BUSINESS ASSOCIATIONS

Sandra S. O'Loughlin & Christopher J. Bonner†

CONTENTS

INTRODUCTION

This *Survey* period included significant case law that considered in-depth business association principles, such as the demand-upon-the-board rule. A legislative development was the signing into law of the Non-Profit Revitalization Act of 2013.

I. LEGISLATIVE DEVELOPMENTS

A. Non-Profit Revitalization Act of 2013

The Non-Profit Revitalization Act of 2013 ("Act") was enacted by the Legislature on June 17, 2013, and signed into law by Governor

† Sandra S. O'Loughlin is a Partner at Hiscock & Barclay, LLP. in Buffalo, New York; Adjunct Professor and Lecturer, University at Buffalo Law School, State University of New York; J.D., State University of New York at Buffalo Law School; B.A., Daemen College; Rosary Hill College.

Christopher J. Bonner is of counsel at Hiscock & Barclay, LLP. in Syracuse, New York; J.D., Harvard Law School; B.A., Williams College.

Andrew Cuomo during this *Survey* period on December 19, 2013.[1] The Act amends various sections throughout the New York Not-for-Profit Corporation Law ("N-PCL") and affects the corporate governance of universities and hospitals, as well as other non-profit organizations doing business in New York.

The provisions of the Act most affecting corporate governance are described below.

1. Audits

The Act raised the thresholds above which a charitable organization is required to obtain a review or an audit from an independent certified public accountant.[2] For a review, the threshold has been raised from $100,000 to $250,000 in annual gross revenue and support; for an audit, the threshold is phased in from $500,000 to $1,000,000, as set forth in the following table:[3]

	Review required:	Audit required:
Before June 30, 2014	At least $100,000 but not more than $250,000	More than $250,000
July 1, 2014 through June 30, 2017	At least $250,000 but not more than $500,000	More than $500,000
July 1, 2017 through June 30, 2021	At least $250,000 but not more than $750,000	More than $750,000
From and after July 1, 2021	At least $250,000 but not more than $1,000,000	More than $1,000,000

1. Act of June 17, 2013, ch. 549, § 1, 2013 McKinney's Sess. Laws of N.Y. 8072 (codified at N.Y. NOT-FOR-PROFIT CORP. LAW § 101 (McKinney 2014)) (most sections of the Non-Profit Revitalization Act of 2013 became effective July 1, 2014); *Governor's Memorandum of Approval of ch. 549 (approval #12)*, STATE OF N.Y. EXECUTIVE CHAMBER (Dec. 19, 2013), *available at* http://www.nysba.org/Sections/Business/Committees/Legislative_Affairs_Committee/Approval_Memorandum_for_Non-Profit_Revitalization_Act_of_2013.html.

2. *See* N.Y. EXEC. LAW § 172-b(1), 172-b(2), 172-b(2-a). The phase-in provision is ch. 549, § 133, 2014 McKinney's Sess. Laws of N.Y. 1452.

3. The information provided in the table can be found at: N.Y. EXEC. LAW § 172-b(1), 172-b(2), 172-b(2-a).

If a corporation is obligated to file an audit report under Executive Law section 172-b, then a designated audit committee, comprised solely of independent directors of the corporation, "shall oversee the accounting and financial reporting processes of the corporation and the audit of the corporation's financial statements."[4] If there is no audit committee, then the board of directors is required to perform this function;[5] only independent directors, however, may participate in deliberations or voting relating to audit oversight matters.[6] The term "independent director" is defined in N-PCL section 102(a)(21) as follows:

> (21) "Independent director" means a director who: (i) is not, and has not been within the last three years, an employee of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key employee of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than ten thousand dollars in direct compensation from the corporation or an affiliate of the corporation (other than reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director as permitted by paragraph (a) of section 202 (General and special powers)[7]); and (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has made payments to, or received payments from, the corporation or an affiliate of the corporation for property or services in an amount which, in any of the last three fiscal years, exceeds the lesser of twenty-five thousand dollars or two percent of such entity's consolidated gross revenues. For purposes of this subparagraph, "payment" does not include charitable contributions.[8]

The requirement that there be independent directors to oversee the audit follows in general principles found in the Sarbanes-Oxley Act of 2002,[9] as set forth in section 10A(m) of the federal Securities Exchange Act of 1934[10] and the related rules of the national securities exchanges,

4. N.Y. NOT-FOR-PROFIT CORP. LAW § 712-a(a).
5. *Id.* § 712-a(a), (b), (c).
6. *Id.* § 712-a(e).
7. *See id.* § 202(a).
8. *Id.* § 102(a)(21).
9. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, § 204, 116 Stat. 745, 773 (2002).
10. Securities Exchange Act of 1934, 15 U.S.C. § 78j-1(m) (2010).

namely, that corporations whose securities trade on the stock exchanges are required to have audit committees comprised of independent directors.

2. Related Party Transactions

As discussed in last year's *Survey*, the Act changed the statutory treatment of related party transactions.[11] Before the Act, N-PCL section 715(a) had language similar to New York Business Corporation Law ("BCL") section 713(a)[12] and New York Limited Liability Company ("LLC") Law section 411(a).[13] The BCL and LLC Law sections require the "material facts" of a transaction in which a director or officer had a "substantial financial interest" to be disclosed to the board of directors.[14]

The Act replaced this test with the term "related party transaction" and requires that the board of directors determine the related party transaction is "fair, reasonable and in the corporation's best interest at the time of such determination."[15] The term "related party transaction," as defined in the Act, is both over-inclusive and under-inclusive.[16] As currently defined, "related party transaction" includes a transaction in which a "relative," defined in N-PCL section 102(a)(22)[17] includes the family members one might expect, but not others, such as a mother-in-law or father-in-law who may have a financial interest. By way of example, board approval is required before an employee buys (with corporate funds) a newspaper that is published by the parents of a board member,[18] but N-PCL section 715(a), as amended, no longer covers the sale of substantially all of the corporation's assets to the mother-in-law or father-in-law of a director or officer.[19]

The Governor's Approval Memorandum for the bill, dated December 19, 2013, states: "This bill as passed contains certain technical defects and barriers to implementation. The Legislature has

11. Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2012-13 Survey of New York Law*, 64 SYRACUSE L. REV. 575, 576-79 (2014).

12. N.Y. BUS. CORP. LAW § 713(a) (McKinney 2014).

13. N.Y. LTD. LIAB. CO. LAW § 411(a) (McKinney 2014).

14. *Id.*; N.Y. BUS. CORP. LAW § 713(a).

15. N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a) (McKinney 2014).

16. *See* O'Loughlin & Bonner, *supra* note 10, at 578.

17. N.Y. NOT-FOR-PROFIT CORP. LAW § 102(a)(22).

18. O'Loughlin & Bonner, *supra* note 10, at 578; *see* N.Y. NOT-FOR-PROFIT CORP. LAW § 102(a)(22), (23) and (24) (defining "relative," "related party," and "related party transaction").

