("Vivir"), in connection with the construction of their residence, and then sought to enforce a judgment on the verdict against Julian Boylan, the owner of Vivir.[110]

The court noted that the requirements to pierce the corporate veil are: "'(1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury.'"[111] In this case, the Ehrenkranzs, who were seeking to pierce the veil, and Julian Boylan, the corporation's owner desiring to avoid personal liability, each presented expert testimony on these requirements.[112]

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105. *Id.* at 2–3 (citing to N.Y. BUS. CORP. § 623(h)(4)).

106. *Id.* at 3.

107. *Id.* at 4.

108. Appleton Acquisition, L.L.C. v. Nat'l Hous. P'ship, 10 N.Y.3d 250, 256–57, 886 N.E.2d 144, 148–49, 856 N.Y.S.2d 522, 526–27 (2008) (limited partner's exclusive remedy against a general partner for fraud and illegality in a merger transaction was an appraisal proceeding) (discussed in Sandra S. O'Loughlin and Christopher J. Bonner, *Business Associations, 2007–2008 Survey of New York Law,* 59 SYRACUSE L. REV. 525, 534–40 (2009)).

109. No. 043523–20092014, 2014 N.Y. Slip Op. 51108(U), at 1 (Sup. Ct. Suffolk Cty. 2014).

110. *Id.*

111. *Id.* at 35 (quoting Morris v. N.Y. State Dep't of Taxation & Fin., 82 N.Y.2d 135, 141, 603 N.Y.S.2d 807, 810–11, 623 N.E. 2d 1157, 1160–61 (1993); Millennium Constr., L.L.C. v. Loupolover, 44 A.D.3d 1016, 1016, 845 N.Y.S.2d 110, 111 (2d Dep't 2007)).

112. *Id.* at 37.

Referring to veil-piercing as "somewhat extraordinary relief[,]"[113] the court held that:

> Faced with two excellent experts and a corporate accountant on an extremely complex matter, the Court finds that the testimony weighs so evenly that it is required to find that the Ehrenkranzs have failed to meet their burden of demonstrating that they are entitled to the somewhat extraordinary relief requested in the context of piercing the corporate veil.[114]

This statement implies that when the evidence for and against piercing the veil results in a draw, preserving the corporate veil wins. The court's decision appears to be more complex, however, because, while the court found that aspects of the complete-domination requirement were present in the facts before it,[115] that domination was not directed against the other parties in this case:

> The real distinction between the case law the Court has reviewed which allows veil piercing and the case at bar lies in the "purpose" element of the doctrine [*that is, the piercing-the-corporate-veil doctrine*]. Thus, while the Court agrees with the [Ehrenkranzs'] excellent expert that Julian Boylan used the corporation for personal expenses and filed questionable tax documents, this is not a case where these actions were done in order to commit a wrong or fraud upon the [Ehrenkranzs].[116]

The *Vivir* case shows that, to succeed on a claim to pierce the corporate veil, the claimant needs to be able to show not only that the corporation's controlling shareholder dominated the corporation, but also that the controlling shareholder used the corporate form to commit a wrong or fraud against the claimant.[117]

V. DERIVATIVE ACTIONS

A. Standing

An important preliminary question in many disputes involving owners of a business entity is whether a legal action should be brought directly or derivatively in the right of the entity.

Elting v. Shawe involved a dispute between the two founders of a

113. *Id.* at 40.
114. *Vivir*, No. 043523–20092014, 2014 N.Y. Slip Op. 51108(U), at 40.
115. *Id.* at 40–42.
116. *Id.* at 42.
117. *See generally id.*

large business which provided translation services.[118] Elizabeth Elting and Philip Shawe were the only directors, and were co-CEOs, of TransPerfect Global, Inc. (TPG), a Delaware corporation.[119] Ninety percent of TPG's revenues came from the operations of its wholly-owned subsidiary TransPerfect Translations International, Inc. (TPI), a New York corporation.[120] Elting brought claims in New York, some directly and some derivatively, on behalf of TPG, the Delaware corporate parent, to remove Shawe as a director and officer of TPI, to dissolve TPI, and for breach of fiduciary duty.[121] Shawe and Elting also litigated in Delaware for judicial dissolution of TPG.[122] The New York court, having decided not to dismiss the New York claims in favor of the Delaware litigation, proceeded to issue helpful rulings on Elting's standing under the BCL to bring her various claims.[123]

BCL section 706(d) provides that the holder of ten percent of the outstanding shares of a corporation may bring an action to remove a director for cause.[124] BCL section 716(c) provides that a ten percent holder may bring an action to remove an officer for cause.[125] The *Elting* court held that these sections do not give standing to a person whose ownership is only indirect and beneficial.[126] Because Elting owned fifty percent of the parent Delaware corporation TPG and TPG owned one-hundred percent of the New York subsidiary TPI, Elting did not have standing to bring direct claims to remove Shawe as a director and officer.[127] As fifty percent owner of the Delaware parent TPG, however, Elting did have standing to sue derivatively under sections 706(d) and 716(c).[128] As to the rights of a stockholder of a Delaware corporation to bring a derivative action in the right of a subsidiary of the Delaware

118. No. 651423/2014, 2014 N.Y. Slip Op. 32126(U), at 2 (Sup. Ct. N.Y. Cty. 2014). The intramural contention between the founders was extreme. Details are described in a decision by the Delaware Chancery Court decided after the period covered by this *Survey*. *See In re* Shawe & Elting L.L.C., C.A. No. 9661–CB, 2015 Del. Ch. LEXIS 213, at *3–5 (Del. Ch. Aug. 14, 2015).

119. *Elting*, No. 651423/2014, 2014 N.Y. Slip Op. 32126(U), at 1.

