STATE OF NEW YORK
SUPREME COURT COUNTY OF MONROE

DANIEL D'ANGELO, on behalf of himself as a Shareholder in D'ANGELO HEATING & PLUMBING, INC., and as a Member in L&D PROPERTIES, LLC and in the right of D'ANGELO HEATING & PLUMBING, INC., and L&D PROPERTIES, LLC,

Plaintiff,

v.

ANDREA LEONE,

Defendant.

DECISION AND ORDER

Index #2005/09815

Defendant, Andrea Leone, moves pursuant to CPLR 3212 for an order granting him partial summary judgment. Plaintiff, Daniel D'Angelo, on behalf of himself as a Shareholder in D'Angelo Heating & Plumbing, Inc. and as a member in L&D Properties, LLC and in the right of D'Angelo Heating & Plumbing, Inc. and L&D Properties, LLC ("D'Angelo"), cross moves for the following: (1) an order disqualifying Phillips Lytle, LLC, as defense counsel and (2) leave to amend the complaint.

After plaintiff's father, Michael D'Angelo, sold his 50% interest of the above named corporation to plaintiff, the parties entered into a Shareholder Agreement on December 30, 1999, providing for 50% ownership in each party. Defendant, who is Michael D'Angelo's son-in-law, served as President, and

plaintiff, Michael's son, served as Vice President. The business grew substantially, according to defendant largely by his efforts.

It is undisputed that the parties negotiated to increase defendant's ownership share of the business to 70%, but that these negotiations failed and each party remains a 50% shareholder. Each party hired separate counsel to represent them in these negotiations. Defendant was represented by Thomas R. Burns, Esq. of Phillips Lytle LLP and plaintiff was represented by William W. Moehle, Esq. Negotiations broke down over issues relating to joint hiring and firing of employees (desired by plaintiff but rejected by defendant), valuation of plaintiff's proposed 30% share in the event of deadlock or a sale of the company, and annual distribution of funds to guarantee payment of plaintiff's tax share of the company's Subchapter S income. Defendant asserts, however, that the parties agreed to "continue in business together but I would receive 70% of the income of the business even though we did not formally agree to the change in the stock ownership." The failed negotiations above described occurred in 2003, and evidently were resumed in earnest in 2006, after suit was filed. Defendant's attorney, Burns, in correspondence alluded to the deadlock provisions of the 1999 Shareholder Agreement early on during these negotiations, but evidently business transpired without significant incident until

plaintiff filed suit in September 2005, alleging that defendant looted corporate assets, converted rental income, filed inaccurate tax returns, and otherwise used the business for his personal benefit to the detriment of the corporation, all in violation of his fiduciary obligations to the corporation. The complaint also seeks an accounting and damages for these and other acts of fraud in relation to unauthorized check cashing for defendant's personal benefit. Thereafter, defendant formally declared a deadlock in an October 9, 2006 letter, offered to buy plaintiff's 50% share under §7.2 of the Shareholder Agreement for $1,200,000 cash via an October 24 letter, and now seeks summary judgment enforcing the deadlock provisions of the Agreement after rejection of the offer and defendant's rejection of plaintiff's counteroffer to buy defendant's share for $900,000, both contained in a letter dated November 16, 2006.

Plaintiff by cross-motion seeks disqualification of defense counsel and opposes summary judgment on the ground that defendant's conduct described in the complaint constitutes a material breach of the Shareholder Agreement precluding specific performance thereof under the "unclean hands" doctrine, and on the additional ground that business has carried on quite successfully such that the deadlock provisions are not invoked. Plaintiff contends that the two parties are not "so divided as to the direction of the company's business and the management of the

company's affairs, that the votes required for action by the members cannot be obtained." Shareholder Agreement §7.1 (emphasis supplied).

Plaintiff does not oppose the motion for partial summary judgment on the ground that the pleadings are as yet incomplete (no reply to the counterclaims has been served, albeit by agreement of the parties) and on the additional ground that defendant is moving for summary judgment on an unpleaded counterclaim or defense, and he eschews any effort to move against any of the claims or allegations contained in the Complaint. Defendant's Memorandum of Law (12-18-06), at p.2. Neither the Complaint nor the Answer seek relief under the deadlock provisions of the Shareholder Agreement, nor does the Answer set up as an affirmative defense the claim that the deadlock provisions are invoked by the circumstances. In other words, defendant seeks "specific performance of the buy/sell option" contained in §7.2, id., at 6, but he has failed to plead a counterclaim for specific performance in his Answer. Similarly, defendant attempts to transform his motion into one for dissolution of the corporation in his reply papers (esp. defendant's undated Memorandum of Law in opposition to disqualification and relating to the deadlock, at 10-12), but no cause of action for dissolution via counterclaim or otherwise appears in the pleadings.

