SHORT FORM ORDER

INDEX
NO.: 11-38972

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: 8-10-12
ADJ. DATE: 10-26-12
Mot Seq. 002-MD
003-MD
004-MotD

NORTH COAST OUTFITTERS, LTD.,

Plaintiff,

-against-

CHARLES W. DARLING III, and
CHARLIES HORSE, INC.,

Defendant.

WICKHAM, BRESSLER, GORDON & GEASA, PC
Attorneys for Plaintiff
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Upon the following papers numbered 1 to 121 read on this motion to dismiss; Notice of Motion/ Order to Show Cause and supporting papers 1 - 40, 85 - 94, 106 - 111; Notice of Cross Motion and supporting papers_____; Answering Affidavits and supporting papers 41 - 59, 95 - 103, 112 - 119; Replying Affidavits and supporting papers 60 - 84, 104 - 105, 120 - 121; Other_____; (~~and after hearing counsel in support and opposed to the motion~~) it is,

ORDERED that the motion (002) by the plaintiff for an order restraining the defendant Charles W. Darling, III from voting his shares in the plaintiff company at any meeting or otherwise in favor of his election, or his designee(s) to any office of plaintiff or as a director of plaintiff, or occupying any office of the plaintiff or acting as a director of the plaintiff is denied; and it is further

ORDERED that the motion (003) by the defendants to disqualify the law firm Wickham, Bressler, Gordon & Geasa, P.C. as attorneys for Steven Allison, William J. Mills, III, and Robert L. Mills, II is denied; and it is further

ORDERED that the motion (004) by the plaintiff for an order pursuant to CPLR 3014 and 3024 compelling the defendants to provide a more definite pleading and to dismiss the amended counterclaims is granted to the extent that the ninth through the twentieth counterclaims are dismissed; and it is further

ORDERED that the parties are directed to appear at a preliminary conference on Friday,

January 25, 2013 at 9:30 a.m.

In this breach of contract action, the plaintiff North Coast Outfitters, Ltd., a New York Corporation, seeks, among other things, damages, an accounting, and a constructive trust from the defendants Charles W. Darling, III and Charlies Horse, Inc. for alleged breach of fiduciary duty, conversion, unjust enrichment, and unfair competition. The record reveals that the defendant Darling formed the plaintiff corporation on February 26, 1998, as the sole stockholder, officer, and director. On December 18, 1998, William J. Mills, III, Robert L. Mills, II, Steve Allison, Robert Logomasini, Maria La France, and Jack Tinelli became directors and shareholders. Darling developed products which were patented and trademarked, the expenses of which were paid by the plaintiff. Sometime in 1998, Darling agreed to assign his rights in the patents and trademarks upon the payment of a percentage of sales of the products, and granted a license to the plaintiff to utilize the patents and trademarks. In 2000, the plaintiff and Darling entered into employment agreements employing Darling as chief executive officer and president for compensation. The most recent agreement was entered into on October 30, 2009 for a term of three years.

The employment agreement contained a covenant whereby the plaintiff agreed not to sue Darling for any matter arising out of his ownership or management of the plaintiff unless it arose out of gross negligence or deliberate malfeasance, and provided for attorneys fees. The employment agreement required Darling to devote his primary working time and best efforts to the performance of his duties and prohibited Darling from taking any action contrary to the best interests of the plaintiff.

The record reflects that in or around October, 2009, the patents were assigned to non-party Valiant Rock, LLC, instead of the plaintiff. In May, 2011, Darling resigned as president and CEO of the plaintiff effective July 20, 2011. Darling began to utilize a new website called Charlieshorse.co, which is very similar to the original website, Charlieshorse.com. Shortly thereafter, Darling allegedly removed all emails, corporate minutes and records and documents from the corporate offices. The instant action was subsequently commenced by filing on December 24, 2011. The complaint contains twelve causes of action, alleging breach of fiduciary duty, unjust enrichment, breach of contract, unfair competition, and seeking an accounting, a declaratory judgment, constructive trust, and removal from the company. The defendants served their answer and asserted twenty counterclaims against the plaintiff and directors Steven Allison, William J. Mills, III, and Robert L. Mills, II (hereinafter "the directors").

The plaintiff now moves for an order restraining and enjoining the defendant Darling from voting his shares in plaintiff at any meeting or otherwise in favor of the election of Darling or his designee to any office of plaintiff or as a director of plaintiff, and occupying any office of plaintiff or acting as a director of plaintiff. In his affirmation, the plaintiff's attorney also seeks to amend the complaint. However, no notice of such application to amend was provided in the order to show

cause and is therefore denied (CPLR 2214 [a]). The defendants move to disqualify the law firm Wickham, Bressler, Gordon & Geasa, P.C. (hereinafter "the Wickham firm") from representing the directors in connection with the counterclaims asserted against them by the defendants. The plaintiff moves for an order compelling the defendants to serve a more concise pleading in substitution for the amended answer with counterclaims, and dismissing the third-party complaint.

