Cohen v Lenoble
2007 NY Slip Op 33091(U)
September 19, 2007
Supreme Court, New York County
Docket Number: 0601871/2007
Judge: Helen E. Freedman
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SCANNED ON 9/25/2007

[* 1]

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HELEN E. FREEDMAN PART 39
Justice

J. RICHARD COHEN, GLENN S. COHEN, and GUY R. COHEN, Individually and Derivatively on Behalf of COLE REALTY CORP.,

Plaintiffs,

v.

PAUL LENOBLE, GAIL LENOBLE, THE CLARETT GROUP LLC, DANIEL HOLLANDER, and COLE REALTY CORP.,

Defendants.

INDEX NO. 601871/07

MOTION DATE

MOTION SEQ. NO. 001

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion is decided in accordance with accompanying memorandum decision.

Dated: September 19, 2007

Helen E. Freedman, *J.S.C.*

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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J. RICHARD COHEN, GLENN S. COHEN, and GUY R. COHEN, individually and derivatively on behalf of COLE REALTY CORP.,

Plaintiffs,

-against- Index No. 601871/07

PAUL LENOBLE, GAIL LENOBLE,THE CLARETT GROUP LLC, DANIEL HOLLANDER, and COLE REALTY CORP.

Defendants.

----------X

HELEN E. FREEDMAN, J:

In this action plaintiffs J.Richard Cohen, Glenn S. Cohen, and Guy R. Cohen (collectively "Cohen" or "the Cohens"), individually and derivatively on behalf of Cole Realty Corp. seek to preliminarily and permanently enjoin Paul and Gail LeNoble ("the LeNobles") from selling or transferring their shares of Cole Realty Corp. to the Clarett Group, LLC, and Daniel Hollander, a principal of Clarett (collectively "Clarett") or any other person or entity that is not eligible to be a shareholder of a Subchapter S corporation, pursuant to 26 U.S.C. § 1361. In addition to an injunction against the sale, plaintiffs seek to enjoin defendants from interfering with efforts to lease portions of the property. The underlying claims against the LeNobles are for breach of fiduciary duty and corporate waste for which compensatory and punitive damages are sought. The claim against Clarett and Hollander are for aiding and abetting breach of fiduciary duty.

Cole Realty Corporation ("Cole Realty") is now an S corporation that owns four acres of land in Astoria, Queens. Cole Realty is an entity formed in 1984 by J. Richard Cohen and Paul LeNoble to purchase the Astoria land that would accommodate their respective lumber

businesses. LeNoble Lumber Co. was a lumber company and JRC Lumber Corp. (Cohen's company "JRC") was a lumber moulding company. The Cohens (originally Richard and Shirleen) and the LeNobles (Paul and Gail) each own a 50% interest in Cole Realty. At the present time, the Board of Directors consists of Paul LeNoble, president, Richard Cohen, vice president, and Gail LeNoble, secretary. The parties did not draft a shareholder's agreement, and there are no documents restricting transfers of shares or providing for a right of first refusal, but in 1987 LeNoble advanced JRC Lumber $121,340 pursuant to a written agreement that provided that in the event of default a proportionate amount of the Cohen's stock would be held in escrow and paid over to LeNoble. The debt was never repaid and no share transfer occurred, but there has been a reaffirmation of the debt to the extent that the Cohens agreed to pay Paul LeNoble $170,000 in 2005.

By 2003, neither lumber company was in occupancy, and it appeared that both parties wanted to sell the property. JRC had been sold and the new owner remained as a tenant, but left with a rent arrearage. There were disputes concerning leasing of the property. Although both parties engaged in attempts to sell the property, and an offer of up to $17,500,000 from Marx Development Group was obtained, the sale did not go through. LeNoble contends that Richard Cohen's son Guy Cohen, an attorney, to whom some shares of the Cohen portion had been transferred, "sabotaged" the sale. A second offer by one Thankam Vasilatos (or Vasilakos) was also allegedly thwarted by Guy Cohen. The younger Mr. Cohen then obtained an appraisal at his own expense which came in at $9,000,000 with an indication that the value of the land was potentially as much as $30,200,000 if zoning were changed.

Later, the Cohens (primarily Glenn Cohen) offered to buy LeNoble out for $5,000,000

after commissioning a Phase II Environmental Study, also at their expense and against the wishes of the LeNobles, which they claim decreased the value of the land because of prospective remediation costs. They now insist that a known broker like Cushman and Wakefield be hired to market the land at a "competitive" price. Clarett Corporation, through its principal Daniel Hollander, avers that it has negotiated an offer to the LeNobles of $8 million for their shares, but that when he tried to negotiate with the Cohens, they set an asking price of way above what the LeNobles sought so he made an opening offer to the Cohens of an amount that was less than what he had offered the LeNobles. He indicates that Clarett would be prepared to increase its offer. Hollander also attests that Clarett is a well established developer of residential and mixed-use buildings, but that it can not purchase the shares in a manner that would allow Cole Realty to retain its S Corporation tax status because of Clarett's structure, its financing and partnerships. Hollander states that for Cole to retain Subchapter S status, Clarett would have to entrust significant funds to an individual nominee who would be subject to bankruptcy and community property laws. A corporate shield would be necessary for the financing that would be needed for development.