19. Act of June 17, 2013, ch. 549, § 29, 2013 McKinney's Sess. Laws of N.Y. 8072 (codified at N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a)) (initial approval of the Act).

agreed to remedy these deficiencies by passing additional legislation. On that basis, I am signing this bill."[20] After the Governor's signature, but before the majority of the Act's provisions became effective on July 1, 2014, an article appeared in the May 2014 *New York State Bar Association Journal* and included an analysis of the definition of "related party transaction."[21] The article observed that the language was excessively broad and could have unintended consequences.[22] Notwithstanding these demonstrated concerns, the Legislature, at the time of this writing, had not passed a correcting amendment.

3. Board Policies

Conflict of Interest Policy. The Act requires every not-for-profit corporation, regardless of type or size, to adopt a written conflict of interest policy.[23] In that regard, the Act includes the following minimum requirements:

(1) A definition of a conflict of interest;

(2) A procedure to disclose a conflict of interest to the audit committee or, if there is no audit committee, to the board of directors;

(3) A prohibition against the conflicted person being present at or participating in a board or committee vote on the matter giving rise to such conflict;

(4) A prohibition against the conflicted person attempting improperly to influence the deliberation or voting;

(5) A requirement to document the existence and resolution of a conflict; and

(6) Procedures to disclose, address, and document related party transactions under N-PCL section 715.[24] Since a "related party" can include an entity in which a "relative" of a director, officer or key employee has an interest above certain threshold percentages described in N-PCL section 102(a)(23),[25] the procedures cover a broad scope.

Another mandatory provision of the policy requires that each director, before his or her initial election and then every year thereafter, deliver to the corporation a signed statement identifying:

20. *Governor's Memorandum of Approval of ch. 549 (approval 12)*, *supra* note 1.

21. Frederick G. Attea & Kelly E. Marks, *The New York Non-Profit Revitalization Act: A Summary and Analysis*, 86 N.Y. ST. B.J. 28, 31-33 (May 2014).

22. *Id.* at 32.

23. N.Y. NOT-FOR-PROFIT CORP. LAW § 715-a.

24. *Id.* § 715-a(b).

25. *Id.* § 102(a)(23).

> (A) [every] entity [(1)] of which such director is an officer, director, trustee, member, owner (either as a sole proprietor or a partner), or employee, and [(2)] with which the corporation has a relationship[;] and
>
> [(B)] any transaction in which the corporation is a participant and in which the director might have a conflicting interest.[26]

Whistleblower policy. The Act also requires every not-for-profit corporation that has at least twenty employees and $1 million in annual revenue to adopt a "whistleblower policy."[27] The policy:

> shall provide that no director, officer, employee or volunteer of a corporation who in good faith reports any action or suspected action taken by or within the corporation that is illegal, fraudulent or in violation of any adopted policy of the corporation shall suffer intimidation, harassment, discrimination or other retaliation or, in the case of employees, adverse employment consequence.[28]

The minimum requirements for a whistleblower policy include:

> (1) Procedures for the reporting of violations or suspected violations of laws or corporate policies, including procedures for preserving the confidentiality of reported information;
>
> (2) A requirement that an employee, officer or director of the corporation be designated to administer the whistleblower policy and to report to the audit committee or other committee of independent directors or, if there are no such committees, to the board; and
>
> (3) A requirement that copy of the policy be distributed to all directors, officers, employees and to volunteers who provide substantial services to the corporation.[29]

4. Conclusion

In sum, the Act reinforces common law policies of corporate governance with documentation requirements. Almost certainly, compliance will increase the costs in time and money of operating as a not-for-profit corporation. Over the long term, it may be difficult to determine how beneficial the Act is because the consequences of its burdens are more likely to be more visible and quantifiable than its benefits. Many non-profit corporations, as they struggle to meet financial goals and manage expenses, may now also need to worry about crossing revenue thresholds, and by so doing, triggering

26. *Id.* § 715-a(c).
27. *Id.* § 715-b(a).
28. N.Y. NOT-FOR-PROFIT CORP. LAW § 715-b(a).
29. *Id.* § 715-b(b).

additional compliance burdens.

Unfortunately, the Act's current text, particularly the aberrant possibilities lurking in the definition of "related party transaction," as well as other concerns expressed in the Governor's call for technical amendments, show that the Act was not fully thought through.

B. Repeal of Tax Law Section 180

A welcome development for corporate practitioners was the repeal, on March 31, 2014, of the small, but nagging, tax on shares imposed by New York Tax Law section 180.[30] The tax on shares was required to be computed on the filing of every certificate of incorporation, and every amendment to a certificate of incorporation, with the New York Secretary of State. Effective January 1, 2015, the tax was repealed,[31] and this calculation was no longer required.

II. PARTNERSHIPS

The Court of Appeals' decision in *In re Thelen LLP* addressed a closely followed question affecting the mobility of lawyers between large law firms by deciding that the "unfinished business rule" does not apply to ongoing hourly matters that a law firm partner takes from a dissolved firm to a new firm.[32]

In order to resolve a split between decisions of the U.S. District Courts regarding New York law,[33] the U.S. Court of Appeals for the Second Circuit had certified these questions, arising out of the bankruptcy of the Thelen and Coudert Brothers law firms, to the New York Court of Appeals:

> Under New York law, is a client matter that is billed on an hourly basis the property of a law firm, such that, upon dissolution and in related bankruptcy proceedings, the law firm is entitled to the profit earned on such matters as the "unfinished business" of the firm?
>
> If so, how does New York law define a "client matter" for purposes of the unfinished business doctrine and what proportion of the profit derived from an ongoing hourly matter may the new law firm retain?[34]

30. Act of March 31, 2014, ch. 59, § 2, 2014 McKinney's Sess. Law News S-6359-D (repealing N.Y. TAX LAW § 180 (McKinney 2013)).

31. Act of March 31, 2014, ch. 59, § 2, 2014 McKinney's Sess. Laws of N.Y. S-6359-D.

32. 24 N.Y.3d 16, 22, 20 N.E.3d 264, 266-67, 995 N.Y.S.2d 534, 536-37 (2014).

33. See O'Loughlin & Bonner, *supra* note 10, at 577-83 for descriptions of the earlier decisions; Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2011-12 Survey of New York Law*, 63 SYRACUSE L. REV. 559, 577-83 (2013).

34. Geron v. Seyfarth Shaw LLP, 736 F.3d 213, 225 (2d Cir. 2013).

In the words of an earlier decision regarding unfinished business, "[a] departing partner is not free to walk out of his firm's office carrying a Jackson Pollack painting he ripped off the wall of the reception area, simply because the firm has dissolved."[35]

The unfinished business doctrine was first applied to law firms in the leading California case of *Jewel v. Boxer*,[36] interpreting Uniform Partnership Act provisions, which were the same in California as in New York.[37] *Jewel* held that, absent an agreement to the contrary, profits from a dissolved law firm's unfinished business are owed to the former partners in proportion to their partnership interests.[38] It is not apparent from the *Jewel* opinion whether the unfinished business considered by the California court included ongoing hourly billing matters.