120. *Id.* at 1–2.

121. *Id.* at 1.

122. *Id.* at 5.

123. *Id.* at 6–7 (citing Boulden v. Albiorix, Inc., C.A., No. 7051–VCN, 2013 Del. Ch. LEXIS 31, at *59 (Del. Ch. Jan. 31, 2013); N.Y. BUS. CORP. LAW §§ 706(d), 716(c) (McKinney 2003)).

124. N.Y. BUS. CORP. LAW § 706(d).

125. *Id.* § 716(c).

126. *Elting*, No. 651423/2014, 2014 N.Y. Slip Op. 32126(U), at 6.

127. *Id.*

128. *Id.* at 6–7 (citing *Boulden*, C.A. No. 7051–VCN, 2013 Del. Ch. LEXIS 31, at *59; N.Y. BUS. CORP. LAW §§ 706(d), 716(c)).

corporation, the court cited the Delaware Chancery Court decision of *Boulden v. Albiorix, Inc.*, for the proposition that Delaware would allow a stockholder to bring the action.[129]

Practitioners may note the possibility of an alternate ground to bring a derivative action in New York. BCL section 1319 permits the shareholders of a non-New York corporation to bring a derivative action in the right of that corporation if the non-New York corporation is "doing business in this state,"[130] provided that the specific action is not exempted by BCL section 1320.[131] The *Elting* decision court did not state whether TPG, the Delaware parent, was doing business in New York.[132]

Elting's action included a derivative claim to dissolve TPI, the New York subsidiary, under BCL section 1104, which allows a petition for dissolution by holders of one-half of the voting shares.[133] The court stated that section 1104 "is intended for situations in which there is 50/50 deadlock between shareholders."[134] The court noted that, because Elting was not a shareholder of the New York subsidiary, she would not have had standing to bring a section 1104 action directly; hence Elting had to sue derivatively, as a stockholder of the Delaware parent, to cause it to dissolve TPG under section 1104.[135] The court held, however, that *only* a holder of precisely fifty percent of the votes could bring a dissolution proceeding under section 1104,[136] meaning that the Delaware parent, because it owned one hundred percent of the New York subsidiary rather than fifty percent, could not bring a section 1104 proceeding.[137] Thus the court dismissed Elting's section 1104 proceeding.[138]

In a shareholder dispute involving a non-New York parent

129. *Id*. at 7 (citing *Boulden*, C.A. No. 7051–VCN, 2013 Del. Ch. LEXIS 31, at *59) (stating in dicta that a stockholder of a parent can bring an action in the right of a subsidiary).

130. N.Y. BUS. CORP. LAW § 1319(a)(2) (McKinney 2003).

131. N.Y. BUS. CORP. LAW § 1320(a) (McKinney 2003) (exempting, from specified actions, corporations whose shares are listed on a national securities exchange or less than half of whose total business income for the preceding three fiscal years was allocable for franchise tax purposes to New York).

132. *See Elting*, No. 651423/2014, 2014 N.Y. Slip Op. 32126(U).

133. *Id.* at 7 (citing N.Y. BUS. CORP. LAW § 1104(a) (McKinney 2003)).

134. *Id.*

135. *Id.* (citing Rust v. Turgeon, 295 A.D.2d 962, 963, 746 N.Y.S.2d 223, 225 (4th Dep't 2002)).

136. *Id.* at 7–8 (citing N.Y. BUS. CORP. LAW § 1104 (McKinney 2003)).

137. *Elting*, No. 651423/2014, 2014 N.Y. Slip Op. 32126(U), at 8 (citing N.Y. BUS. CORP. LAW § 1104).

138. *Id.* at 7–8 (citing N.Y. BUS. CORP. § 1104).

corporation and a New York corporation subsidiary, *Elting* shows that BCL sections 706(d) and 716(c) are available, but claims under those sections should be brought as derivative actions.[139]

Tsoukas v. Tsoukas, a dispute between family members owning a close corporation, included an action by Konstantinos Tsoukas (referred to in the opinion as "Gus") who was a director, officer and fifty percent shareholder of the corporation, against his brother Minas Tsoukas (referred to in the opinion as "Mike"), who was also a director and an officer.[140] Mike defended the action by claiming that Gus lacked standing because he had not complied with rules governing a shareholder's derivative action.[141] The Second Department held that Gus did not have to comply with the shareholder derivative rules because, as an officer of the corporation, he had independent standing under section 720(b) of the BCL[142] to bring an action against Mike.[143]

B. LLC Derivative Actions

Univest I Corp. v. Skydeck Corp. d/b/a Pay2Park ("*Univest*"), a decision from the Supreme Court in Erie County, raised several instructive points regarding LLCs and derivative actions.[144]

There were four parties involved in *Univest*: (1) 470 Pearl Street, L.L.C. ("470 Pearl"), a two-member New York LLC whose only asset was a parking lot at 470 Pearl Street in the City of Buffalo, New York; (2) Univest I Corp. ("Univest"), a member which owned fifty percent of 470 Pearl; (3) Buffalo Development Corporation (BDC), which owned the other fifty percent of 470 Pearl and was the manager of 470 Pearl

139. *Id.* at 6–7 (citing Boulden v. Albiorix, Inc., C.A., No. 7051–VCN, 2013 Del. Ch. LEXIS 31, at *59 (Del. Ch. Jan. 31, 2013); N.Y. BUS. CORP. §§ 706(d), 716(c) (McKinney 2003)).

140. 125 A.D.3d 872, 873–874, 4 N.Y.S.3d 261, 263–64 (2d Dep't 2015).

