

County of Suffolk v Love'M Sheltering, Inc.
2017 NY Slip Op 31005(U)
March 28, 2017
Supreme Court, Suffolk County
Docket Number: 1399/10
Judge: Thomas F. Whelan
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SUPREME COURT - STATE OF NEW YORK
I.A.S. PART 33 - SUFFOLK COUNTY

PRESENT:

Hon. THOMAS F. WHELAN
Justice of the Supreme Court

MOTION DATE: 12/20/16
SUBMIT DATE: 3/10/17
Mot. Seq. # 010 - MD
Mot. Seq. # 011 - XMD
CDISP: No

-----X
COUNTY OF SUFFOLK, :
: :
Plaintiff, :
: :
-against- :
: :
LOVE'M SHELTERING, INC., and its officers and :
directors, LOVE'M, INC., and its officers and :
directors, RICHARD MORRISON, in his individual :
capacity, MARY MORRISON, in her individual :
capacity, :
: :
Defendants :
: :
-----X

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Upon the following papers numbered 1 to 12 read on this motion for the plaintiff for order requiring disclosure and cross motion by the Morrison & Love'M Inc. defendants for a protective order; Notice of Motion/Order to Show Cause and supporting papers 1 - 4; Notice of Cross Motion and supporting papers 5-7; Opposing papers: 8-9; Reply papers: 10; 11; Other 12 (memorandum); ~~(and after hearing counsel in support of and in opposition to the motion)~~ it is,

ORDERED that this motion (#010) by the plaintiff for an order directing the individual defendants, Richard and Mary Morrison, to issue authorizations for the release of their individual federal and state tax returns for the 1999-2006 tax years is considered under CPLR 3124 and is denied but such denial is without prejudice to the interposition of a new motion for the same relief following the plaintiff's review of the corporate tax returns for the years 1999-2006 and the completion of other possible discovery proceedings, if any; and it is further

ORDERED that the cross motion (#011) by the Morrison defendants for a protective order against any demands for the release of the personal tax returns is considered under CPLR 3103 and is denied.

The plaintiff commenced this action to enforce a judgment in the amount of \$809,417.91 against defendants Morrison and Love'M, Inc. which the plaintiff secured against defendant, Love'M Sheltering, Inc. (hereinafter "Sheltering") in January of 2008. This judgment was awarded upon the plaintiff's successful prosecution of its claim to recover overpayments made to Sheltering under a 1999 contract by which Sheltering agreed to provide emergency housing and other services to indigent residents of Suffolk County. This claim was interposed as a counterclaim in a hybrid Article 78/declaratory judgment action commenced by Sheltering against the plaintiff in 2004 and was predicated upon the terms of the 1999 contract between the parties and a June 8, 2004 audit of Sheltering's fiscal operations from January 1, 2000 through December 31, 2000 by the Suffolk County Comptroller. Sheltering's challenges to the validity of the audit and the amount of overpayments to which the plaintiff claimed an entitlement were rejected by the trial court in an order dated April 7, 2005 (*see* Index #14978/2004). The order of the trial court was affirmed by the Appellate Division, Second Department on October 24, 2006 (*see Love'M Sheltering, Inc. v County of Suffolk*, 33 AD3d 923, 824 NYS2d 98 [2d Dept 2006]).

Sheltering was a not-for-profit corporation that rented operating space from defendant, Love'M, Inc., a related not-for-profit corporation. Both Sheltering and Love'M, Inc. were formed, operated and/or controlled by the Morrison defendants. The audit, upon which the \$809,417.91 judgment in favor of the County against Sheltering issued, included the sum of \$149,700.00 in disallowed rental payments allegedly made by Sheltering to Love'M, Inc., as owner of the premises out of which Sheltering conducted its operations. The basis for the disallowance was the auditor's lack of access to the financial records of Love'M, Inc., which further served as a basis for the auditor's conclusion that the rental agreements between the two non-profits were not at arms lengths. These findings were affirmed by both the trial court and the Appellate Division's order of October 24, 2006.

In 2005, the plaintiff declined to renew its contract with Sheltering and thereafter, Sheltering ceased its operations. Subsequent to the entry of the plaintiff's January 28, 2008 judgment against Sheltering, the plaintiff issued an execution thereon. However, the execution was returned unsatisfied by the Sheriff, as no assets of Sheltering against which a levy could be made were found. Although Love'M, Inc., continued to operate its real estate business following the close of Sheltering in 2005, Love'M Inc. ceased its operations sometime in 2008. On December 22, 2009, the Morrison defendants won the Mega Millions Lottery Jackpot which yielded them a net payout of some \$65,000,000.00.