In concluding that hourly fee matters are not partnership property, the Court of Appeals gave primary emphasis to:

> the "unqualified right to terminate the attorney-client relationship at any time" without any obligation other than to compensate the attorney for "the fair and reasonable value of the *completed services*." In short, no law firm has a property interest in future hourly legal fees because they are "too contingent in nature and speculative to create a present or future property interest," given the client's unfettered right to hire and fire counsel.[39]

The Court of Appeals also mentioned policy considerations. Because the unfinished business rule does not apply when a partner leaves before dissolution, the rule "would encourage partners to get out the door, with clients in tow, *before* it is too late, rather than remain and work to bolster the firm's prospects. Obviously, this run-on-the-bank mentality makes the turnaround of a struggling firm less likely."[40] Furthermore, once the law firm has dissolved, it becomes impractical for the clients to keep the same attorney because the attorney's new law firm will not be interested in the hourly billing matters that the attorney brought from the old firm.[41]

35. Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP, 480 B.R. 145, 157 (S.D.N.Y. 2012).

36. 203 Cal. Rptr. 13 (Cal. Ct. App. 1984).

37. *See* N.Y. P'SHIP LAW §§ 1-126 (McKinney 2014).

38. *Jewel*, 203 Cal. Rptr. at 15.

39. *In re Thelen*, 24 N.Y.3d 16, 28 N.E.3d 264, 270-71 995 N.Y.S.2d 534, 540-41 (2014) (quoting In re Cooperman, 83 N.Y.2d 465, 473, 633 N.E.2d 1069, 611 N.YS.2d 465, 468 (1994); Verizon New England, 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)).

40. *Id.* at 32, 20 N.E.3d at 273, 995 N.Y.S.2d at 543.

41. *Id.*

III. LIMITED LIABILITY COMPANIES

In *PC-Palladio, LLC v. Nassi*, PC-Palladio, LLC (the Judgment Creditor) obtained a judgment against Craig Nassi (the Judgment Debtor) in U.S. District Court for the Northern District of Illinois, and sought a turnover order from the U.S. District Court for the Southern District of New York against several limited liability companies (LLCs) in which the Judgment Debtor had an interest.[42] Initially, the Southern District granted the turnover order and ordered 224 Centre Realty, LLC (224 Centre), where the Judgment Debtor had a membership interest and capital account of at least $480,521, to turn over that sum to the Judgment Creditor.[43]

Upon reconsideration, the court later vacated its order[44] on the grounds that it had been under the mistaken impression that the capital account at 224 Centre "was being held in something equivalent to a personal account of Judgment Debtor's."[45] The court noted, "[T]he $480,521 was merely a measure of Judgment Debtor's equity in 224 Centre"[46] and held that ordering 224 Centre to turn over assets would be in violation of LLC Law section 607(b),[47] "which prohibits the creditor of a limited liability company's member from 'exercis[ing] legal or equitable remedies with respect to[] the property of the limited liability company.'"[48]

DiGirolomo v. Sugar LI, L.L.C. illustrates the willingness of a court to fashion a remedy to fit the particular facts of a dispute among owners of a business association.[49] *DiGirolomo* dealt with an LLC where the operating agreement permitted the controlling member to cause the LLC to make mandatory capital calls upon the other members for specified reasons.[50] The operating agreement further provided that, if a member failed to make the mandatory capital contribution, the members who did contribute could buy out the non-contributing member at a specific dollar price per membership unit.[51] But when the LLC later made a capital call, two minority members refused to comply

42. 13 Mc. 234, 2014 U.S. Dist. LEXIS 19362, *1-2 (S.D.N.Y. 2014).
43. *Id.* at *23-24.
44. PC-Palladio, LLC v. Nassi, No. 13 Mc. 234, 2014 U.S. Dist. LEXIS 46193 (S.D.N.Y. Apr. 1, 2014).
45. *Id.* at *3.
46. *Id.*
47. *Id.* (citing N.Y. LTD. LIAB. CO. LAW § 607(b) (McKinney 2014)).
48. *Id*. at *4 (citing N.Y. LTD. LIAB. CO. LAW § 607(b)).
49. Index No. 008756/13 (Sup. Ct. Nassau Cnty., Nov. 20, 2013).
50. *Id.* at *2.
51. *Id.*

on the grounds that the controlling member was siphoning money from the LLC and had made the capital call in bad faith.[52] When the controlling member demanded that the minority members sell him their membership units at the specified price, the minority members sought an injunction against the demanded purchase.[53] In an earlier motion, the court had preliminarily enjoined the forced sale of the minority members' interests because of probable bad faith of the majority member in making the capital call.[54]

The court observed that ordinarily a forced sale of the defaulting member's interest is enforceable if the operating agreement so provides.[55] Here, however, and despite *DiGirolomo* not being a dissolution proceeding, the court relied on a recent Second Department decision in *Mizrahi v. Cohen*,[56] which opined that a forced buyout, in the right circumstances, can be an appropriate equitable remedy.[57] The *DiGirolomo* court held:

> While the price agreed upon in the operating agreement is generally enforceable, the court may impose a surcharge or adjustment, if the majority member has dissipated assets or engaged in other oppressive conduct toward the minority members (Business Corporation Law section 1104-a(d)[)].
>
> Since the court may adjust the buyout price based upon a dissipation of assets, it may temporarily restrain the repurchase of a minority member's interest, pending determination of the appropriate adjustment.[58]

Thus, the court granted a preliminary injunction against the controlling member's repurchasing the minority members' LLC interests.[59]

IV. CORPORATIONS

Verizon New York, Inc. v. Village of Westhampton Beach addressed basic questions of corporation law: does a corporation have the legal right to use its property for activities that, although not prohibited, have no direct relation to its corporate purposes; and, if so,

52. *Id.* at *3.
53. *Id.* at *2, *3.
54. *Id.* at *3.
55. *Id.* (citing N.Y. LTD. LIAB. CO. LAW § 502(c)).
56. 104 A.D.3d 917, 961 N.Y.S.2d 538 (2d Dep't 2013).
57. *DiGirolomo*, Index No. 008756/13, at *4 (citing *Mizrahi*, 104 A.D.3d at 920).
58. *Id.*
59. *Id.* at *2.

where is the authority for such a right?[60] The court found that Verizon New York, Inc. ("Verizon") had the legal right to allow a religious group to attach wires and wooden or plastic strips to its telephone poles,[61] and that authority to do so is found in section 202(a)(7) of the New York BCL.[62]

Verizon and Long Island Lighting Company, doing business as LIPA, sued the Village of Westhampton Beach and the Village of Quogue (together, the "Villages") for a declaratory judgment regarding the plaintiffs' right to attach certain wires and wooden or plastic strips to their utility poles.[63] An association of Jewish residents in the east end of Long Island (the East End Eruv Association, or "EEEA") desired to establish an "eruv," which, in accordance with their religious beliefs, is a delineated area wherein persons are permitted to move objects from place to place without violating the Sabbath.[64] The eruv was to be delineated by wires and marked by wooden or plastic strips called "lechis" attached to the sides of telephone poles and other utility poles.[65] Even though Verizon entered into contracts with the EEEA, which permitted lechis to be attached to its poles,[66] some residents, both Jews and non-Jews,[67] from the Villages objected to the lechis. The municipal governments of the Villages claimed that Verizon did not have the corporate authority under state law to allow lechis to be attached to its utility poles.[68]

This case ultimately came to federal court because, earlier, EEEA had filed a federal constitutional suit against, among others, the Villages.[69] In *Verizon*, Verizon, as plaintiff, had filed an action for declaratory judgment and injunctive relief, and had designated the

60. No. CV 11-252, 2014 U.S. Dist. LEXIS 84479 (E.D.N.Y. June 16, 2014).

61. *Id.* at *102.