"While the general rule is that a party may not obtain summary judgment on an unpleaded cause of action (Cohen v. City Co. of New York, 283 N.Y. 112), it is also true that summary judgment may be awarded on an unpleaded cause of action if the proof supports such cause and if the opposing party has not been misled to its prejudice." Weinstock v. Handler, 254 A.D.2d 165, 166 (1st Dept. 1998). See Cecos Inter., Inc. v. Advanced Polymer Sciences, Inc., 245 A.D.2d 1017 (4th Dept. 1997); Home Savings of America, FSB v. Coconut Island Properties, Ltd., 226 A.D.2d 1138, 1139 (4th Dept. 1996); Deborah Inter. Beauty, Ltd. v. Quality King Distributors, Inc., 175 A.D.2d 791, 793 (2d Dept. 1991). Accordingly, and because plaintiff professes no surprise or prejudice, it is appropriate to consider the merits of the motion for summary determination that the deadlock provisions of the Shareholder Agreement require a buyout at defendant's offered price of $1,200,000. On the other hand, defendant's notice of motion did not seek dissolution as an alternate remedy and it would be inappropriate to consider that unpleaded remedy, which is raised for the first time in defendant's reply papers. Similarly, plaintiff's request for partial summary judgment declaring defendant in material breach of the Shareholder Agreement, not contained in any notice of motion and made for the first time in his reply affidavit served the day of oral argument, is denied.

The Motion to Disqualify

Turning first to the cross-motion to disqualify Phillips Lytle as defense counsel, plaintiff raises two arguments. First, plaintiff contends that defense counsel represented Leone throughout the failed negotiations concerning the 70%-30% ownership issue, and therefore must testify as a crucial witness. Plaintiff states in his affidavit that Mr. Burns "attempted to negotiate the defendant's purchase of a controlling interest in the Company," and therefore is a "key witness as to discussions and negotiations had between the parties on this crucial issue as to how much money the defendant actually stole from the company and me." D'Angelo affidavit (1-17-07) at ¶5-7. Second, plaintiff alleges that "Phillips Lytle and Thomas Burns, Esq. have been representing the company for years," although plaintiff refers to only two instances thereof, involving the purchase of Ken's Plumbing in 2002 and a Mechanic's Lien matter in 2000. Plaintiff contends that these prior representations of the corporation disqualify defense counsel from representing Leone on this suit. These arguments are taken in turn, but only after consideration of defendant's contention that the matter was waived by plaintiff's delay in making the motion.

The lawsuit was filed in September 2005 and defense counsel appeared in the action via service of the Answer in November 2005. No motion to disqualify was made until last month, nearly

two years later, and in response to defendant's summary judgment motion. Plaintiff's counsel now, in his cover letter enclosing plaintiff's Reply Affidavit, suggests that the delay was due to the fact that "[w]e only recently became aware of the true extent of Phillips Lytle's representation of D'Angelo's and its involvement in the issues surrounding the 70/30 issue," Pezzullo letter (1-23-07), but plaintiff does not make the same argument in his affidavit, or otherwise assert that he did not know, when he filed suit, that Burns represented defendant in the 2003 negotiations. Nor could he feign ignorance of Burns' representation given the fact that he hired Mr. Moehle to represent him in those negotiations and either received copies of correspondence from Burns (Burns letter of 1-15-03) or played an active part in negotiations he had to know Burns participated in on behalf of defendant (Burns letters of 3-25-03, 5-13-03). Given the correspondence cited immediately above, it would be incumbent on plaintiff himself to swear that he had no knowledge of Burns' representation of either defendant or the corporation, given his undisputed status as a 50% shareholder of a close corporation, not locked out of the business by this dispute and, according to the submissions on both sides, an active participant in the day-to-day affairs of the business. His failure to do so means that the delay in making the motion is unexplained.

