

Hirsch v Grassi & Co., CPAs
2011 NY Slip Op 31998(U)
July 11, 2011
Supreme Court, New York County
Docket Number: 113019/2010
Judge: Joan A. Madden
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SUPREME COURT OF THE STATE OF NEW YORK -- NEW YORK COUNTY

PRESENT: Hon. Joan A. Miller
Justice

PART 11

Index Number : 113019/2010
HIRSCH, LELAND
vs.
GRASSI & CO., CPAS
SEQUENCE NUMBER : 004
AMEND SUPPLEMENT PLEADINGS

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____
MOTION CAL. NO. _____

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 the attached Memorandum Decision + Order.

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

FILED

JUL 18 2011

NEW YORK
COUNTY CLERK'S OFFICE

Dated: July 11, 2011

[Signature]
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION
Check if appropriate: DO NOT POST REFERENCE
 SUBMIT ORDER/ JUDG. SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 11

FILED

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-----X
LELAND HIRSCH, CHARLOTTE HIRSCH,
HARBORAGE ISLE CONSULTING, INC.,
HIRSCH FAMILY TRUST, HIRSCH HOLDINGS, LLC.,
LELAND HIRSCH FAMILY PARTNERSHIP, and
LELAND HIRSCH REVOCABLE TRUST

Plaintiffs,

-against-

Index No. 113019/10

GRASSI & CO., CPAs, and LOUIS GRASSI,
Defendants.

-----X
JOAN A. MADDEN, J.:

Plaintiffs Leland Hirsch, Charlotte Hirsch, Harborage Isle Consulting, Inc., Hirsch Family Trust, Hirsch Holdings, LLC., Leland Hirsch Family Partnership, and Leland Hirsch Revocable Trust (together "plaintiffs") move pursuant to CPLR 3025(b) for leave to file a first amended complaint. Defendants Grassi & Co., CPAs, and Louis Grassi ("Grassi") oppose the motion, and cross move pursuant to CPLR 3211(a)(1) and (7) to dismiss the complaint in its entirety. For the reasons set forth below, the motion to amend is granted in part and denied in part and the cross motion is denied.

Background

Beginning in or around 2004, Hirsch retained Grassi as the sole accountant to provide all accounting and tax-related services for the plaintiffs, as well as for two entities in which Hirsch held a fifty-percent (50%) interest. In mid-2010, plaintiffs decided to engage a new accountant, Stanley Blicht ("Blicht") of the accounting firm Farber, Blicht, Eyerman & Herzog, LLP ("Farber Blicht"), due to dissatisfaction with Grassi's services. Soon after, plaintiffs requested that Grassi provide Blicht with access to client files, tax returns, and copies of all working papers

prepared or obtained in connection with Grassi's engagement with plaintiffs. On August 16, 2010, Grassi refused to comply with plaintiffs' request unless Blicht sign and agree to a waiver letter¹ placing restrictions on the use of Grassi's work papers. Blicht refused to sign the letter, and Grassi thereafter rebuffed (on August 26, September 8, and October 1) repeated efforts by plaintiffs and Blicht to gain access to all of their files and materials in Grassi's possession.²

On October 4, 2010, plaintiffs commenced this action and moved, by an Order to Show Cause, for an order directing Grassi to produce the entire work product generated on plaintiffs' behalf so they could file their 2009 tax returns before the October 15 deadline. Grassi thereafter conceded that plaintiffs were entitled to all of plaintiffs' records, books, files and tax returns, but not the work papers prepared by Grassi in connection with its engagement. By decision and order dated October 13, 2010, this court denied that part of plaintiffs' motion seeking the work papers, finding that the record was insufficient at that point in the case to establish plaintiffs' entitlement to the papers. Consequently, Blicht was required to recreate Grassi's work product in order to file plaintiffs' 2009 tax returns before the applicable tax deadlines.

The original complaint included causes of action for negligence and professional malpractice, and for breach of a fiduciary duty in connection with the failure to timely provide

¹ In the proposed waiver letter dated August 16, 2010, Grassi demanded that Blicht agree that (i) the information obtained from Grassi's working papers would not be used by Farber Blicht for any other purpose other than to provide accounting and tax services to plaintiffs and (ii) Farber Blicht would not provide expert testimony or litigation support services or otherwise comment on the quality of Grassi's work product (Proposed Amended Complaint ¶15).

