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SHORT FORM ORDER

INDEX No. 837-11

SUPREME COURT - STATE OF NEW YORK
I.A.S. PART 45 - SUFFOLK COUNTY

PRESENT:

Hon. THOMAS F. WHELAN
Justice of the Supreme Court

MOTION DATE 1/9/12
ADJ. DATES 2/10/12
Mot. Seq. # 001-Mot d
PC: **4/20/12**
CDISP Y____ N X

RUDOLF GUENZEL and MARGUERITE GUENZEL on behalf of themselves individually and as shareholders of American Culture, Inc. n/k/a All Cultures, Inc. and Salon Source, Inc.,

Plaintiffs,

-against-

AMERICAN CULTURE, INC. n/k/a All Cultures, Inc. and Salon Source, Inc., LOUIS GUARNERI, individually and as President and Director of American Culture, Inc. n/k/a All Cultures, Inc. and Salon Source, Inc., SALON SOURCE-DEALS ON WHEELS, INC., AMERICAN CULTURE-THE LOOK, THE SALON, INC. and AMERICAN CULTURE MANUFACTURING, INC.,

Defendants.

BROWN & ALTMAN, LLP
Attys. For Plaintiffs
510 Broadhollow Rd.
Melville, NY 11747

LYNN, GARTNER, DUNNE & COVELLO
Attys. For Defendants
330 Old Country Rd.
Mineola, NY 11501

Upon the following papers numbered 1 to 12 read on this motion to compel the production of corporate books and records and to disqualify counsel; Notice of Motion/Order to Show Cause and supporting papers 1 - 3; Notice of Cross Motion and supporting papers ____; Answering Affidavits and supporting papers 4-5; Replying Affidavits and supporting papers 6-8; Other 9-10 (memorandum); 11 (memorandum); 12 (memorandum); (~~and after hearing counsel in support and opposed to the motion~~) it is,

ORDERED that those portions of this motion (#001) by the plaintiffs wherein they demand the production of the books and records of the certain corporate defendants is only to the limited extent set forth below; and it is further

ORDERED that those portions of this motion wherein the plaintiffs seek to compel a forensic accounting of the books and records of the certain corporate defendants and to pay the costs thereof and legal fees incurred is denied; and it is further

ORDERED that the remaining portions of this motion wherein the plaintiffs seek an order disqualifying the defendants' counsel is granted only to the limited extent set forth below; and it is further

ORDERED that a preliminary conference is scheduled for **April 20, 2012**, at 9:30 am in Part 45 at the courthouse located at 1 Court Street - Annex, Riverhead, NY 11901.

In 2004, the plaintiffs, at the invitation of defendant Guarneri, invested in the first two corporations named as defendants in this hybrid corporate dissolution proceeding/shareholders derivative action and money damages action. The plaintiffs assert that they now own, collectively, 43% of the outstanding shares of stock in defendant American Culture, Inc., n/k/a All Cultures, Inc.[hereinafter AC] and 50% of the outstanding shares of stock in defendant Salon Source, Inc [hereinafter SS]. The plaintiffs were also named directors of each corporation.

While defendant AC remains a going concern, defendant, SS was dissolved in July of 2010 by a Proclamation/Annulment filed on July 28, 2010 with the Department of State. Some four years prior thereto, such a dissolution was allegedly authorized by a June 28, 2006 resolution of the Board of Directors of SS that included the plaintiffs. In their complaint and moving papers, the plaintiffs allege that defendant Guarneri's failure to immediately cease the business operations of defendant SS, as contemplated by the June 28, 2006 resolution of the Board of Directors, allowed Guarneri to misappropriate the assets and the business of SS and convert same to the other corporations listed in the caption and/or to himself, individually.

With respect defendant AC, the record reflects that the plaintiffs actively participated in its operations as directors through January 1, 2010, the date on which a Board of Directors meeting was held in the home of the plaintiffs in Fort Meyers, Florida (*see* ¶ 34 of Affidavit in Support by plaintiff, R. Guenzel, dated November 28, 2011). The plaintiffs' further involvement in business operations of AC is evidenced by the plaintiffs' 2009-2010 efforts to re-locate AC's warehouse from Long Island to Dallas/Fort Worth, Texas and plaintiff, R Guenzel's active participation in negotiating a proposed lease for such a warehouse in Texas. Defendant Guarneri's subsequent determination to reject the re-location efforts of the plaintiffs and Guarneri's "unilateral" execution of a new warehouse lease on premises situated on Long Island are among the several acts for which the plaintiffs seek redress in this hybrid action. Other evidence of the plaintiffs' active role in the business of AC is reflected in the appointment of their daughter as the Chief Fiscal Officer of AC in July of 2009. Eight months thereafter, the tenure of the plaintiff's daughter as AC's Chief Fiscal Officer was ended by her, due to alleged mistreatment by bookkeepers and others employed by AC, including defendant Guarneri.

