To commence the statutory time period of appeals as of right (CPLR 5513[a]), you are advised to serve a copy of this order, with notice of entry, upon all parties.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER
COMMERCIAL DIVISION

Present: HON. ALAN D. SCHEINKMAN,
Justice.

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In the Matter of the Application of
LISA M. ROMITA, LOUIS C. ROMITA, and LYNDA A. ROMITA,

Holders of at least Twenty Percent of all Outstanding Voting of all Outstanding Shares of Castle Oil Corporation,
Petitioners,

Index # 53145/11

Motion Seq. #'s 2, 4, 8 & 9
Motion Date: 8/31/12

MARY DIGIROLAMO, in her own right, and V. Anthony DIGIROLAMO, as attorney in fact for MARY DIGIROLAMO,
Third Party Petitioners,

-against-

For the Dissolution of
CASTLE OIL CORPORATION, A Domestic Corporation,
Respondent.

MICHAEL ROMITA, in his individual capacity, MAURO CHRISTOPHER ROMITA, in his individual capacity, the ESTATE OF JACK ROMITA, MAURO CHARLES ROMITA, CARLA L. ROMITA, MICHAEL NICHOLAS ROMITA, JACK ROMITA JR., in his individual capacity and MICHAEL H. MEADVIN, and in their representative capacities as co-executors of THE ESTATE OF JACK ROMITA, JACK ROMITA, JR., ISABELLE ROMITA, and MAURO J. ROMITA SKRAPITS, and

MICHAEL ROMITA REVOCABLE TRUST, MICHAEL ROMITA, in his capacity as Trustee for the MICHAEL ROMITA REVOCABLE TRUST, MAURO C. ROMITA REVOCABLE TRUST, and MAURO CHRISTOPHER ROMITA, in his capacity as Trustee for the MAURO C. ROMITA REVOCABLE TRUST,
Additional Respondents.

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Scheinkman, J.:

Third Party Petitioners Mary Digirolamo in her own right and V. Anthony Digirolamo as her attorney in fact ("Third Party Petitioners") move (Motion Sequence #2) to:

(1) enjoin Castle Oil, Inc. ("Castle Oil") from advancing or otherwise paying legal fees in connection with the defense of the Respondents Michael Romita, Mauro Christopher Romita, Estate of Jack Romita, Mauro Charles Romita, Carla L. Romita, Michael Nicholas Romita, Jack Romita, Jr., and Michael Meadvin (the "Individual Respondents");

(2) require that the Individual Respondents reimburse Castle Oil for the expenses paid to date (the first and second branches are hereinafter referred to as the "Injunction/Claw Back Motion");

(3) for a ruling that Castle Oil's assertion of attorney-client privilege with respect to certain documents is invalid and ordering the production of all documents identified by Castle Oil as privileged on its privilege document log.

Petitioners Lisa M. Romita, Louis C. Romita and Lynda A. Romita (the "Petitioners") cross-move to (1) join the Injunction/Claw Back Motion; (2) join the branch of the Third Party Petitioners' motion which seeks to compel the production of documents on Castle Oil's privilege document log, and (3) compel the production of the Enterprise Valuation performed by Merrill Lynch (Motion Sequence #8).

Third Party Petitioners[1] move for (1) an order striking the Verified Answer of Castle Oil dated October 5, 2011 and the Verified Answer of Castle Oil to Third Party Petitioners' Cross-Claims and Counterclaim Against Petitioners dated November 1, 2011; and (2) a protective order pursuant to CPLR 3103 precluding Castle Oil from propounding further discovery requests on Third Party Petitioners and Petitioners (Motion Sequence #4).

Third Party Petitioners move for a default judgment against Respondents Michael Romita, Mauro Christopher Romita, the Estate of Jack Romita (through its Co-Executors Jack Romita, Jr., Isabelle Romita, and Maura J. Romita Skraptis) and the Michael Romita and Mauro Christopher Romita Revocable Trusts (the "Controlling Shareholders") (Motion Sequence #9).

All of these motions are opposed by the Controlling Shareholders.

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[1]Based on a letter dated July 30, 2012 from Petitioners' counsel, Martin H. Kaplan, Esq. (Gusrae Kaplan & Nusbaum PLLC), Petitioners joined in the motion to strike Caste Oil's pleading and for a protective order (*see* Affirmation of Thomas E. Thornhill in Support of Motion to Strike Answer and For Protective Order dated August 1, 2012 ["Thornhill Protective Order Aff."], Ex. A). As a result, all references to the Third Party Petitioners with regard to this motion should be deemed as also referring to Petitioners.