141. *Id.* at 875, 4 N.Y.S.3d at 265 (citing Brown v. Brown, 143 A.D.2d 248, 249, 532 N.Y.S.2d 157, 158 (2d Dep't 1988); Conant v. Schnall, 33 A.D.2d 326, 327–28, 307 N.Y.S.2d 902, 904–05 (3d Dep't 1970); Rapoport v. Schneider, 29 N.Y.2d 396, 400, 328 N.Y.S.2d 431, 435, 278 N.E.2d 642, 644–45 (1972); N.Y. BUS. CORP. LAW § 720(b) (McKinney 2003 & Supp. 2016)). Those rules include, for example, the requirement under BCL section 626(c) to make a demand upon the Board of Directors, or be excused from making such demand. N.Y. BUS. CORP. LAW § 626(c) (McKinney 2003).

142. N.Y. BUS. CORP. LAW § 720(b). Section 720(b) authorizes the corporation, an officer, a director, or certain other parties, to bring an action against directors or officers for misconduct, such as violation of fiduciary duties. *Id.*

143. *Tsoukas*, 125 A.D.3d at 875, 4 N.Y.S.3d at 265 (citing *Brown*, 143 A.D.2d at 249, 532 N.Y.S.2d at 158; then citing *Conant*, 33 A.D.2d at 327–28, 307 N.Y.S.2d at 904–05; *Rapoport*, 29 N.Y.2d at 400, 328 N.Y.S.2d at 435, 278 N.E.2d at 644–45; N.Y. BUS. CORP. § 720(b)).

144. No. 2014–811644 (Sup. Ct. Erie Cty. Nov. 2, 2014).

under the 470 Pearl's operating agreement; and (4) Skydeck Corporation ("Skydeck"), an entity which also managed other parking lots in the City of Buffalo.[145] Mark D. Croce was Chief Executive Officer of Skydeck and President of BDC.[146]

While Univest had no management rights under the operating agreement of 470 Pearl,[147] the operating agreement contained a provision which allowed either member of 470 Pearl unilaterally to terminate the lease with Skydeck.[148] Its purpose may have been to protect Univest against collusion between BDC and Skydeck. In any event, Univest claimed that Skydeck was paying a below-market rent and successfully used this provision to terminate the lease.[149] Skydeck thereafter became a holdover tenant at the parking lot owned by 470 Pearl.[150]

Despite successfully terminating the lease, Univest had won a hollow victory.[151] As only a member of 470 Pearl, Univest had no authority to lease 470 Pearl's parking lot to any other party, while BDC, as manager of 470 Pearl, had no express obligation under 470 Pearl's operating agreement to look for any tenant to replace Skydeck.[152] Univest therefore brought a derivative proceeding on behalf of 470 Pearl to evict Skydeck and bring in a new tenant.[153]

The *Univest* court noted that, in the case of *Gorbrook Associates v. Silverstein*, a shareholder of a corporation had been allowed to bring a derivative suit in the right of the corporation to evict the corporation's holdover tenant.[154] Assuming that a member of an LLC had a right equivalent to that of a shareholder, the *Univest* court concluded that the "demand futility" requirement applies to LLCs as well as corporations.[155] With that, the court found that demand-futility was

145. *Id.* at 2–3.

146. *Id.* at 3.

147. *Id.* at 2.

148. *Id.* at 3.

149. *Univest*, No. 2014–811644, at 3. The lease termination was the subject of a related proceeding. *Id.*

150. *Id.*

151. *Id.* at 3.

152. *Id.*

153. *Univest*, No. 2014–811644, at 1, 3.

154. *Id.* at 6 (citing Gorbrook Assocs. v. Silverstein, 40 Misc.3d 425, 436–37, 965 N.Y.S.2d 851, 858–59 (Dist. Ct. Nassau Cty. 2013)).

155. *Id.* at 7 (citing Lee Hu v. Ziming Shen, 57 A.D.3d 616, 618, 870 N.Y.S.2d 373, 374–75 (2d Dep't 2008); Evans v. Perl, No. 602898/05, 2008 N.Y. Slip Op. 50775(U), at 8–9 (Sup. Ct. N.Y. Cty. 2008); Fine v. N.Y. Cmty. Bank, No. 1780 2011, 2011 N.Y. Slip. Op. 51935(U), at 2 (Sup. Ct. Queens Cty. 2011)).

adequately pleaded, because BDC, the managing member of 470 Pearl, had the same chief executive officer as Skydeck, the holdover tenant,[156] and the chief executive officer of BDC had stated (in one of the papers before the court) that BDC as managing member had negotiated the lease between 470 Pearl and Skydeck in order to benefit BDC.[157] Therefore BDC was interested in the transaction, and demand was excused.[158]

In *Univest*, the defendant raised the difficult question of whether an LLC member may contractually waive rights to bring a derivative action.[159] The Affirmation of Robert E. Knoer, filed December 30, 2014,[160] (the "Affirmation") noted that the operating agreement contained the provision that:

> The Manager [*i.e.*, BDC] must, . . . obtain the vote in favor of, consent to, or approval of a Majority in Interest of the Members before he may cause or permit 470 Pearl to take any action with respect to . . . the following events or matters:
>
> * * *
>
> (h) Cause or permit 470 Pearl to (i) commence, prosecute, defend or settle any claim, action or proceeding of any nature by or against 470 Pearl, or (ii) confess a judgment against 470 Pearl[.][161]

BDC argued that this provision constituted a waiver by Univest of its right to bring a derivative action.[162] The court had two responses to this argument.[163] First, the court noted that the operating agreement was executed in 2005.[164] The right of an LLC member to bring a derivative action was not firmly established until the Court of Appeals held that it existed, in *Tzolis v. Wolff*,[165] decided in 2008, thus weakening the argument that Univest had knowingly waived its rights to bring a derivative action.[166] Second, the language in the operating agreement,

156. *Id*. at 1–2, 7.