The failure of explanation and plaintiff's undisputable

knowledge of the extent of Burns' prior representation of defendant also means that an inference may be drawn that the motion was "made to gain a tactical advantage in the litigation, or for purposes of delay." St. Barnahas Hospital v. N.Y. City Health and Hospitals Corp., 7 A.D.3d 83, 94-95 (1st Dept. 2004). See also, Talvy v. American Red Cross in Greater New York, 87 N.Y.2d 826 (1995), aff'ing for reasons stated at, 205 A.D.2d 143, 149, 153-54 (1st Dept. 1994). Moreover, considered with respect to Burns himself, plaintiff has presented only "arguably" meritorious reasons why he should be disqualified by reason of his alleged "crucial role in the negotiations underlying this dispute," and he "did not adequately show what the testimony of the advocate witness [Burns] is expected to be [and thus why he 'ought' to be called as a witness on behalf of defendant], how it will be adverse to the client [citation omitted], or how the client will be prejudiced." Phoenix Assurance Co. of N.Y. v. C.A. Shea & Co., Inc., 237 A.D.2d 157 (1st Dept. 1997)(bracketed material supplied). Accordingly, "[a]t this early 'stage of the proceedings, where discovery has not yet been had, disqualification . . . is premature." Id., *quoting* Kirshan, Shron, Cornell & Tertelbaum v. Sauarese, 182 A.D.2d 911, 912. "The fact that plaintiff intends to call . . . [Burns] as a witness is not sufficient in and of itself to overrule defendant's right to choose . . . [his] own counsel" or to avoid

the finding that the motion is premature. Id. at 912-13.

Even if plaintiff had succeeded in overcoming the laches and prematurity hurdles,[1] he could not succeed, even if he showed Burns ought to be called on defendant's behalf, but see S & S Hotel Ventures L.P. v. 777 S.H. Corp., 69 N.Y.2d 437, 445-46 (1987)("testimony may be relevant and even highly useful but still not strictly necessary."); Davin v. JMAM, LLC, 27 A.D.2d 371 (1st Dept. 2006); Eisenstadt v. Eisenstadt, 282 A.D.2d 570, 571 (2d Dept. 2001), in disqualifying defendant's current litigation counsel at Phillips Lytle. Davin v. JMAM, LLC, 27 A.D.3d 371, 371 (1st Dept. 2006); Sokolow, Dinaud, Mercadier & Carreras LLP v. Lacher, 299 A.D.2d 64, 76 (1st Dept. 2002). Despite some conclusory and unsupported suggestions to the contrary in plaintiff's submissions, "[a]t this juncture, there is no basis to conclude that any other attorney affiliated with

[1] The twin findings of laches and prematurity are not in conflict. The point of the prematurity finding is not that plaintiff should have waited to bring the motion, but that he has not, given the fact discovery has barely begun, met his burden to show that Burns ought to be called as a witness on behalf of defendant and has only arguably invoked DR 5-102(A). The laches finding is directed to an entirely different consideration, viz., that plaintiff should have alerted the court and the opposing party at the outset of litigation that he had an objection to Burns' representation of defendant. The fact that he failed to do so suggests employment of the motion as a tactical ploy to delay consideration of the impact of the buy-sell provisions. That is the only point of the laches finding, which in and of itself has rarely, if ever, been thought enough to cause a denial of an otherwise meritorious motion to disqualify. Where the motion invokes the court's discretion, as this one does, laches should be added to the equation.

the . . . [Phillips Lytle] firm ought to be called as a witness." Id. 299 A.D.2d at 76. See DR 5-102(A); Talvy, supra, 205 A.D.2d at 152 ("even assuming, arquendo, that a current . . . [Phillips Lytle] attorney 'ought' to be called as a witness at trial, the disqualification of the entire firm would still not be warranted"). Accordingly, the cross-motion is denied insofar as it concerns Burns' representation of defendant in 2003.

