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Recent Trends in New York Partnership Law–Written, Oral, and Implied Partnerships, Fiduciary Duties, and Remedies

By Gerard V. Mantese and Emily S. Fields

> CAMERON: We'd love for you to work with us, Mark. I mean, we need a gifted programmer who's creative.
>
> TYLER: And we know you've been taking it in the shins.
>
> DIVYA: The women's groups are ready to declare a Fatwa, and this could help rehabilitate your image.
>
> MARK: Wow. You'd do that for me?
>
> DIVYA: We'd like to with you.
>
> CAMERON: Our first programmer graduated and went to work at Google. Our second programmer just got overwhelmed with school work. We would need you to build the site and write the code and we'll provide . . .
>
> MARK: I'm in.
>
> CAMERON: — the money. What?
>
> MARK: I'm in.
>
> TYLER: Awesome.[1]

In this scene from the film *The Social Network*, several students discuss forming a business relationship to create a social networking website. Despite this alleged agreement, Mark Zuckerberg, "Mark," allegedly delays working on their project to secretly create his own website, Facebook. Mark's website becomes wildly successful, and he excludes Cameron, Tyler, and Divya from its profits.[2]

Was this enough to form a partnership? New York law defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit."[3] Partnerships may be formed by express, written agreements, which clearly identify and define the roles, rights, and duties of the parties. They also may be formed by oral agreement. Or, partnerships may be implied from the parties' conduct, even if the parties have never used the word "partner" or "partnership" to describe their relationship. Partnerships give rise to strict fiduciary duties.[4] Under the Partnership Law, partners are accountable to one another as fiduciaries.[5] The requirements for partnership formation permit courts to find that a partnership exists from the nature of the parties' relationship and therefore subject partners to liability for breach of fiduciary duties. In fact, parties may be subject to liability for breaching duties they may not necessarily know they owed to the other partners. Thus, it is important to understand the factors that courts analyze to determine whether a partnership exists.

Partnership Factors

New York courts examine four factors to determine whether a partnership exists. The presence or absence of a single factor is not dispositive.[6] Rather, courts will look at the entirety of the parties' relationship.[7] They look at the parties' intent (express or implied), whether the parties had joint control and management of the business, whether the parties shared in the profits and losses, and whether the parties combined their knowledge, skill, or property in their endeavors.[8]

In *Yuen v. Branigan*, the New York Supreme Court applied the partnership factors and held that the plaintiff pled sufficient facts as to the existence of an oral partnership agreement to defeat the defendants' motion for summary judgment.[9] The plaintiff sued for breach of fiduciary duties among other things, alleging that he entered into an oral partnership agreement with the defendants to operate a hedge fund.[10] Under the alleged agreement, the plaintiff became a "partner" of the hedge fund and received an equity interest.[11] The court noted several indicia of a partnership, including the defendants' holding the plaintiff out to the world as a partner,[12] the plaintiff's vested equity interest,[13] and the plaintiff's role as head of trading of defendants' hedge fund, which required the plaintiff's knowledge and skill.[14]

Similarly, in *Koether v. Sherry*, the plaintiff sufficiently pled the existence of a partnership to avoid summary judgment.[15] In *Koether*, the plaintiff alleged that he and the defendant agreed to use their shared expertise to develop a business and share in its profits.[16] The Kings County Supreme Court determined that the plaintiff adequately pled shared profits and losses (the essential element of a partnership), which was supported by documentary evidence.[17] The plaintiff also produced sufficient evidence

Gerard V. Mantese is the CEO at Mantese Honigman, PC, with offices in Manhattan; Troy, Michigan; and St. Louis, Missouri. He practices in the area of business litigation, focusing on shareholder and member disputes, partnership litigation, fiduciary duties, and contract law. He argued the only two statutory shareholder and member oppression cases ever accepted for review by the Michigan Supreme Court. He handles complex business litigation in courts around the country. **Emily S. Fields** is an associate attorney at Mantese Honigman, PC. She concentrates in commercial litigation, including partnership and shareholder disputes.

to establish that he and the defendant jointly managed the business. This evidence included emails in which the parties discussed employee compensation and profit-maximizing strategies.[18] Given the parties' joint efforts to establish and manage the business over the course of their relationship, the court found that the plaintiff sufficiently alleged the existence of a partnership, giving rise to fiduciary duties.[19]

Fiduciary Duties

In *Meinhard v. Salmon*, Chief Judge Benjamin Cardozo elegantly described the fiduciary duties that partners owe one another, a standard which is still applied nearly 90 years later. Judge Cardozo wrote that,

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[20]

Courts will enforce these duties with "uncompromising rigidity."[21] Partners owe their partners fiduciary duties, and courts take this obligation seriously. New York courts hold shareholders of closely held corporations,[22] managers of LLCs,[23] and trustees[24] to the same standard of fiduciary duties. Shareholders of closely held corporations, LLC managers, trustees, and partners owe strict fiduciary duties to the shareholders, members, beneficiaries, and partners of their respective enterprises.

