SHORT FORM ORDER **INDEX NUMBER: 36253-2008**

SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION, PART 46, SUFFOLK COUNTY

Present:
HON. EMILY PINES
J. S. C.

Original Motion Date: 11-12-2008
Motion Submit Date: 01-07-2009
Motion Sequence No's.: 001 RRH
002 RRH

X
In the Matter of the Application of Harlin Schwartzman,

Petitioner,

for the Judicial Dissolution of First Rate Capital Corp, a New York Corporation pursuant to Sec. 1104-a of the Business Corporation Law,
X

Harlin Schwaretzman, individually, and as a shareholder, and suing on behalf of First Rate Capital Corp.,

Plaintiff,

-against-

Thomas Arena, Larry Brand and First Rate Capital Corp.,

Defendants.
X

Attorney for Petitioner/ Plaintiff
Herman Israel Fleischman, Esq.
1758 Bedford Avenue
Merrick, New York 11566

Attorney for Defendants Arena, Brand and First Rate
Westerman, Ball Edrer Miller & Sharfstein, LLP
170 Old Country Road, Suite 400
Mineola, New York 11501

ORDERED, that the Petition for Dissolution of First Rate Capital Corp. (motion sequence no. 1) brought on by Order to Show Cause (PINES, J.) dated September 29, 2008 and the Cross-Motion to Dismiss (motion sequence no. 2) brought on by Notice of Cross-Motion dated November 3, 2008 are determined to the extent that a hearing is scheduled for April 20, 2009 at 9:30 a.m. before the undersigned. The purpose of the hearing is to determine whether petitioner, Harlin Schwartzman has standing to bring this special proceeding pursuant to BCL §1104-a.

Petitioner/plaintiff, Harlin Schwartzman ("petitioner" or "Schwartzman") commenced this hybrid special proceeding pursuant to BCL §1104-a seeking dissolution of First Rate Capital Corp. ("First Rate") and a derivative action and also moves to enjoin the respondents, Thomas Arena ("Arena") and

Larry Brand ("Brand"), from removing any of First Rate's property and equipment. Petitioner alleges that he is a 33 1/3 % owner of the common stock issued for First Rate and thus has standing to bring this proceeding. He further alleges that Arena and Brand also each own 33 1/3% of the outstanding stock of First Rate. Petitioner argues that beginning in January of 2007, his share of the profits was not being sent to him and that he "resigned his position" and asked to be bought out of the business. Petitioner alleges that Arena and Brand are "manipulating the Company's books and records" and also diverting transactions to another business of which they are the sole owners, Axis Mortgage. Petitioner states that in response to his request to be bought out of First Rate, Arena and Brand responded that he was not a shareholder of the corporation and thus he commenced the within action. Petitioner annexes copies of income tax K-1 statements for the years 2003-2006 which list his ownership interest at 33.3333% for the years 2003-2005 and 25% for the year 2006; he states that he did not receive a K-1 statement for the year 2007.

Petitioner has also annexed a copy of the Shareholders' Agreement, dated November 18, 2002, which lists the shareholders as Arena, Brand, Schwartzman and Steven Holman[1], with each owning 50 shares of a total 200 issued common stock of First Rate. The Shareholders' Agreement further provided, at Article X, that at any time, a shareholder may offer to sell his stock to the corporation, but must first offer it to sale to the corporation. Article X sets forth specific procedures for a shareholder and the corporation to follow in the event of such a voluntary withdrawal. Annexed to the moving papers is also a document, dated September 30, 2002, which purportedly is an agreement between the shareholders that the total value of the stock of First Rate is $3,000,000.00 and that such document shall be part of the November 18, 2002 agreement.

Respondents/Defendants cross-move pursuant to CPLR §3211(a)(4) and (7) to dismiss the petition based upon documentary evidence and for failure to state a cause of action for dissolution under BCL §1104-a. Respondents/Defendants assert that petitioner lacks standing to bring this proceeding as he is not the owner of the requisite 20% stock of First Rate. Such argument is based on two theories. First, they argue that in May of 2007, prior to the commencement of this action, petitioner resigned any stock ownership he ever may have had in First Rate. Alternatively, respondents/defendants argue that petitioner never was the holder of 20% of the stock of First Rate because he defaulted in the payment on the promissory note and Stock Purchase Agreement dated April 19, 2002. Additionally, respondents assert that petitioner committed acts of malfeasance against the corporation, including but not limited to applying for a credit card in the corporation's name and using it for his personal benefit, and obtaining a personal mortgage through First Rate for his own benefit, and then defaulting on the mortgage.

