Zelouf v Zelouf
2013 NY Slip Op 32073(U)
August 30, 2013
Supreme Court, New York County
Docket Number: 603746/2009
Judge: Shirley Werner Kornreich

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH PART 54
Justice

Index Number : 603746/2009
ZELOUF, NAHAI
vs.
ZELOUF, DANNY
SEQUENCE NUMBER : 016
PREL INJUNCTION/TEMP REST ORDER

INDEX NO. _____
MOTION DATE 8/28/13
MOTION SEQ. NO. _____

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). 261-267, 269, 277
Answering Affidavits — Exhibits _____ | No(s). 270-273, 276
Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion is

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

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

Dated: 8/30/13

SHIRLEY WERNER KORNREICH J.S.C.

1. CHECK ONE: ..... ☐ CASE DISPOSED ☒ NON-FINAL DISPOSITION
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: PART 54

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NAHAL ZELOUF, both individually and derivatively on behalf of ZELOUF INTERNATIONAL CORP.,

Index No.: 603746/2009

DECISION & ORDER

Plaintiff,

-against-

DANNY ZELOUF, RONY ZELOUF, and ZELOUF INTERNATIONAL CORP.,

Defendants.

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SHIRLEY WERNER KORNREICH, J.:

I. Background

This case involves derivative claims of corporate waste and mismanagement of a family business called Zelouf International Corp. (the Company). The court assumes familiarity with the underlying facts and allegations, discussed in an order dated January 3, 2013, which dismissed plaintiff's direct claims and ordered a trial on her derivative claims. After lengthy pre-trial litigation, the parties attempted to resolve the case by obtaining an independent valuation of the Company so that defendants could buy out plaintiff's shares. A valuation was performed, but the parties did not settle. A jury trial was scheduled to commence on September 9, 2013.

However, in a letter dated August 19, 2013, defendants informed the court that the Company's shareholders were given notice of a Special Meeting to vote on a proposed merger. *See* NYSCEF Doc. No. 260. The purpose and effect of the merger is quite simple: defendants, who control a supermajority of the Company's shares, would vote to buy out plaintiff's shares so

that she would lack standing to maintain her derivative claims. The Company would be merged into a new entity, called ZIC, which would be wholly owned by defendants. If the merger occurred, the trial would be cancelled. Plaintiff's only recourse would be to seek an appraisal of her shares under BCL § 623. Plaintiff objects to her loss of a jury trial and possible reimbursement of her reasonable attorneys' fees in this derivative action.

On August 22, 2013, plaintiff filed a motion for a temporary restraining order (TRO) to prevent the Special Meeting, scheduled for August 30, 2013, from going forward until the court rules on the legality of the merger. Defendants filed their opposition on August 26, 2013. A hearing was held on August 28, 2013, during which the court reserved judgment, issued a TRO pending a decision, and directed letter-briefing on whether the merger would impact plaintiff's right to recoup her attorneys' fees. For the reasons that follow, plaintiff's motion is denied and the TRO is vacated.

II. Discussion

The law governing the proposed merger, which would "freeze-out" plaintiff, was set forth by the Court of Appeals in *Alpert v 28 Williams St. Corp.*, 63 NY2d 557 (1984) (*Alpert I*):

> Generally, the remedy of a shareholder dissenting from a merger and the offered "cash-out" price is to obtain the fair value of his or her stock through an appraisal proceeding. This protects the minority shareholder from being forced to sell at unfair values imposed by those dominating the corporation while allowing the majority to proceed with its desired merger. The pursuit of an appraisal proceeding generally constitutes the dissenting stockholder's exclusive remedy. An exception exists, however, when the merger is unlawful or fraudulent as to that shareholder, in which event an action for equitable relief is authorized.

Id. at 567-68 (internal citations omitted).

The parties dispute whether the tactic employed by defendants – a "freeze-out" merger

on the eve of a trial – is permissible under New York law. This appears to be an unsettled question. Under most circumstances, plaintiff would have a legitimate concern about losing the ability to maintain her derivative claims once the merger was consummated. *See In re Carolina Gardens, Inc.*, 1995 WL 17961777 (Sup Ct, NY County 1995) (Cahn, J.), citing *Rubinstein v Catacosinos*, 91 AD2d 445, 446 (1st Dept 1983) ("It is settled law that a plaintiff stockholder in a stockholder's derivative action loses his right to continue to prosecute the action if he ceases to be a stockholder."). However, the court declines to address this issue because, at the hearing, the parties stipulated that the alleged diminution in value of plaintiff's shares caused by defendants' alleged corporate waste and self-dealing can be factored into the court's appraisal. *See* 8/28/13 Transcript, p. 8-10. Ergo, if plaintiff's shares are currently worth "x", but defendants' improper actions caused the shares to lose "y" in value, the court would award plaintiff "x" plus "y". Moreover, there is no concern that other shareholders would effectively be indemnifying defendants for their bad acts through the Company's payment to plaintiff because defendants are the only other shareholders.

Additionally, if plaintiff prevailed at trial, defendants would have to repay the Company and plaintiff could only obtain a cash recovery if she were bought out afterward. Instead, under defendants' proposal, the Company would pay plaintiff immediately after an appraisal. Defendants, in actuality, would be the effective payors since, as the sole owners of the Company, they, in the end, would realize the loss. This is a more efficient process since it saves all parties – plaintiff, defendants, and the Company – the cost of a jury trial, an appeal, and a subsequent appraisal (either in a dissolution proceeding or in a buy-out), which would far exceed the cost of conducting an appraisal at this time.