Plaintiff also contends that Phillips Lytle represented the corporation, and therefore him, in connection with the acquisition of Ken's Plumbing in 2002 and on a mechanics lien matter in 2000. Plaintiff fails to show, however, that Phillips Lytle represented him individually in either of these matters such that there is a danger that any confidences will be used against plaintiff here. As the court stated in Nunan v. Midwest, Inc., 11 Misc.3d 1052(A) (Sup. Ct. Monroe Co. January 10, 2006):

> "Unless the parties have expressly agreed otherwise in the circumstances of a particular matter, a lawyer for a corporation represents the corporation, not its employees." Talvy v. American Red Cross in Greater New York, 87 N.Y.2d 826 (1995), aff'g for the reasons stated at, 205 A.D.2d 143, 149 (1st Dept. 1994). See also, Bison Plumbing City, Inc. v. Benderson, 281 A.D.2d 955 (4th Dept. 2001); Omasnky v. 64 N. Moore Associates, 269 A.D.2d 336 (1st Dept. 2000); Walker v. Silver Eagle Aircraft Corporation, 239 A.D.2d 252 253, (1st Dept. 1997); Kushner v. Herman, 215 A.D.2d 633, 633-34 (2d Dept. 1995); Deni v. Air Niagara, 190 A.D.2d 1011 (4th Dept. 1993). Plaintiff has not established that Phillips Lytle "assumed an affirmative duty to represent . . . [her]"

> individually. Kushner v. Herman, 215 A.D.2d at 633.
>
> Plaintiff had no reason to expect separate representation by Phillips Lytle, even if she had decided to join the McGrain faction. Indeed, if she, without first declaring her intention to seek legal advice in an individual capacity and executing consents pursuant to DR 5-105(C), see below fn.3, disclosed her intention to do so to Phillips Lytle, she should nevertheless expect that such an intention immediately would be communicated to the Lovenduski faction. This is because both plaintiff as the corporate employee, and Phillips Lytle as corporate counsel, had an obligation to communicate to the corporation any information bearing upon corporate business. Id. 205 A.D.2d at 149-50. See also, Meyers v. Lipman, 284 A.D.2d 207 (1st Dept. 2001); Polovy v. Duncan, 269 A.D.2d 111, 112 (1st Dept. 2000). This is not altered by the mere fact that plaintiff was named as party respondent in the corporate dissolution action. Id. 205 A.D.2d at 150 ("even in circumstances where the employer's attorney represented the employee individually, albeit jointly with former employer, in prior litigation, the court rejected the former employee's attempt to disqualify the employer's attorney because of shared confidences or conflict of interest grounds, holding that the former client could not have reasonably assumed that the attorneys would withhold from the present client the information received")(citing Allegaert v. Perot, 565 F.2d 246, 250-51 (2d Cir. 1977)).

See also Purchase Partners II LLC v. Westreich, NYLJ Monday, Feb. 5, 2007, at p.22 col. 1 (Sup. Ct. N.Y. Co.)(Fried, J.). Thus, plaintiff has no reason to fear use against him of any confidences. He could not have imparted any to Phillips Lytle in connection with its representation of the corporation in either matter. DR 5-108(A)(2); DR 4-101; Jamaica Pub. Serv. Co. v. AIV Ins. Co., 92 N.Y.2d 631, 636-38 (1998).

Nor does plaintiff show that any of the two prior concluded

matters are related to the current dispute such as to create a presumption of shared confidences under the substantial relationship test. DR 5-108(A)(1); Solow v. Grace and Co., 83 N.Y.2d 303 (1994). Indeed, the only "related" matter was Phillips Lytle's prior representation of defendant, not plaintiff who was separately represented, in the failed negotiations concerning the 70/30 stock ownership proposal.

The motion to disqualify is denied.

Defendant's Motion for Partial Summary Judgment

It is well settled that "the proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact." Alvarez v. Prospect Hosp., 68 N.Y.2d 320, 324 (1986) (citations omitted). See also Potter v. Zimber, 309 A.D.2d 1276 (4th Dept. 2003) (citations omitted). "Once this showing has been made, the burden shifts to the nonmoving party to produce evidentiary proof in admissible form sufficient to establish the existence of material issues of fact that require a trial for resolution." Giuffrida v. Citibank Corp., 100 N.Y.2d 72, 81 (2003), *citing* Alvarez, 68 N.Y.2d at 324. "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the responsive papers." Wingrad v. New York Univ. Med. Ctr., 64 N.Y.2d 851, 853 (1985) (citation omitted). See also Hull v. City of North Tonawanda, 6

A.D.3d 1142, 1142-43 (4th Dept. 2004). When deciding a summary judgment motion, the evidence must be viewed in the light most favorable to the nonmoving party. See Russo v. YMCA of Greater Buffalo, 12 A.D.3d 1089 (4th Dept. 2004). The court's duty is to determine whether an issue of fact exists, not to resolve it. See Barr v. County of Albany, 50 N.Y.2d 247 (1980); Daliendo v Johnson, 147 A.D.2d 312, 317 (2nd Dept. 1989) (citations omitted). CPLR 3212(e) allows a court to grant partial summary judgment as to one or more causes of action. Defendant seeks an order granting partial summary judgment as to the enforcement of a buy-sell provision at Section7.2 of the Shareholders Agreement ("the Agreement").

