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Kotlyar v Khlebopros
2014 NY Slip Op 51185(U)
Decided on August 6, 2014
Supreme Court, Kings County
Demarest, J.
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Decided on August 6, 2014

Supreme Court, Kings County

Zina Kotlyar and BORIS KOTLYAR, in the right and on behalf of SEAGATE MINI MALL, INC., SEAGATE BANYA CORP., AND ZAZABOROM, INC., Plaintiff(s),

against

Aleksandr Khlebopros, SEAGATE MINI MALL, INC., SEAGATE BANYA CORP., AND ZAZABOROM, INC., Defendant(s).

013582/13

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Carolyn E. Demarest, J.

The following papers numbered 1 to 10 read herein:*Papers Numbered*

Notice of Motion/Order to Show Cause/

Petition/Cross Motion and

Affidavits (Affirmations) Annexed*31-41*

Opposing Affidavits (Affirmations)*42-50*

Reply Affidavits (Affirmations)*51-57*[*2]

Affidavit (Affirmation)

Memoranda of LawDefendant moves, pursuant to CPLR 3211(a), to dismiss the action for lack of subject matter jurisdiction, lack of standing, and failure to state a cause of action. In the alternative, defendant moves, pursuant to CPLR 3211(a), to dismiss the action due to an arbitration clause, or, in the alternative, pursuant to CPLR 7503, to stay the action pending arbitration.

BACKGROUND

Plaintiffs Zina Kotlyar and Boris Kotlyar are each an officer, director, and shareholder of Seagate Mini Mall, Inc., Seagate Banya Corp., and Za Zaborom, Inc. (the "Corporations"). Each plaintiff has a 16.5% ownership interest in each of the Corporations. Defendant Aleksandr Khlebopros is an officer, director, and shareholder of each Corporation with a 33% ownership interest. The remaining ownership interest is held by Iosif Feldsherov, who is also an officer, director, and shareholder of the Corporations. The Corporations are New York domestic corporations that operate a spa, pool, restaurant, and other property at 3703 Mermaid Avenue, Brooklyn, New York.

Plaintiffs filed a Second Amended Complaint,[FN1] dated November 7, 2013, seeking to remove defendant as a director and officer of the Corporations, pursuant to BCL 706(d) and 716(c), and for money damages, pursuant to BCL 720. Plaintiffs allege that defendant breached his fiduciary duties and committed wasteful management when defendant, *inter alia*, failed to obtain a food protection certificate and pool operator certificate, repeatedly berated employees, caused explosions in the spa's ovens, improperly constructed an outdoor storage room, and engaged in unnecessary maintenance work. As a result, plaintiffs are requesting money damages estimated to be no less than $100,000.

Defendant Aleksandr Khlebopros filed a Verified Answer and Counterclaim, dated January 23,

2014, denying plaintiffs' allegations and counterclaiming for money damages as a result of, *inter alia*, minority shareholder oppression, breach of fiduciary [*3]duty, fraud, unjust enrichment, and conversion. Defendant filed the present motion to

dismiss the complaint or, in the alternative, to compel arbitration pursuant to the Corporations' Shareholders Agreement,[FN2] dated December 5, 2012 ("Shareholders Agreement").[FN3]

DISCUSSION

Defendant moves to dismiss under CPLR 3211(a)(2) for lack of subject matter jurisdiction, CPLR 3211(a)(3) for lack of standing, and CPLR 3211(a)(7) for failure to state a cause of action. In support of the present motion, the defendant argues that the plaintiffs' complaint should be dismissed because the complaint fails to state a derivative cause of action under BCL 626(c). BCL 626(c) states: "In any [shareholders' derivative] 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." Defendant argues that plaintiffs did not attempt to first secure the initiation of an action

by the board as required under BCL 626(c) and that this failure deprives the plaintiffs of

standing and a cause of action and deprives the court of subject matter jurisdiction.