The plaintiffs contend that beginning in 2006, defendant Guarneri engaged in acts of deception designed to keep important business decisions and the financial status and affairs of both corporations from being known to the plaintiffs. In addition, defendant Guarneri is charged with waste, misuse and misappropriation of corporate assets to the detriment of both AC and SS and their shareholders. The plaintiffs further charge defendant Guarneri with fraud and breaches of fiduciary duties owing to the plaintiffs and/or to the corporations for which money damages are demanded. The complaint served contains 32 causes of action, several of which, seek relief on behalf of the plaintiffs, individually.

By the instant motion, the plaintiffs demand the various forms of provisional relief outlined above as well as an order disqualifying the defendants' counsel. For the reasons stated, the motion is granted only to the limited extent set forth below.

New York law affords corporate shareholders desirous of inspecting and copying the books and records of their corporation two distinct, yet overlapping, remedies. The first evolved under common law case authorities while the other is a creature of statute (*see* BCL §§ 624; 1315; ***Peterborough Corp. v Karl Ehmer, Inc.***, 215 AD2d 663, 628 NYS2d 134 [2d Dept 1995]). Neither remedy is absolute, however, as both are conditioned upon the petitioner's possession of bona fide intentions and each are subject to the discretion of the court (*see* ***Matter of Crane v Anaconda Co.***, 39 NY2d 14, 382 NYS2d 707 [1976]).

The common law remedy is discretionary with the court and proceeds upon a showing of reasonableness, good faith and proper purpose (*see id.* at 39 NY2d 18; ***Wisniewski v Polish and Slavic Center, Inc***. 309 AD2d 869, 766 NYS2d 55 [2d Dept 2003]). A shareholder asserting a common law right of access must plead and prove that the inspection demanded is for a proper purpose (*see* ***Matter of Marcato***, 102 AD2d 826, 476 NYS2d 582 [2d Dept 1984]; *see also* ***Matter of Tatko v Tatko Bros. Slate Co.***, 173 AD2d 917, 569 NYS2d 783 [3d Dept 1991]).

The statutory remedy is less onerous insofar as the burden of proof is concerned since the bona fides of a shareholder who satisfies the statutory criteria and pleads them in an enforcement proceeding, will be assumed (*see* ***Matter of Crane v Anaconda Co.*** 39 NY2d 14, 20). However, the corporate documents that are subject to inspection under statutes such as BCL § 624 by qualified shareholders are limited to those enumerated therein (*see* ***Lewis v J&K Plumbing & Heating Co., Inc.***, 71 AD2d 708, 418 NYS2d 244 [2d Dept 1979]; ***Carthage Paper Makers Inc. v Mutual Box Bd. Co.***, 2 AD2d 175, 153 NYS2d 759 [4th Dept 1956]; *see also* ***Wells v League of Am. Theatres and Producers, Inc.***, 183 Misc2d 915, 706 NYS2d 599 [Sup Ct, NY County 2000]). In contrast, the common law remedy is not so limited as it affords a shareholder access to any corporate book or record that is necessary and relevant to the shareholder's stated purpose for the requested inspection (*see* ***Dwyer v Dinardo & Metschl, PC***, 41 AD3d 477, 838 NYS2d 745 [4th Dept 2007]; ***Matter of Troccoli v L&B Contr. Indus., Inc.***, 259 AD2d 754, 687 NYS2d 400 [2d Dept 1999]).

Case authorities have held that "proper purposes" include efforts to ascertain the financial condition of the corporation, the propriety of a dividend distribution, to calculate the value of stock, to investigate corporate undertakings and obtain information in aid of legitimate litigation (*see* ***Matter of Tatko v Tatko Bros. Slate Co., Inc.***, 173 AD2d 917, *supra*). While claims of waste of corporate assets may be a basis for a limited review of the books and records, such requests are granted with great circumspection and only in those cases wherein such claims duly supported (*see* ***Lapsley v. Sorfin Intern., Ltd.***,43 AD3d 1113, 843 NYS2d 141[2d Dept 2007]). Improper purposes have been held to include those which are inimical to the corporation, such as those aimed at discovering business secrets to aid a competitor of the corporation, to secure prospects for personal gains or business or to acquire information to pursue one's own social or political goals (*see* ***Matter of Crane v Anaconda Co.***, 39 NY2d 14, *supra*; ***Matter of Tatko v Tatko Bros. Slate Co., Inc.***, 173 AD2d 917, *supra*).