Turning to the motion for a preliminary injunction against Darling, in support of its motion, the plaintiff submits, among other things, the personal affidavits of George T. Beatty and Frank Feis. Beatty avers in his affidavit, dated May 29, 2012, that he is the president of the plaintiff and that the gravamen of the action is that Darling through his acts and omissions as a prior director and president of the plaintiff breached his fiduciary duty to the plaintiff, unjustly enriched himself at the expense of the plaintiff, converted the assets of the plaintiff, and otherwise acted to the detriment of the plaintiff. Beatty states that Darling solicited and obtained substantial funds and other property from third parties in return for minority interests in the plaintiff, increasing the value of the plaintiff. Darling thereafter looted the plaintiff and otherwise deprived it of its assets and sought to drive the plaintiff into bankruptcy or otherwise end the plaintiff's existence. Beatty states that the continued viability of the plaintiff is now threatened by the upcoming annual meeting of stockholders on May 31, 2012, at which time, he states that Darling will use his majority status to reestablish himself as a director and president and remove current management, which, in his opinion, will irreparably harm the plaintiff.

Frank Feis avers that he is a certified public accountant and the principal of the firm Feis & Associates, P.L.L.C. His firm was retained by the plaintiff, and he performed a limited analysis of the transactions between the plaintiff and Darling. He concludes that numerous improper and questionable transactions occurred between the plaintiff and Darling. His analysis reveals, among other things, an overpayment of $1,008,427 in royalties by the plaintiff to defendant Charlies Horse, Inc. and Valiant Rock, LLC.

In opposition, Darling avers in his affidavit that he is the founder and holder of 51% of the outstanding capital stock of the plaintiff. From February 1998 through his resignation in August 2011, he was the president and chief executive officer of the plaintiff, and from the company's inception in 1998 until June 2011, he was chairman of the board of directors. Darling denies Beatty's assertions that he is looting the plaintiff and never stated an intent to re-install himself as president and director of the plaintiff or to remove its current management. However, should he desire to do so, he believes it is his right as a 51% owner of the plaintiff. He states he has been diagnosed with chronic inflammatory demyelinating polyneuropathy, a progressively debilitating disease that attacks the peripheral nervous system, and as a result, he is physically unable to resume his former position as president. Darling states that there is a conspiracy by four of the minority shareholders of the plaintiff to extort from him monies that he rightfully received from the plaintiff. Darling further denies that he took the corporate agreements and documents. He states that all reimbursed business expenses were properly incurred in furtherance of the plaintiff's business.

To be entitled to a preliminary injunction, the moving party has the burden of demonstrating: (1) a likelihood of success on the merits; (2) irreparable injury absent granting the preliminary injunction; and (3) a balancing of the equities in the movant's favor (*See* CPLR 6301; ***Aetna Ins. Co. v Capasso***, 75 NY2d 860, 862, 552 NYS2d 918 [1990]; ***Dixon v Malouf***, 61 AD3d 630, 630, 875 NYS2d 918 [2d Dept 2009]; ***Coinmach Corp. v Alley Pond Owners Corp.***, 25 AD3d 642, 643, 808 NYS2d 418 [2d Dept 2006]). A plaintiff has not suffered irreparable harm warranting injunctive relief where its alleged injuries are compensable by money damages (*See* ***White Bay Entrs., Ltd. vNewsday, Inc.***, 258 AD2d 520, 685 NYS2d 257 [2d Dept. 1999]). The purpose of a preliminary injunction is to maintain the status quo and prevent the dissipation of property that could render a judgment ineffectual (*see* ***Dixon v Malouf***, *supra*; ***Ruiz v Meloney***, 26 AD3d 485, 486, 810 NYS2d 216 [2d Dept 2006]; ***Ying Fung Moy v Hohi Umeki***, 10 AD3d 604, 781 NYS2d 684 [2d Dept 2004]). The decision to grant or deny a preliminary injunction rests in the sound discretion of the court (*see* ***Dixon v Malouf***, *supra*; ***Ruiz v Meloney***, *supra*). Under the circumstances presented, at this juncture, the plaintiff has failed to demonstrate that it would be successful on the merits, and the complaint seeks money damages for the alleged injuries. In any event, the date of the annual meeting has passed, rendering the application untimely. Accordingly, the motion seeking a temporary restraining order is denied.