Although plaintiffs briefly mention BCL 626(c) in their Second Amended Complaint, they explicitly bring their three causes of actions under BCL 706(d) (to remove defendant as director), 716(c) (to remove defendant as officer), and 720 (for monetary damages). Plaintiffs reassert in the Affirmation in Opposition to the present motion that they are bringing their action under BCL 706(d), 716(c), and 720 as officers, directors, and shareholders of the Corporations and that BCL 626(c) is not applicable.

Unlike BCL 626(c), which authorizes a shareholder to bring a derivative action on behalf of the corporation, BCL 720 does not require an officer or director to first demand that the board initiate an action. As stated by the Third Department in *Conant v Schnall*, 33 AD2d 326, 328 [3d Dept 1970]:

> "An action under section 720 differs from an action under section 626 in many crucial respects. It is not derivative but original, being a statutory right of action rather than an equitable one. This being so, the director may sue in his own name and need not allege his representative capacity. While the cause of action and right of recovery actually belong to the corporation, and the director is suing as a representative, the corporation is only a proper party, neither necessary nor indispensable. Thus, as intended by the Legislature, none of the traditional rules (e.g., demand, stock ownership, judicial approval of settlements) surrounding a [*4]derivative action apply to an action under section 720."

Plaintiffs state in paragraph 20 of their Affirmation in Opposition that they have not brought this action as shareholders instituting a derivative action under BCL 626 but as an officer and director seeking compensation for defendant's alleged breach of fiduciary duties and wasteful management under BCL 720(a)(1)(A). Plaintiffs are suing in their capacities as officers and directors on behalf of the Corporations to enforce a right of recovery belonging to the Corporations (*Conant* at 328; *Bertoni v Catucci*, 117 AD2d 892, 894 [3d Dept 1986]). Because the present suit is not a derivative action, but is a statutorily authorized direct action brought on the Corporations' behalf, the motion to dismiss the action due to lack of subject matter jurisdiction, lack of standing, and failure to state a cause of action is denied.

In the alternative, defendant moves to dismiss this action pursuant to CPLR 3211(a) due to an arbitration agreement, or to stay the action pending arbitration pursuant to CPLR 7503. The Shareholders Agreement compels arbitration for "any dispute or controversy arising among the parties hereto regarding any term, covenant or condition of this Agreement or the breach thereof." In their Affirmation in Opposition, plaintiffs argue that this provision only concerns disputes or controversies among the shareholders and does not pertain to issues of corporate governance, such as the removal of management. However, " [once] it appears that there is, or is not a reasonable relationship between the subject matter of the dispute and the general subject matter of the underlying contract, the court's inquiry' with respect to the arbitrability of the dispute is ended'" (*Ehrlich v Stein*, 143 AD2d 908, 910 [2d Dept 1988], quoting *Nationwide General Ins. Co. v Investors Ins. Co.*, 37 NY2d 91, 96 [1975]). The Shareholders Agreement sets out rules and procedures on how the Corporations are to be managed (*see*, *e.g.*, Shareholders Agreement, pp. 11-12: "[T]he selection or discharge of the officers of the Corporation [is subject to a majority shareholder vote];" "[H]iring and firing of employees and agents of the Corporation [are subject to a majority shareholder vote]"). Thus, the Shareholders Agreement specifically provides for the selection and removal of officers by a majority of shareholders and the relief requested by plaintiffs thus falls within the parameters of the arbitration clause.

Plaintiffs next contend that, even if the issue of defendant's removal is arbitrable, defendant has waived his right to arbitration. A party in an action may waive his right to arbitration if he extensively participated in the litigation process (*see Zimmerman v Cohen*, 236 NY 15, 19 [1923]; *Sherrill v Grayco Builders, Inc.*, 64 NY2d 261, 272 [1985]). Although each case is fact-specific, the courts have found a waiver when a party has taken actions beyond filing an answer and counterclaims (*see*, *e.g.*, *Zimmerman* at 18 (defendant prepared to depose witnesses in China and provided notice of trial); *Sherrill* at 271 (defendant deposed witnesses and exchanged approximately 100,000 documents with [*5]other parties in the litigation)). The courts have also found waiver when a party has unduly delayed his request for arbitration (*see Rusch Factors, Inc. v Fairview Mfg. Co.*, 34 AD2d 635, 635 [1st Dept 1970] (defendant failed to raise arbitration defense despite receiving multiple extensions to answer)). However, in order to waive arbitration, a party must engage in litigation to such an extent as to manifest a preference for litigation (*Matter of Cusimano v Berita Realty*, 103 AD3d 720, 721 [2d Dept 2013]).