62. N.Y. BUS. CORP. LAW § 202(a)(7) (McKinney 2014). Section 202(a) provides, in relevant part, "Each corporation . . . shall have power in furtherance of its corporate purposes . . . to make contracts . . . ." *Id.*

63. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *3. Because LIPA is organized under a unique statute, the Long Island Power Authority Act, the court's analysis regarding LIPA was not relevant to the following discussion. *See* N.Y. PUB. AUTH. LAW §§ 1020-1020-kk (McKinney 2014).

64. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *2.

65. *Id.*

66. *Id.* at *9.

67. *See* Hody Nemes, *Hamptons Eruv Passes Key Legal Hurdle: Orthodox Groups Win Battle With East End Town*, JEWISH DAILY FORWARD (June 18, 2014), http://forward.com/articles/200350/hamptons-eruv-passes-key-legal-hurdle/.

68. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *3-4.

69. *Id.* at *4.

complaint as related to the earlier federal action.[70] All parties in both actions consented to the jurisdiction of a United States magistrate judge,[71] who rendered the decision in *Verizon*.

Among the arguments put forth by the Villages as to lack of authority, the argument relevant to the law of business associations was that Verizon's corporate powers were limited solely to actions in furtherance of its public function as a telephone utility.[72] Consequently Verizon had no power or authority to allow lechis to be attached to its poles.[73]

Verizon is a telephone corporation organized under Article 3 of the New York Transportation Corporations Law ("TCL").[74] Under section 27 of the TCL, a telephone corporation such as Verizon has authority to "erect, construct and maintain the necessary fixtures for its lines[.]"[75] According to the Village of Westhampton Beach ("Westhampton Beach"), "[T]he grant by the government of a right to a private entity must be strictly construed against the grantee."[76] Therefore Westhampton Beach argued that Verizon's corporate authority extended no further than to place the utility poles and maintain them: "Construing [TCL section] 27 against Verizon . . . Westhampton Beach contends that there is no interpretation which would permit Verizon . . . to allow private entities to attach private objects to public utility poles for private purposes,"[77] or, for that matter, permit Verizon to do anything that was not related to its business as a telephone corporation.

The court held, however, that Verizon had corporate powers in addition to those set forth in the TCL.[78] The court noted that section 4 of the TCL provides that the BCL applies to corporations formed under the TCL.[79] Section 202(a)(7) of the BCL authorizes corporations to make

70. *Id.*

71. *Id.* at *7.

72. *Id.* at *46

73. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *46-47.

74. *Id.* at *49; N.Y. TRANSP. CORP. LAW § 25 (McKinney 2014).

75. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *44 (quoting N.Y. TRANSP. CORP. LAW § 27 (McKinney 2014)).

76. *Id.* at *47.

77. *Id.* at *48. Because LIPA was not organized under the TCL, but rather was specially chartered by act of the New York Legislature, the argument regarding Verizon's statutory authority to attached lechis to its utility poles was not directly applicable to LIPA. *Id.* at *50-51.

78. *Id.* at *57.

79. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *35 (citing N.Y. TRANSP. CORP. LAW § 4).

contracts.[80] Citing the 1975 decision in *New York Telephone Company v. Town of North Hempstead*[81] for the proposition that a transportation corporation "possesses the right to enter into contractual agreements with others for use of space on its poles,"[82] the court concluded that Verizon had "sufficient authority . . . to enter into private contracts for the use of [its] utility poles, unrelated to the provision of . . . telephone services."[83]

An additional point in the court's reasoning was that the lechis did not run afoul of the municipalities' rights under their police powers. While Verizon conceded that "municipalities may generally impose reasonable limits on utility pole attachments pursuant to the municipalities' police powers,"[84] Verizon claimed that there were no municipal regulations prohibiting the attachment of lechis to its poles.[85] Verizon also asserted "that the lechis are small and blend in aesthetically to the utility poles, and consequently will not affect the municipalities or the safety or qualify of life of their residents."[86] The court found no ordinance or regulation of Westhampton Beach prohibiting the attachment of lechis to the utility poles, but did not have sufficient information to determine whether the Quogue Village Code applied.[87] Lechis could therefore be attached to Verizon's telephone poles, at least in the Village of Westhampton Beach.

If a telephone corporation did not have a legal right, subject to municipal police powers and other law, to choose what, if anything, could be posted on its telephone poles, then who did? The *Verizon* court, following the *North Hempstead* precedent, thus used BCL section 202(a)(7) as a source of residual corporate powers over corporation property[88] and avoided the logical absurdity of concluding that no one owned the right.

80. *Id.* at *35 (citing N.Y. BUS. CORP. LAW § 202(a)(7)).

81. 86 Misc. 2d 487, 385 N.Y.S.2d 436 (Sup. Ct. Nassau Cnty. 1975) (telephone corporation could use its telephone poles for additional, non-telephone purposes; the telephone corporation had the corporate power under TCL § 4(a) and BCL § 202(a) to require the Town of North Hempstead to pay rent to use the corporation's telephone poles to install street lighting), *aff'd mem.*, 52 A.D.2d 934, 385 N.Y.S.2d 505 (2d Dep't 1976), *modified*, 41 N.Y.2d 691, 363 N.E.2d 694, 395 N.Y.S.2d 143 (1977).

82. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *35.

83. *Id.* at *103.

84. *Id.* at *81.

85. *Id.* at *81-82.

86. *Id.* at *82.

87. *Verizon N.Y., Inc.*, No. CV 11-252 (AKT), 2014 U.S. Dist. LEXIS 84479, at *104.

88. *Id.* at *57.

V. FIDUCIARY DUTIES

The opinion in *Gjuraj v. Uplift Elevator Corp.* restated legal principles applicable in an oppression of a minority shareholder case. [89] Plaintiff Gjuraj, a 15% shareholder in Uplift Elevator Corp.,[90] accused Ivica Lubina, the majority shareholder[91] and an officer of the corporation,[92] of:

> freezing [Gjuraj] out of the corporation and failing to pay him his share of the profits . . . [and] distributing profits to . . . an employee of the corporation, without making a 15% distribution of profits to plaintiff, as required, … relocating the corporation's office without plaintiff's knowledge and without giving plaintiff access to it, and … closing out the corporation's bank account on which plaintiff was a signatory and opening another corporate account on which plaintiff was not a signatory.[93]

The court's opinion enumerated the following principles:

(1) Lubina, as the majority shareholder of a closely-held corporation, had a fiduciary duty to the plaintiff as a minority shareholder.[94]

(2) Lubina's distribution of profits to another employee, but excluding Gjuraj, combined with Lubina's denial to Gjuraj of access to corporate property, breached that fiduciary duty.[95]

(3) Gjuraj's claim for his 15% of profits distributions gave him "standing to bring his breach of fiduciary duty claims as direct, as well as derivative, causes of action, since defendants' freezing him out of the corporation and failing to pay him his share of the profits harmed him individually, and [would give him individually] the benefit of any recovery."[96]