All of these motions are consolidated for purposes of deliberation and determination.

FACTUAL AND PROCEDURAL HISTORY

This is a combined dissolution/derivative action which has been brought pursuant to Business Corporation Law ("BCL") §1104-a and BCL § 720. The dispute involves the affairs of Castle Oil Corporation ("Castle Oil"), a New York corporation, alleged to be the largest fuel oil distributor in the New York metropolitan area. Castle Oil is also alleged to be a wholesale supplier to other independent oil distributors in the New York metropolitan area (Amended Verified Petition at ¶ 1-2).

This action was initiated by the filing in this Court's efiling system ("NYSCEF") of an Order to Show Cause ("OTSC") and a Verified Petition by Petitioners on July 26, 2011. The Court signed the OTSC in the form proposed by Petitioners. The OTSC directed "Castle Oil, the New York State Department of Taxation and Finance, and all persons interested in Castle Oil" to appear on the return date (September 9, 2011) and show cause as to why Castle Oil should not be dissolved pursuant to BCL § 1104-a. The OTSC further provided for publication of the OTSC in the *Journal News* for three weeks prior to the return date and for service of the OTSC and its underlying papers pursuant to BCL § 1106(c) upon Castle Oil, the New York Department of Taxation and Finance and "upon each person named in the petition who is not a petitioner." At that time, the Petition was brought solely against Respondent Castle Oil and the relief sought was limited to Castle Oil's dissolution pursuant to BCL § 1104-a.

On the return date of the OTSC (September 9, 2011), a number of matters were discussed. First, Petitioners requested to amend the petition and the Court granted that request, giving Petitioners until September 16, 2011 to file an Amended Petition. Second, Petitioners sought to file an second OTSC in order to seek a temporary restraining order against the sale of real property owned by a subsidiary of Castle Oil – Castle North Terminals, Inc. (discussed *infra*). However, based on representations by counsel for Castle Oil that there was no intent to proceed with that transaction in the foreseeable future, the issue became moot. Third, Petitioners' counsel raised the issue that in a BCL § 1104-a dissolution, the entity itself is not supposed to pay the legal fees of the other shareholders who were defending against dissolution. The Court noted that Mr. Meadvin, Castle Oil's general counsel, was present and had, in effect, opposed Petitioners' request for a temporary restraining order and seemingly was contending that Petitioners were "off base" and that the company would be injured if the transaction did not proceed. The Court further noted that there was a fine line between the position of management and the position of the Company since the majority of shareholders are in essence the Company.

Petitioners' counsel stated that Petitioners would hold off on any motion and that they would do what they needed to do "in connection with discovery" (Tr. at

42). At that time, Mr. Hess, outside counsel from the law firm of Holland & Knight, represented that Holland & Knight was hired to represent Castle Oil (*id.*). Counsel for Petitioners acknowledged that he had not discussed the fee payment issue with Mr. Hess and agreed to do so and "if necessary, []approach the Court again" (Tr. at 44). Hence, the Court understood that no judicial action was then being requested and that Petitioners would bring the issue back to Court if judicial action was required.

Fourth, in an effort to see if it was necessary to proceed with a dissolution hearing, the Court inquired as to whether Castle intended to exercise its statutory right to buy-out Petitioners. Mr. Hess informed the Court that Castle Oil did not intend to do so (Tr. 9). Recognizing that a dissolution proceeding is a special proceeding in which discovery is subject to judicial discretion (*see* CPLR 408), the Court afforded the parties approximately three months for discovery in aid of dissolution and scheduled a hearing on dissolution for December 12, 2011.