157. *Id.* at 7.

158. *Univest*, No. 2014–811644, at 7.

159. *Id.* at 6.

160. Affidavit for Defendant at 1, *Univest*, No. 2014–811644 (Sup. Ct. Erie Cty. 2014).

161. *Univest*, No. 2014–811644, at 6.

162. *Id.* at 1–2.

163. *Id.* at 6 (citing Tzolis v. Wolff, 10 N.Y.3d 100, 102, 884 N.E.2d 1005, 1005, 855 N.Y.S.2d 6, 6 (2008)).

164. *Id.* at 6.

165. *Tzolis*, 10 N.Y.3d at 102, 884 N.E.2d at 1005, 855 N.Y.S.2d at 6. See Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2007–08 Survey of New York Law*, 59 SYRACUSE L. REV. 525, 548-554 (2009).

166. *Univest*, No. 2014–811644, at 6 (citing *Tzolis*, 10 N.Y.3d at 102, 884 N.E.2d at

quoted above, did not "vest in the manager sole authority to bring any action in the name of [470 Pearl]."[167] The language spoke only to what BDC, as manager, must do before 470 Pearl itself could bring a direct action.[168]

Although *Univest* held that the language before it contained no waiver, as Peter Mahler's *New York Business Divorce* webpage stated, "as lawyers who draft operating agreements continue to push the LLC freedom-of-contract envelope,"[169] the questions arises whether an LLC operating agreement *could* contain an effective waiver by an LLC member of its rights (as stated in *Tzolis v. Wolff*[170]) to bring a derivative action.

C. Disclosure-Only Settlements

During this *Survey* period, the Commercial Division of the Supreme Court in New York County began to reject disclosure-only settlements. The term "disclosure-only settlement" generally refers to a settlement of a shareholder derivative action against a corporate transaction, where the settlement is based primarily upon the corporate defendant making supplemental disclosures and paying the attorneys' fees of class counsel, in return for the class representative giving, on behalf of the class, a broad release of claims.[171]

In *West Palm Beach Police Pension Fund v. Gottdiener*, the first of three cases during this *Survey* period opining on disclosure-only settlements, the settlement was approved.[172] However, in two subsequent decisions, *Gordon v. Verizon Communications, Inc.*[173] and *City Trading Fund v. Nye*,[174] the courts rejected the parties' proposed disclosure-only settlements.

The first decision, *West Palm Beach Police Pension Fund v. Gottdiener*, dated October 22, 2014, involved the acquisition by merger of Duff & Phelps Corporation.[175] The plaintiff brought a class-action

1005, 855 N.Y.S.2d at 6).

167. *Id.*

168. *Id.*

169. Peter Mahler, *Not Your Father's Derivative Action*, N.Y. BUS. DIVORCE (Mar. 16, 2015), http://www.nybusinessdivorce.com/2015/03/articles/llcs/univest/.

170. *Tzolis*, 10 N.Y.3d at 102, 855 N.Y.S.2d at 6, 884 N.E.2d at 1006.

171. *See* Gordon v. Verizon Commc'n, Inc., No. 653084/13, 2014 N.Y. Slip Op. 33367(U), at 4 (Sup. Ct. N.Y. Cty. 2014).

172. No. 650144/13, 2014 N.Y. Slip Op. 32777(U), at 6 (Sup. Ct. N.Y. Cty. 2014).

173. No. 653084/13, 2014 N.Y. Slip Op. 33367(U), at 15 (Sup. Ct. N.Y. Cty. 2014).

174. No. 651668/14, 2015 N.Y. Slip Op. 50008(U), at 20 (Sup. Ct. N.Y. Cty. 2015).

175. *Gottdiener*, No. 650144/13, 2014 N.Y. Slip Op. 32777(U), at 2.

suit alleging that the directors of Duff & Phelps had breached fiduciary duties by approving the merger and by making material misstatements and omissions in the Preliminary Proxy Statement.[176] To settle the case, Duff & Phelps made additional disclosures in connection with the merger.[177]

In the court's decision approving the settlement, several of the factors mentioned by the court should be noted in view of the later cases regarding disclosure-only settlements: (1) no objector to the settlement appeared before the court;[178] (2) some prior New York case law approved disclosure-based settlements of class actions;[179] (3) Delaware law, "although not applicable to this case," was "useful guidance,"[180] and five Delaware decisions since 2007 approved disclosure-only settlements;[181] (4) obtaining anything at all for the shareholders was a good result for the plaintiff, because the plaintiff's claim for money damages "does not have a strong likelihood of success on the merits":[182] a fact admitted by the plaintiff;[183] and (5) "the supplemental disclosures provide[d] benefit to the shareholders."[184] The court had previously noted that, "[u]nder Delaware law, disclosures need not be 'material' in order to support a class action settlement involving a merger, but must provide 'benefit' to the shareholders."[185]

In the second case, *Gordon v. Verizon Communications, Inc.*, the court considered a disclosure-only settlement reached on the following facts:[186] On September 2, 2013, the nominal defendant, Verizon Communications Inc. ("Verizon") announced that it had agreed with Vodafone Group plc to buy a forty-five percent interest from Vodafone

176. *Id.* Duff & Phelps Corporation was subject the Proxy Rules of the U.S. Securities and Exchange Commission, 17 C.F.R. § 240.14a–1 *et seq.* (2015), and as required by those rules had filed a draft, called a "Preliminary," Proxy Statement. A Preliminary Proxy Statement is, in most cases, publicly available on the EDGAR database at the SEC's website. *See* U.S. SEC. & EXCHANGE COMMISSION, www.sec.gov (last visited May 23, 2016).