In support of its application for a preliminary injunction, plaintiffs claim that changing the corporate structure to a Subchapter C Corporation would subject them to double taxation in that the corporation would be taxed on earnings and dividends and the individual recipients of the earnings would again be taxed on their portion of income. They contend that they would also be double taxed on the gains that they would realize from the future sale of their stock once the corporation was no longer eligible for S corporate status. A Subchapter S corporation is not taxed at the corporate level. Each shareholder pays income tax on the dividend income he or she

receives. Plaintiffs cite *A.W. Chesterton Co. Inc. v Chesterton,* 128 F.3d 1 (1st Cir. 1997). In that case, the First Circuit affirmed the United States District Court for the District of Massachusetts which enjoined a minority shareholder from effecting a transfer to two dummy corporations that he had set up which would have destroyed the subchapter S status of the Corporation. The shareholders agreement did have a right of first refusal by the company or other shareholders which defendant circumvented by setting up the shell corporations to make the purchase. The purpose of setting up the shell corporations was to force the company to purchase his shares since he was unable to sell the shares to the company or elsewhere. The district court found that minority shareholders had an elevated fiduciary duty to the corporation and other shareholders, that the proposed sale which would terminate the Subchapter S status was a breach of that fiduciary duty, that the corporation would suffer irreparable harm as a result of the sale, and the balance of equities weighed in favor of an injunction. The United States Court of Appeals for the First Circuit found that the district court had not abused its discretion in finding that Chesterton had breach his fiduciary duty of "utmost good faith and loyalty," and had pursued his own interest, and that loss of the Subchapter S status would cause irreparable harm to the corporation and other shareholders.

Plaintiffs also cite *Zeitlin v. Hanson Holdings, Inc.,* 48 N.Y.2d 684, 412 N.Y.S.2d 877 (1979) for the general proposition that "bad faith fiduciary transactions may serve to bar a planned sale of shares." However, defendants also cite that case averring that it specifically allowed the majority shareholder to transfer controlling shares of stock at a premium price without first offering the stock to the minority shareholders. Defendants also cite *Levy v. American Beverage Corporation,* 265 A.D.208, 38 N.Y.S.2d 517 (1st Dept. 1942) which held that

where there was no evidence of actual fraud, the sale by majority shareholders of shares that caused loss to the company was not compensable. That court specifically indicated that a majority stockholder does not become a fiduciary for other stockholders merely as a result of stock ownership.

A party seeking a preliminary injunction has the burden of showing (1) likelihood of success on the merits, (2) irreparable harm in the absence of the injunction, and (3) that the balance of equities weighs in its favor. *W.T Grant Co. v. Srogi,* 52 N.Y.2d 496, 438 N.Y.S.2d 761 (1981). In the absence of fraud or abusive conduct, a shareholder is free to dispose of his stock as his self-interest dictates. *Borden v. Guthrie,* 23 A.D.3d 313, 260 N.Y.S.2d 769 (1st Dept. 1965). Absent looting of corporate assets, conversion of a corporate opportunity, fraud or other acts of bad faith, a controlling stockholder is free to sell and a purchaser is free to buy...a controlling interest. *Zeitlin v. Hanson Holdings, Inc.,* 48 N.Y.2d 684, 412 N.Y.S.2d 877 (1979).

While the federal district court in *A.W. Chesterton Co. Inc. v. Chesterton,* 128 F.3d 1 (1st Cir. 1997) found that under the particular circumstances of that case, the prospect of conversion from Subchapter S to a Subchapter C constituted a breach of a fiduciary duty to the majority shareholders who had a right of first refusal, the circumstances here are markedly less sympathetic to plaintiffs. The LeNobles, desirous of retiring, have been attempting to sell their shares in Cole Realty at least since 2005, and the Cohens, despite alleged protestation to the contrary, have resisted attempts to sell their Cole Realty shares. Although the Cohens now claim they want to list the Cole Realty property with Cushman and Wakefield or another top broker, they have done nothing to further such a plan. On the other hand, the LeNobles have produced a buyer who is prepared to purchase all of the shares for significantly more than the current

appraised value or the LeNoble shares alone.

Based on what are uncontroverted facts, plaintiffs cannot satisfy their burden of demonstrating either likelihood of success on the merits or a balance of equities in their favor. In the absence of a shareholders agreement to the contrary, shareholders ordinarily have the right to sell shares to further their own interests. The LeNobles have set forth good reasons for wanting to sell their shares to Clarett. While it is true that changing the nature of the corporation from a Subchapter S to a Subchapter C corporation might inflict monetary damage upon the Cohens shares, that is not the purpose of the proposed sale. The LeNobles are not trying to change the nature of the corporation for any nefarious reason even though Clarett's purchase would have that effect of converting the corporation to a less desirable form. Clarett, on the other hand, offers a legitimate reason for not acquiring the shares in a form that would allow the corporation to continue as a Subchapter S entity. Thus, it does not appear that any of the defendants have breached their fiduciary obligation to plaintiffs. Should any evidence of a breach surface, monetary damages would compensate plaintiffs.

Based on the foregoing, the application to enjoin the sale or transfer of shares of Cole Realty Corp. to Clarett Group or any other entity is denied.

Settle Order on notice.

Dated: September 19, 2007

Enter:

Helen E. Freedman, J.S.C.