

Tufo v Pellegrino

2012 NY Slip Op 33375(U)

July 20, 2012

Supreme Court, New York County

Docket Number: 112188/2011

Judge: Anil C. Singh

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

HON. ANIL C. SINGH
SUPREME COURT JUSTICE

PRESENT: Justice

PART 61

TUFO, JOHN

INDEX NO. 112188/2011

-v-

MOTION DATE

FRANK A. PELLEGRINO, CPA

MOTION SEQ. NO. 001

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits No(s).

Answering Affidavits — Exhibits No(s).

Replying Affidavits No(s).

Upon the foregoing papers, it is ordered that this motion is decided in accordance with the annexed order

DECIDED IN ACCORDANCE WITH ACCOMPANYING DECISION / ORDER

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

Dated: 7/25/12

HON. ANIL C. SINGH, J.S.C. SUPREME COURT JUSTICE

- 1. CHECK ONE: CASE DISPOSED
2. CHECK AS APPROPRIATE: MOTION IS: GRANTED DENIED GRANTED IN PART OTHER
3. CHECK IF APPROPRIATE: SETTLE ORDER SUBMIT ORDER DO NOT POST FIDUCIARY APPOINTMENT REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 61

----- X
JOHN TUFO, individually, and as director, officer
employee, and 25% shareholder of WESTCHESTER
AUTOMOBILE CO. INC. d/b/a Acura of Westchester,
and as a general partner of HARBEN ASSOCIATES
and TRIPLE D ASSOCIATES, and JANICE TUFO,

Plaintiffs,

Index No.:
112188/2011

- against-

FRANK PELLEGRINO, CPA; and PELLEGRINO
& SHERWIN LLP, as certified public accountants,

Defendants.

----- X

ANIL C. SINGH, J.:

In this action for accounting malpractice and related claims,
defendants Frank Pellegrino, CPA (Pellegrino) and Pellegrino &
Sherwin LLP, as Certified Public Accountants (together,
defendants) move, pursuant to CPLR 3211 (a) (1) and (7), for an
order dismissing the complaint submitted by plaintiffs John Tufo
(Tufo), individually and as director, officer, employee, and 25%
shareholder of Westchester Automobile Co. Inc. d/b/a Acura of
Westchester (WAC), and as a general partner of Harben Associates
(Harben) and Triple D Associates (Triple D), and Janice Tufo
(collectively, plaintiffs).

BACKGROUND AND FACTUAL ALLEGATIONS

Tufo is a 25% shareholder of WAC, which is a car dealership.
There are four shareholders altogether, each holding shares of

25%. WAC pays rent to Triple D. Harben is a business entity, and the four shareholders are all general partners of Harben. Although terminated from WAC, Tufo was and remains a general partner of both Triple D and Harben.

Defendants are a firm of certified public accountants. Defendants have been WAC's accountants for at least 22 years. Pellegrino also provided personal accounting services for Tufo for at least 10 years, and also provided personal accounting services for the other shareholders.

The four shareholders of WAC entered into a shareholders' agreement in October 2008. Part of the shareholders' agreement states that, "[d]uring the term of this Agreement the Shareholders shall be employed by the Corporation and shall receive equal compensation from the Corporation." Defendants' Exhibit 1, at 2.

Another section of the shareholders' agreement states that the president shall have the authority to, among other things, "[s]upervise accounting work and prepare tax returns for approval by the Corporation Accountants" and "[m]aintain books and records." *Id.* at 9. Tufo is not WAC's president. The agreement further advises that any major business decisions require the written approval of each shareholder.

Plaintiffs have another case presently pending in which they are claiming that the other shareholders breached the agreement by, among other things, not obtaining Tufo's written approval

before making business decisions, such as taking out a business loan and appointing one of the other shareholders as the Chief Operations Officer of WAC. The other shareholders, WAC's comptroller, WAC, Triple D and Harben are all defendants in that action.

In the related action, Index No. 110604/2011, Tufo further alleges that the other shareholders "froze out" Tufo from the business, thereby effectively terminating him and canceling his health insurance, which was contrary to the terms of the shareholders' agreement. Even though he still remains a shareholder, the other shareholders also allegedly do not want him present at WAC. Tufo maintains that he was supposed to be receiving the same salary as the other shareholders, but that the other shareholders breached the agreement by paying him a much lower salary than the others. The other shareholders, according to Tufo, are hoarding money and assets from WAC, to the detriment of Tufo, and also have breached their fiduciary duties to him and the companies. Tufo allegedly has also been denied access to the companies' books and records. Plaintiffs' Exhibit 2, Second Amended Complaint, Index No. 110604/2011.