Respondents rely on the Stock Purchase Agreement dated April 19, 2002, in support of their

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[1]Holman's shares were apparently bought out at some point prior to commencement of this proceeding.

argument that petitioner never owned the requisite 20% of the outstanding stock of First Rate. The Stock Purchase Agreement, between Arena, as seller and petitioner, as buyer, provided for petitioner's purchase of 25 shares (representing 12 1/2%) of the outstanding shares of First Rate for the price of $81,250.00, with $12,500.00 being paid upon the signing of the Agreement. This Stock Purchase Agreement further provided that the shares of stock would not be issued to petitioner, but rather would remain in escrow pending payment of the full purchase price. In conjunction with the Stock Purchase Agreement, petitioner also signed a Promissory Note in which he agreed to pay Arena the balance due under the Stock Purchase Agreement, to wit, the sum of $68,750.00. Pursuant to the terms of the Promissory Note, petitioner was to make twenty-four (24) installment payments in the sum of $3,172.46 each, commencing on May 1, 2002 and on the first day of each month thereafter. Respondents allege that petitioner also signed a $68,750.00 Promissory Note to Brand for the purchase of an additional 12 ½% interest (thus bringing petitioner's ownership to 25%), but such is not annexed to the papers submitted to the Court.

Respondents allege that petitioner never made payments on the Promissory Note[2], and further that petitioner failed and refused to contribute capital to the corporation. Based on the amounts paid to respondents for the stock purchase, they allege petitioner never owned more than 7.5% of the outstanding stock, and that pursuant to the terms of the Stock Purchase Agreement, those shares were forfeited when petitioner failed to pay the balance due and owing. Additionally, respondents allege that petitioner resigned from the corporation as evidenced by a letter dated May 21, 2007, annexed to the cross-motion. With regard to the K-1 income tax statements, respondents assert that although petitioner did receive such statements, they were erroneous as to the shareholder value and moreover, that the K-1 statements are not proof of ownership. Turning to petitioner's allegation that respondents are diverting business to "Axis Mortgage", respondents assert that First Rate is actually registered with the State Banking Department under the name "Axis Mortgage" and has annexed a certificate evidencing same.

The submissions further reflect that in or about November of 2004, petitioner was arrested and charged with grand larceny and possession of a forged instrument. Shortly thereafter, in December of 2004, he entered into a Resignation and Stock Surrender Agreement, wherein petitioner resigned as an officer and director of First Capital and the stock shares he agreed to purchase were held in escrow. Subsequently, the criminal charges against petitioner were resolved and the parties entered into a "Reinstatement Agreement", dated January 26, 2007, wherein petitioner was reinstated to his position as an officer and director and his "right to purchase" the stock being held in escrow was also restored.

After petitioner's reinstatement to the corporation, respondents allege that they each (Arena and Brand), made significant capital contributions to the corporation, but that despite repeated demands,

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[2]Respondents assert that they have commenced an action against petitioner on the promissory notes pursuant to CPLR §3213.

petitioner failed to do so himself. Subsequently, on or about May 21, 2007, petitioner tendered a letter to Arena and Brand stating, "Please accept this letter as my resignation as 1/3 shareholder of First Rate Capital Mortgage Bankers effective immediately." A copy of the letter is annexed to the cross-motion papers. Thus, respondents urge the Court to recognize that even if petitioner had the requisite interest to bring this proceeding (which they do not concede), he forfeited such right when he tendered his resignation letter on May 21, 2007.

Based upon all of the foregoing, respondents assert that petitioner lacks standing to bring this dissolution and requests that the Court dismiss the petition in its entirety.

Petitioner submits a reply and argues that although he did resign as an officer and director of First Rate he never resigned as a shareholder. He claims that "any document presented to the Court purporting to be" his resignation as a shareholder is not genuine. He states he never tendered the May 21, 2007 document to Arena and/or Brand. Regarding his alleged default on the payment of the promissory note, petitioner claims that deductions were made from his share of the profits to repay the amounts owed on the notes. In support of this claim, petitioner annexes an affidavit from Richard Antaki ("Antaki"), the former controller of First Rate. Antaki states that he was employed by First Rate from November 2002 to July of 2008 and that during this period, petitioner was a shareholder and that he provided such information to First Rate's accountants for preparation of the K-1 statements. Antaki states that the allegations that petitioner failed to pay according to the terms of the promissory notes is false and that according the records of the corporation, petitioner paid about $83,500.00, leaving approximately $56,000.00 due and owing. Additionally, Antaki states that in May of 2007 Arena and Brand told him that petitioner resigned as an employee, director and officer, but they did not say he resigned as a shareholder.

