

Zelouf v Zelouf

2013 NY Slip Op 33906(U)

January 3, 2013

Supreme Court, New York County

Docket Number: 603746/2009

Judge: Shirley Werner Kornreich

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

JUSTICE SHIRLEY WERNER KORNREICH

PRESENT: _____
Justice

PART 54

Index Number : 603746/2009
ZELOUF, NAHAI
vs.
ZELOUF, DANNY
SEQUENCE NUMBER : 006
SUMMARY JUDGMENT

INDEX NO. _____
MOTION DATE 10/19/12
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) 110-115
Answering Affidavits — Exhibits _____ No(s) 133-143
Replying Affidavits _____ No(s) 145-152

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

MOTION DECIDED BY ACTION OF COURT
WITH ACCOMPANYING MEMORANDUM
DECISION AND ORDER.

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

Dated: 1/3/13

SHIRLEY WERNER KORNREICH
J.S.C., J.S.C.

- 1. CHECK ONE: ... CASE DISPOSED ... NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: ... MOTION IS: ... 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

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

Index No.: 603746/2009

Plaintiff,

DECISION & ORDER

-against-

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

Defendants.

-----X
SHIRLEY WERNER KORNREICH, J.:

Defendants Danny Zelouf and Rony Zelouf (collectively, the Individual Defendants) filed a motion for summary judgment, pursuant to CPLR 3212, against plaintiff Nahal Zelouf. Defendants' motion is granted in part and denied in part for the reasons that follow.

I. Factual Background & Procedural History

Defendant Zelouf International Corp. (ZIC), a New York corporation, is a family owned textile business founded in 1984 by Shafik Zelouf. In 2003, Shafik died, and his son, Joseph Zelouf, succeeded him as CEO. Joseph died in 2004. Following the probate of his estate, his son, defendant Danny Zelouf, became the CEO and the holder of 50% of the shares of ZIC. Shafik's other sons, defendant Rony Zelouf and non-party Emil Zelouf, each held 25% of the shares of ZIC. That same year, Emil suffered a stroke that left him disabled. His wife, plaintiff Nahal Zelouf, became the owner of Emil's shares.

In 2009, plaintiff commenced this action for alleged mismanagement of ZIC, asserting seven causes of action: (1) a derivative claim for breach of fiduciary duty; (2) a direct claim for breach of fiduciary duty; (3) a derivative claim for misappropriation of corporate assets; (4) a derivative claim for waste of corporate assets; (5) a derivative claim for conversion; (6) a direct claim for the imposition of a constructive trust; and (7) a direct claim for an equitable accounting.

As this is the Individual Defendants' motion for summary judgment, the Court relies on the following facts, which are either undisputed or recited in the light most favorable to plaintiff.

In 2008, plaintiff instituted a special proceeding in which she obtained ZIC's General Ledgers and Journals for review. Upon inspection, plaintiff learned that ZIC utilized a computer accounting program called MOD2. After commencing the instant action, plaintiff obtained discovery of ZIC's financial records from MOD2. Plaintiff contends that her forensic accountant's review of the MOD2 data, compared to the data in the General Ledgers and Journals, reveals substantial anomalies demonstrating that the Individual Defendants have committed financial malfeasance by diverting corporate assets for their benefit and for the benefit of their family members. Plaintiff specifically contends that Danny diverted business from ZIC to other companies that he controls, such as Zelouf West, Ltd. and Total Package Garment LLC. Plaintiff also contends that the Individual Defendants improperly used corporate funds to benefit themselves and their family by, *inter alia*, making unsecured loans to themselves and paying salaries and providing luxury cars for family members who did not work for the company.

II. Discussion

It is well established that summary judgment may be granted only when it is clear that no triable issue of fact exists. *Alvarez v Prospect Hosp.*, 68 NY2d 320, 325 (1986). The burden is upon the moving party to make a *prima facie* showing of entitlement to summary judgment as a matter of law. *Zuckerman v City of New York*, 49 NY2d 557, 562 (1980); *Friends of Animals, Inc. v Associated Fur Mfrs., Inc.*, 46 NY2d 1065, 1067 (1979). A failure to make such a *prima facie* showing requires a denial of the motion, regardless of the sufficiency of the opposing papers. *Ayotte v Gervasio*, 81 NY2d 1062, 1063 (1993). If a *prima facie* showing has been made, the burden shifts to the opposing party to produce evidentiary proof sufficient to establish the existence of material issues of fact. *Alvarez*, 68 NY2d at 324; *Zuckerman*, 49 NY2d at 562. The papers submitted in support of and in opposition to a summary judgment motion are examined in the light most favorable to the party opposing the motion. *Martin v Briggs*, 235 AD2d 192, 196 (1st Dept 1997). Mere conclusions, unsubstantiated allegations, or expressions of hope are insufficient to defeat a summary judgment motion. *Zuckerman*, 49 NY2d at 562. Upon the completion of the court's examination of all the documents submitted in connection with a summary judgment motion, the motion must be denied if there is any doubt as to the existence of a triable issue of fact. *Rotuba Extruders, Inc. v Ceppos*, 46 NY2d 223, 231 (1978).