(4) Finally, Lubina, as an officer of the corporation, was also liable to Gjuraj personally for money owed by the corporation to Gjuraj, because "'a corporate officer who participates in the commission of a tort may be held individually liable, regardless of whether the officer acted on behalf of the corporation in the course of official duties and regardless of whether the corporate veil is pierced.'"[97]

89. 110 A.D.3d 540, 973 N.Y.S.2d 172 (1st Dep't 2013).
90. *Id.* at 540, 973 N.Y.S.2d at 173.
91. *Id.* at 541, 973 N.Y.S.2d at 173-74.
92. *Id.* at 541, 973 N.Y.S.2d at 174.
93. *Id.* at 540-41, 973 N.Y.S.2d at 173-74.
94. *Gjuraj*, 110 A.D.3d at 541, 973 N.Y.S.2d at 173-74.
95. *Id.* at 541, 973 N.Y.S.2d at 174.
96. *Id.* at 540, 973 N.Y.S.2d at 173 (citations omitted).
97. *Id.* at 541, 973 N.Y.S.2d at 174 (quoting Peguero v. 601 Realty Corp., 58 A.D.3d

The court also exercised discretion regarding the remedy, noting that although the plaintiff had demonstrated his right to common-law dissolution, in this particular instance the preferable remedy was a buy-out at fair value of the plaintiff's interest, rather than a buy-out coupled with dissolution of the corporation.[98]

VI. DERIVATIVE ACTIONS

A. Exclusive Forum By-laws

A current problem in corporate law is that one publicized corporate event, such as a merger, is frequently challenged by different stockholders of an affected corporation in courts of various jurisdictions.[99] One possible approach to the problem of proliferating lawsuits based on the same occurrence is for a corporation to adopt, in its certificate of incorporation or by-laws, a requirement that stockholder derivative cases can only be brought in the courts of the jurisdiction where the corporation is incorporated. One normally expects that restricting stockholder remedies would reduce the power of stockholders to vindicate their rights. A settlement in any one jurisdiction, however, under the "full faith and credit" clause of the Constitution,[100] generally precludes other lawsuits on the same subject matter. As pointed out by Professor John C. Coffee, Jr. as early as 1995, the fact that a settlement in any one jurisdiction will preclude later settlements in other jurisdictions tends to create a "reverse auction" for derivative cases, because the defendant corporation can choose to settle with the shareholder plaintiff who agrees to the lowest amount:

> One . . . form of collusion . . . involves what this Article will call a "reverse auction," namely a jurisdictional competition among different teams of plaintiffs' attorneys in different actions that involve the same underlying allegations. The first team to settle with the defendants in effect precludes the others (who may have originated the action and litigated it with sufficient skill and zeal that the defendants were eager to settle with someone else).[101]

Paradoxically, restricting stockholder actions to an exclusive forum

556, 558, 873 N.Y.S.2d 17, 21 (1st Dep't 2009)).

98. *Id.* at 542, 973 N.Y.S.2d at 174.

99. *See, e.g*, John C. Coffee, Jr., *M&A Litigation: More and More Dysfunctional*, N.Y. L.J. (Mar. 21, 2013).

100. U.S. CONST. art. IV, § 1.

101. John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1370 (1995).

could result in improved recoveries for harm to stockholders. A threshold question regarding this approach is to determine the extent to which the courts will enforce an exclusive forum clause in the certificate of incorporation or by-laws.

A Delaware forum selection clause was upheld by the Commercial Division of the Supreme Court in New York County in *Hemg Inc. v. Aspen University*.[102] The plaintiffs in *Hemg* brought direct and derivative actions on behalf of the corporation against certain directors.[103] Aspen Group, Inc. ("Aspen"), the nominal corporate defendant in the derivative action, had been a public shell company, that is, a corporation registered as a reporting company with the United States Securities and Exchange Commission, but one having no business operations, or only nominal business operations.[104] In a reverse merger, Aspen became the parent corporation of Aspen University, an online education business.[105] The derivative action in *Hemg* claimed that the director defendants had breached their fiduciary duty, wasted corporate assets, and diluted shareholder equity.[106]

The by-laws and certificate of incorporation of Aspen, a Delaware corporation:

> provide that the Court of Chancery of the State of Delaware is the sole and exclusive forum for (i) any derivative action brought on behalf of the Company, and (ii) any action asserting a claim for breach of fiduciary duty owed by any director or officer of the Company to the Company or the Company's shareholders.[107]

The plaintiffs asserted that the forum selection clauses permitting suit only in Delaware were "invalid because they were adopted unilaterally by the Board of Directors, without the consent or vote of the plaintiffs or other shareholders, prior to [the corporation] becoming a public company . . . ."[108]

102. No. 650457/13, 2013 N.Y. Slip Op. 32871(U), at 6 (Sup. Ct. N.Y. Cnty. 2013).

103. *Id.* at 3.

104. *Id.* at 2-3.

105. *Id.* In a reverse merger, the shareholders of an operating company agree to exchange their shares for newly-issued shares of the public shell company. As a result of the exchange, the public shell company obtains ownership of the shares of the operating company, and the shareholders of the operating company obtain ownership of most of the shares of the public shell company. The shareholders have, in effect, traded their ownership of a non-reporting operating company for ownership of a public reporting holding company. This process was described in the Current Report of Aspen Group, Inc. on Form 8-K, filed with the Securities and Exchange Commission on March 19, 2012.

106. *Id.* at 3.

107. *Hemg Inc.*, No. 650457/13, 2013 N.Y. Slip Op. 32871(U), at 4.

108. *Id.* Under section 241 of the Delaware GCL, the directors of a corporation may

The court rejected this argument for two reasons. First, the court dismissed the argument that a certificate of incorporation could *in general* be valid, but that *a particular* provision would be valid only if adopted by a publicly-reporting company:

> The court finds no merit to this position as it does not contest the validity of the Certificate of Incorporation, but rather the applicability of one of its provisions due to the status of the corporation at the time of adoption. The court knows of no legal theory that supports plaintiffs' argument.[109]

Second, the court noted that the Delaware Court of Chancery had recently decided *Boilermakers Local 154 Retirement Fund v. Chevron Corp*.[110] *Boilermakers* held that under Delaware law, if a certificate of incorporation of a Delaware corporation authorizes a board of directors to adopt by-laws, then a forum-selection by-law can be validly adopted by the board of directors without stockholder approval.[111] The court in *Hemg* reasoned that Aspen's certificate of incorporation and by-laws were similar to the certificate of incorporation and by-laws in *Boilermakers*; and therefore, Aspen's stockholders should be bound by the forum selection clauses.[112] With that, the court dismissed the derivative claims because they were required to be brought in the Delaware Court of Chancery.[113]

Interestingly, under the Delaware GCL, the stockholders should have approved the merger by vote of a majority of the outstanding stock, and by doing so become stockholders of Aspen.[114] Thus, a majority could have actively voted on whether or not to be stockholders in a corporation with a forum-selection clause in its certificate of incorporation. The opinion in *Hemg* does not address this point, but the court already had sufficient reasons to enforce the forum-selection clause.