177. *Gottdiener*, No. 650144/13, 2014 N.Y. Slip Op. 32777(U), at 2.

178. *Id.* at 3, 6.

179. *Id.* at 4.

180. *Id.* at 5.

181. *Id.*

182. *Gottdiener*, No. 650144/13, 2014 N.Y. Slip Op. 32777(U), at 6.

183. *Id.* The subsequent cases, *Gordon v. Verizon Communications, Inc.*, No. 653084/13, 2014 N.Y. Slip Op. 33367(U) (Sup. Ct. N.Y. Cty. 2014) and *City Trading Fund v. Nye*, No. 651668/14, 2015 N.Y. Slip Op. 50008(U) (Sup. Ct. N.Y. Cty. 2015) analyze reasons why plaintiff's counsel might proffer—as justification for approving the settlement, an affirmative statement that its own case is weak.

184. *Gottdiener*, No. 650144/13, 2014 N.Y. Slip Op. 32777(U), at 6.

185. *Id.* at 5.

186. No. 653084/13, 2014 N.Y. Slip Op. 33367(U), at 4 (Sup. Ct. N.Y. Cty. 2014).

in a joint venture doing business as Verizon Wireless.[187] Verizon already owned the other fifty-five percent.[188] On September 5, 2013, three days later, the plaintiff filed a complaint alleging that Verizon's board of directors was paying an excessive price in violation of its fiduciary duties to shareholders.[189]

Verizon filed a Preliminary Proxy Statement for the transaction with the U.S. Securities and Exchange Commission (SEC) on October 8, 2013.[190] The plaintiff filed an Amended Class Action Complaint on October 22, 2013, adding claims that the director defendants breached their fiduciary duties by failing to disclose material information about the transaction.[191] On December 6, 2013, plaintiff's and defendants' counsel agreed in principle to settle the action on the basis that (1) Verizon would make certain further disclosures to Verizon's stockholders, and (2) if at any time in the next three years Verizon sold or spun off former Verizon Wireless assets having a book value in excess of $14.4 billion—which was roughly five percent of the dollar value of Verizon's purchase of Vodafone—Verizon would require a fairness opinion from an independent financial advisor.[192] Verizon incorporated the disclosures in a definitive Proxy Statement filed with the SEC on December 13, 2013, and Verizon stockholders approved the transaction on January 28, 2014.[193]

The trial court preliminarily approved the settlement and scheduled a hearing to determine whether it should give final approval to the settlement.[194] However, unlike the *West Palm Beach Police Pension Fund* settlement discussed above, two objectors appeared, including a law professor, Sean J. Griffith,[195] who spoke for one of the objectors.[196] Consequently, the trial court was "moved . . . to [t]ake a second look at the terms of the proposed settlement" in order to make a "final determination whether it is truly fair, adequate, reasonable and in the

187. *Id.* at 1–2.

188. *See* Press Release, Verizon, Verizon Reaches Agreement to Acquire Vodafone's 45 Percent Interest in Verizon Wireless for $130 Billion (Sept. 2, 2013), http://www.verizon.com/about/news/verizon-reaches-agreement-acquire-vodafones-45-percent-interest-verizon-wireless-130-billion.

189. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 2.

190. *Id.*

191. *Id.*

192. *Id.* at 2–3.

193. *Id.* at 3.

194. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 3.

195. T.J. Maloney Chair and Professor of Law, Fordham Law School.

196. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 3.

best interest of class members."[197]

The court's analysis began with a description of the phenomenon of disclosure-only settlements:

> The court is dealing here with a settlement . . . involving remedial disclosure (known as a disclosure-only settlement), accompanied by a substantive undertaking with respect to future asset sales. The disclosure-only settlement is a procedural device used to conclude litigation that invariably accompanies acquisitions of publicly traded corporations. In fact, over ninety seven percent of such transactions attract at least one shareholder lawsuit, and many attract several such suits, often filed in multiple jurisdictions. Most of this litigation settles, but pecuniary relief is rare. Settlements typically are based on a package of supplemental disclosures or, somewhat less frequently, a minor amendment to the acquisition agreement.[198]

The court noted that, because the shareholders, as a class, are being "being divested of valuable rights in the form of a broad release of claims executed by the plaintiff,"[199] the enhanced disclosure must be a "material improvement over what had previously been disclosed."[200]

The court in *Gordon* then reviewed all of the additional disclosure produced as a result of the plaintiff's efforts and concluded that none were material.[201] Of particular interest is the court's opinion regarding three tables added to the section of the Definitive Proxy Statement discussing the opinions of Verizon's financial advisors.[202]

One of the additional tables listed comparable-companies analysis:

> The Definitive Proxy discloses that the financial advisors compared selected financial data of Verizon Wireless with three other publicly traded companies . . . These included firm value, EBITDA, churn rate, postpaid subscribers and revenue estimates. It then lists the actual metrics in tabular form.[203]

This information had been included by Verizon before negotiating with the plaintiff, but the proposed settlement added a table

197. *Id.* at 3 (citing Klein v. Roberts Am. Gourmet Food, Inc., 28 A.D.3d 63, 70–71, 808 N.Y.S.2d 766, 773 (2d Dep't 2006)).

198. *Id.* at 4 (citing Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 559 (2015); ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: MARCH 2012 UPDATE 1 (2012)).

199. *Id.*

200. *Id.*

201. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 5–12.

202. *Id.* at 8.