With respect to an examination of the books and records of defendant, AC, the court finds that the plaintiffs failed to demonstrate the requisite proper purpose under principles of common law jurisprudence. Accordingly, the court grants the plaintiffs' demands for an inspection of the corporate books and records of defendant AC pursuant to BCL § 624(d), only with respect to the corporate books and records enumerated in BCL § 624(a) *provided* that a written demand for such inspection is duly served upon defendants' counsel on not less than ten [10] days notice, together with the affidavit required by BCL § 624(c), duly executed by both plaintiffs.

The plaintiff's application for an inspection of the corporate books and records of defendant SS is denied, in light of its dissolution by Proclamation/Annulment on July 28, 2010. The moving papers failed to demonstrate that the books and records of a dissolved corporation are subject to an inspection under principles of common law or under the provisions of BCL § 624.

The plaintiffs' demands for a forensic accounting of the books and records of the subject corporations by a forensic accountant designated by the plaintiffs and that the costs thereof, together with legal fees incurred, is denied. In their moving papers, the plaintiffs' claims for accountings at this early stage of the litigation are premised upon an expanded reading of the inspection rights afforded shareholders under BCL § 624 and the common law principles enunciated above. The court, however, rejects these claims as unmeritorious due to the marked differences between and inspection of books and records and a "forensic" accounting. The plaintiffs' entitlement to accountings from defendants AC and SS, if any, must be predicated upon their pleaded claims for accountings, which are equitable in nature rather than statutory.

It is clear under controlling case authorities that a plaintiff is not generally entitled to discovery of the defendant's financial records until the right to an equitable accounting has been established (*see* ***Schreier v Mascola***, 81 AD2d 909, 439 NYS2d 197 [2d Dept 1981]; ***Alderman v Eagle***, 41 AD2d 641, 340 NYS2d 716 [2d Dept 1973]; *see also* ***LSY Intl. Inc. v Kerzner***, 140 AD2d 256, 528 NYS2d 561 [1st Dept 1988]). It is equally clear that the right to an equitable accounting is dependent upon the absence of an adequate remedy at law and the existence of a confidential or fiduciary relationship between the accounting party and the plaintiff (*see* ***United Telecard Distrib. Corp. v Nunez***, 90 AD3d 568, 936 NYS2d 17 [1st Dept 2011]; ***Weinstein v Natalie Weinstein Design Assoc.***, 86 AD3d 641, 928 NYS2d 305 [2d Dept 2011]; *cf.* ***Wilensky v. JRB Mktg. & Opinion Research, Inc.***, 137 AD2d 520, 524 NYS2d 264 [2d Dept 1988]). While shareholders in a close corporation owe fiduciary duties to one another, a corporation does not owe fiduciary duties to its members or shareholders (*see* ***United Telecard Distrib. Corp. v Nunez***, 90 AD3d 568, *supra*; ***Hyman v New York Stock Exch., Inc.***, 46 AD3d 335, 848 NYS2d 51 [1st Dept 2007]). An accounting by a corporation to its shareholders is thus not an available remedy in advance of a finding of an entitlement thereto (*see* ***Weisman v Awnair Corp. of America***, 3 NY2d 444, 165 NYS2d 745 [1957]). The plaintiffs' demands for a forensic accounting by both AC and SS and for an order that the defendants shall bear the cost thereof, including counsel fees incurred by the plaintiff in connection therewith, are denied.

The remaining portions of the plaintiffs' motion wherein they demand an order disqualifying defendants' counsel is granted only to the extent that John W. Dunne, Esq. and the law firm of Lynn, Gartner, Dunne & Covello, LLP., are hereby disqualified from their further representation of defendant Guarneri. It is well established that "[o]ne who has served as attorney for a corporation may not represent

an individual shareholder in a case in which his interests are adverse to other shareholders" (***Morris v Morris***, 306 AD2d 449, 763 NYS2d 622 [2d Dept 2003]; ***Guiliano v Carlisle***, 211 AD2d 757, 621 NYS2d 685 [2d Dept 1995]). Under this rule, it appears that attorney Dunne and his law firm, who represented both corporations and serves or served as service agent therefor, must be disqualified from their further representation of defendant Gaurneri, a fellow shareholder in each corporation at issue (*see* ***Morris v Morris***, 306 AD2d 449, *supra*). However, the moving papers failed to demonstrate the need for the further disqualification of attorney Dunne and his firm. Defendant Guarneri shall have thirty-five days from the date of this order to retain and appear herein by new counsel. Should he fail to do so, he shall be deemed to be proceding in a self-represented capacity.

A preliminary conference is scheduled for April 20, 2012 as set forth above.

DATED: 2/17/12

THOMAS F. WHELAN, JSC