In the present complaint, plaintiffs allege that Pellegrino was involved in the negotiations which resulted in the shareholders' agreement, and also "represented" Tufo and the other shareholders individually in their negotiations for this

agreement. As such, according to plaintiffs, defendants should have been familiar with the shareholders' agreement and therefore "aided and abetted" the alleged violations and breaches of the shareholders' agreement by the other shareholders. For instance, plaintiffs allege that defendants should have known that Tufo should have been compensated by the same amount as the other shareholders. However, defendants allegedly aided and abetted the violations since the tax returns, created by defendants, showed that all of the shareholders received differing salaries, with Tufo having the lowest salary. Also in relation to the other complaint, plaintiffs claim that Pellegrino represented WAC with respect to the loan, and should have known that Tufo did not approve this loan.

Plaintiffs continue that defendants owed them an undivided duty of loyalty, and that the defendants were not free of conflicts of interest, to plaintiffs' detriment. The complaint contains five causes of action. In the first cause of action, plaintiffs allege that defendants breached their agreement with plaintiffs. The second cause of action is for conversion. In the third cause of action, plaintiffs claim that defendants failed to disclose the possible conflicts of interest. The fourth cause of action is for breach of fiduciary duty and the fifth is for negligence.

Pellegrino submits an affidavit dated October 2011, which was

also submitted in connection with the related action. In this affidavit, Pellegrino states that his firm has been the accountant for WAC for 22 years. He maintains that, since at least 2003, there had never been a year in which all four shareholders had received the same salaries, and that he had never received a complaint about this. Pellegrino further maintains the following:

Over the many years that I have represented both the business and Mr. Tufo, Mr. Tufo has never complained to me of any concerns about the discrepancy in compensation. To my knowledge, Mr. Tufo was well aware of the compensation terms and was very familiar with the method of payment that was being used and up until approximately 2008, he participated in every shareholder compensation decision.

Defendants' Exhibit 2, ¶ 14.

Pellegrino writes that he advised the individuals that they could "recover their capital contribution in the form of an increase in salary and accordingly, bonuses were accrued in December 2010 to repay the \$150,000 put into the Company without reducing the additional paid in capital account." *Id.*, ¶ 12. He also states that he has been Tufo's personal accountant since 2000, and that currently his services "are limited to the preparation of [Tufo's] personal tax returns." *Id.*, ¶ 13.

Tufo, in response to Pellegrino's last two statements, claims that Pellegrino's testimony contradicts itself, in that Pellegrino was admittedly more than just Tufo's personal accountant, but was also an advisor for Tufo's "finances, business, budgeting and investments." Tufo Affidavit, ¶ 4.

Pellegrino submits an affidavit, dated December 2011, in support of the motion to dismiss. He states that he provided income tax returns for WAC and for plaintiffs, and that at no time during the relationship did any of the parties agree to any professional services beyond tax preparation. Pellegrino continues that defendants "did not provide any professional services to Plaintiffs or the WAC parties in connection with administering WAC Parties' payroll" or the shareholders' agreement. Affidavit of Frank Pellegrino, ¶ 8. He maintains that he first learned about the shareholders' agreement in October 2011.

Defendants attach the written contracts that they had with the WAC parties, and also with plaintiffs, for the engagement of accounting services. The written engagement agreement between defendants and plaintiffs sets forth that the defendants would prepare the plaintiffs' tax returns, and that all information about the engagement would be confidential.

The most recent engagement letter between defendants and WAC, dated November 15, 2010, states that defendants will assist WAC with tax preparation and income tax matters. The letter notes that the WAC staff will submit the monthly dealer statements to defendants for review for obvious errors, but that defendants' review is not intended to be the financial review for WAC. Defendants state that they are only responsible for preparing the

tax returns, and not for auditing or verifying the data provided, and that the WAC staff is "responsible for filing payroll and sales tax returns and the regular maintenance of your accounting records." Pellegrino Affidavit, Exhibit B, at 8. The defendants' engagement letter also sets forth that WAC management is responsible for the journal entries to the financial statements, and that the defendants "cannot be relied upon to disclose errors, fraudulent financial reporting, misappropriation of assets or direct illegal acts that may exist." *Id.*

Tufo claims that, according to the W-2 forms from 2010, one of the other shareholders was paid the salary of \$1,056,547.94 while Tufo was paid \$256,880.00. As such, Tufo believes that he is entitled to the difference in salaries. Given the fact that defendants prepared the W-2 forms, Tufo maintains that "Pellegrino was, at all times, part and parcel of [the other defendants'] fraud and misconduct directly injuring me and injuring WAC." Tufo Affidavit, ¶ 12. Among other things, Tufo further alleges that defendants were paid checks for their services, which were never authorized by Tufo. These payments purportedly evidence that "defendants were obviously more than just tax return preparers" *Id.*, ¶ 22.