Section 7 of the Agreement is entitled "Deadlock Between Shareholders" and states:

> 7.1 Definition.
>
> For purposes of this Agreement, a "Deadlock" will be deemed to exist between the Shareholders if they are so divided as to the direction of the Company's business and the management of the Company's affairs,[2] that the votes required for action by the members cannot be obtained.
>
> 7.2 Option in Event of Deadlock.
>
> If a Deadlock exists between the Shareholders, any Shareholder may offer to purchase all, but not less than all, of the shares then owned by the other Shareholder by

[2] emphasis supplied.

> delivering to the other Shareholder his written offer to purchase the Shares of the Shareholder. Such offer shall set forth the purchase price and the terms for payment of the purchase price for the other Shareholder's Shares. The Shareholder to whom any such offer is made shall have thirty (30) days from the date such offer is given in which either to accept the offer as proposed or to give notice to the Offering Shareholder of his intent to purchase the Shares of the Offering Shareholder at the same price and on the same terms set forth in the written offer from the Offering Shareholder. If the Shareholder to whom an offer is made pursuant hereto fails to give notice of his decision either to sell his shares or to purchase the Shares of the Offering Shareholder within the thirty (30) day period after the offer is given, such Shareholder shall be deemed to have accepted the offer on the terms set forth therein. Any closing pursuant to this Paragraph 7.2 shall take place not later than thirty (30) days after any Shareholder becomes obligated to sell his or her Shares pursuant hereto.

Plaintiff contends that summary judgment must be denied because defendant substantially breached the Shareholder Agreement. Plaintiff does not allege any breach of the express terms of the Shareholder Agreement, but alleges instead that defendant breached the implied covenant of good faith and fair dealing, which is implied in all contracts. See Outback/Empire I, Ltd. Partnership v. Kamitis, Inc., __ A.D.3d __, 826 N.Y.S.2d 747 (2d Dept. 2006); Wilmington Trust Co. v. Strauss, 13 Misc.3d 1231(A) (Sup. Ct. N.Y. Co. 2006). The implied covenant "is breached when a party to a contract acts in a manner that, although not expressly forbidden by any contractual provision, would deprive

the other party of the right to receive the benefits under the agreement." Jaffe v. Paramount Communications, Inc., 222 A.D.2d 17, 22-23 (1st Dept. 1996). See also, Dalton v. Educational Testing Service, 87 N.Y.2d 384 (1995). New contractual rights are not created by an implied covenant. See Fesseha v. TD Waterhouse Investor Serv., Inc., 305 A.D.2d 268 (1st Dept. 2003); In re Enron Corp., 292 B.R. 752, 783 (S.D.N.Y. 2003).

Unquestionably, plaintiff continues to receive substantial benefits under the Agreement. He is employed and draws salary and corporate distributions. He alleges, however, that, but for defendant's looting of company assets in various ways to the tune of some $600,000, he would have benefitted even more if defendant's activities alleged to be in derogation of the corporation's interests had not occurred. Indeed, plaintiff alleges that many of defendant's transgressions were remedied during bilateral negotiations during 2006 and before. To be sure, plaintiff alleges fraud in defendant's cashing for the latter's benefit of certain checks made payable to the corporation. But the damage alleged is not that plaintiff was deprived of all benefits accruing to him under the Shareholder Agreement, but instead is that the benefits accruing to him would have been marginally greater if defendant had not committed the alleged fraud/conversion/corporate looting and the like. The question is whether such conduct, if proved, substantially

defeats the expectation of the parties to the deadlock buy/sell provision.

