

Third Eye Prod., LLC v Malanoski

2008 NY Slip Op 33136(U)

November 18, 2008

Supreme Court, New York County

Docket Number: 602523/2008

Judge: Herman Cahn

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

PRESENT: Cahn
Justice

PART 49m

Third Eye Production S, LLC

INDEX NO. 602523/08

- v -

MOTION DATE _____

MOTION SEQ. NO. 001

Martin Malanowski et al

MOTION CAL. NO. _____

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

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DISPOSITION IN MOTION SEQUENCE

Dated: 11/18/08

[Signature]
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

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

[* 2]
SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 49

-----X
THIRD EYE PRODUCTIONS, LLC,

Plaintiff,

-against-

Index No. 602523/2008

MARTIN MALANOSKI and HOME NYC, LLC,

Defendants.
-----X

Herman Cahn, J.:

Motion sequence numbers 001 and 002 are consolidated herein for purposes of disposition.

In motion sequence number 001, plaintiff Third Eye Productions, LLC moves for an order: preliminarily enjoining defendants Martin Malanoski and Home NYC, LLC from using the trade name, "Home NYC," in furtherance of any business; compelling defendants to account for monies received and paid through any Home NYC, LLC financial account; compelling defendants to promptly turn over all business assets in their possession to Third Eye, including all cash, files and equipment, in order to prevent any further misappropriation of assets; and directing an expedited discovery schedule, CPLR 6301.

In motion sequence number 002, Third Eye moves for an order disqualifying the law firm of Mitchell Silberberg & Knupp, LLP, including Lauren Wachtler, Esq., a member of the firm, from representing defendants in this action on the grounds that said firm and attorney are seriously conflicted because of concurrent and prior representation, and in any event should not represent defendants because of the advocate-witness rule.

Third Eye was formed in January 2005 in Delaware by Malanoski and nonparty Harry

Armon. Armon owns 80% of Third Eye and is its managing member and chief executive officer (CEO). Malanoski owns the remaining 20% and is an officer and director.

Third Eye alleges that, at the time of its creation, Armon and Malanoski set up a division in New York City to provide post-production editing services for commercial media advertisements. Further, the division is named Home NYC and is run on a day-to-day basis by Malanoski. Third Eye paid Malanoski an annual salary and authorized him to draw additional funds, as needed. Third Eye alleges that Malanoski led Armon to believe that the Home NYC division was breaking even financially and was worth approximately \$200,000. Third Eye claims that it uses the name Home NYC as its trade name and that the name appears on all its letters and advertising materials.

Third Eye alleges that, on August 25, 2008, Armon visited the Home NYC division's offices on Greene Street, where he spoke with employees about Malanoski's operation of the division and examined its financial books and records. Armon discovered that Malanoski, in August or September 2007 and while a Third Eye officer and director, incorporated an independent corporation under the name, "Home NYC, LLC," which provided the same services to the same clients as did the Home NYC division, while using the division's employees, equipment, and assets.

Third Eye admits that, on the date of his visit, Armon, with the aid of a signatory on a Home NYC, LLC bank account, withdrew \$48,000 from the account and transferred those funds to Third Eye (Compl, ¶ 28). Armon represents that he, acting on behalf of Third Eye, used \$17,000 of the funds to pay the Home NYC division payroll and \$10,000 to pay Third Eye's attorneys' fees incurred in this action. By order issued September 4, 2008, the Court directed

Armon to use \$17,000 of the funds to meet the next payroll and the remaining funds to pay the premium due on the employees' health insurance plan. The Court further directed that any shortfall on these payment obligations must be paid by Home NYC, LLC. Lastly, the Court directed Third Eye to provide defendants with a written list describing in detail which Home NYC expenses were paid out of the \$48,000, and prohibited Third Eye from spending any portion of the funds to make payments not directed elsewhere in the order.

In the complaint, plaintiff alleges that, beginning in August or September 2007, Malanoski diverted customer payments intended for its Home NYC division to his Home NYC, LLC corporation, by depositing them into a bank account that he had set up in the name of the LLC entity. Third Eye also alleges that, while Malanoski did pay some funds over to it and paid the salaries of certain Third Eye employees, he retained funds without Third Eye's knowledge or authorization. Plaintiff further argues that, in this manner, Malanoski diverted Third Eye's funds, assets and customers, having an approximate value of \$1,000,000 and amassed accounts receivable totaling approximately \$220,000 and approximately \$5,000 in cash rightfully belonging to Third Eye. Plaintiff claims during the period of Malanoski's alleged defalcations, it paid Malanoski approximately \$30,000 as salary.