DISCUSSION

On a motion to dismiss pursuant to CPLR 3211, the facts as alleged in the complaint are accepted as true, the plaintiff is

given the benefit of every possible favorable inference, and the court must determine simply whether the facts alleged fit within any cognizable legal theory. *Mendelovitz v Cohen*, 37 AD3d 670, 671 (2d Dept 2007); see also *P.T. Bank Central Asia N.Y. Branch v ABN AMRO Bank N.V.*, 301 AD2d 373, 375 (1st Dept 2003). Under CPLR 3211 (a) (1), a dismissal is appropriate only "if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Leon v Martinez*, 84 NY2d 83, 88 (1994). Under CPLR 3211 (a) (7), however, "a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint and the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one [internal quotation marks and citations omitted]." *Id.*

I. Plaintiffs' Claim for Negligence:

Plaintiff's fifth and final cause of action is one grounded in professional malpractice.¹ Plaintiffs state that defendants "committed negligence, causing damages" Complaint, ¶ 224. To establish a cause of action for malpractice, defendants must establish that "there was a departure from the accepted standards of practice and that the departure was a proximate cause of the injury." *Kristina Denise Enterprises, Inc. v Arnold*, 41 AD3d 788,

¹This claim will be discussed first since plaintiffs' first cause of action is duplicative of this one.

788 (2d Dept 2007).

As explained below, plaintiffs' claims are misplaced as against defendants since defendants were not involved in the underlying transactions which gave rise to plaintiffs' alleged injuries. Plaintiffs provide almost 20 pages in their memorandum of law discussing the shareholders' agreement and how defendants "participated in the creation of and knew of" this agreement, especially the part which stated that the shareholders were to be given equal compensation. Although on a motion to dismiss the plaintiff's allegations are given a favorable inference, "bare legal conclusions as well as factual claims flatly contradicted by the record are not entitled to any such consideration." *Gershon v Goldberg*, 30 AD3d 372, 373 (2d Dept 2006); see also *O'Donnell, Fox & Gartner, P.C. v R-2000 Corp.*, 198 AD2d 154, 154 (1st Dept 1993). It is undisputed that defendants were not parties to the shareholders' agreement and do not have any obligations or duties with respect to the agreement. Pellegrino also claims that he was unaware of such an agreement until October 2011.

Regardless, even if defendants were familiar with the shareholders' agreement, defendants' engagement letter to the WAC parties explicitly informs the parties that WAC is responsible for supplying the financial data, and that defendants cannot be relied upon to disclose fraudulent financial reporting. Defendants further explained in their engagement letter that WAC is

responsible for payroll and regular accounting maintenance. It was WAC's comptroller or other parties, and not the defendants, who paid Tufo his salary, decided to terminate Tufo, stopped his 401K contributions, applied for a loan without consulting with Tufo, paid defendants with checks that were never authorized by Tufo, among the plaintiffs' other allegations. Defendants' preparation of the tax returns or even the provision of financial advice, would not have led to plaintiffs' alleged damages.

In terms of failing to comply with the standards of the accounting profession, plaintiffs contend that defendants made mistakes on the tax returns, such as failing to issue some individuals 1099 forms, and mislabeling loans to shareholders as trade notes and accounts receivables as Line 2a in WAC's tax return. Plaintiffs' expert, whose affidavit for the related action is attached to plaintiffs' papers in this action, and is also cut and pasted into plaintiffs' memorandum of law, states that WAC had negative equity, and that WAC produced inconsistent factory dealer statements. These later allegations, such as negative equity, obviously solely belong in the related action, and do not involve defendants. And, the dealer statements, provided by WAC, although reviewed by defendants, as explained in the engagement letter, were "not intended to be a review of the financial statements" of WAC.

Nonetheless, plaintiffs' expert further maintains the

following:

The Shareholders' Agreement mandates that Alex Muscarella is a twenty five (25) share, and a twenty five (25) percent shareholder; yet he did not receive a K-1 from the business until 2010. This is a discrepancy violating the Shareholders' Agreement having substantial tax consequences for Mr. Tufo and WAC. Mr. Tufo was improperly and detrimentally taxed on his income in 2008 and 2009.