² Specifically, it is alleged that on August 26, 2010, Blicht requested copies of plaintiffs' 2006 and 2007 tax returns, work papers in support of plaintiffs' tax returns filed in 2006 through 2008, and work papers and 1099s for the 2009 tax year (¶18). On September 8, 2010, Hirsch requested the following materials be transferred to Blicht: (a) all supporting documentation used to prepare 1099 INT, 1099 DIV, and 1099 B for all accounts held at Merrill Lynch and Fidelity; (b) 1099 Form for FMH Capital; (c) all hedge fund and partnership K-1s; (d) all documents regarding real estate taxes; (e) all documents regarding charitable contributions as reported on schedule A; (f) supporting schedules of realized gains and losses as reported on schedule D; (g) all documents regarding the sale of art; (h) all W-2s (¶19).

plaintiffs' client files, tax returns, and work papers. Plaintiffs now move to amend the complaint to add a another cause of action for negligence and professional malpractice relating to the preparation of their 2008 tax return, and a claim for prima facie tort. Grassi opposes the motion, and cross-moves to dismiss.

Discussion

“Leave to amend a pleading should be ‘freely given’ (CPLR3025[b]) as a matter of discretion in the absence of prejudice or surprise.” Zaid Theatre Corp. v. Song Realty Co., 18 A.D.3d 352, 355-56 (1st Dep’t. 2005) (internal citations and quotations omitted). That being said, however, “in order to conserve judicial resources, an examination of the underlying merits of the proposed causes of action is warranted.” Eighth Ave. Garage Corp. v. H.K.L. Realty Corp., 60 A.D.3d 404, 405 (1st Dep’t.), lv dismissed, 12 N.Y.3d 880(2009). At the same time, leave to leave to amend will be granted as long as the proponent submits sufficient support to show that [the] proposed amendment is not “palpably insufficient or clearly devoid of merit.” MBIA Ins. Corp. v. Greystone & Co., 74 A.D.3d 499 (1st Dep’t. 2010). In addition, “[o]nce a prima facie basis for the amendment has been established, that should end the inquiry, even in the face of a rebuttal that might provide a subsequent basis for a motion for summary judgment.” Pier 59 Studios, L.P. v. Chelsea Piers, L.P., 40 A.D.3d 363, 365 (1st Dep’t. 2007).

Here, as Grassi does not argue that it will be prejudiced or surprised by the proposed amended complaint, the only issue is whether the proposed pleading is of sufficient merit. As plaintiffs are seeking leave to amend the complaint, the court will consider the proposed pleading, including the two causes of action asserted in the previous complaint, which are amplified in the instant motion, under the standard set forth above.

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The court will first consider whether the proposed first and second causes of action for negligence and professional malpractice are viable. The proposed first cause of action alleges that Grassi negligently prepared plaintiffs' 2008 tax returns by (1) recording the same income twice and (2) taking a mortgage interest expense deduction despite the fact that plaintiffs did not hold a mortgage. The proposed second cause of action alleges that plaintiffs are entitled to all of their client files, tax returns, and work papers, and Grassi's subsequent failure to deliver the requested documents in a timely manner is a violation of 8 N.Y.C.R.R. §29.10 and constitutes professional malpractice.

Grassi argues that the proposed first cause of action should not be permitted to be added. In regards to the claim of malpractice in relation to the mortgage deduction, Grassi submits documentary evidence of a mortgage statement issued by Desjardin Bank reflecting plaintiffs' mortgage interest activity for the 2008 tax year. Grassi contends that this statement conclusively establishes that Grassi properly took the mortgage interest expense deduction on the plaintiffs' 2008 tax return, and thus it cannot be held liable for professional malpractice. As for the claim that Grassi committed malpractice by twice recording income on the 2008 return, Grassi contends that the complaint fails to adequately specify on which tax return the alleged error exists, and thus such allegation is legally insufficient. Grassi also argues that plaintiffs' alleged damages in the form of potential tax penalties are too speculative and inadequate to satisfy the damages element of the proposed first cause of action.

"Accounting malpractice or professional negligence contemplates a failure to exercise due care and proof of a material deviation from the recognized and accepted professional standards for accountants and auditors, generally measured by GAAP and GAAS, promulgated by the American Institute of Certified Public Accountants ("AICPA"), which proximately causes

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damage to [the] plaintiff.” Cumis Ins. Soc’y, Inc. v. Tooke, 293 A.D.2d 794, 798 (3rd Dep’t. 2002). See e.g., D.D. Hamilton Textiles, Inc. v. Estate of Mate, 269 A.D.2d 214 (1st Dep’t. 2000). “Proof of proximate causation is an essential element [to] any malpractice claim, including accountant’s malpractice.” Herbert H. Post & Co. v. Sidney Bitterman, Inc., 219 A.D.2d 214, 223 (1st Dep’t. 1996). “[Thus,] the [client] must establish, beyond the point of speculation and conjecture, a causal connection between its losses and the [accountant’s] actions.” Id. at 224.