In an amended complaint served by the plaintiff, it demands that the January 28, 2008 judgment it obtained against Love'M Sheltering be enforced against defendants, Love'M, Inc., Richard Morrison and Mary Morrison. These claims are predicated upon allegations that the court should pierce or disregard the corporate veil of Sheltering for purposes of the plaintiff's judgment and charge the Morrisons and Love'M, Inc. with liability therefor due to the domination and control exerted over Sheltering and the other actionable excesses in which the Morrisons, individually or through Love'M, Inc., purportedly engaged.

By the instant motion (#010), the plaintiff seeks an order pursuant to C.P.L.R. 3124 directing the individual Morrison defendants to issue authorizations for the release of said defendants' personal income tax returns for the years 1999-2006. The basis for this relief is predicated upon purported stonewalling by the Morrison defendants with respect to answers given at their depositions regarding payments received by said defendants from the defendant corporations, especially, Love`M Inc., which allegedly reflect the diversion of corporate assets to the Morrisons or the commingling of such corporate assets with the personal finances of the Morrisons. This diversionary and/or commingling of corporate assets with the Morrisons allegedly occurred beyond the audit year of 2000 and ended in 2006 following the cessation of the operations of Love`M, Inc. and the "liquidation" of its assets.

At a compliance conference held in September of 2016, counsel allegedly agreed that both corporations would issue appropriate authorizations for the release of corporate tax returns for the years 1999-2006 but that the issue of the release of personal tax returns would be put before the court in a motion such as the instant one. The plaintiff reports in its March 3, 2017 reply papers, that it never received authorizations nor copies of the corporate tax returns from either of the corporate defendants. In a submission entitled "Reply Affirmation", counsel for defendant Love`M Sheltering, Inc., which is not a target of the plaintiff's motion nor a party to the cross motion by the defendants, advised said counsel "filed the appropriate authorization with the Internal Revenue Service for copies of the corporate tax returns" and that none had been received. The reply papers served by counsel for the cross moving defendants [the Morrisons and Love`M Inc.] contain like averments regarding the filing of authorizations for the release of the corporate tax returns of defendant, Love`M, Inc.

The opposition to the plaintiff's motion (#010) and the support for the cross motion (#011) for a protective order by counsel for the cross moving defendants is based in part upon the fact that the plaintiff did not engage in good faith efforts to resolve the issue and never served a predicate notice or other written demand for the either the corporate tax returns that were the subject of the oral agreement among counsel struck at the above described compliance conference, nor did the plaintiff serve a notice or demand for the production of the personal state and federal tax returns that are demanded by the plaintiff on its motion-in-chief. Defense counsel goes on to challenge the plaintiff's entitlement to copies of the individual tax returns of the Morrison defendants on substantive grounds such as relevance and whether the material is available from other sources.

However, the court rejects these procedural challenges to the plaintiff's entitlement to the relief requested. Neither the claim of an absence of a good faith effort nor the claim that the absence of a duly served notice or demand for the production of the personal income tax returns have merit. The record reflects that a demand for the production of the personal income tax returns of the Morrison defendants for the years 1999, 2000 and 2001 was included in the plaintiff's Notice of Discovery and Inspection dated July 26, 2010 and rejected by the defendants as irrelevant. The record further reveals that the Morrison defendants were questioned, without objection, to financial transactions undertaken by them under both corporate forms evidencing payment of corporate monies and/or assets to themselves, personally, and to other family members while corporate defendant Sheltering continued to operate through 2005 and during defendant, Love`M Inc.'s

continued operations which slowed thereafter and finally ceased in 2008. The individual defendants were likewise questioned as to the details of the liquidation and distribution of corporate monies and assets upon the cessation of the operations of each corporate defendant. In addition, the deposition testimony of both of the Morrison defendants indicate that they were also questioned about checks drawn on corporate accounts and made payable to the Morrison defendants, individually, for services allegedly performed, reimbursement of monies allegedly expended by them on behalf of the corporate defendants, and checks and other documentation relating to their personal income tax filings. Moreover, defendant Mary Morrison testified with respect to her draw of a check on an account owned by Love`M, Inc., made payable to herself in the amount of \$10,000.00 and the subsequent payment from her personal account of two checks totaling \$10,000.00 to the United States Treasury and the State Treasurer for payment of personal income taxes due by said defendant (*see* Deposition of R. Morrison, page 240).