The deadlock provisions themselves do not say whether they are to be enforced notwithstanding that one party may have breached an implied covenant of good faith by committing corporate waste and conversion of assets, whether by fraud or otherwise. Defendant contends that the provision is a stand-alone provision and was designed to avoid just this type of litigation. Plaintiff contends, on the other hand, that the deadlock provisions presuppose an equal financial footing on the part of each party and that defendant's conduct gave him a superior financial position or ability to take advantage of the buy/sell provision. On the latter point, however, the Shareholder Agreement itself makes no distinction according to the financial ability of either party to invoke §7.2, and assuredly would not by its terms prevent defendant from using separately obtained family or other funds in a buyout of the corporation. Commentators have observed that a buy-sell agreement of the "shoot-out" variety, also variously referred to as a "Texas buy-sell," or a "Russian Roulette" buy-sell, as this one assuredly is, "can operate in favor of the wealthier party." Wayne M. Gazur, The Forgotten Link: "Control" in Section 482, 15 Northwestern J. Inter. L. and Bus. 1, 45 n.170 (1994). To the same effect are John Goodgame, When Getting Out Is Hard To Do, 14

Bus. Law Today 31, 36 (May/June 2005); Note, Practical Considerations for Drafting and Utilizing Deadlock Solutions for Non-Corporate Business Entities, 2001 Colum. Bus. Rev. 231 (text at nn. 35-43, 55-56, and immediately following)(2001). The parties did not negotiate terms to protect the less wealthy shareholder, and the court cannot now supply them. Cf., Larken Minnesota, Inc. v. Wray, 881 F.Supp. 1413 (D. Minn. 1995), aff'd, 89 F.3d 841 (8th Cir. 1996). Accordingly, the equal financial footing argument does not avail plaintiff.

Nor does plaintiff draw strength from his argument that a deadlock as defined in the Agreement has not occurred because the business is thriving despite the parties' differences, and because the day-to-day management of the business has survived well enough. The deadlock provision unambiguously refers to shareholders "so divided as to the direction of the Company's business and the management of the Company's affairs, that the votes required for action by the members cannot be obtained." §7.1 (emphasis supplied). Thus it is not plausible to read this provision to apply to the day-to-day operations of the company, or as precluding the deadlock of a thriving business. Chimart Associates v. Paul, 66 N.Y.2d 570, 573 (1986)("but the provision does not reasonably admit of such an interpretation"). The parties have a real and continuing dispute concerning management of the company's affairs on a number of fronts: (1) a proposed

70/30 percent ownership split; (2) whether continuation of the 70/30 profit/distribution split acquiesced in the plaintiff in 2001 and 2002 should be continued thereafter, and (3) whether plaintiff should have any control over payroll/personnel matters. That dispute has persisted through unsuccessful settlement negotiations for over three years. They simply cannot obtain the votes "for action" to resolve these management disputes. Accordingly, defendant establishes as a matter of law under the Agreement that a deadlock exists triggering the buy-sell provision, and plaintiff fails to raise an issue of fact to the contrary.

The more serious objection plaintiff raises is that plaintiff has materially breached the Shareholder Agreement and therefore is not entitled to specific performance of the deadlock provisions under the "unclean hands" doctrine.[3] He relies in large measure on Holland v. Ryan, 307 A.D.2d 723 (4th Dept. 2003), in which the appellate court, sua sponte, declined summary judgment to a plaintiff in a real estate purchase and sale dispute who, it was alleged in sworn statements, "agreed to a side payment of $50,000 to enable plaintiff to avoid a higher assessed value for the property." Id. 307 A.D.2d at 725. The court held that, "'as a matter of public policy,'" the court

[3] Plaintiff apparently does not seek rescission of the agreement, either in his original complaint or in the proposed amended complaint.

should find "a triable issue of fact whether the basis of this action 'is immoral and one to which equity will not lend its aid.'" Id. 307 A.D.2d at 725 (quoting Janke v. Janke, 47 A.D.2d 445, 450 (4th Dept. 1975), aff'd for reasons stated, 39 N.Y.2d 786 (1976), and Muscarella v. Muscarella, 93 A.D.2d 993 (4th Dept. 1983), respectively).