B. Demand Excused (or Not)

Continuing the judicial development of LLC derivative actions

amend the Certificate of Incorporation before the corporation has received payment for any of its stock. DEL. CODE ANN. tit. 8, § 241 (2014).

109. *Hemg Inc.*, No. 650457/13, 2013 N.Y. Slip Op. 32871(U), at 4-5.

110. *Id.* at 5 (citing 73 A.3d 934 (Del. Ch. 2013)).

111. *Hemg Inc.*, No. 650457/13, 2013 N.Y. Slip Op. 32871(U), at 5 (quoting *Boilermakers Local 154 Ret. Fund*, 73 A.3d at 939-46, 956).

112. *Id.* at 6.

113. *Id.*

114. *See* DEL. CODE ANN. tit. 8, § 251(c) (2014).

commenced in *Tzolis v. Wolff*,[115] the First Department, in *Najjar Group, LLC v. West 56th Hotel LLC*,[116] noted the rule in BCL section 626(c) that a shareholder's complaint in a derivative action must set forth "'with particularity,' the shareholder's efforts to secure the initiation of that action [*i.e.*, the shareholder's lawsuit] by the board of directors, or . . . sufficient and particular reasons for not making such efforts."[117]

As authority for applying a similar rule to LLCs, the court referred to its previous decision in *Segal v. Cooper*, where "plaintiff alleged with sufficient particularity that a majority of the controlling members of the limited liability company were interested in the challenged transactions and that therefore a demand to initiate a lawsuit would have been futile."[118] As in the *Najjar Group* case, *Segal* had involved an LLC, rather than a corporation. Nevertheless, *Segal* cited the Court of Appeals decision in *Marx v. Akers*, a case interpreting BCL section 626(c), as authority for the existence of a demand-futility exception to the requirement to make a demand upon the controlling members of the LLC.[119]

In *Central Laborers' Pension Fund v. Blankfein*, three consolidated shareholder derivative actions presented a novel argument.[120] The shareholders sued the board of Goldman Sachs Group, Inc. ("Goldman"), a Delaware corporation,[121] in December 2009 and January 2010,[122] prior to Goldman's announcing its 2009 employee bonuses. The shareholders claimed that Goldman was *likely to* announce bonuses high enough that total employee compensation for 2009 would roughly equal 50% of the firm's net revenues for 2009.[123] Further, the shareholders claimed "that such a level of compensation would be excessive, given their view that [Goldman's] 2009 revenues were due, not to the performance of its employees, but to 'accounting trickery' and government intervention in the wake of the 2008 financial

115. 10 N.Y.3d 100, 109, 884 N.E.2d 1005, 1010, 855 N.Y.S.2d 6, 11 (2008) (recognizing LLC member may bring derivative action against LLC's controlling persons, although LLC law is silent regarding derivative actions); see Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2007-08 Survey of New York Law*, 59 SYRACUSE L. REV. 525, 548-54 (2009).

116. 110 A.D.3d 638, 974 N.Y.S.2d 58 (1st Dep't 2013).

117. *Id.* at 639, 974 N.Y.S.2d at 59 (citing N.Y. BUS. CORP. LAW § 626(c) (McKinney 2014)).

118. 49 A.D.3d 467, 468, 856 N.Y.S.2d 12, 13 (1st Dep't 2008).

119. *Id.* (citing *Marx v. Akers*, 88 N.Y.2d 189, 198, 666 N.E.2d 1034, 1039, 644 N.Y.S.2d 121, 126 (1996)).

120. 111 A.D.3d 40, 42, 971 N.Y.S.2d 282, 283 (1st Dep't 2013).

121. *Id.*

122. *Id.* at 42, 971 N.Y.S.2d at 284.

123. *Id.* at 42-43, 971 N.Y.S.2d at 284.

meltdown."[124]

Plaintiffs' allegations under BCL section 626(c),[125] as to why demand upon the board was excused, consisted entirely of the following:

> [T]he anticipated compensation announcement would "not [be] a product of a valid exercise of the business judgment of the Defendants [the GSG directors], who participated in, approved, and/or permitted the wrongs." Plaintiffs further alleged that, "because the Board is beholden to [GSG] and its executives, the Board is not disinterested and lacks sufficient independence to exercise its business judgment in setting a compensation policy."[126]

Shortly after the complaints were filed, Goldman announced that its employee compensation for 2009 would be 35.8% of net revenue, while the comparable percentage for 2008 had been 48%.[127] The plaintiffs claimed victory and stated that their filing had saved the corporation $5 billion in employee compensation.[128] Plaintiffs then announced that they would voluntarily dismiss their lawsuits and petitioned for an award of attorneys' fees of $5 million under BCL section 626(e).[129] Plaintiffs argued that they were entitled to attorneys' fees because, by suing the corporation for a wrong not yet done, but about to be done, plaintiffs had saved the corporation from making excessive payments.[130]

This argument opened a vast new world of possibilities for shareholder derivative suits: namely, that a shareholder could sue a corporation for a potential future mistake, then claim attorneys' fees for the mistake not made. In response, the corporate defendant could theoretically defend the case by alleging that the shareholder suit made no causal contribution to the corporate decision ultimately not taken,[131]

---

124. *Id.* at 43, 971 N.Y.S.2d at 284.

125. N.Y. BUS. CORP. LAW § 626(c) (McKinney 2014) (providing that "[i]n any such action, the complaint shall set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board or the reasons for not making such effort.").

126. *Cent. Laborers' Pension Fund*, 111 A.D.3d at 43, 971 N.Y.S.2d at 284.

127. *Id.*

128. *Id.* at 43-44, 971 N.Y.S.2d at 284-85.

129. *Id.*; N.Y. BUS. CORP. LAW § 626(e) provides, in relevant part:

> If the action on behalf of the corporation was successful, in whole or in part, or if anything was received by the plaintiff or plaintiffs or a claimant or claimants as the result of a judgment, compromise or settlement of an action or claim, the court may award the plaintiff or plaintiffs, claimant or claimants, reasonable expenses, including reasonable attorney's fees . . . .

130. *Id.* at 43-44, 971 N.Y.S.2d at 284-85.

131. *See Cent. Laborers' Pension Fund*, 111 A.D.3d at 44 n.4, 971 N.Y.S.2d at 285 n.4 (plaintiffs and defendants disputed whether the lawsuit caused the alleged corporate

thus requiring a determination of fact to be made at trial.

To avoid the distinctly unsettling prospect of derivative suits being filed against corporations to prevent potential future mistakes, the First Department relied on the demand requirement, where at least a determination can be made on the pleadings.

At the trial court level, plaintiffs had lost on the question of whether demand on the board was excused:

> [T]he court found that plaintiffs did not make any allegations from which it could be inferred that the setting of employee compensation at the level plaintiffs had anticipated would have constituted a waste of corporate assets or would otherwise have been outside the protection of the business judgment rule, nor did plaintiffs' allegations place in doubt the disinterest or independence of the [ten] non-employee directors of [Goldman].[132]

The plaintiffs did not dispute that finding,[133] but argued that they were nevertheless entitled to attorneys' fees under BCL section 626(e)[134] because the mere filing of the lawsuits was sufficient to cause the board of directors to save corporate money.[135]

The First Department held that "plaintiff, to be entitled to a fee award, must meet all requirements for standing to bring a derivative action 'on behalf of the corporation'–both the requirements relating to shareholding (paras. [a] and [b]) and the requirement for a pre-suit demand or excuse thereof (para. [c])."[136] The court chose to treat the demand requirement in BCL section 626(c) as a substantive requirement, rather than a mere pleading requirement.[137] The court then held that it was too late for the plaintiffs to amend their complaint to correct their allegations of demand futility:

> It is no answer to say that, had the litigation gone forward, plaintiffs

benefit).