Third Eye alleges that, in an attempt to conceal his misconduct from Third Eye, Malanoski caused the LLC entity to pay almost \$200,000 to the landlord of the space rented by Third Eye on Greene Street in Manhattan for reasons unrelated to rental obligations, and that the landlord has paid funds to the LLC entity.

Third Eye argues that Malanoski's misconduct has destroyed the ability of Armon and Malanoski to work together and that they are at an impasse as to how, or whether, to continue to

[* 5]

operate Third Eye together.

On these allegations, Third Eye asserts causes of action against Malanoski for breach of fiduciary duty and against both defendants for misappropriation, fraudulent concealment, conversion, unfair competition, diversion of corporate opportunity, and use of a name with intent to deceive, *see* General Business Law § 133. Third Eye seeks to impose a constructive trust on certain funds held by defendants, and seeks injunctive relief, an accounting, and more than \$1,000,000 in compensatory and punitive damages.

Defendants deny Third Eye's allegations of misconduct and allege that Malanoski began using the name, Home NYC, in 2005, prior to meeting Armon, and formed the LLC entity in 2007 to conduct an entirely different business from that allegedly conducted by Third Eye. Defendants allege that the LLC entity was formed as a vehicle with which to create and produce original video content, and never performed post-production editing.

By order dated August 29, 2008 and extended September 4, 2008, the Court granted Third Eye's request for a temporary restraining order to the extent that the Court temporarily restrained defendants and their agents from withdrawing funds from the Home NYC, LLC entity bank accounts other than in the ordinary course of business and from diverting funds due to the LLC entity. If further directed them to maintain the status quo and do nothing to interfere with the equipment at the Home NYC division office facilities, together with other, related relief, pending further court order.

Third Eye now seeks to: preliminarily enjoin defendants and their agents from using the trade name, "Home NYC," in furtherance of any business; compel defendants to fully account for all monies received and paid through any Home NYC, LLC financial account; and compel

defendants to promptly turn over all business assets in their possession to Third Eye, including all cash, files and equipment, in order to prevent further misappropriation of assets.

In partial opposition, defendants agree to most of the interim relief requested by Third Eye solely in order to preserve the Home NYC, LLC, without prejudice to their defenses asserted here and their right to assert claims, including breach of fiduciary duty claims, against Armon. They contend that Third Eye lacks standing to seek the relief it now requests and that Malanoski had an absolute right to start a new, noncompeting business.

First, defendants expressly agree to stop using the Home NYC name in furtherance of any business, except as to current clients whom they will identify to Third Eye, pending a final determination of this action or further court order (Malanoski Aff., ¶¶ 8, 12).

Second, defendants expressly agree, without prejudice to their defenses and proposed claims, to provide Third Eye or a receiver with financial books and records and to account for all monies received and paid through all Home NYC, LLC financial accounts since its formation (*id.*, ¶¶ 13, 14). Defendants have already produced a preliminary draft of a schedule of monies received and paid out by the LLC entity during the pendency of this action.

Last, defendants expressly agree, pending a final determination in this action and without prejudice to their defenses and claims, to preserve all Home NYC cash, files, and equipment; however, they refuse to turn over such cash and assets to Third Eye (*id.*, ¶¶ 15, 16).

Defendants request that a receiver be appointed to open a bank account to hold Home NYC funds and receivables received during the pendency of this action and to pay Home NYC expenses from that account. Defendants have produced a schedule of Home NYC accounts receivable and payable and agree to pay the invoices listed from cash in its bank account, as

directed in the prior court order, or until a receiver is appointed to perform this function.

Malanoski requests that he be paid a \$10,000 monthly stipend to continue operation of the business under supervision of the receiver or in the event that no receiver is appointed.

To demonstrate entitlement to an injunction directing a party to perform a particular act or requiring a party to refrain from certain behavior, the plaintiff must show a probability of success on the merits, the danger of irreparable injury in the absence of the injunction, and that a balancing of the equities lies in its favor (*Aetna Ins. Co. v Capasso*, 75 NY2d 860, 862 [1990]; *W.T. Grant Co. v Srogi*, 52 NY2d 496, 517 [1981]; CPLR 6301).

Here, each side has presented entirely different versions of the underlying facts in support of, or against, the demonstration of each of these elements that are impossible to reconcile on the evidence now before the Court.