In Holland v. Ryan, however, the plaintiff moved for summary judgment on the very contract entered into to avoid a lawful duty to pay taxes. Our Court of Appeals, and this department, has been careful to apply the unclean hands doctrine "only where the plaintiff [defendant in this case] has dealt unjustly in the very transaction of which he complains." Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d 282, 286-87 (1963). The equitable defense of unclean hands "is not an avenger at large." Id. 13 N.Y.2d at 286 (citing 2 Pomeroy, Equity Jurisprudence §399; Rice v. Rockefeller, 134 N.Y. 174, 187 (1892)). In seeking enforcement of the §§7.1-7.2 buy-sell provisions of the Shareholder Agreement, defendant "is not seeking to enforce a contractual duty of . . . [plaintiff] against which illegality could be argued [citations omitted], or to enforce an 'inequitable' interest in . . . [the assets of the corporation]." Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d at 286. The buy-sell provision, the contractual term sued on creating the duty to sell, is not one against which any of plaintiff's allegations of

wrongdoing pertain. "There must at least be a direct connection between the illegal transaction and the obligation sued upon." McConnell v. CommonwealthPictures Corp., 7 N.Y.2d 465, 471 (1960). In other words: "When equitable relief is sought, not to enforce an executory obligation arising out of an illegal transaction, but to protect a status of ownership . . . [arising out of an indisputably valid contract executed well before the alleged wrongdoing of defendants], wrongs done by . . . [defendant] in respect of the property at some time prior to the acquisition of . . . [defendant's buy-sell interest (i.e., by virtue of the happening of a deadlock under the Agreement for reasons quite divorced from defendant's alleged wrongdoing)] may not now be raised by this . . . [plaintiff] to defeat otherwise available relief." Seagirt Realty Corp. v. Chazanof, 13 N.Y.2d at 287 (bracketed material supplied). See also, Fundamental Portfolio Advisors, Inc. v. Tocqueville Asset Management, L.P., 22 A.D.3d 204, 217 (1st Dept. 2005); National Union Fire Ins. Co. of Pittsburgh v. Robert Christopher Associates, 257 A.D.2d 1, 8 (1st Dept. 1999); Messersmith v. American Fidelity Co., 187 App. Div. 35 (4th Dept. 1919), aff'd 232 N.Y. 161 (1921); 55 N.Y. Jur.2d, Equity §118 (misuse of confidential information external to the contractual provision at issue, thus failing to "establis[h] wrongdoing with respect to the negotiation of the contract for which the . . . [defendant] is seeking specific

performance, does not support the affirmative defense of unclean hands"); See McClintock on Equity (2d ed. 1948) § 26 ("The general principle is that equity will not lend its aid to enable a party to reap the benefit of his misconduct, or to enable him to continue it, but, where the misconduct has ceased and the right claimed in the suit did not accrue because of it, the misconduct will be held to be collateral and not to defeat the right to affirmative relief.")(emphasis supplied). By any measure, the right claimed by defendant did not accrue by reason of his alleged misconduct.

These principles are well known in the Fourth Department. In Janke v. Janke, 47 A.D.2d 445 (4th Dept. 1975), aff'd for reasons stated below, 39 N.Y.2d (1976), the court declined to apply the unclean hands doctrine because "courts will sever the legal from the illegal aspects where possible to afford relief." Id. 47 A.D.2d at 450-51. "Where the illegal transactions can be separated from plaintiff's claim, the unclean hands doctrine should not be invoked to defeat . . . [the moving party's claim]." Id. 47 A.D.2d at 451. Here, defendant in his moving papers eschews any effort to defeat a fair consideration of plaintiff's several claims against him. Defendant only wants summary judgment declaring that the buy-sell deadlock provisions have been invoked, and is content to permit the parties' competing claims of fraud, conversion, and misappropriation

(allegedly occurring well after execution of the Shareholder Agreement) to proceed to discovery and trial. In the partnership context, the doctrine of unclean hands does not defeat an otherwise meritorious cause of action for an accounting. Smith v. Long, 281 A.D.2d 897, 898-99 (4th Dept. 2001); Dwyer v. Nicholson, 109 A.D. 862, 863 (2d Dept. 1985). In Dwyer v. Nicholson, supra, over the objections that unclean hands should preclude relief, the court held that no hearing was "necessary to determine plaintiff's right to an accounting where the formation of her right, to wit, the partnership agreement, is clearly proven," and the legal claims as between the parties should operate "as set-offs to the accounting only." Id. 109 A.D.2d at 863.