The Individual Defendants argue that the complaint should be dismissed because plaintiff has asserted both direct and derivative claims in the same lawsuit. This argument is not supported by the caselaw. See *Baliotti v Walkes*, 134 AD2d 554, 555 (2d Dept 1987). Rather, a complaint should be dismissed only where there is a "mingling of derivative claims and individual claims" such that the court cannot untangle the "confusing hodge-podge" of direct and

derivative claims. *Barbour v Knecht*, 296 AD2d 218, 228 (1st Dept 2002) (citing *Abrams v Donati*, 66 NY2d 951 (1985)).

The Appellate Division, First Department, has adopted Delaware's *Tooley* standard to determine if a claim is direct or derivative. See *Yudell v Gilbert*, 99 AD3d 108, 113-14 (1st Dept 2012). Under *Tooley*, the question of whether a claim is direct or derivative "must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?" *Tooley v Donaldson, Lufkin & Jenrette, Inc.*, 845 A2d 1031, 1033 (Del 2004) (emphasis in original).

Here, the complaint is clear as to which of plaintiff's claims are direct or derivative. For each cause of action, plaintiff identifies who is owed the duty and who would receive the benefit of recovery (plaintiff or ZIC). The direct claims are the second, sixth, and seventh causes of action. The derivative claims are the first, third, fourth, and fifth causes of action. Thus, plaintiff's assertion of both direct and derivative claims does not warrant dismissal because there is no confusion about the nature of each claim. Finally, the Court notes that plaintiff has standing to maintain the derivative causes of action since, as discussed *infra*, there are questions of fact about whether "the challenged transaction was so egregious on its face that it could not have been the product of sound business judgment of the directors." *Marx v Akers*, 88 NY2d 189, 200-01 (1996).

A. *Derivative Claims (Breach of Fiduciary Duty, Misappropriation of Corporate Assets, Waste of Corporate Assets, and Conversion)*

A fiduciary duty is a relationship of higher trust that arises out of an obligation to act for or give advice to another upon matters within the scope of the relation. *EBCI, Inc. v Goldman Sachs*, 5 NY3d 11, 31 (2005). It is well established that corporate directors and officers have fiduciary duties to the corporation, including the duty of good faith, due care, and vigilance in the preservation and use of its property. *Levandusky v One Fifth Ave. Apartment Corp.*, 75 NY2d 530, 538 (1990); *see generally* NYJUR BUSINESSREL § 706. “The essence of a waste claim is ‘the diversion of corporate assets for improper or unnecessary purposes.’ To disprove a waste claim, a director who had a personal interest in challenged payments has the burden of showing that they were made in good faith and were fair to the corporation.” *SantiEsteban v Crowder*, 92 AD3d 544, 546 (1st Dept 2012) (citing *Aronoff v Albanese*, 85 AD2d 3, 5 (2d Dept 1982)). Moreover, “directors are liable for all forms of waste of assets regardless of whether they were intentional or negligent.” *Shapiro v Rockville Country Club, Inc.*, 22 AD3d 657, 658 (2d Dept 2005). To establish a cause of action for conversion, plaintiff must establish 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 Cas. & Sur. Co. v Glass*, 75 AD2d 786 (1st Dept 1980).

Summary judgment on the derivative causes of action is denied because there are myriad questions of material fact. A theme that emerges throughout the Individual Defendants’ briefs is that plaintiff has failed to “point to any documentary evidence supporting her allegation[s].” *See* Def. Mem., p.11. For instance, the Individual Defendants contend that plaintiff has failed to explain how the data in MOD2 proves that there were “at least two competing sets of books for ZIC’s business.” In making this argument, the Individual Defendants are attempting to

improperly shift their *prima facie* burden onto plaintiff. *See Zuckerman, supra*. As the Individual Defendants are moving for summary judgment, they have the burden of establishing that there is no question of fact that the financial data in the record demonstrates that the alleged financial malfeasance did not occur. They have not done so. The failure to meet their *prima facie* burden obviates the need for plaintiff to raise a question of fact and requires denial of the motion. *See Ayotte, supra*.