The parties dispute whether Third Eye has legal standing to demand any injunctive relief against defendants. Third Eye alleges that it formed, and presently owns, the post-production Home NYC division and paid its employees' salaries through an account maintained under its tax identification number by its wholly owned subsidiary, nonparty IGP Acquisitions LLC. Third Eye also alleges that Armon holds an 80% interest and Malanoski a 20% interest in IGP.

On the other hand, defendants allege that Malanoski created the trade name Home NYC in 2005, before he met Armon, and has continuously used the name as a vehicle to develop a specialized video content business that coordinates freelance writers and directors in producing and marketing unique videos and does not compete with the post-production business. Defendants allege that Malanoski personally financed and acquired the special equipment needed to operate the business. Defendants also allege that IGP is an independent company which

operates the Greene Street post-production business and pays the salaries of the individuals employed in that business, and that Third Eye has never operated any business at the Greene Street address.

The parties also dispute whether Third Eye, the Home NYC division, and the Home NYC, LLC are competitors in violation of the Third Eye operating agreement. The Third Eye operating agreement permits Malanoski to operate a business which does not compete with Third Eye's business or to operate a business which does compete, provided that the competitive opportunity be offered to, and declined in writing by, Third Eye, before Malanoski undertakes it (Third Eye LLC Operating Agr., § 5.7 [a]). Third Eye alleges that all three were in the post-production business, while defendants allege that Malanoski would use the post-production house operated by IGP at the Greene Street offices to edit, add effects, and clean up the raw product created by the Home NYC, LLC entity.

The parties dispute whether Third Eye or defendants have the right to use the Home NYC trade name. A preliminary injunction may be appropriate where the defendant employs a business name that is similar to that employed by the plaintiff without the plaintiff's knowledge or consent (*Fusha Japanese Rest., Inc. v Fusha*, 17 AD3d 226, 227 [1st Dept 2005]; General Business Law § 133). Here, Third Eye and Malanoski each lay claim to the creation and use of the name.

With these allegations, Third Eye and defendants have raised triable issues, including whether the two Home NYC businesses are competitors. Where a defendant has submitted evidence raising an issue of fact as to any of the elements required for issuance of a preliminary injunction, "the court shall make a determination by hearing or otherwise whether each of the elements required for issuance of a preliminary injunction exists" (CPLR 6312 [c]). Accordingly,

[* 9]

the issue of whether Third Eye has established the three elements required for the issuance of a preliminary injunction is referred to a Special Referee to hear and report with recommendations.

However, inasmuch as the parties agree that the Home NYC business must survive and its employees and other creditors should be paid, and in view of defendants' agreement to continue operating the business and to pay the business' creditors out of the accounts receivable and to provide Third Eye with an accounting, the Court extends the TRO, pending confirmation of the Special Referee's report following the hearing directed above. The Court also directs defendants to cease using the Home NYC name in furtherance of any business, except as to current clients whom they identify to Third Eye, pending confirmation of the Special Referee's report, to provide Third Eye with copies of financial books and records, to account to Third Eye for all monies received and paid through all Home NYC, LLC financial accounts since its formation, and to preserve all Home NYC cash, files and equipment. Defendants shall provide Third Eye with all such financial documents, on the first of each month. The parties are to confer amongst themselves as to how and where the documents are to be turned over. Further, an accountant designated by Third Eye shall have the authority to periodically examine defendant Home NYC LLC's business records, which shall be made available to the accountant on three days notice, during business hours. The accountant's fee shall be paid by defendant Home NYC LLC. He shall report to Third Eye, but his report shall also be made available to defendant.

All of the above, is in addition to the provisions and directions of the Court's prior orders.

Next, Third Eye seeks an order disqualifying the Mitchell law firm and Wachtler, one of its partners, from representing defendants in this litigation on a number of grounds, including their concurrent representation of Third Eye in another action pending before the Supreme Court (*see*

Third Eye Prods. d/b/a HomeNYC v Grey Worldwide, Sup Ct, NY County, index no. 115947/07 [the *Grey* action]).

In opposition, defendants contend that the plaintiff here is not the same entity as the plaintiff in the *Grey* action and that, therefore, no conflict of interest exists. The Mitchell firm and Wachtler allege that they commenced the *Grey* action on behalf of the Home NYC, Third Eye's "doing business as" name, rather than on behalf of Third Eye, the Delaware limited liability corporation, in order to collect a debt owed to Home NYC, LLC. They also assert that they believe that the Delaware LLC never had any connection to the post-production business being conducted at the Greene Street office, was never an operating company, had no payroll, paid no payroll taxes, and was inactive until the day before the commencement of the instant action.