There, nonetheless, are two concerns that the court must weigh before allowing the merger. The first is plaintiff's contention that, even though she would get to litigate her derivative claims as part of the appraisal, she cannot be stripped of her right to a jury trial. However, since her claims are merely derivative – meaning that any recovery would go directly to the Company – the right to a jury trial really belongs to the Company. Thus, if this action is decided by the court instead of a jury, plaintiff's individual rights are not impacted. Indeed, the primary reason why individual shareholders are not generally permitted to maintain claims on behalf of the corporation is that their incentives are not aligned with the corporation's interests. *See generally Marx v Akers*, 88 NY2d 189 (1996).

At this stage of the litigation, there is no doubt that the parties' interests are severely divergent. A jury trial is not remotely in the best interest of the Company. In addition to the costs discussed earlier, plaintiff intends to call many of the Company's current customers to testify at trial. As defendants accurately contend, dragging customers into this contentious family dispute, where each side has attempted to air decades of dirty laundry, is harmful to the business. To be sure, the mounting legal bills and time consumed in litigation also serve none of the parties' best interests. Therefore, the court finds that plaintiff has no legitimate grievance about not going forward with a jury trial. *See Alpert v 28 William St. Corp.*, 124 Misc2d 512, 519 (Sup Ct, NY County 1983), *aff'd* 97 AD2d 681 (1st Dept 1983), *aff'd Alpert I, supra* ("It is a legitimate and proper corporate purpose … to alleviate dispute and dissension by buying out minority interests … when the corporate costs, retention of counsel … and the dealing with minorities absorbs a substantial portion of the corporate earnings.").

Finally, the court must consider plaintiff's concern about recouping her legal fees. Pursuant to BCL § 626(e), plaintiff, if she prevailed on her derivative claims, may have recouped her reasonable legal fees from the Company. *Glenn v Hoteltron Sys., Inc.*, 74 NY2d 386, 393 (1989). But, even if plaintiff prevailed after a jury trial, she could not have recovered all of the fees she has paid in this action. First, as always, the court would have to evaluate the reasonableness of her legal bills. *See Getty Petroleum Corp. v G.M. Triple S. Corp.*, 187 AD2d 483 (2d Dept 1992). Second, until earlier this year, plaintiff had asserted both direct and derivative claims. It is well established that plaintiff cannot recover her legal fees for prosecuting her direct claims. *See A.G. Ship Maintenance Corp. v Lezak*, 69 NY2d 1, 5 (1986) ("the prevailing party may not collect [attorneys' fees] from the loser unless an award is authorized by agreement between the parties or by statute"). Consequently, the court would have had to evaluate the percentage of her fees attributable to her derivative claims.

In contrast, in an appraisal proceeding under BCL § 623, a shareholder may recover the cost of the appraisal proceeding itself. *Dimmock v Reichhold Chemicals, Inc.*, 41 NY2d 273, 277 (1977); *Quill v Cathedral Corp.*, 241 AD2d 593 (3d Dept 1997). Plaintiff is concerned that, if the appraisal proceeding occurs instead of a trial, she will lose the ability to recover the fees she paid so far for the derivative claims. However, as discussed earlier, the appraisal of plaintiff's shares will factor in the valuation of her derivative claims. Such valuation necessarily would include her legal fees because derivative claims inherently contain the expectation that a meritorious plaintiff will recoup legal fees. *See Glenn*, 74 NY2d at 393 (plaintiff's legal fees "should be paid by the corporation, which has benefitted from the plaintiff's efforts and which would have borne the costs had it sued in its own right"). Hence, in the appraisal, while the only

separate award of costs will be for the expense of the appraisal itself, the court will incorporate the legal fees that plaintiff would have recovered in her derivative action into the valuation of her shares.

In sum, since the ultimate right of plaintiff to recover on her derivative claims will be preserved in the appraisal proceeding and there has been no showing that the proposed merger is "unlawful or fraudulent", the court will not enjoin the merger. Accordingly, it is

ORDERED that the motion by plaintiff Nahal Zelouf, for an injunction prohibiting the contemplated merger is denied and the TRO issued on the August 28, 2013 record is hereby vacated; and it is further

ORDERED that this decision has no bearing on and does not consider the fairness of the merger or the amount of money plaintiff is entitled to receive for her shares, which shall be adjudicated by this court in lieu of a jury trial; and it is further

ORDERED that pursuant to the parties' stipulations on the August 28, 2013 record, the appraisal of plaintiff's shares shall include the lost value, if any, resulting from defendants' alleged bad acts that were the subject of plaintiff's derivative claims (including the reasonable attorneys' fees discussed herein); and it is further

ORDERED that a pre-appraisal conference will be held in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, on September 9, 2013 at 10:00 in the forenoon.

Dated: August 30, 2013

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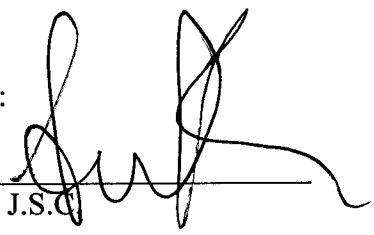

J.S.C.