Nineteen Twenty Four, Inc. v Parachini
2015 NY Slip Op 30236(U)
February 17, 2015
Supreme Court, New York County
Docket Number: 653984/2014
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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NINETEEN TWENTY FOUR, INC., CARLO MIRARCHI, as shareholder and Secretary of Nineteen Twenty Four, Inc., & BRANDON HOY, as shareholder and Vice President of Nineteen Twenty Four, Inc.,

Index No.: 653984/2014

DECISION & ORDER

Plaintiffs,

-against-

CHRISTOPHER PARACHINI, Individually and as President and Minority Shareholder of Nineteen Twenty Four, Inc.,

Defendant.

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SHIRLEY WERNER KORNREICH, J.:

In this action involving a close corporation and its directors, officers and major shareholders, defendant seeks to disqualify plaintiffs' counsel. For the reasons that follow, the motion is granted.

I. Procedural History

On December 30, 2014, plaintiffs, who are a close corporation (the Corporation) and shareholders, a director and the Vice President and Secretary of the Corporation, brought this action against defendant, a shareholder, director, president and treasurer of the Corporation. The complaint contends that defendant resigned from the Corporation, accepted a buy-out of his shares, and, thereafter, refused to sell his shares and disrupted the business of the Corporation. The Corporation, allegedly, then terminated defendant for cause. The complaint asserts causes of action, *inter alia*, for an injunction barring defendant from operating, managing or gaining access to the Corporation, breach of the shareholder agreement, and breach by defendant of his

fiduciary obligations to the Corporation.[1] Among other things, it seeks specific performance of the buy-out.

On December 31, 2014, plaintiffs, by order to show cause, moved for a temporary restraining order and a preliminary injunction. The parties settled the temporary restraining order (TRO) by stipulation, and the motion for a preliminary injunction was set down for a hearing on January 8, 2015. The allegations in the request for injunctive relief mirrored the complaint. Plaintiffs sought 1) to enjoin defendant from access to the operations, records and management of the business; 2) a declaration as to the ownership of the Corporation's shares; and 3) control of the day-to-day operations of the Corporation.

On January 5, 2015, defendant filed his papers opposing the preliminary injunction and cross-moved for a preliminary injunction to 1) enjoin the Corporation and plaintiffs from interfering with his authority as director, president and treasurer of the Corporation; 2) enjoin plaintiffs from pursuing the purchase of his shares based on his alleged termination or resignation; 3) direct that defendant continue to be paid his salary and benefits; 4) grant him access to the Corporation's books and records and his emails; and 5) disqualify plaintiffs' counsel. He also requested vacatur of the TRO.

On January 8, the court granted a TRO, barring defendant from the corporate premises, directing that he be given full access to the Corporation's books and records and further directing that he continue to be paid his salary and benefits. The motions were adjourned to January 23.

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[1] The action appears to have been brought directly by the Corporation against defendant but also appears to have been brought derivatively, although the caption is ambiguous. In any event, no demand or demand futility is alleged.

On January 20, 2015, defendant answered the complaint and asserted individual and derivative counterclaims. Specifically, he alleged, by way of counterclaim, that plaintiffs breached the shareholder agreement in their attempts to terminate his involvement in the Corporation and breached the shareholder agreement, their fiduciary duties and their duty of loyalty by incurring indebtedness on behalf of the Corporation in order to finance the buy-out of defendant's shares by them, not the Corporation.

The parties appeared for the hearing on the preliminary injunction on January 23. Plaintiffs were accompanied by fourteen corporate employees, who allegedly were prepared to testify against defendant. Defendant brought two witnesses, neither of which worked for the corporate entity. The TRO was continued, plaintiffs agreed to provide defendant with copies of his past emails and the hearing on the preliminary injunction was adjourned pending the court's decision on disqualification of plaintiffs' counsel.

II. Background

It is undisputed that Nineteen Twenty Four Inc. (the Corporation) owns a restaurant in Brooklyn, New York -- Roberta's. Plaintiff Hoy and defendant Parachini were first involved in creating the restaurant in early 2007 and were joined by plaintiff Mirarchi later that year. Together the three men formed the Corporation, which consisted of 200 shares, and signed a shareholder agreement. Hoy and Parachini each owned 54 shares, Mirarchi owned 25 shares and passive investors owned 43 shares. The parties dispute whether the remaining 24 shares were ever distributed and which of the individual parties to this action owns them.