An attorney may not represent a party in one matter and be adverse to that party in another concurrent matter unless the attorney demonstrates "the absence of any 'actual or apparent conflict in loyalties or diminution in the vigor of . . . representation'" (*Thaler v Jacoby & Meyers Law Offices*, 294 AD2d 230, 231 [1st Dept 2002], quoting *Dembitzer v Chera*, 285 AD2d 525, 526 [2d Dept 2001]). Here, the Mitchell firm and Wachtler have failed to so demonstrate.

While apparently no signed retainer agreement exists between the Mitchell firm and the plaintiff in the *Grey* action, it is clear from the parties' allegations and the documentary evidence that the *Grey* action was commenced well before Malanoski created the Home NYC, LLC entity, and well before the instant dispute arose, during a time when Armon and Malanoski were partners in a number of businesses, using different names, including Third Eye, Home NYC and IGP. In the *Grey* action, the plaintiff, "Third Eye Productions d/b/a HomeNYC," seeks to recover \$47,500 pursuant to an invoice issued on January 1, 2007 by "Third Eye Productions LLC." In addition,

Third Eye and the Home NYC, LLC each allege that each, at different times, paid Wachtler's fees incurred in prosecuting the *Grey* action.

Significantly, and even accepting as true, for purposes of this motion only, defendants' contention that Malanoski and the post-production business were the primary contact and client, the undisputed record clearly establishes that the Mitchell firm and Wachtler considered Third Eye to be their client. They identified their client as "Third Eye" on all *Grey* action documents and, as late as August 28, 2008, requested payment of legal fees from Third Eye, through its attorneys in this action. Such concurrent representation presents a conflict of loyalties. While defendants represent in their reply papers that they have instructed the Mitchell firm and Wachtler to move to withdraw as counsel for Third Eye in the *Grey* action, court records demonstrate that such motion has not yet been made. Inasmuch as the Mitchell firm and Wachtler currently represent Third Eye in active litigation, they are disqualified from representing defendants in this litigation.

Accordingly, it is

ORDERED that motion sequence 001 is granted to the extent that the issue of whether Third Eye has established the three elements required for the issuance of a preliminary injunction is referred to a Special Referee to hear and report with recommendations, except that, in the event of and upon the filing of a stipulation of the parties, as permitted by CPLR 4317, the Special Referee, or another person designated by the parties to serve as referee, shall determine the aforesaid issue; and it is further

ORDERED that this motion is held in abeyance pending receipt of the report and

recommendations of the Special Referee and a motion pursuant to CPLR 4403 or receipt of the determination of the Special Referee or the designated referee; and it is further

ORDERED that counsel for the party seeking the reference or, absent such party, counsel for plaintiff shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet (available in the Motion Support Office or on the court website) upon the Special Referee Clerk in the Motion Support Office in Room 119 at 60 Centre Street, who is directed to place this matter on the calendar of the Special Referee's Part (Part 50 R) for the earliest convenient date; and it is further

ORDERED that the temporary restraining order issued on August 29, 2008 and extended on September 4, 2008 is extended, pending confirmation of the Special Referee's report with recommendations; and it is further

ORDERED that defendants are directed to temporarily, pending confirmation of the Special Referee's report: cease using the Home NYC name in furtherance of any business, except as to current clients whom they identify to Third Eye, provide Third Eye with copies of financial books and records, account to Third Eye for all monies received and paid through all Home NYC, LLC financial accounts since its formation, and preserve all Home NYC, LLC cash, files and equipment, and to comply with the other provisions relating to the furnishing of documents to plaintiff, and permitting an accountant designated by plaintiff to regularly examine its books and records, and the other provisions of this decision and order; and it is further

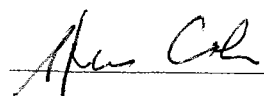
ORDERED that motion sequence number 002 is granted; and it is further

ORDERED that Mitchell Silberberg & Knupp, LLP and Lauren Wachtler, Esq. and all attorneys associated with them are disqualified from representing defendants Martin Malanoski

and Home NYC, LLC in the instant action, effective ten business days after the date of service by plaintiff upon Mitchell Silberberg & Knupp, LLP and Lauren Wachtler, Esq. of a copy of this order with notice of entry.

Dated: November 18, 2008

ENTER:

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J.S.C.