To the extent that the proposed first cause of action relates to the mortgage interest expense deduction, Grassi has shown that the claim is “palpably insufficient and devoid of merit.” MBIA, 74 A.D.3d at 499. The mortgage statement introduced by Grassi plainly demonstrates that in the 2008 tax year, Hirsch’s wife, Lisa Mathisen Noble, owned property at 3200 North East 29th Street, Unit 501, Ft. Lauderdale, FL 33308, and there was a mortgage in place on that property. Since Hirsch and Noble filed a joint tax return as spouses for the 2008 tax year, this documentary evidence clearly shows that Grassi properly recorded a mortgage interest expense deduction in 2008, and thus did not deviate from a standard of care set forth by the accounting profession. Notably, in opposition, plaintiffs do not contest this fact.

As for the aspect of the proposed first cause of action alleging that Grassi negligently recorded income twice on the 2008 tax return, such claim is legally sufficient to establish a prima facie cause of action for the claim of professional malpractice. See Pier 59, 40 A.D.3d at 365. Grassi’s alleged failure to ensure the accuracy of plaintiffs’ tax returns establishes a basis for finding a deviation from the standard of care promulgated by the accounting profession, and nothing in the record indicates that the claim is devoid of merit. Moreover, despite Grassi’s assertion that plaintiffs failed to allege the exact form upon which the error exists, plaintiffs are

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not required to plead with such a high level of specificity. In addition, at this early stage of the litigation, the claim cannot be rejected for insufficiently specifying the nature of damages. Accordingly, plaintiffs' motion for leave to amend to add the proposed first cause of action should be granted to the extent that the claim relates to the negligent recording of income twice on plaintiffs' 2008 tax return.

The proposed second cause of action is for negligence and professional malpractice in connection with the failure to timely deliver client files, tax returns, and work papers. Specifically, this claim alleges that Grassi failed to turn over, upon request, copies of plaintiffs' 2006 and 2007 tax returns, as well as 1099s for the 2009 tax year, and thus constitutes a deviation from the standards of care set forth by the accounting profession. Grassi contends that this cause of action is moot as this court previously denied plaintiffs' Order to Show Cause to the extent it sought to compel Grassi to produce its work papers, and that it has subsequently furnished Blicht with all documents necessary to complete the 2009 tax return for plaintiffs. Grassi also argues, *inter alia*, that plaintiffs are not entitled to any of the work papers they seek under 8 N.Y.C.R.R. §29.10(a)(8)(iv), and thus are not liable for failing to deliver these documents. Furthermore, with respect to the alleged damages in the form of professional costs incurred by Blicht in the recreation of Grassi's work product, Grassi contends that they should not be financially burdened by plaintiffs' decision to switch accountants.

Grassi's position is unavailing. First, the court's previous decision regarding Grassi's work papers was made in the context of an Order to Show Cause seeking the immediate production of documents at the time of the commencement of this action. The court's denial of the motion was based on the insufficiency of the record. The court noted it made "no determination as to whether the work [papers] are otherwise discoverable." Moreover, although

Grassi eventually turned over some of the records sought by plaintiffs, the damages alleged are based on Grassi's failure to turn them over in a timely manner.

Next, to assess the prima facie merit of this claim, the standards promulgated by AICPA must be examined to ascertain whether Grassi's failure to deliver the requested documents constitutes a material deviation from the recognized and accepted professional standards for accountants. AICPA states that when a former client makes a request for client-provided records,³ client records prepared by the accountant,⁴ or supporting records that have not been previously provided by the client,⁵ the accountant should comply with the former client's request as soon as practicable, but no later than forty-five (45) days after the request is made. AICPA Professional Standards ET §501.02. See N.Y. Comp. Codes R. & Regs., tit. 8, §29.10(a)(8) (unprofessional conduct in the profession of accounting includes refusing to furnish to a client upon request (i) copies of tax returns; or, (ii) copies of reports or other documents that were previously issued to or for such client; or, (iii) any accounting or other records belonging to or obtained for the client which the accountant may have had occasion to remove from the client's premises or to receive for the client's account). Thus Grassi's alleged failure to timely deliver the 2006 and 2007 tax returns and the 2009 1099s to plaintiffs upon their request sets forth a prima facie basis for a claim of negligence and professional accounting malpractice.