The shareholder agreement provides that "for so long as this Agreement is in effect," the shareholders agree to elect plaintiff Hoy and defendant, Parachini, to the board of directors,

which cannot consist of more than two directors. Para. 2(a). However, "[i]f any director ceases to be a shareholder, he shall submit to the Corporation his written resignation as director effective as of the date he ceases to own any shares of stock in the Corporation." *Id.* Further, the agreement provides that the directors "shall elect" Parachini as president and treasurer, Hoy as vice president and Mirarchi as treasurer. *Id.* at 2(b). Again, should any officer cease to be a shareholder, "he shall submit his written resignation as an officer of the Corporation as of the date he ceases to be a Shareholder." *Id.* The consent of seventy-five per cent of the shareholders is required to amend the shareholder agreement. *Id.*at 10(b). The shareholder agreement specifies that the directors determine the compensation of shareholders for their services [*Id.* at 2(d)], the officers and directors are to devote their "best efforts to the best interests and advancement of the Corporation" [*Id.* at 2(f)], and directors and officers are liable to shareholders for "willful misfeasance, fraud, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his directorship or office." *Id.* at 2(g).

The shares of each shareholder and his contribution is set forth in paragraph 3(a). No investor shareholder owns more than 9 shares. Additionally, 24 shares are not accounted for and paragraph 3(b) states in regard thereto:

> No Issuance of Additional Shares. It is the intention and agreement of the parties that their respective interests in the Corporation shall not be diluted by the issuance or sale of new Shares. Accordingly, the Corporation shall not issue or sell any additional stock after the date hereof, whether by way of original issue *or sale of treasury shares, without the prior consent of all Shareholders.* [emphasis added]

The shareholder agreement provides for restrictions on the transfer of shares, stating that transfer and sale outside the agreement's requirements are void. *Id.* at 5. If a shareholder wishes to transfer or sell his shares, he must send detailed written notice to the Corporation offering to

sell his shares to the Corporation *and the other shareholders*. *Id.* at 6(a). The Corporation has first right of purchase, which may be exercised within a 60 day period by giving notice to the offerer *and other shareholders*. *Id.* at 6(b). If the Corporation chooses not to purchase the shares, the "Operating Shareholders"[2] may do so by giving notice *to all of the other shareholders* within 10 days of the close of the 60 day period. *Id.* at 6(c). Further, if a shareholder's employment by the Corporation is terminated for cause, that shareholder "shall be deemed to have given notice to the Corporation and the other Shareholders of the date of such termination of employment to sell all of his Shares upon the terms and conditions provided in [the agreement]." *Id.* at 6(j). The purchase price for any sale is to be computed in accordance with the provisions of paragraph 8 of the agreement. Transfer of shares is to be recognized "as effective only upon the close of business on the last day of the calendar month following" acceptance of the offer to sell and payment of the purchase price. *Id.* at 6(k) & (l).

Finally, seventy-five per cent of shareholders must consent to incur or refinance indebtedness of the Corporation [*Id.* at 10(c)], the shareholder agreement was adopted as part of the Corporation's by-laws thereby making the corporation a party thereto [*Id.* at 15], and all notices are required to be given in writing, sent by certified mail and deemed given on the date of mailing. *Id.* at 18(a). The agreement is governed by New York law and subject to the exclusive jurisdiction of the New York County courts. *Id.* at 18(e). Pursuant to the agreement, the shareholders also agreed that the agreement is enforceable by injunctive relief and specific performance since violation thereof would constitute irreparable harm [*Id.* at 18(g)] and that the

[2] Operating Shareholders" is not defined in the agreement. However, all parties to this action agree that the term refers to the officers and directors.

agreement is the entire agreement of the parties and may not be amended unless in writing by the "parties to be charged." *Id.* at 18(h).