Plaintiff's Exhibit 6, ¶ 16.

However, the tax returns from 2008 and 2009 have Alex Muscarella listed as having 0% shares. *Id.*, ¶ 13. Presumably defendants calculated those returns based on the information given to them by WAC, and did not have the responsibility to review the shareholders' agreement for any discrepancies. WAC's president, according to the shareholders' agreement, is responsible for the accounting and budget. As such, since the shareholder had zero shares for those two years, he did not receive a K-1.

Regardless, as with all of the other allegations, even if, assuming, *arguendo*, for purposes of this motion, that defendants made mistakes on WAC's tax returns, these mistakes did not cause Tufo the damages of which he complains, such as not receiving the same salary as the other shareholders.

Defendants, citing to *Parrott v Coopers & Lybrand* (263 AD2d 316, 324-325 [1st Dept 2000]), *affd* 95 NY2d 479 (2000), contend that only WAC parties may bring a claim against defendants for negligently prepared tax returns, since the accountant only owes a duty of care to the corporation, and not to the shareholders. In

response, plaintiffs claim that *Parrott v Coopers & Lybrand, supra*, is "inapplicable because the plaintiffs pled, among other causes of action, the defendants' negligent preparation of their personal or individual tax returns." Plaintiffs' Sur-Reply, at 18. This explanation by plaintiffs further demonstrates how plaintiffs are claiming personal damages by defendants' alleged actions, when, in reality, as defendants properly maintain, defendants had "no authority to direct how or in what manner the WAC parties were going to operate their business, including payroll, financing, etc." Defendants' Reply Memorandum of Law, at 14.

Accordingly, since defendants did not proximately cause plaintiffs' injuries, plaintiffs are unable to sustain a cause of action for negligence/malpractice, and it is dismissed.

II. Plaintiffs' Claim for Breach of Contract:

Plaintiffs argue that defendants "breached their agreement and contract and relationship with plaintiffs to represent them with undivided loyalty ... without conflicts of interest ... failing to comply with and respect the highest standards of the certified public accounting profession." Complaint, ¶ 213. Plaintiffs explain that the contracts allegedly breached were the ones that defendants had with plaintiffs both orally and in writing, to advise them on financial matters and with tax returns.

This cause of action is based on the same set of facts and

damages as the negligence cause of action and is dismissed as duplicative. See e.g. *Mitschele v Schultz*, 36 AD3d 249, 252 (1st Dept 2006) ("Plaintiff's assertion in support of the [breach of contract] claim is that defendant accountants violated their agreement to provide professional services in accordance with good and accepted professional standards. This is nothing more than a rephrasing of the claim of malpractice in the language of breach of contract ... "). As such, this first cause of action is dismissed as duplicative of the fifth cause of action for negligence.

III. Plaintiffs' Claim for Conversion:

The Appellate Division, First Department, has held the following with respect to conversion:

In order to establish a cause of action for conversion it must be proven by a fair preponderance of the credible evidence that (1) plaintiff had legal ownership or an immediate superior right of possession to specific identifiable personal property, and (2) defendant exercised unauthorized dominion over the property to the exclusion of the plaintiff's rights.

Aetna Casualty & Surety Co. v Glass, 75 AD2d 786, 786 (1st Dept 1980); see also *Pintex Corp. v Poughkeepsie Finishing Corp.* (233 AD2d 232, 233 [1st Dept 1996]).

Plaintiffs contend that defendants have certain records which have not been turned over to them. Plaintiffs provide a 36-item list in their memorandum of law. This list is the same list

provided by the plaintiffs' expert in the expert's affidavit which was submitted in support of the related action as against the comptroller, shareholders, and others. For instance, some of these records include, among other things, life insurance policies, floor planning of all new or late model hybrids, petty cash books and records, and loan information. Plaintiffs have been provided with WAC's tax returns. It is apparent that the sought-after records, even if they contain the tax returns, would not be the type of records kept by defendants, but would be kept by the other shareholders or others. Moreover, despite plaintiffs' argument that the defendants allegedly are storing the items, the shareholder agreement itself provides that the president shall maintain the books and records.

As such, since defendants did not exercise "unauthorized dominion" over the items sought by plaintiffs, a conversion claim cannot be sustained and the second cause of action is dismissed.