The remaining issue is whether Grassi's failure to turn over work papers in a timely manner is sufficient to state a claim for negligence/professional malpractice, based on allegations that plaintiffs are entitled to all of Grassi's work papers created on their behalf. In

³ These records are accounting or other records belonging to the client that were provided to the accountant by or on behalf of the client, including reproductions of such records

⁴ These records are accounting or other records (i.e., tax returns, general ledgers, subsidiary journals, and supporting schedules) that the accountant was engaged to prepare for the client.

⁵ These records include information not reflected in the client's books and records that are otherwise not available to the client with the result that the client's financial information is incomplete.

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general, AICPA deems work papers as the property of the accountant, and thus such documents need not be provided to the client. AICPA Professional Standards ET §501.02. Work papers are defined as including, but not limited to, audit programs, analytical review schedules, and statistical sampling results, analyses, and schedules prepared by the client at the request of the accountant. Id. However, when a client hires a new accountant, it is customary that the predecessor accountant will make themselves available to the successor for consultation and to make available certain work papers. AICA Professional Standards AR §400.08. “Ordinarily, the predecessor accountant should provide the successor access to documentation relating to matters of continuing accounting significance and those relating to contingencies.” Id. at §400.08. The predecessor accountant may deny access to such work papers for valid business reasons, including, but not limited to unpaid fees by the client.⁶ Id. Additionally, AICPA stipulates that state law may impose stricter requirements on the working papers of accountants.

The New York State Board of Regents⁷ imposes such additional requirements on the professional accountant, stating that unprofessional conduct in the practice of accountancy includes “refusing to furnish to a client upon request: (iv) copies of information contained in an accountant’s working papers, if such information would ordinarily constitute part of the client’s books *and* is not otherwise available to the client.” See N.Y. Comp. Codes R. & Regs., tit. 8, §29.10(a)(8)(iv) (emphasis added).

In the proposed second cause of action, plaintiffs claim entitlement to work papers in support of plaintiffs’ tax returns from 2006 through 2009, and specifically those in connection with the securities investment schedules Grassi prepared in the 2008 tax year. While the

⁶ There is no dispute in this case over whether Grassi has been paid for the services they provided to plaintiffs.

⁷ In New York State, admission to the practice of public accountancy and the regulation of the profession is supervised by the New York Board of Regents and administered by the Education department. N.Y. Educ. L. §6504.

proposed amended complaint potentially seeks certain work papers that may turn out to be beyond what is permitted under the applicable professional standards of public accounting, the claim cannot be said to lack in prima facie merit at this juncture.

Moreover, plaintiffs have established an adequate basis for satisfying the damages element of the proposed second cause of action. The professional costs and expenses incurred by plaintiffs for Blicht's recreation of Grassi's work product were a foreseeable result, flowing directly and naturally from Grassi's alleged failure to timely provide client files, tax returns, and work papers. Accordingly, the claim is of sufficient merit, and the proposed second cause of action is valid and may be added to the complaint.

Plaintiffs' proposed third cause of action is for the breach of a fiduciary duty. This cause of action alleges the existence of a fiduciary relationship between the parties due Grassi's status as plaintiffs' sole accountant for approximately six (6) years. Furthermore, plaintiffs allege that a fiduciary duty was imposed on Grassi as they provided all of plaintiffs' accounting and tax-related services, as well as certain services for two other entities in which Hirsch held a fifty-percent (50%) interest (Artec Systems Group, Inc. and Michael Leland, Ltd.). The complaint alleges that Grassi's failure to turn over the client files, tax returns, and work papers requested by plaintiffs in a timely manner constituted a breach of that duty, as evidenced by Grassi's attempt to "extort" a waiver from Blicht.

"A fiduciary relationship exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." EBCI, Inc., 5 N.Y.3d 11, 19 (2005). "Such relationship . . . is grounded in a higher level of trust than normally present in the market place between those involved in arms-length business transactions. Id. at 19. "In order to establish the breach of a fiduciary duty, the plaintiff

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must prove: (1) the existence of fiduciary relationship; (2) misconduct by the defendant; (3) damages that were directly caused by the defendant's misconduct." Fitzpatrick House III, LLC v. Neighborhood Youth & Family Servs., 55 A.D.3d 664 (2nd Dep't. 2008).