The parties agree that Roberta's enjoyed success, and the Corporation's business expanded to include Roberta's Pizza to Go, a frozen pizza business, and a seasonal restaurant, Rippers, on the Rockaway Boardwalk. Also, in 2010, Mirarchi, Hoy and Parachini formed an LLC, Severed Heads, to open additional restaurants. The LLC was owned equally by the three men, and in 2012, the LLC opened Blanca, an upscale restaurant, in Brooklyn. Another LLC was formed in Nevada, Robert's Pizza, to hold Roberta's intellectual property in order to license the Roberta brand. Apparently, the Corporation is in discussion to open restaurants in Asia and a restaurant in the as yet unopened ACE Hotel to be located on Orchard Street on the Lower East Side of New York[3]

Pursuant to a retainer agreement between Helbraun Levey & O'Donoghue (the Helbraun Firm) and the Corporation, the Helbraun Firm agreed to serve as "General Counsel" to the Corporation, effective June 5, 2014. According to the Helbraun Firm, it specializes in representing restaurants and represented the Corporation regarding its liquor licensing, licensing of its intellectual property, contracting issues, employee disputes and personal injury matters.

By July of 2014, the parties no longer agreed on how to operate their businesses. Consequently, defendant suggested being bought out, and the individual plaintiffs and defendant began negotiating the sale of defendant's interests. In August, defendant retained counsel, Jeffrey Michalczak, to represent him in the negotiations. The Helbraun Firm negotiated for the

[3] The operating agreements for the LLCs are not part of this record nor are the LLCs part of this litigation.

purchase of all of defendant's business interests for Hoy and Mirarchi, who it referred to as its "clients". O'Donoghue aff. in support of OSC, Exhib. B.

During the negotiations, defendant sent a Letter of Intent (LOI), dated August 21, to Hoy and Mirarchi. It was signed only by defendant and apparently was considered an offer in the negotiations. That LOI embodied the sale of defendant's interests in the Corporation, Severed Heads LLC and Rippers LLC for $2.975 million. Parachini aff. in opposition to OSC, Exhib. B. On September 6, in an apparent response to a counteroffer, Parachini offered to sell his interests in the Corporation, Severed Heads and Rippers for $2.9 million and asked for an additional $2.5 million for "the intellectual property". *Id.* at Exhib. C. The offer was rejected, and in October, in an email to Mirarchi, Parachini asked that the parties negotiate the price without the involvement of their attorneys (Michalczak and the Helbraun Firm), something that apparently had not happened thus far. *Id.* at Exhib. D. In response, Mr. Helbraun of the Helbraun Firm reached out directly to Parachini offering to buy his interests for $2 million, 15% being paid immediately and the rest paid over a six or an eight year period at 8%;[4] in regard to the intellectual property, a 33% royalty of net revenue from any licensing deals was offered. *Id.* at Exhib. E.

On December 3, Mr. Michalczak wrote to Mr. Helbraun regarding their negotiations. O'Donoghue aff. in support of OSC, Exhib. B. Mr. Helbraun responded that his *clients* wanted a clean break and that they "do not have the inclination or the funds" to pay more than they had last offered. *Id.* On December 5, Mr. Michalczak responded that Parachini had accepted the

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[4] Section 6 of the shareholder agreement, which provides for the voluntary sale of shares to the Corporation or shareholders, specifies that upon such sale, not less than 20% of the purchase price must be paid in cash or certified check within ten days after notice of intention to purchase, and the remainder would be paid in sixty monthly installments, beginning thirty days after the notice of intention to purchase, which pay-out would be evidence by a negotiable installment

offer. *Id.* Nonetheless, negotiations apparently broke down, and Parachini wrote Mirarchi and Hoy on December 16 "in an effort to resume discussion." Parachini aff. in opposition to OSC, Exhib. F. In that writing, Parachini noted that he "had rejected the deal" that day, wished to discuss the matter without their attorneys, and stated that he intended to call for a shareholder meeting to address corporate governance as well as other things. *Id.* The next day, on December 17, the Helbraun Firm sent Parachini a formal letter *on behalf of the Corporation*, terminating Parachini for cause, informing him that he no longer is a shareholder or an employee pursuant to the shareholder agreement, and advising him that "because you have been terminated for cause, upon redemption of your shares, you shall also have resigned your position as President and Treasurer of the Company, effective immediately." *Id.* at Exhib.G. The letter continued by advising Parachini that *the Corporation* "exercised its option to purchase your shares immediately upon your termination for cause and resignation, pursuant to Section 6(j) of the Shareholder Agreement," that his termination was effective retroactively to August 1 "or at a minimum upon receipt of this letter, which we estimate to be December 22," and reminded Parachini both of the confidentiality and the two year non-compete clauses in the shareholder agreement. *Id.*