203. *Id.*

summarizing these comparisons.[204] The court did not think that adding the table of metrics added value to the disclosure:

> While these details do provide more information concerning the financial advisor's comparable companies analysis, they fail in any way to contradict or otherwise alter the substance of that analysis. The court is of the view that this disclosure adds no value for shareholders. If inserting tables to complement every bit of analysis by financial advisors was considered valuable and material, there would surely be an SEC rule mandating just that. Its absence from disclosure regulations demonstrates a degree of administrative mercy on analysts and shareholders who comb disclosure documents for items of merit.[205]

The plaintiff's efforts also added a table to the proxy statement which listed other public company minority buy-ins.[206] The court criticized this particular table in the following terms:

> The court is of the view that there is no added value here . . . . All the table lists are public companies in a wide range of unrelated businesses—entertainment, copper, financial services and food retail. [sic] The table gives rudimentary information such as deal value, consideration, percentage ownership, and premium. By itself this information simply does not inform a shareholder with respect to an investment decision. No complementary information with respect to the financial condition or business of the companies is provided. Nothing is said about their competitive position. Surely, these factors are necessary to evaluate a percentage premium or to give it any meaning.[207]

The third table described a comparison by Verizon's financial advisors of selected financial data of Verizon Wireless, with similar data for other selected companies.[208] The proxy statement "explain[ed] the advisors['] methodology in great detail"[209] and described "the bottom line implied equity values"[210] of Verizon Wireless. The plaintiff claimed that its efforts added value to the proxy statement by the insertion of a table showing the actual financial data used by the

204. *Id.* at 6, 8.

205. *Id.* at 8.

206. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 9. A minority buy-in is a transaction where, as in the Verizon-Vodafone transaction that was the subject of this case, one company purchases the minority interest of a second company, where the purchasing company already owns the majority interest of the second company.

207. *Id.*

208. *Id.* at 10.

209. *Id.*

210. *Id.* at 9.

financial advisors.[211] The court considered the table to be useless surplusage:

> The table is stark in its lack of consequence because it merely adds more unnecessary detail, without materially changing the textual presentation that had previously appeared in the Preliminary Proxy. . . . The additional information uncovers no contradiction and no conflict. In the court's view it simply provides another tabular presentation of material covered by the text and, as such, cannot be recognized as a material disclosure enhancement.[212]

The court then criticized the disclosures claimed by the plaintiff as a whole:

> In sum, these Supplemental Disclosures individually and collectively fail to materially enhance the shareholders' knowledge about the merger. They are unnecessary surplusage added to a disclosure document already filled with much that is detail for the sake of detail. They provide no legally cognizable benefit to the shareholder class.[213]

The court's discussion of the Supplemental Disclosures is relevant and gratifying to business law practitioners who draft or review disclosure documents. Longer disclosure is not necessarily better disclosure.[214] At the same time, practitioners should note that the court looked to the presence or absence of an SEC disclosure rule as guidance regarding whether information is "valuable and material."[215]

The proposed settlement in *Gordon* also included an agreement by Verizon that, if at any time during the three years after December 6, 2013, Verizon were to sell or spin off Verizon Wireless assets having a book value above $14.4 billion, Verizon would obtain a fairness opinion, or financial advice, from an independent financial advisor.[216] The court pointed out that $14.4 billion was roughly five percent of the value imputed to Verizon Wireless in the Preliminary Proxy Statement.[217]

The court gave little value to this element of the proposed settlement. The court offered a précis regarding the use of fairness opinions since the decision of the Delaware Supreme Court in *Smith v. van Gorkom*:

211. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 10.
212. *Id.* at 10–11.
213. *Id.* at 11–12.
214. *Id.* at 5.
215. *Id.* at 8.
216. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 2–3.
217. *Id.* at 2.

> There [in *Smith v. van Gorkom*], one of the numerous factors taken into account in the court's holding that the directors of the acquired corporation had violated their duty of care was the absence of a fairness opinion. No court has since held that obtaining a fairness opinion in connection with a merger is required in order to satisfy the directors' duty of care, although courts have viewed it favorably in scrutinizing directors' behavior.
>
> For obvious reasons, since *van Gorkom*, fairness opinions have been routinely obtained in merger transactions.[218]

The *Gordon* court noted that fairness opinions appear less frequently in asset dispositions, especially in a divestiture of a small percentage of the company's assets.[219] The court's discussion of fairness opinions is worth quoting at length for its commentary on whether they are legally required:

> Whether or not to obtain one [a fairness opinion] is still viewed as an appropriate area for exercise of the directors' business judgment. Fairness opinions are expensive and, in a situation where the board of directors is comfortable with respect to the value of the disposed assets, can represent an additional layer of unnecessary cost incurred for no value.
>
> After considerable reflection, it is the court's judgment that the proposed feature of the Settlement relating to mandatory fairness opinions may actually operate to curtail the Company's directors' flexibility and ability to employ their collective business experience in connection with minimal (5%) asset dispositions. It locks in an additional layer of cost without any assurance that real value will be obtained for the expenditure. It seems to be based on a misreading of *van Gorkom*. That decision never said fairness opinions were uniformly beneficial or required in mergers, let alone in connection with dispositions of as little as 5% of a company's assets. Indeed, the fairness opinion feature of the Settlement may be said to undermine best practices relating to corporate governance.[220]

The court, having examined each element of the proposed settlement, then spoke to the general phenomenon of disclosure-only settlements:

> An increasing body of commentary has decried the tsunami of litigation, and attendant suspect disclosure-only settlements,

218. *Id.* at 12 (citing Smith v. van Gorkom, 488 A.2d 858, 876 (Del. 1985) (directors liable to stockholders for approving merger without adequate information)).

219. *Id.*

220. *Id.* at 12–13.