132. *Id.* at 45, 971 N.Y.S.2d at 285.

133. *Id.* at 45, 971 N.Y.S.2d at 286.

134. *Id.* at 46, 971 N.Y.S.2d at 286; *see* N.Y. BUS. CORP. LAW § 626(e).

135. *Cent. Laborers' Pension Fund*, 111 A.D.3d at 44, 971 N.Y.S.2d at 285.

136. *Id.* at 46, 971 N.Y.S.2d at 286-87 (referring to N.Y. BUS. CORP. LAW § 626(a)-(b), which provides:

> (a) An action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor, by a holder of shares or of voting trust certificates of the corporation or of a beneficial interest in such shares or certificates.
>
> (b) In any such action, it shall be made to appear that the plaintiff is such a holder at the time of bringing the action and that he was such a holder at the time of the transaction of which he complains, or that his shares or his interest therein devolved upon him by operation of law.).

137. *Cent. Laborers' Pension Fund*, 111 A.D.3d at 47, 971 N.Y.S.2d at 287.

> could have amended their complaint to make sufficiently particularized allegations of demand futility. If plaintiffs believed that they had a basis for such an amendment, they should have submitted that evidence to Supreme Court in support of their fee application.[138]

Furthermore, if the plaintiffs were to demonstrate demand futility, the court held that they needed to show demand futility under Delaware law, where Goldman is incorporated.[139]

In addition to quoting the Court of Appeals in *Bansbach v. Zinn* as to the importance of the demand requirement,[140] the First Department spoke at length as to why, in this case, the demand requirement was the right instrument for rejecting the fee request:

> To award fees to a derivative plaintiff who has neither made a demand nor alleged demand futility, upon the mooting of the suit by board action promptly after it was filed, would reward that plaintiff for unjustifiably wresting the management of the corporation from those to whom it is entrusted by law and by the rest of the shareholders. . . . [T]he basis for awarding attorneys' fees to a derivative plaintiff under the substantial benefit doctrine is the avoidance of unjust enrichment. On the other hand, an officious intermeddler who gratuitously foists an unrequested benefit upon another is not entitled to compensation from the recipient because the other party's receipt of the benefit without compensation does not constitute unjust enrichment. Absent a showing that the demand requirement has been complied with or excused, a derivative plaintiff has no justification for acting on behalf of the corporation. Under such circumstances, denying that plaintiff compensation from the corporation for any benefit allegedly conferred by the litigation does not constitute unjust enrichment, and the denial of fees fully accords with the doctrine of substantial benefit.
>
> Further, plaintiffs overlook that, if their main concern was saving money for [Goldman]'s shareholders by reducing excessive employee compensation, they might well have accomplished the same result (assuming for the sake of argument that their actions had any influence on the board) by presenting the board with a formal demand, as the law contemplates. If plaintiffs had made such a demand, and the board had set compensation at the level it ultimately did (which plaintiffs deem satisfactory), [Goldman] shareholders would have benefitted from the corporation's reduced compensation expense as well as from avoiding having to pay plaintiffs' attorneys' fees (and avoiding having to oppose or defend their fee application), since

138. *Id.*

139. *Id.* at 44-45, 971 N.Y.S.2d at 285.

140. *Id.* at 47, 971 N.Y.S.2d at 287 (quoting Bansbach v. Zinn, 1 N.Y.3d 1, 8, 801 N.E.2d 395, 401, 769 N.Y.S.2d 175, 180 (2003)).

> attorneys' fees are not payable pursuant to section 626(e) where no lawsuit has been initiated. Rather than risk achieving a positive result for the shareholders without bringing a lawsuit that might result in the imposition of fee liability on the corporation, plaintiffs commenced a lawsuit against the board without first making a demand (without excuse, as previously discussed). In other words, by going straight to court rather than making a pre-suit demand as the law requires, plaintiffs seem to be trying to achieve the same result at greater cost to the corporation. We do not believe that the law should afford them this option.[141]

The *Central Laborers* decision presents a strong justification for the demand-upon-the board rule, and suggests what might happen if the rule did not exist.

In *Sacher v. Beacon Associates Management Corp.* the derivative plaintiffs were successful in pleading that demand upon management would have been futile. [142] The plaintiffs were members of an investment fund, Beacon Associates, LLC II (Beacon) that was managed by Beacon Assets Management Corp. (BAMC).[143] Beacon lost money by investing money in Bernard Madoff's Ponzi scheme.[144] The plaintiffs brought a derivative action against several defendants, including BAMC and Friedberg, Smith & Co., P.C. (Friedberg), Beacon's independent auditor.[145] The plaintiffs claimed "that Friedberg had a duty to discover Madoff's fraud and that its negligence proximately caused Beacon to sustain damages."[146]

According to the court:

> The plaintiffs sufficiently pleaded with particularity that demand upon BAMC to assert the claim against Friedberg on Beacon's behalf would have been futile (*see* Business Corporation Law section 626[c]). The amended complaint alleges that BAMC had a direct financial interest in Friedberg's issuance of clean audit opinions in the form of continued higher fees for maintaining the investment with Madoff, as well as inflated fees based on a percentage of Beacon's fictitious profits. Further, it alleges that BAMC's principals did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances . . . .[147]

141. *Central Laborers*, 111 A.D.3d at 47-48, 971 N.Y.S.2d at 287-88 (internal citations and quotations omitted).

142. 114 A.D.3d 655, 980 N.Y.S.2d 121 (2d Dep't 2014).

143. *Id.* at 655, 980 N.Y.S.2d at 123.

144. *Id.*

145. *Id.*

146. *Id.* at 657, 980 N.Y.S.2d at 124.

147. *Sacher*, 114 A.D.3d at 656, 980 N.Y.S.2d at 123 (internal citations omitted).

Notably, Business Corporation Law ("BCL") section 626(c),[148] cited by the court, applies to corporations and not to other forms of business associations. The citation to BCL section 626(c) is yet another instance of a corporation law principle being extended by analogy to LLCs.

Sacher is also noteworthy because Friedberg attempted to defend itself against this derivative claim, made on behalf of the putative plaintiff entity Beacon, by invoking the *in pari delicto* doctrine, which "is an equitable defense based on agency principles which bars a plaintiff from recovering where the plaintiff is itself at fault."[149] The effectiveness of the doctrine had recently been confirmed by the Court of Appeals in *Kirschner v. KPMG LLP*,[150] which involved claims by investors in a bankrupt corporation where the corporation's independent auditor had failed to detect fraud by management.[151] The *in pari delicto* doctrine was not available to the independent auditors in *Sacher*, however, because "[t]he defense requires intentional conduct on the part of plaintiff [that is, Beacon] or its agents."[152] In *Sacher*, the complaint did not allege that the audit client committed intentional fraud,[153] but only that the audit client "did not fully inform [itself] . . . to the extent reasonably appropriate under the circumstances."[154]

Thus, the *in pari delicto* doctrine has the unexpected result that an independent auditor who fails to detect a client's intentional fraud might have a better defense than the auditor who fails to detect a client's negligence.