Partners, and other fiduciaries, are obligated to act in the interests of their partners (rather than in their own interests) and with good faith, due care, and undivided loyalty, among other things.[25] They are required to make full disclosures of material facts, such as conflicts of interest and divided loyalty.[26] Under Partnership Law § 43, each partner is required to account to the partnership for any benefit received in any transactions connected with the partnership.[27]

This standard of conduct applies to partners regardless of how the partnership was formed. Therefore, parties who may be unaware that they are indeed partners of a partnership will also be held to this strict standard of conduct.

Breach of Fiduciary Duties

To establish a breach of fiduciary duty, the plaintiff must show that a fiduciary relationship existed, that the other party breached such duty, and that such wrongful conduct caused the plaintiff damage.[28] Therefore, if the plaintiff can establish an oral or implied partnership, the defendant is subject to liability for any misconduct that injured the plaintiff.

In *Frame v. Maynard*, the First Department held that the defendant breached fiduciary duties owed to the plaintiffs (his partners) when he failed to fully disclose information material to a specific transaction.[29] The defendant offered to acquire the plaintiffs' partnership interests in a particular piece of property for roughly $850,000.[30] The plaintiffs accepted the offer.[31] However, the defendant failed to fully disclose the actual value of the property at issue, which he recently had appraised for over $2 million.[32] The court found it "beyond dispute" that such a disclosure would have influenced the plaintiffs' decision to accept the offer, and so the defendant's failure to disclose constituted a breach of fiduciary duties.[33]

"In New York, partnerships may be formed without express agreements and may even by implied from conduct."

In *Pokoik v. Pokoik* (involving an LLC), the First Department held that the defendant breached fiduciary duties owed to the plaintiff.[34] The parties had entered into a settlement agreement, under which the plaintiff agreed to make payments of $2.2 million to certain properties in which they had an interest.[35] The company's accountant informed the defendant, the managing member of the LLC, that the transactions would result in a $750,000 tax liability.[36] To avoid a negative effect on himself, the defendant placed the entire tax burden on the plaintiff's shoulders.[37] The defendant did so without informing the plaintiff about the tax liability or that the plaintiff was the only member shouldering the burden.[38] The court determined that the defendant breached duties owed to the plaintiff.[39]

In another New York case, *Huang v. Sy*, the Second Department reaffirmed the lower court's holding that the defendant breached fiduciary duties.[40] The defendant engaged in self-dealing by making payments out of the partnership's funds to himself and entities he alone controlled, without obtaining consent from his partners.[41] The court found "no basis to disturb the Supreme Court's determination."[42]

Remedies for Breach

A breach of the fiduciary duties owed pursuant to Partnership Law § 43 is one of the events that triggers an innocent partner's right to an accounting. Partnership Law § 44 affords each partner the right to an accounting if: (1) he is excluded from partnership business or property; (2) he has such a right under an agreement; (3) his partner has violated § 43; or (4) the situation otherwise renders an accounting just and equitable.[43] In fact, the court may order a party to account for a breach of fiduciary duties where the relationship between the parties was never reduced to a writing, or even labeled a partnership.

Damages for breach of fiduciary duties include disgorgement of profits earned from the breach and damages from lost opportunities caused by the misconduct.[44] The court may award appreciation damages where the breach is the result of serious misconduct.[45] If possible, property transferred in a transaction that gives rise to a breach of fiduciary duties must be returned.[46] The court may also award interest for a breach of fiduciary duties.[47]

In *Frame v. Maynard*, the court ordered the defendant to disgorge the plaintiffs' share of the profits the defendant earned from the subject transaction, with interest.[48] The *Huang* plaintiffs were entitled to be restored to the position they were in before they joined the venture, with interest.[49]

Conclusion

In New York, partnerships may be formed without express agreements and may even be implied from conduct. Regardless of how the partnership is formed, the partners owe one another stringent fiduciary duties. Those in breach may be ordered to disgorge profits and pay damages for lost profits, among other remedies. It is imperative that parties engaged in business transactions understand the factors that courts analyze to determine whether a partnership in fact exists, as partnership duties are rigid and exacting.