Turning to the defendants' motion seeking to disqualify the Wickham firm as counsel for the directors, in support of their motion, the defendants submit the personal affidavit of the defendant Charles Darling. Darling avers that he is the founder, treasurer and holder of 51% of the outstanding capital stock of the plaintiff. He states that Steven Allison, Robert Mills and William Mills are the current members of the board of directors of the plaintiff. They are also minority shareholders of the plaintiff, with Steven Allison owning 14.5%, and William Mills and Robert Mills each owning 9.5% of the outstanding capital stock. Darling states that the representation of the plaintiff and the directors by the Wickham firm constitutes an impermissible conflict of interest pursuant to Rule 1.7 of the Rules of Professional Conduct, in that the plaintiff is a party in this litigation and that Darling may institute cross claims against the directors on behalf of the plaintiff.

In opposition, the directors contend that there was no prior representation of the plaintiff by the Wickham firm, and that they have consented to the representation. In support, the directors submit, among other things, the personal affidavits of William J. Mills and George T. Beatty. Mills avers that he is a director of North Coast Outfitters, Ltd. and that he consents to the representation of himself and the plaintiff by the Wickham firm. He states that there is no conflict of interest or representation of differing interests. Beatty avers that he is the president and chief executive officer of the plaintiff and also states that he consents to the representation of himself and the plaintiff by the Wickham firm.

Rule 1.7 (a) of the Rules of Professional Conduct prohibit an attorney from representing a client "if the representation will involve the lawyer in representing differing interests." However, "[notwithstanding] the existence of a concurrent conflict of interest under paragraph (a), a lawyer

may represent a client if:

> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing.

Where the Rules of Profesional Conduct (22 NYCRR 1200.00) are invoked in the litigation, courts "are not constrained to read the rules literally or effectuate the intent of the drafters, but look to the rules as guidelines to be applied with due regard for the broad range of the interests at stake" (***Neisig v Team I***, 76 NY2d 363, 369-370, 559 NYS2d 493 [1990]; see ***S & S Hotel Ventures Ltd. Partnership v 777 S. H. Corp.***, 69 NY2d at 43). It is the Supreme Court's responsibility to balance the competing interests, and "the disqualification of an attorney is a matter that rests within the sound discretion of the Supreme Court" (***Falk v Gallo***, 73 AD3d 685, 901 NYS2d 99 [2010]; *see* ***Cardinale v Golinello***, 43 NY2d 288, 292, 401 NYS2d 191 [1977]; ***Nationscredit Fin. Servs. Corp. V Turcios***, 41 AD3d 802, 839 NYS2d 523 [2007]; ***Schmidt v Magnetic Head Corp.***, 101 AD2d 268, 277, 476 NYS2d 151 [1984]).

The Court finds, in its discretion, that under the circumstances presented, the defendants have failed to meet their burden that the Wickham firm's removal is warranted. There is no evidence that the plaintiff and the directors have differing interests, but even if they do, the Wickham firm has produced affidavits which consent to the joint representation. In addition, the Wickham firm affirms that it is confident that it can competently represent both the plaintiff and directors without any conflict of interest. This belief expressed by the Wickham firm is reasonable, the representation is not prohibited by law, there are no cross claims between the plaintiff and the directors. Accordingly, the motion to disqualify the Wickham firm is denied.

Turning to the plaintiff's motion to compel repleading and to dismiss the counterclaims, the gravamen of the motion is that the defendants failed to state a cause of action. The plaintiff and the directors also contend that the assertion of counterclaims against the directors as counterclaim defendants which were styled as a third-party action is unauthorized by the CPLR in that the defendants have not complied with the service requirements of CPLR 1007. In addition, the claims of tortious interference with contract against the directors may not lie for inducing breach by the corporation itself while they acted in their corporate capacities. Moreover, the directors assert that the claims for breach of fiduciary duty do not set forth the circumstances of the alleged wrong in detail.

With regard to the branch of the motion seeking to compel repleading, the plaintiff and the

directors contend that the amended answer, counterclaims, and third-party complaint is a voluminous, rambling and irrelevant pleading, and seek to compel repleading in plain and concise statements pursuant to CPLR 3014 and 3024. Under the circumstances presented, the Court finds that the answer and counterclaims are not so vague or ambiguous that a response could not be made and declines to compel repleading.