After some email correspondence on December 23 from Parachini to Hoy, Mirarchi, and others at Roberta's and from the Helbraun Firm to Parachini [*Id.* at Exhib. H], new counsel for Parachini wrote to the Helbraun Firm on December 24. *Id.* at Exhib. I. That letter formally rejected the termination letter, explaining why it was invalid under the shareholder agreement. *Id.*

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note at a 10% rate of interest. Sh. Agree. 6(f).

The Helbraun Firm represents all plaintiffs in this action.

III. Discussion

> A movant seeking disqualification of an opponent's counsel bears a heavy burden. A party has a right to be represented by counsel of its choice, and any restrictions on that right "must be carefully scrutinized". ... Courts should also examine whether a motion to disqualify, made during ongoing litigation, is made for tactical purposes, such as to delay litigation and deprive an opponent of quality representation. The decision of whether to grant a motion to disqualify rests in the discretion of the motion court. [citations omitted].

Mayers v Stone Castle Partners, LLC, 2015 NY Slip Op 00295 (1st Dept Jan. 8, 2015).

With New York's adoption of a new code of professional conduct in 2009, disqualification motions are now governed by the Rules of Professional Conduct embodied in 22 NYCRR 1200.0. *See Mayers*, *id.* at *5. Particularly relevant here are Rules 1.13(a) and (d), 1.7(a), (b)(3), and (4), and 1.0(f), (j), (l) and (n).

Rule 1.13 provides:

> (a) When a lawyer employed or retained by an organization is dealing with the Organization's directors, officers, employees, members, shareholders or other constituents, and it appears that the organization's interests may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall explain that the lawyer is the lawyer for the organization and not for any of the constituents.
> ....
> (d) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the concurrent representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Rule 1.7(a) prohibits a lawyer from representing a client if a reasonable lawyer would conclude that:

> (1) the representation will involve the lawyer in representing differing interests;

Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

....

(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.

Material terms used in the previous rules are defined in Rule 1.0. Rule 1.0 provides:

(f) "Differing interests" include every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest.

(j) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated information adequate for the person to make an informed decision, and after the lawyer had adequately explained to the person the material risks of the proposed course of conduct and reasonably available alternatives.

(l) "Matter" includes any litigation, judicial or administrative proceeding, case, claim, application, request for a ruling or other determination, contract, controversy, investigation, charge, accusation, arrest, negotiation, arbitration, mediation or any other representation involving a specific party or parties.

(n) "Person" includes an individual, a corporation, an association, a trust, a partnership, and any other organization or entity.

(q) "Reasonable" or "reasonably," when used in relation to conduct by a lawyer, denotes the conduct of a reasonably prudent and competent lawyer. When used in the context of conflict of interest determinations, "reasonable lawyer" denotes a lawyer acting from the perspective of a reasonably prudent and competent lawyer who is personally disinterested in commencing or continuing the representation.

(x) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including .... email.

Defendant argues that plaintiffs' counsel, who has represented the corporation prior to the buy-out negotiations, after the negotiations fell apart, and in the present litigation, may not

represent plaintiffs, who are shareholders, against defendant, another shareholder. Defendant relies on *Morris v Morris,* 306 AD2d 449 (2d Dept 2003), *Dembitzer v Chera*, 285 AD2d 525 (2d Dept 2001), and *Fleet v Pulsar Constr. Corp.*, 143 AD2d 187 (2d Dept 1988), cases which disqualified counsel for corporations and a partnership who represented shareholders against other shareholders of the corporations or an individual partner against another partner. *Morris* and *Dembitzer*, decided under the old rules of conduct, simply cited to previous DR 5-108,[5] which prohibited an attorney from representing a party in a lawsuit against a former client in the same or a substantially related matter. *Fleet* explained that disqualification in such circumstances was grounded on the obligation of the attorney to preserve the confidences and secrets of the former client and on the appearance of impropriety.[6] Plaintiffs oppose the disqualification motion arguing that no conflict and no prejudice exist since defendant has never revealed any confidential information to corporate counsel, and if he did, it was information already known by plaintiffs. The court need not reach the question of whether Parachini confided in the Helbraun Firm and would be prejudiced thereby since Rule 1.13 dictates the firm's disqualification.