Respondents submit papers in further support of their cross-motion to dismiss the petition. They now annex a report by Alan T. Robillard of Forensic Science Applications[3], who opines that the May 21, 2007 letter by petitioner contains the authentic signature of petitioner, thus attempting to refute petitioner's claim that the document was not genuine. Respondents challenge the affidavit of Antaki, who they characterize as a former bookkeeper who was terminated by First Rate. They deny petitioner paid $83,000.00 for the stock purchase although they argue that even if he did, he still defaulted on the full payment under the promissory notes. Respondents reiterated that the Reinstatement Agreement recognized petitioner's outstanding obligations with regard to the payments for the purchase of the stock shares and that at that time, petitioner was merely reinstated as an employee and officer of First Rate. Finally, respondents assert that even if petitioner was a shareholder, that the Shareholders' Agreement

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[3]Robillard was the former chief of the Forensic Document Examination Unit of the Federal Bureau of Investigation, Laboratory Division.

contained a compulsory buy-out provision which set forth a procedure for the evaluation and payment for his interest in the shares of First Capital.

Business Corporation Law §1104-a provides a procedure for a minority shareholder to seek dissolution of a corporation. That section states in relevant part:

> **§1104-a. Petition for judicial dissolution under special circumstances**
>
> (a) The holders of shares representing *twenty percent or more* of the votes of all outstanding shares of a corporation, ..., no shares of which are listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association, entitled to vote in an election of directions may present a petition of dissolution on one or more of the following grounds:
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> (1) The directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders;
> (2) The property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by its directors, officers or those in control of the corporation.

(Emphasis added).

The Second Department has repeatedly held that where there are conflicting allegations as to whether a petitioner has the requisite ownership interest necessary to bring a dissolution proceeding under §1104-a, the Court must hold a hearing to determine whether the petitioner is actually a shareholder. ***In the Matter of Ruivo,*** 305 A.D.2d 688, 761 N.Y.S.2d 238 (2d Dept. 2003); ***In the Matter of Fancy Windows & Doors Mfg.,*** 244 A.D.2d 484, 664 N.Y.S.2d 113 (2d Dept. 1997); ***LaBarbera v. D'Amico,*** 240 A.D.2d 640, 659 N.Y.S.2d 96 (2d Dept. 1997). Where the parties' affidavits create questions of fact, the Court cannot determine stock ownership as a matter of law and a hearing must be held on the issue. ***Singer v. Evergreen Decorators, Inc.,*** 205 A.D.2d 694, 613 N.Y.S.2d 667 (2d Dept. 1994). The issue of ownership must be addressed as a preliminary matter before the Court can consider the merits of the petition. ***In the Matter of Finando,*** 226 A.D.2d 634, 641 N.Y.S.2d 384 (2d Dept. 1996).

In the case at bar, the conflicting assertions by the parties create questions of fact regarding petitioner's ownership interest, if any, in First Rate, which must be resolved before the Court can consider the merits of the petition. The Court notes that petitioner was receiving K-1 income tax statements reflecting a varied degree of stock ownership, which respondents merely dismiss as being either erroneous or not probative of the issue of ownership. Moreover, while the Court finds persuasive the May 21, 2007 purported resignation letter as evidence of petitioner's surrender of his shareholder

interest, petitioner denies the authenticity of this document. Equally disconcerting is the disparate claims as to whether petitioner made payments on the promissory notes via deductions from his share of the profits. Although petitioner submits an affidavit from Antaki claiming that such payments were made, respondents similarly dismiss these allegations as the machinations of a disgruntled former employee who is currently engaged in a business venture with petitioner.

In view of these contradictory allegations, the Court must conduct a hearing on the issue of petitioner's ownership interest in First Rate. A hearing is therefore scheduled for April 10, 2009 at 9:30 a.m. before the undersigned.

This constitutes the ***DECISION*** and ***ORDER*** of the Court.

Dated: February 24, 2009
Riverhead, New York

Emily Pines
EMILY PINES
J. S. C.