IV. Plaintiffs' Claim for Conflict of Interest:

According to plaintiffs, Pellegrino counseled the other shareholders and WAC at the same time that he counseled plaintiff. As such, plaintiffs claim that defendants demonstrated conflicts of interest. The American Institute of Certified Public Accountants (AICPA), Rules of Conduct, which is provided by plaintiffs, sets forth the following, in pertinent part:

03 102-2-Conflicts of interest A conflict of interest may occur if a member performs a professional service

for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, *Confidential Client Information* [ET section 301.01].

Plaintiffs knew that defendants were the accountants for WAC for at least 22 years, and plaintiffs still decided to use defendants for their personal tax accountants as well for at least 10 years. As such, this relationship was disclosed to plaintiffs, and they consented to defendants' services. And, according to Pellegrino, a discrepancy in salary had been occurring since 2003 and Tufo had never complained about the discrepancy to defendants.

In their lengthy sur-reply, plaintiffs claim that they are able to sustain a claim for conflict of interest since "[v]ery **importantly, defendants aided and abetted the freezing and locking-out of plaintiff from the business and terminating all of plaintiff John Tufo's compensation, including benefits and perks** [emphasis in original]." Plaintiffs' Sur-Reply, at 12. However, as previously mentioned, plaintiffs' claims are misplaced, since defendants, as WAC's accountants, would not be responsible for paying Tufo or providing him with "perks," such as an EZ pass, on the job.

Plaintiffs allege that Pellegrino was "not free from conflicts of interests to plaintiffs' detriment. Pellegrino was not truthful to plaintiffs' detriment." Complaint, ¶¶ 175, 176. Tufo also explains that Pellegrino presented him with a buy-out proposal which Pellegrino created, and that Pellegrino allegedly "advised [him], against [his] best interests, to accept the buy-out proposal" Tufo Affidavit, ¶ 21. However, assuming that plaintiffs' allegations are true, for the purposes of this motion, defendants also prepared the personal tax returns for the other shareholders as well, so it would be a breach of confidentiality for defendants to share with Tufo the other shareholders' personal tax returns. AICPA's Rule 301 provides that a "member in public practice shall not disclose any confidential client information without the specific consent of the client." Furthermore, Tufo never used the alleged "buy out proposal," so no damages can be claimed from this proposal.

Accordingly, plaintiffs cannot plead a cause of action for conflict of interest, and it is dismissed.

V. Plaintiffs' Claim for Breach of Fiduciary Duty:

The Appellate Division, First Department, has held that the "duty owed by an accountant to a client is generally not fiduciary in nature" *Able Energy, Inc. v Marcum & Kliegman LLP*, 69 AD3d 443, 444 (1st Dept 2010). Despite this, plaintiffs argue that they can plead a limited circumstance which would lead to a

fiduciary relationship between defendants and plaintiffs. See e.g. *Block v Razorfish, Inc.*, 121 F Supp 2d 401, 403 (SD NY 2000) (some New York cases appear to recognize certain limited circumstances in which an accountant's misconduct can give rise, among other claims, to a claim for breach of fiduciary duty--such as in situations where the accountant engages in affirmative fraud on the client")

As previously mentioned, plaintiffs argue that Pellegrino's affidavits contradict themselves in that he was understating his role as just a personal accountant for Tufo and his family. However, the court does not find that the alleged services and advice provided by Pellegrino to Tufo, such as budgeting and investments, contradict Pellegrino's statements in his affidavits.² See e.g. *Friedman v Anderson*, 23 AD3d 163, 165 (1st Dept 2005) ("Accountants have a duty to perform within the scope of their professional accounting standards, which generally go beyond simple auditing and bookkeeping. ... In other words, imparting financial advice regarding client investments is an integral part of accounting today"). Contrary to plaintiffs' contentions, this alleged discrepancy would not give rise to any special circumstances, such as affirmative fraud, which would establish a breach of fiduciary duty claim. Accordingly, this

² Plaintiffs' other allegations with respect to breach of fiduciary duty are the same ones pled as part of the conflict of interest claim and will not be re-addressed.

cause of action is dismissed.

The court has considered plaintiffs' remaining contentions and finds them without merit.

CONCLUSION

Accordingly, it is hereby

ORDERED that the motion of defendants Frank Pellegrino, CPA and Pellegrino & Sherwin LLP, as Certified Public Accountants to dismiss the complaint herein is granted, and the complaint is dismissed in its entirety against said defendants, with costs and disbursements to said defendants as taxed by the Clerk of the Court; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly in favor of said defendants.

DATED:

7/24/12


Anil C. Singh

**HON. ANIL C. SINGH
SUPREME COURT JUSTICE**