That being said, the parties and their experts vigorously dispute numerous aspects of the financial data, including the very meaning of certain entries and their proper calculation, such as cost of goods sold. Furthermore, it is clear that the dispute over the MOD2 data is central to this case. The extent of the parties' dispute over the MOD2 data is best exemplified by the Individual Defendants' contention that a comparison of "ZIC's actual books and records" with the MOD2 data is improper because MOD2 is "an alternative bookkeeping system . . . that is not used for accounting purposes." Reply Mem., p.6. This fundamental dispute over what the data in MOD2 represents precludes summary judgment.

There also are numerous questions of fact that preclude summary judgment regarding the other alleged financial improprieties, such as diversion of corporate opportunities to other companies (such as Zelouf West), personal loans to Danny, and salaries/benefits given to family members (such as luxury cars and tuition payments). The scope of disagreement and confusion is so profound that the parties cannot even agree on the most trivial, non-material facts, such as whether Jaslene Rekhi Sawhney, whose college tuition was paid by ZIC, was Danny's cousin. Ultimately, for plaintiff to prevail on these derivative claims, she will have to overcome the presumption that these challenged transactions are subject to the protections of the business judgment rule. *See Marx, supra*. However, on the record that is currently before this Court,

there is too much confusion and dispute over the facts to ascertain the purpose and propriety of these transactions. As this is the Individual Defendants' motion, it is their burden to demonstrate that there are no questions of material fact. They have not met that burden. Summary judgment on all of the derivative claims is denied, and the factual determinations pertinent to these issues must be resolved at trial.

B. Direct Claims (Breach of Fiduciary Duty, Constructive Trust, and Equitable Accounting)

Plaintiff cannot maintain her direct cause of action for breach of fiduciary duty because she did not suffer a harm distinct from the harm suffered by ZIC. The alleged wrongs committed by the Individuals Defendants are for mismanagement of ZIC.

Likewise, plaintiff cannot maintain her direct cause of action for a constructive trust. She has not identified a harm that was uniquely suffered by her. The imposition of a constructive trust is an equitable remedy and requires the plaintiff to establish "(1) a confidential or fiduciary relationship, (2) a promise, (3) a transfer in reliance thereon, and (4) unjust enrichment." *Modica v Modica*, 15 AD3d 635 (2d Dept 2005) (citing *Simonds v Simonds*, 45 NY2d 233 (1978)). Additionally, a constructive trust will not be granted unless the plaintiff establishes that there is no adequate remedy at law. *Evans v Winston & Strawn*, 303 AD2d 331, 333 (1st Dept 2003). Plaintiff has neither established that she transferred any money to the Individual Defendants nor explained why monetary damages would be inadequate to compensate her for the Individual Defendants' alleged wrongs.

Finally, plaintiff cannot maintain her direct cause of action for an equitable accounting. "[T]o be entitled to an equitable accounting, a claimant must demonstrate that he or she has no

adequate remedy at law.” *Unitel Telecard Distribution Corp. v Nunez*, 90 AD3d 568, 569 (1st Dept 2011). Here, plaintiff has obtained ZIC’s financial records in discovery, obviating the need for an accounting. *See Addax BV Geneva Branch v Eastern of New Jersey, Inc.*, 2007 WL 1321027, at *2 (SDNY 2007).

As a result, summary judgment is granted to the Individual Defendants on plaintiff’s direct causes of action for breach of fiduciary duty, constructive trust, and equitable accounting. Accordingly, it is

ORDERED that the motion by defendants Danny Zelouf and Rony Zelouf for summary judgment against plaintiff Nahal Zelouf is granted on the direct causes of action (the second, sixth, and seventh), and said causes of action are hereby dismissed; and it is further

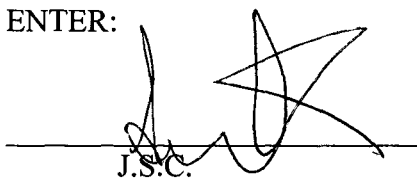
ORDERED that the motion by defendants Danny Zelouf and Rony Zelouf for summary judgment against plaintiff Nahal Zelouf is denied on the derivative causes of action (the first, third, fourth, and fifth); and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre St., rm. 228, New York, N.Y., for a pre-trial conference on February 5, 2013 at 11:00 in the forenoon; and it is further

ORDERED that the Clerk shall enter judgment accordingly.

Dated: January 3, 2013

ENTER:


J.S.C.