The standard for determining a CPLR 3211 (a) (7) motion is well settled. If a "plaintiff is entitled to a recovery upon any reasonable view of the stated facts", the complaint is legally sufficient and the motion must be denied. (***219 Broadway Corp. v Alexander's, Inc.***, 46 NY2d 506, 509, 414 NYS2d 889 [1979]). "Whatever an ultimate trial may disclose as to the truth of the allegations, on such a motion, a court is to take them as true and resolve all inferences which reasonably flow therefrom in favor of the pleader." (***Sanders v Winship***, 57 NY2d 391, 394, 456 NYS2d 720 [1982]; *see also*, ***Barr v Wackman***, 36 NY2d 371, 375, 368 NYS2d 497 [1975]).

The defendants assert twenty counterclaims against the plaintiff and the directors. The Court finds that the first through the eighth counterclaims asserted against the plaintiff state a cause of action inasmuch as they allege that the plaintiff violated the terms of the 2004 Agreement, the 2009 Agreement and the 2009 Trademark Licensing Agreement.

With regard to the counterclaims asserted against the directors, who are non-parties to the action, the third party pleading is improper. Third party practice is allowed when a person not a party is or may be liable to that defendant for all or part of the plaintiff's claim against that defendant pursuant to CPLR 304 (CPLR 1007). Here, the defendant alleges different claims than those asserted against the plaintiff, that the directors induced the corporation to breach its contracts with the defendants, and that the directors breached their fiduciary duty to the corporation. In addition, the plaintiff and the directors contend that they were not properly served pursuant to CPLR 1007. In any event, the commencement of a third party action is immaterial under these circumstances inasmuch as the defendants have failed to state a cause of action against the directors in the ninth through twentieth causes of action.

The counterclaims which allege that the directors tortiously interfered with the plaintiff's contracts with the defendants are dismissed. The general rule is that a corporation exists independently of its owners, who are not personally liable for its obligations, and that individuals may incorporate for the express purpose of limiting their liability (*see* ***Bartle v Home Owners Cooperative, Inc.***, 309 NY 103, 106, 309 NY (N.Y.S.) 103 [1955]; ***Seuter v Lieberman***, 229 AD2d 386, 387, 644 NYS2d 566 [2d Dept 1996]). The ninth, eleventh, thirteenth, fifteenth, and seventeenth causes of action which allege that the directors induced the plaintiff to breach certain contracts with the defendants, are dismissed, inasmuch as the directors of a corporation may not be held liable for tortious interference with contract by virtue of their actions as directors (***Majestic Farms Supply, Ltd. v Service Riding Apparel, Ltd.***, 137 AD2d 501, 524 NYS2d 245 [2d Dept 1988]). In addition, none of the defendants' factual assertions reflect the commission by the

directors of an independent tort, separate and distinct from their actions as directors of the corporate plaintiff. Moreover, the defendants failed to allege any bad faith by the directors while carrying out their corporate duties (***Murtha v Yonkers Child Care Ass'n***, 45 NY2d 913, 915, 411 NYS2d 219 [1978]; *see* ***Buckley v 112 Cent. Park South, Inc.***, 285 App Div 331, 334, 136 NYS2d 233 [1954]; *see also* ***Schoninger v Yardarm Beach Homeowners' Asso.***, 134 AD2d 1, 523 NYS2d 523 [2d Dept 1987]).

The counterclaims which allege that the directors breached their fiduciary duty are also dismissed. In order to establish a breach of fiduciary duty, a plaintiff must prove the existence of a fiduciary relationship, misconduct by the defendant, and damages that were directly caused by the defendant's misconduct (***Kurtzman v Bergstol***, 40 AD3d 588, 590, 835 NYS2d 644 [2d Dept 2007]). Directors or officers of a corporation stand in a fiduciary relationship to the corporation, must act in good faith and "owe the corporation their undivided loyalty and are not permitted to derive personal profit at the expense of the corporation." (***Yu Han Young v Chiu***, 49 AD3d 535, 536, 853 NYS2d 575 [2d Dept 2008]; ***Schachter v Kulik***, 96 AD2d 1038, 1039, 466 NYS2d 444 [2d Dept 1983]). Inasmuch as the defendants have failed to allege damages that were directly caused by the directors' alleged misconduct, the tenth, twelfth, fourteenth, sixteenth, eighteenth, nineteenth and twentieth counterclaims are dismissed.

Accordingly, the plaintiff's motion seeking a preliminary injunction is denied, the motion to disqualify the Wickham firm from representing the plaintiff and the directors is denied, and the motion seeking to compel repleading of the counterclaims and to dismiss the counterclaims is granted to the extent that the ninth through the twentieth counterclaims are dismissed.

Dated: 12/17/12

THOMAS F. WHELAN, J.S.C.