The Helbraun Firm represented the Corporation before the individual parties sought to sever their ties and continues to represent the Corporation. It presently also represents the

[5] Present Rule 1.09(c) is similar to DR5-108 and speaks to a conflict faced by counsel who is representing a client against a former client in the context of confidential information and the danger of revealing such information confided by the former client.

[6] The viability of disqualification based merely on the appearance of impropriety and without a showing of prejudice is questionable under the new rules. *See Mayers*, *supra; but see Cohen v Cohen*, 2015 NY Slip Op 00839 (2d Dept Feb. 4, 2015) ("'doubts as to the existence of a conflict of interest must be resolved in favor of disqualification so as to avoid even the appearance of impropriety'").

individual plaintiffs, who are a director, officers and shareholders of the Corporation. Under Rules 1.13(d) and 1.7(a), the Helbraun Firm may not continue such representation both because it represents differing interests of key directors, officers and shareholders of the Corporation [*Gordon v Obiakor*, 117 AD3d 681, 683 (2d Dept 2014)], but, more importantly, because the interests of the Corporation and the individual plaintiffs differ.[7] The defendant's counterclaims plausibly allege that Hoy and Mirarchi breached their duties to the Corporation in negotiating a buyout of defendant's shares for the individual plaintiffs, not the Corporation, improperly put the Corporation in debt to do so, and violated the shareholder agreement in doing so. Under these circumstances where serious charges of self-dealing and usurpation of corporate opportunity by a director and officers of the Corporation are alleged, a conflict exists between the Corporation and the individual plaintiffs. Rule 1.17(a)(1). Indeed, it is questionable that such a conflict could possibly be waived given the fact that counsel's representation involves "the assertion of a claim by one client [the Corporation] against another client [the individual plaintiffs] represented by the lawyer in the same litigation." Rule 1.17(a)(3); *Campbell v McKeon*, 75 AD3d 479, 480 (1st Dept 2010) (counsel for organizational client required to act reasonably necessary and in best interests of client when individual associated with client may have violated legal duties which are likely to result in substantial injury to organization). The representation of the corporation will be directly adverse to Hoy and Mirarchi, and the Helbraun Firm could not possibly exert its best efforts in representing both.

[7] Indeed, the interests of the Corporation, to the extent that it consists of all shareholders – the investor shareholders as well as the operating shareholders – may differ from those of all of the parties to this litigation.

However, even were waiver permissible by consent, no proper consent was given since under the shareholder agreement such consent would have had to come from the board of directors, without Hoy's participation. Rule 1.13(d). In other words, Parachini or Parachini and the investor shareholders (Rule 1.13[d]) would have had to consent to Helbraun's representation of the Corporation during this litigation. That did not occur. Nor is there a writing evidencing a waiver of the conflict through informed consent. Rule 1.7(4).

In sum, defendant, who moved for disqualification at the first opportunity in this litigation, has met his burden of establishing that continued representation of plaintiffs by the Helbraun Firm violates 1.13 and 1.7 of the Rules of Professional Conduct. Accordingly, it is

ORDERED that defendant's motion to disqualify the Helbraun Firm from representing plaintiffs is granted and the Heilbraun Firm is disqualified from representing Nineteen Twenty Four, Inc., Carlo Mirarchi and Brendon Hoy, and it is further

ORDERED that the instant action is stayed for 45 days from the date of this decision, for plaintiffs to retain new counsel; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, for a status conference on April 9, 2015 at 10:30 in the forenoon.

Dated: February 17, 2015

ENTER:

J.S.C.