> associated with public acquisitions today. Anyone objectively analyzing this phenomenon will find its root cause in the judicial precedents of the last twenty-five years dealing with corporate governance in connection with mergers. A body of law meant to protect shareholder interests from the absence of due care by the corporation's managers has been turned on its head to diminish shareholder value by divesting them of valuable rights via the broad releases that plaintiffs have fashioned at the demand of concerned defendants and their counsel and imposing additional gratuitous costs, i.e. attorneys' legal fees on the corporation.[221]
>
> Also in this connection, the remarkable parade of the most experienced, highly regarded corporate merger lawyers who ostensibly are failing to draft merger disclosure documents which do not require enhancement or correction strikes the court as implausible. Corporate lawyers drafting complex disclosure documents in connection with the sale of securities in public capital markets experience no such problem. They do not need litigation lawyers to teach them how to correctly craft disclosure documents. Why do merger lawyers? [222]

Having concluded that disclosure-only settlements like the one before it impose costs on the corporation with no benefit, the court then noted the disturbing incentives on both sides to sacrifice shareholder rights to benefit corporate management and plaintiffs' counsel:

> The totality of the situation here is captured by the court in *Creative Montessori Learning Centers v Ashford Gear LLC*, 662 F.3d 913, 918 (7th Cir 2011):
>
> "[W]e and other courts have often remarked the incentive of class counsel, in complicity with the defendant's counsel, to sell out the class by agreeing with the defendant to recommend that the judge approve a settlement involving a meager recovery for the class but generous compensation for the lawyers—the deal that promotes the self-interest of both class counsel and the defendant and is therefore optimal from the standpoint of their private interests."[223]

The *Gordon* court then rejected the proposed settlement, refusing

221. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 13–14 (citing Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 BOS. C.L. REV. 1, 2 (2015)). Subsequently, Professor Griffith's objections in several disclosure-only settlements was noted by *The Wall Street Journal*. Liz Hoffman, *Professor Takes His Issues with Merger Lawsuits to Court*, WALL ST. J., Jul. 28, 2015, http://www.wsj.com/articles/professor-takes-his-issues-with-merger-lawsuits-to-court-1438126132.

222. *Gordon*, No. 653084/2013, 2014 N.Y. Slip Op. 33367(U), at 13–14.

223. *Id.* at 14 (quoting Creative Montessori Learning Ctrs. v. Ashford Gear L.L.C., 662 F.3d 913, 918 (7th Cir. 2014) (Posner, J.), (vacating class certification in a junk-fax suit because of misconduct by putative class counsel)).

to "be an enabler of an unwarranted divestiture of shareholder rights by virtue of plaintiff's release, as well as [an enabler of] misuse of corporate assets were plaintiff's legal fees to be awarded.[224]

City Trading Fund v. Nye was a shareholder suit against Martin Marietta Materials, Inc. (MMM) with regard to its proposed acquisition by merger of Texas Industries, Inc.[225] The merger was announced on January 28, 2014.[226] MMM's preliminary proxy statement was filed with the SEC on March 3, 2014.[227] MMM's definitive proxy statement was filed on May 30, 2014, and on that day the plaintiffs filed suit to enjoin the merger,[228] claiming that the definitive proxy statement contained inadequate disclosure.[229] The shareholder vote on the merger was scheduled for June 30, 2014.[230] An injunction hearing was scheduled for June 20, 2014.[231] The parties settled the night before the injunction hearing.[232] As part of the settlement, on June 20, 2014, MMM publicly filed additional disclosure on the SEC's publicly available EDGAR database.[233] The opinion in *City Trading Fund* was a ruling on the plaintiffs' motion to approve the settlement.[234]

As in *Gordon*,[235] the plaintiffs alleged that the proxy statement omitted information to which shareholders were entitled, and, as in *Gordon*, the terms of the settlement were an agreement by MMM "to make certain supplemental disclosures to the shareholders in exchange for a limited release pertaining to claims regarding inadequate disclosure."[236] The court emphasized the limited nature of the release in a footnote:

> The releases had to be limited because the court made clear it would not have approved the settlement if *all* claims arising from the merger

224. *Id.* at 15.

225. City Trading Fund v. Nye, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U), at 1 (Sup. Ct. N.Y. Cty. 2015).

226. *Id.* at 3.

227. *Id.*

228. *Id.* at 3–4.

229. *Id.* at 4.

230. *City Trading Fund*, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U), at 4.

231. *Id.*

232. *Id.* at 2.

233. *Id.* at 10. The additional disclosures are available at: http://www.sec.gov/Archives/edgar/data/97472/000095015714000623/form8-k.htm (last visited May 23, 2016).

234. *Id.* at 1.

235. Gordon v. Verizon Commc'ns, Inc., No. 653084/13, 2014 N.Y. Slip Op. 33367(U) (Sup. Ct. N.Y. Cty. 2014).

236. City Trading Fund v. Nye, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U), at 10 (Sup. Ct. N.Y. Cty. 2015).

> were released, such as breaches of fiduciary duty impacting the sale price. A disclosure-only lawsuit merits disclosure-only releases. Other shareholders should not be precluded from later suing the board if real misconduct occurred.[237]

The settlement also provided that MMM would pay plaintiffs' counsel a fee of $500,000, subject to court approval.[238]

The court in *City Trading Fund* found, as the court in *Gordon* had found, that the alleged omissions were not material.[239] The court in *City Trading Fund* concluded:

> [W]hen the original alleged omissions and supplemental disclosures are closely scrutinized, it is clear that they are not only immaterial, they are grossly immaterial . . . . Plaintiffs' counsel wants $500,000 for bringing this lawsuit. This lawsuit has already cost the shareholders tens of (or possibly hundreds of) thousands of dollars to defend. This is a problem.[240]

The court mentioned in a footnote that the problem was not solved by reimbursement under an insurance policy:

> Even if the Company's fees are paid for by an insurance company, the costs of the premium due to the existence and viability of this sort of disclosure suit also imposes a cost onto the Company. Regardless of who funds these lawsuits, they no doubt impose very real uncertainty and risks . . . on the involved companies.[241]

The court proceeded to discuss merger lawsuits of this kind in general, and described how the interests of the parties induce settlement without regard to the merits of the case:

> It is no secret that when a public company announces a merger, lawsuits follow. There is nothing inherently wrong with this phenomenon. If the merger price is woefully unjustifiable or if shareholders are not given adequate disclosure to cast an informed vote, a lawsuit is very much the proper way to redress these matters. However, the ubiquity and multiplicity of merger lawsuits, colloquially known as a "merger tax," has caused many to view such lawsuits with a certain degree of skepticism. The lawsuits are filed only a relatively short time before the shareholder vote, and all it takes is a remote threat of injunction or delay to rationally incentivize settlement, even if defendants firmly and rightfully believe the lawsuit has no merit and would be disposed on a motion to dismiss or at the

237. *Id.* at 10, n.11.
238. *Id.* at 10.
239. *Id.* at 4–8.
240. *Id.* at 12.
241. *City Trading Fund*, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U), at 12 n.12.

> summary judgment stage. Most commonly, the lawsuits are brought on behalf of the company being acquired, and the claim is that the shareholders are not being bought-out at a high enough price. . . .
>
> No one, not even plaintiffs, disputes this reality. The defendant corporation's cost-benefit calculus almost always leads the company to settle. Even a slight change of an adverse outcome will induce a company to rationally settle given the costs. . . . The very nature of this lawsuit incentivizes settlement, regardless of its frivolity.[242]

Having described the reason why shareholder suits against public company mergers usually result in settlement, the court then stated that shareholder protection required the courts to act as gatekeepers:

> Approving the settlement in this case would both undermine the public interest and the interests of MMM's shareholders. It would incentivize plaintiffs to file frivolous disclosure lawsuits shortly before a merger, knowing they will always procure a settlement and attorneys' fees under conditions of duress—that is, where it is rational to settle obviously frivolous claims. Without the court serving as a gatekeeper, plaintiffs who file such ligation [sic] will continue to unjustifiably extract money from shareholders, who get no benefit from the litigation but nonetheless end up paying two sets of attorneys, both plaintiffs' and defendants'.[243]

In a footnote, the court made clear that it was not categorically criticizing all shareholder class actions:

> Of course, that . . . frivolous lawsuits are filed has the unfortunate effect of sullying the reputation of the plaintiffs' class action bar and may cause the public to look upon meritorious merger lawsuits with unwarranted suspicion. In other words, disincentivizing frivolous lawsuits actually bolsters the credibility of legitimate merger cases, which, in turn, leads to the better sort of governance and disclosure that corporate class action lawsuits are supposed to incentivize.[244]

The court reasoned further on policy grounds, describing why disclosure-only settlements might actually result generally in worse disclosure, rather than better:

> If all mergers will spawn disclosure lawsuits, regardless of the sufficiency of the actual disclosures, a board may well be incentivized not to care so much if the initial disclosures are adequate. This would be unfortunate. . . . [I]f directors worry that plaintiffs will not settle unless they can proffer some additional, material disclosure, an even

242. *Id*. at 12–13.
243. *Id*. at 18.
244. *Id*. at 18, n.22.

> more perverse incentive may exist to intentionally withhold some material disclosure so the directors have a bone to throw plaintiffs' counsel when it comes time to settle.
>
> That being said, the incentives surrounding mergers can never be fully perfected, and mergers taxes may simply be a reality, an inevitable cost of doing business. However, even if that is the case, this court sees no reason to countenance frivolous litigation.[245]

While the court sharply criticized many things done by the plaintiffs' counsel throughout the course of the *City Trading Fund* litigation,[246] the court also stated that, if the additional disclosures were "legally material,"[247] the court would have made some award of attorneys' fees, "limited . . . to an amount commensurate with the value of the disclosures."[248] The court rejected any payment of attorneys' fees on the grounds that the additional disclosures had no value.[249]

The *Gordon*[250] and *City Trading Fund*[251] decisions are gratifying because they address a well-known deficiency in the legal system regarding business mergers and, from the narrower perspective of the legal practitioner, they apply common sense and recognize that more disclosure is not necessarily better. As *City Trading Fund* acknowledged, however, the decisions cannot eliminate the dynamics of the "merger tax" litigation.[252] Because the potential damage from a last-minute injunction is high, the incentives of the defendant corporation to settle are correspondingly high, regardless of the merits of the litigation. If the defendant corporation is unable to settle by offering to issue supplemental, but immaterial, disclosure, what else will the defendant have to offer?

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245. *Id.* at 20 (footnote omitted).

246. *City Trading Fund*, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U), at 1–22.

247. *Id.* at 18.

248. *Id.*

249. *Id.*

250. Gordon v. Verizon Commc'ns, Inc., No. 653084/13, 2014 N.Y. Slip Op. 33367(U) (Sup. Ct. N.Y. Cty. 2014).

251. *City Trading Fund*, No. 651668/2014, 2015 N.Y. Slip Op. 50008(U).

252. "[T]he incentives surrounding mergers can never be fully perfected . . . ." *Id.* at 20.

CONCLUSION

This *Survey* period included a significant amendment to the LLC law. Case law during this period gives helpful guidance and analysis on the doctrine of apparent authority, on standing to bring derivative actions, and on liability of partners in a registered limited liability partnership. Finally, this *Survey* period evidenced growing judicial scrutiny of disclosure-only settlements in shareholder derivative actions.