In this case, defendant has only submitted an answer with counterclaims for money damages as a result of, *inter alia*, minority shareholder oppression, breach of fiduciary duty, fraud, unjust enrichment, and conversion, all of which are subject to the arbitration clause of the Shareholders Agreement. In his answer, defendant has reserved his right to "assert all defenses which may be pertinent," which encompasses the right to compel arbitration. The defendant promptly moved to compel arbitration two months after submitting his answer, when he finally received copies of the Shareholders Agreement from corporate counsel.[FN4] The courts have directed arbitration in cases with lengthier delays (*see*, *e.g.*, *Riggi v Wade Lupe Constr. Co.*, 176 AD2d 1177 [3d Dept 1991] (six months); *Byrnes v Castaldi*, 72 AD3d 718, 720 [2d Dept 2010] (four months)). Furthermore, plaintiffs have failed to show that compelling arbitration at this stage in the litigation would be prejudicial to them (*Byrnes* at 720 (considering the possibility of prejudice in granting arbitration)). No witnesses have been deposed and no document discovery has been produced. As arbitration actions may only be dismissed after the completion of arbitration and an award is made, *(Langemyr v Campbell*, 23 AD2d 371, 374 [2d Dept 1965], *affd* 21 NY2d 796 [1968]), the present action is stayed pending arbitration and the motion to dismiss the action, based upon the pendency of arbitration, is denied. Defendant shall serve a demand for arbitration within 15 days.

Finally, defendant seeks costs and sanctions under NYCRR 130-1.1, claiming that plaintiffs' action is frivolous. However, under section (c) of the rule, conduct is considered frivolous only if it is "completely without merit in law or fact," "undertaken primarily to delay or prolong," or "assert[ing] material factual statements that are false." Plaintiffs have successfully established

standing and alleged viable causes of action against the defendants in this case; their conduct is not frivolous as defined by NYCRR 130-1.1. Consistent with the foregoing ruling, defendant's motion to dismiss the plaintiff's claims as frivolous for failure to state a cause of action is denied. Defendant's motion to impose costs and sanctions is denied as completely lacking merit.**CONCLUSION**

Defendant's motion to dismiss for lack of subject matter jurisdiction and standing, failure to state a cause of action, and for sanctions is denied. The issue of defendant's [*6]removal as a director and officer of the Corporations is arbitrable under the Shareholders Agreement and defendant has not waived his right to do so through his participation in this litigation. Pursuant to CPLR 7503(a), defendant's motion to dismiss the action is denied, however, the action is stayed pending arbitration.E N T E R,

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Carolyn E. DemarestJ. S. C.

Footnotes

Footnote 1: Plaintiffs filed a Verified Complaint, dated July 30, 2013, and a First Amended Complaint, dated October 4, 2013. Under CPLR 3025(a): "A party may amend his pleading once without leave of court . . . at any time before the period for responding to it expires . . . ." Because the First Amended Complaint was never served, plaintiffs did not violate CPLR 3025(a) when they filed their Second Amended Complaint (*cf. Schroeder v Good Samaritan Hospital*, 80 AD3d 744 [2d Dept 2011]).

Footnote 2: The Corporations each have a Shareholders Agreement that are substantively identical.

Footnote 3: The Corporations are nominally named as defendants in this action and they have not filed an answer or participated in the litigation.

Footnote 4: Defendant does not explain why he did not possess a copy of the Shareholders Agreement, and does not elaborate on how this has affected the present litigation.

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