Endnotes

1. THE SOCIAL NETWORK (Sony Pictures 2010).
2. Miguel Helft, *Court Upholds Facebook Settlement With Twins*, N.Y. TIMES, April 11, 2011, http://www.nytimes.com/2011/04/12/technology/12facebook.html.
3. N.Y. P'ship Law § 10(1).
4. *Meinhard v. Salmon*, 249 N.Y. 458, 463-64 (1928).
5. N.Y. P'ship Law § 43.
6. *Fasolo v. Scarafile*, 120 A.D.3d 929, 930; 991 N.Y.S.2d 820 (N.Y. App. Div. 4th Dep't 2014).
7. *Id.*
8. *Hammond v. Smith*, 151 A.D.3d 1896, 1897; 57 N.Y.S.3d 832 (N.Y. App. Div. 4th Dep't 2017), *citing Griffith Energy Inc v. Evans*, 85 A.D.3d 1564; 925 N.Y.S.2d 282 (N.Y. App. Div. 4th Dep't 2011).
9. *Yuen v. Branigan*, 2015 NY Misc LEXIS 3252, at *26 (Sup. Ct. New York Co. 2015).
10. *Yuen*, 2015 NY Misc LEXIS 3252, at *1-2.
11. *Yuen*, 2015 NY Misc LEXIS 3252, at *4-5.
12. *Id.* at *25-26.
13. *Id.* at *26.
14. *Id.*
15. *Koether v. Sherry*, 40 Misc 3d 1237(A); 977 N.Y.S.3d 667 (Sup. Ct. Kings Co. 2013).
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Meinhard v. Salmon*, 249 N.Y. 458, 463-64 (1928).
21. *Id.* at 464.
22. *Brunetti v. Musallam*, 11 A.D.3d 280, 280; 783 N.Y.S.2d 347 (N.Y. App. Div. 1st Dep't 2004) ("The relationship between shareholders in a close corporation, vis-à-vis each other, is akin to that between partners and imposes a high degree of fidelity and good faith.").
23. *Kalikow v. Shalik*, 43 Misc. 3d 817, 824-25; 986 N.Y.S.2d 762 (Sup. Ct. Nassau Co. 2014) ("A partner, and by analogy, a [minority managing] member of a limited liability company, has a fiduciary obligation to others in the partnership or [LLC]...").
24. *Carbone v. Betz*, 101 A.D.3d 866, 868; 955 N.Y.S.2d 209 (N.Y. App. Div. 2d Dep't 2012).
25. *RSSM CPA LLP v. Bell*, 2017 N.Y. Misc LEXIS 40, at *31; 2017 NY Slip Op. 30020(U) (Sup. Ct. New York Co. 2017).
26. *Dubbs v. Stribling & Assocs.*, 96 N.Y.2d 337, 340; 752 N.E.2d 850 (2001).
27. N.Y. P'ship Law § 43(1).
28. *Pokoik v. Pokoik*, 115 A.D.3d 428, 429; 982 N.Y.S.2d 67 (N.Y. App. Div. 1st Dep't 2014).
29. *Frame v. Maynard*, 83 A.D.3d 599; 922 N.Y.S.2d 48 (N.Y. App. Div. 1st Dep't 2011).
30. *Id.* at 601.
31. *Id.*
32. *Id.* at 602.
33. *Id.*
34. *Pokoik v. Pokoik*, 115 A.D.3d 428; 982 N.Y.S.2d 67 (N.Y. App. Div. 1st Dep't 2014).
35. *Id.* at 429.
36. *Id.* at 429-30.
37. *Id.*
38. *Id.* at 430.
39. *Id.* at 432.
40. *Huang v. Sy*, 62 A.D.3d 660, 661; 878 N.Y.S.2d 398 (N.Y. App. Div. 2d Dep't 2009).
41. *Id.* at 661
42. *Id.*
43. N.Y. P'Ship Law § 44.
44. *Herman v. Herman*, 2017 NY Misc LEXIS 1862, at *8-9; 2017 NY Slip Op. 31034(U) (Sup. Ct. New York Co. 2017), citing *105 E Second St. Assoc v. Bobrow*, 175 A.D.3d 746, 746-47; 573 N.Y.S.2d 503 (N.Y. App. Div. 1st Dep't 1991).
45. *Id.*
46. *Id.* at * 9, citing *In re Estate of Rothko*, 43 N.Y.2d 305, 322; 372 N.E.2d 291 (1977).
47. *Id.* at *9.
48. *Frame v. Maynard*, 107 A.D.3d 582; 969 N.Y.S.2d 6 (N.Y. App. Div. 1st Dep't 2013).
49. *Huang v. Sy*, 18 Misc. 3d 1141(A); 859 N.Y.S.2d 903 (Sup. Ct. Queens Co. 2008), *aff'd*, *Huang v. Sy*, 62 A.D.3d 660; 878 N.Y.S.2d 398 (N.Y. App. Div. 2d Dep't 2009).