The same situation obtains here. Defendant's right to specific performance of the buy-sell deadlock provisions relate to an agreement entered into well prior to any alleged wrongdoing by defendant, and is therefore severable from the causes of action in plaintiff's complaint and proposed amended complaint. Moreover, the circumstances giving rise to the deadlock, the parties' dispute concerning the 70/30 split of ownership and their current dispute concerning whether a 70/30 split of distributions is appropriate given defendant's claimed superior management skills, despite the now conceded 50-50 ownership interests showed by each side, together with their dispute over authority to make personnel and payroll decisions on behalf of

the corporation, are entirely divorced from the parties' competing claims against each other, the latter of which may be prosecuted as offsets/credits/debits from the buy-sell purchase price.[4] I have found two cases tending to the contrary view, Ross v. Meyer, 286 A.D.2d 610 (1st Dept. 2001); Cohen v. Katz, 242 A.D.2d 448 (1st Dept. 1997), but on their facts they are distinguishable, and in any event to the extent they are not distinguishable, they are incompatible with Seagirt Realty Corp. v. Chazanoff, supra, and Janke v. Janke, supra. They also are inconsistent with the decision in Goldberg v. Goldberg, 173 A.D.2d 679 (2d Dept. 1991) and Fender v. Prescott, 64 N.Y.2d 1079 (1985), aff'ing for the reasons stated on that part of opinion below as deals with specific performance, 101 A.D.2d 418 (1st Dept. 1984). In Goldberg, the court upheld plaintiff's right to the equitable remedy of partition as against the defense of unclean hands by reason of his alleged "embezzle[ment][of] funds from an account which was used to pay expenses of the subject property." Goldberg, 173 A.D.2d at 680. The court held that the

[4] This conclusion is not altered by the fact that plaintiff also contends that defendant's continuation of the 70/30 profit/distribution split after the parties' two year agreement regarding the same amounts to conversion of corporate assets and a breach of fiduciary duty. It is defendant's claimed right or entitlement to the continued split in his favor, and plaintiff's rejection of it, that forms the dispute over the future of the company and the management of its affairs. This consideration is quite separate from what amounts defendant paid himself since 2003, and how the payments were engineered by him, each of which will be resolved when the competing claims of the parties are resolved, together with an accounting, if necessary.

claim of embezzlement was separate from the property rights at issue and that "defendant's remedy is to seek an allowance or credit against the plaintiff in the partition suit." Id. 173 A.D.2d at 680. To be sure, the accounting cases and partition cases involve a mandated statutory remedy, but the Shareholder Agreement at issue here involves a no less mandatory form of relief once the contractual preconditions, i.e., deadlock (as defined), occur.

In Fender v. Prescott, the principal case relied on by defendant here, the party against whom specific enforcement of the corporate buy-sell agreement was sought was alleged to have committed misappropriation and diversion of corporate opportunities and to have otherwise breached his fiduciary duty to the corporation and the shareholder seeking specific enforcement of the buy-sell agreement entered into by the two 50% shareholders. Unlike in this case, the buy-sell agreement was entered into shortly after the conduct asserted as unclean hands was committed (here the asserted unclean hands arose out of conduct occurring years after the buy-sell agreement was executed). Id. 101 A.D.2d at 419-20. Although the court held that factual issues precluded determination on summary judgment of the misappropriation/diversion/breach of fiduciary duty claims against the party seeking enforcement of the buy-sell agreement, id., 101 A.D.2d at 423-24, summary judgment on the specific performance claim was granted because "[t]he terms of the buy-

sell agreement are clear and specific and required defendant to transfer his shares to plaintiff upon Fender's exercise of the option provided for in the agreement." Id. 101 A.D.2d at 424. The opinion does not reveal whether the unclean hands doctrine was raised as a defense to specific performance of the buy-sell agreement, but, as plaintiff insists here, the court would be bound to do so sua sponte if the defense was even arguably meritorious. Holland v. Ryan, 307 A.D.2d at 725; Janke v. Janke, 47 A.D.2d at 449-50 (unclean hands raised sua sponte and rejected by the court on the ground that "the courts will sever the legal from the illegal aspects where possible to afford relief").

Accordingly, the motion for summary judgment directing specific performance of the buy-sell deadlock provisions of the Shareholder Agreement is granted.

The motion to amend the complaint is granted.

SO ORDERED.

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KENNETH R. FISHER
JUSTICE SUPREME COURT

DATED: February 13, 2007
Rochester, New York