Under these circumstances, the court finds that the material now sought by the plaintiff is sufficiently related to the factual averments in the amended complaint, to matters on which the Morrison defendants testified at their depositions and to the subsequent discussions among counsel regarding the disclosure of tax returns. Defense counsel's claim that the Morrison defendants were testifying not as individuals, but as officers and directors of the corporate defendants, is belied by the record. The fact that plaintiff's counsel did not call for the production of the tax returns following the completion of the depositions is irrelevant and does not preclude the interposition of the plaintiff's motion seeking this relief. Contrary to the contentions of the defense counsel, a written demand for the production of the individual tax returns for a portion of the years not demanded was included in the plaintiff's 2010 Notice for Discovery and Inspection and the court is satisfied with the contents of the affirmation of good faith attached to the plaintiff's moving papers. Accordingly, the purported absence of any predicate written notice or demand or good faith efforts to resolve the dispute are not a basis for a denial of this motion.

However, the court finds that at least one of the cross moving defendants substantive objections to the relief demanded has merit.

It is incumbent on the party seeking disclosure to demonstrate that the method of discovery sought will result in the disclosure of relevant evidence or is reasonably calculated to lead to the discovery of information bearing on the claims (*see Allen v Crowell–Collier Pub. Co.*, 21 NY2d 403, 288 NYS2d 449 [1968]). Unsubstantiated, bare allegations of relevancy and reasonable calculation are insufficient to establish the factual predicate regarding relevancy (*see Beckles v Kingsbrook Jewish Medical Center*, 36 AD3d 733, 830 NY2d 203 [2d Dept 2007]). Instead, a showing that the method of discovery sought will result in the disclosure of relevant evidence or matter that is reasonably calculated to lead to the discovery of admissible proof bearing on the claims is required (*see Vyas v Campbell*, 4 AD3d 417, 771 NYS2d 375 [2d Dept 2004]).

Among the factors relevant to a determination of whether a corporate owner has abused the privilege of doing business in the corporate form, which is a key element of a claim for piercing the corporate veil, is whether there was a "failure to adhere to corporate formalities, inadequate capitalization, commingling of assets, and use of corporate funds for personal use (*see JGK Indus.*,

LLC v Hayes NY Business, LLC, 145 AD3d 979, 45 NYS3d 479 [2d Dept 2016]; *Millenium Constr., LLC v Loupolover*, 44 AD3d 1016, 1016–1017, 845 NYS2d 110 [2d Dept 2007]). The plaintiff's pleaded claims for relief and the discovery proceedings held herein squarely touched upon these factors and rendered them germane to the issues to be determined in resolving the claims and defenses of the parties.

It is well established that the courts of this State are normally reluctant to order the production of individual tax returns, but they will do so where special circumstances so warrant (*see Four Aces Jewelry Corp. v Smith*, 256 AD2d 42, 680 NYS2d 539, 540 [1st Dept 1998]; *see also Dore v Allstate Indem. Co.*, 695 NYS2d 422, 264 AD2d 804 [2d Dept 1999]). The special circumstances requirement is met in cases wherein an inference of fraudulent conduct may fairly be drawn from factual allegations asserted to support pleaded claims for relief, including cases, such as the instant one, wherein a claim is based upon improper transfers of corporate assets by a corporation is winding down or going under (*see Holme v Global Mins. & Metals Corp.*, 90 AD3d 423, 424, 934 NYS2d 30 [1st Dept 2011]). That a claim to pierce the corporate veil of a corporation is similarly based is indisputable.

Here, the plaintiff made a sufficient showing of the relevance of the information due to the inference of potentially fraudulent conduct that arises from the matters uncovered to date in the discovery process to support a finding as to the existence of special circumstances thereby warranting the granting of the plaintiff's motion (*see Holme v Global Mins. & Metals Corp.*, 90 AD3d 423, *supra*). However, the plaintiff failed to demonstrate how the disclosure of the information on the personal income tax returns of the Morrison defendants would result in the disclosure of relevant evidence or other material that is reasonably calculated to lead to the discovery of admissible proof bearing on the issues framed above such as inadequate capitalization, commingling of assets, and use of corporate funds for personal use (*see id; Vyas v Campbell*, 4 AD3d 417, *supra*). As pointed out by defense counsel, personal income tax returns do not depict the sources of income and losses reported therein. So while the court rejects the remaining contentions posited in opposition to the plaintiff's motion and in support of the defendants' cross motion, the claim that the release of the information contained in the personal tax returns would not result in the disclosure of relevant evidence or other material that is reasonably calculated to lead to the discovery of admissible proof has sufficient merit to warrant denial of the plaintiff's motion.

Accordingly, the plaintiff's motion (#010) to compel the disclosure of the personal tax returns of the Morrison defendants is denied but such denial is without prejudice to the interposition of a new motion for the same relief following the plaintiff's review of the corporate tax returns for the years 1999-2006 and the completion of other possible discovery proceedings. The defendants' cross motion (#011) is denied, unconditionally, in its entirety.

Dated: March 28, 2017


THOMAS F. WHELAN, J.S.C.