VII. FOREIGN BUSINESS ENTITIES

In *Palisades Tickets, Inc. v. Daffner*, the plaintiff Palisades Tickets, Inc. sued Gerald Daffner, a New York attorney, alleging that he assisted his clients in the concealment of assets to avoid a judgment.[155] In his defense, Daffner claimed that, under BCL section 1312(a),[156] the

148. N.Y. BUS. CORP. LAW § 626(c) (McKinney 2014).

149. *Sacher*, 114 A.D.3d at 657, 980 N.Y.S.2d at 124 (citation and internal quotation marks omitted).

150. 15 N.Y.3d 446, 938 N.E.2d 941, 912 N.Y.S.2d 508 (2010).

151. The *Kirschner* decision is discussed in Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2010-2011 Survey of New York Law*, 64 SYRACUSE L. REV. 531, 532-46 (2012).

152. *Sacher*, 114 A.D.3d at 657, 980 N.Y.S.2d at 124 (citing *Kirschner*, 15 N.Y.3d at 474, 938 N.E.2d 957, 912 N.Y.S.2d at 524).

153. *Id.* at 657, 980 N.Y.S.2d at 124.

154. *Id.* at 656, 980 N.Y.S.2d at 123 (citation omitted).

155. 118 A.D.3d 619, 620, 989 N.Y.S.2d 25, 26 (1st Dep't 2014).

156. N.Y. BUS. CORP. LAW § 1312(a) (McKinney 2014). Section 1312(a) provides in

plaintiff lacked capacity to bring the lawsuit because it was not authorized to do business in New York as a foreign corporation.[157] But the defendant's argument failed because the defendant pointed to only one underlying business transaction in New York, which was insufficient to show "doing business:"

> While it is undisputed that plaintiff is a foreign corporation and is unauthorized to do business in New York State, defendant has not established entitlement to dismissal of the action pursuant to Business Corporation Law [section] 1312(a), which bars suits by foreign corporations that do business in New York without authorization. Even if the underlying judgment arose from a business transaction with the judgment debtors, who are New York residents and corporations, evidence of a single transaction is insufficient to sustain defendant's burden of showing that the corporation engaged in "systematic and regular" business activities in this State.[158]

Culligan Soft Water Co. v. Clayton Dubilier & Rice LLC summarizes the rights under New York law for a plaintiff bringing a shareholder's derivative action against a foreign corporation.[159] The plaintiffs were minority shareholders of Culligan, Ltd. (Culligan), a Bermuda company which did business in New York,[160] and brought derivative claims against individuals and entities that were directors, officers and shareholders of Culligan,[161] as well as various other entities.[162] According to the First Department, the claims had been dismissed at the trial court level in accordance with the "internal affairs" doctrine, which "'recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors and shareholders.'"[163]

The court stated that the internal affairs doctrine did not prevent derivative claims from being brought against "those defendants who are

---

relevant part:

> A foreign corporation doing business in this state without authority shall not maintain any action or special proceeding in this state unless and until such corporation has been authorized to do business in this state and it has paid to the state all fees and taxes imposed under the tax law . . . as well as penalties and interest charges related thereto, accrued against the corporation.

Id.

157. *Palisades Tickets, Inc.*, 118 A.D.3d at 620, 989 N.Y.S.2d at 26.
158. *Id.* (citations omitted).
159. 118 A.D.3d 422, 988 N.Y.S.2d 134 (1st Dep't 2014).
160. *Id.* at 422, 988 N.Y.S.2d at 136.
161. *Id.*
162. *Id.*
163. *Id.* (citing Edgar v. MITE Corp., 457 U.S. 624, 645 (1982)).

not current officers, directors, and shareholders of Culligan . . . ."[164] and that the doctrine does not "apply to claims based on sections of the [BCL] enumerated in [BCL sections] 1317 and 1319."[165] BCL section 1319(a)(2) provides that "the following provisions, to the extent provided therein, shall apply to a foreign corporation doing business in this state, its directors, officers and shareholders: . . . Section 626 (Shareholders' derivative action brought in the right of the corporation to procure a judgment in its favor)."[166] Thus, according to the court, "the issue of plaintiffs' standing to bring a shareholder derivative action is governed by New York law, not Bermuda law."[167] The First Department distinguished *In re CPF Acquisition Co. by Kagan v. CPF Acquisition Co.*,[168] a contrary opinion of the court holding plaintiff's standing to sue a Delaware corporation to be governed by Delaware law, on the grounds that "there is no indication that the plaintiff in that case raised [BCL section] 1319."[169]

The court next held that New York law governs violations of BCL section 720,[170] which BCL section 1317(a)(2)[171] makes applicable to a foreign corporation doing business in New York.[172]

Finally, the court did not allow the derivative plaintiffs to sue for breach of fiduciary duty,[173] stating, "to the extent plaintiffs allege a violation of the [BCL] not enumerated in [BCL section] 1317 (e.g. section 717, which is part of plaintiffs' breach of fiduciary duty claim), New York law does not apply. Those claims are governed by Bermuda law, and were thus correctly dismissed."[174]

164. *Culligan Soft Water Co.*, 118 A.D.3d at 422, 988 N.Y.S.2d at 136. The opinion does not state what the relationship of those other defendants to Culligan was.

165. *Id.* (referring to N.Y. BUS. CORP. LAW §§ 1317, 1319 (McKinney 2014)).

166. N.Y. BUS. CORP. LAW § 1319(a)(2).

167. *Culligan Soft Water Co.*, 118 A.D.3d at 423, 988 N.Y.S.2d at 136.

168. 255 A.D.2d 200, 682 N.Y.S.2d 3 (1st Dep't 1998).

169. *Culligan Soft Water Co.*, 118 A.D.3d at 423, 988 N.Y.S.2d at 136.

170. N.Y. BUS. CORP. LAW § 720. Section 720 allows actions against a director or officer for, among other things:

> The neglect of, or failure to perform, or other violation of his duties . . . [;] [t]he acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violations of his duties . . . [and] [t]o set asset an unlawful conveyance, assignment or transfer of corporate assets, where the transferee knew of its unlawfulness.

Id. § 1317(a)(1)-(2).

171. *Id.* § 1317(a)(2).

172. *Culligan Soft Water Co.*, 118 A.D.3d at 423, 988 N.Y.S.2d at 136-37.

173. *Id.* at 423, 988 N.Y.S.2d at 137.

174. *Id.* (citations omitted).

CONCLUSION

The most significant legislative development during the *Survey* period was amendment of the N-PCL in accordance with the Non-Profit Revitalization Act of 2013. In case law developments, the Court of Appeals established that the hourly-rate business of a New York law partnership does not constitute "unfinished business" which a dissolved partnership can pursue if a client follows a former partner. Other case law explored existing legal principles, with some cases providing valuable guidance.