"As a general rule, accountants are not fiduciaries to their clients, except where the accountants are directly involved in managing the client's investments." Carper v. Nussbaum, 36 A.D.3d 176, 193(2nd Dep't. 2006). See e.g., DG Liquidation, Inc. v. Anchin, Block, & Anchin, LLP., 300 A.D.2d 70, 71 (1st Dep't. 2002). "A conventional business relationship, without more, does not become a fiduciary relationship by mere allegation." Friedman v. Anderson, 23 A.D.3d 163, 166 (1st Dep't. 2005). "A cause of action for a breach of a fiduciary duty between a [client and accountant] may survive, for pleading purposes, where the complaining party sets forth allegations that, *apart from the terms of the contract*, [there was] a relationship of higher trust than [which] would arise from the contract alone. EBC I, Inc., 5 N.Y.3d at 20 (emphasis added).

Here, the proposed third cause of action does not sufficiently plead any facts from which it can be inferred that a fiduciary relationship existed between Grassi and the plaintiffs. Rather, plaintiffs' allegations are consistent with their contractual relationship with Grassi, as they allege only that certain services were provided to them. The pleadings fail to establish how Grassi being retained as plaintiffs' sole accountant for approximately six (6) years and providing "certain services" for Artec Systems Group, Inc. and Michael Leland, Ltd. established a fiduciary relationship between the parties. Furthermore, plaintiffs neither provide any factual allegations as to the existence of management control by Grassi over plaintiffs' investments, nor any facts outside the sphere of the contract.

In addition, the claim for breach of a fiduciary duty does not involve any distinct allegations or damages from those suffered by the alleged professional malpractice. Both claims

involve Grassi's failure to turn over client files, tax returns, and work papers in a timely manner, and resulted in the same form of damages plead by plaintiffs. Therefore, these claims cannot be separately maintained. See e.g., Nevelson v. Carro, 290 A.D.2d 399 (1st Dep't. 2002); Mecca v. Shang, 258 A.D.2d 569 (2nd Dep't. 1999), lv dismissed, 95 NY2d 791 (2000); Sage Realty Corp. v. Proskauer Rose, LLP., 251 A.D.2d 35 (1st Dep't. 1998). Accordingly, the proposed third cause of action is without merit.

The proposed fourth cause of action is for prima facie tort. Plaintiffs allege that Grassi intentionally failed, without excuse or justification, to provide competent accounting services, and purposely failed to respond to their requests for their client files, tax returns, and work papers.

The requisite elements for a cause of action sounding in prima facie tort include: (1) the intentional infliction of harm, (2) resulting in special damages, (3) without excuse or justification, (4) by an act or series of acts which are otherwise legal. Del Vecchio v. Nelson, 300 A.D.2d 277 (2nd Dep't. 2002). Central to this cause of action is that the defendant's intent has been solely to injure the plaintiff, or that defendant acted from disinterested malevolence, meaning that the genesis which will make a lawful act unlawful must be a malicious one, unmixed with any other, and exclusively directed to injure and damage another. Beardsley v. Kilmer, 236 N.Y.2d 80, 90 (1923). In other words, a malicious intention must be defendant's sole motivation in order to recover under a claim of prima facie tort. Squire Records, Inc. v. Vanguard Rec. Soc'y, Inc., 25 A.D.2d 190 (1st Dep't.), appeal dismissed, 17 N.Y.2d 870 (1966). Recovery is barred if other motives exist, including, but not limited to, profit, self-interest, or business advantage. Id. Here, plaintiffs fail to plead any factual allegations as to the malicious intention of Grassi to purposely inflict damage upon them. In fact, the gravamen of the

complaint is that Grassi refused to provide the requested documents and work papers as it feared exposure to potential liability for malpractice. Thus, plaintiffs have failed to plead sufficient factual support for their claim of prima facie tort. Accordingly, the claim is clearly devoid of merit, and cannot be added.

Conclusion

In view of the above, it is

ORDERED that the motion to amend the complaint is granted only to the extent of permitting plaintiffs to add the first and second causes of action; and it is further

ORDERED that the cross-motion to dismiss is denied as moot in view of the proposed amended pleading; and it is further

ORDERED that plaintiffs shall serve and file, within 30 days of this decision and order, an amended complaint consistent with the opinion set forth above; and it is further

ORDERED that within 30 days of serving the amended complaint, defendants shall file an answer to the amended complaint; and it is further

ORDERED that the parties shall appear for a preliminary conference in Part 11, room 351, 60 Centre Street, New York, NY on September 15, 2011 at 9:30 A.M.

A copy of this decision and order is being sent to the parties by my chambers.

DATED: July 17, 2011

FILED

J.S.C.

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