An Amended Petition was filed on September 16, 2011. As part of the amended pleading, additional respondents were added: Michael Romita, Mauro Christopher Romita, Jack Romita, Mauro Charles Romita, Carla L. Romita, Michael Nicholas Romita, Jack Romita, Jr., and Michael Meadvin.[2]

On October 3, 2011, Third Party Petitioners Mary Digirolamo in her own right and V. Anthony Digirolamo as her attorney in fact filed a Notice of Appearance. Due to an opening in the Court's schedule (the possibility of which was discussed at the September 9 conference), in a conference call with counsel on September 22, 2011, the December 12 hearing date was advanced to December 5, 2011. Thereafter, in a conference call with Chambers on September 29, 2011, all counsel agreed to allow Third Party Petitioners to intervene in the action. The Court then held a Preliminary Conference on October 6, 2011 and set a discovery cut-off date on the other claims (*i.e.*, the derivative claims alleging breach of fiduciary duty) for March 29, 2012 and a Trial Readiness Conference for March 30, 2012. The Court made clear that the hearing on December 5, 2011 was only on the dissolution claim and, while there was overlap in that some of the grounds for dissolution were also asserted as grounds for derivative recovery, the Court would not, if these grounds were established, be determining the issue of damages as part of the December 5, 2011 hearing.

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[2]By stipulation dated July 11 &12, 2012 and so-ordered on July 16, 2012 (the "July 2012 Stipulation"), the parties agreed to add as additional respondents the current owners of the shares of Class A Voting Stock previously held by Respondents Michael Romita and Mauro Christopher Romita, namely the Michael Romita Revocable Trust (with Michael Romita also added in his capacity as trustee of that trust) and the Mauro C. Romita Revocable Trust (with Mauro Christopher Romita added in his capacity as trustee of that trust) (hereinafter the "Trust Respondents").

On October 6, 2011, Respondent Castle Oil answered the Amended Verified Petition by denying its material allegations and asserting various affirmative defenses, including (1) that the claims are barred based on Petitioners' failure to make a demand on the Board to bring suit or to allege facts showing such demand would be futile under BCL § 626, and (2) that the claims are barred by the business judgment rule. With regard to the absence of answers from the Individual Respondents, Castle Oil stated:

> As a result of the severance order issued by the Court on September 22, 2011, the claims against "Additional Respondents" Michael Romita, Mauro Christopher Romita, Jack Romita, Mauro Charles Romita, Carla L. Romita, Michael Nicholas Romita, Jack Romita, Jr., and Michael M. Meadvin have been severed from the case pending the outcome of the dissolution proceeding against Castle. Additional Respondents will respond to the Petition, and/or to any further pleading allowed by the Court, when and if the claims against them are restored to this case and upon proper service of process upon the Additional Respondents (Verified Answer at preamble [hereinafter "Disclaimer and Reservation of Rights"]).

Contrary to Castle Oil's assertion, the Court did not issue a written severance order on September 22, 2011 or, indeed, ever. That said, there is no question but that, during the September 22, 2011 conference call with counsel, the Court plainly directed that the issue of dissolution would precede the issues presented in the derivative action.

Severance involves lopping off claims and making separate actions of them (*see* Siegel, New York Practice §129 [5th ed]). The Court's direction of September 22, 2011 (and of September 9, 2011) was bifurcation, in which the trial of one part of the case occurs prior to the trial on another part.

On October 12, 2011, Digirolamo joined the action by filing a Verified Answer and Cross-Claims ("Third Party Petitioners' Pleading"). On November 1, 2011, Castle Oil filed its Verified Answer to Third Party Petitioners' Cross-Claims and Counterclaim Against Petitioners. In that answer, Castle Oil again provided the same Disclaimer and Reservation of Rights' language on behalf of the Individual Respondents. Castle Oil further denied the material allegations, asserted the same affirmative defenses, added an additional affirmative defense that the claims were barred by the statute of limitations and that "Third Party Petitioners have failed to properly serve process on Castle and/or Additional Respondents" (Verified Answer at ¶155, Tenth Affirmative Defense).

Castle also asserted a counterclaim for contribution and indemnification against Petitioners which was predicated on the Third Party Petitioners' claims found at paragraphs 78-80 that the Controlling Shareholders allowed Petitioners (1) to use Castle Oil employees to provide services for their personal benefit at the Company's expense, (2) to use Castle Oil credit cards to purchase gasoline for their personal vehicles, and (3) to take gasoline from tanks owned and maintained by Castle Oil. Thus, in the event the Third Party Petitioners were successful in establishing this claim, Castle Oil was seeking indemnification and contribution from Petitioners. On November 21, 2011, Petitioners filed their Reply to the Counterclaim wherein Petitioners denied the material allegations of the Counterclaim and asserted various affirmative defenses, including that the counterclaim was untimely and could not be asserted as of right as Castle Oil had failed to seek leave of court to amend its answer and/or assert the counterclaim. Of significance, no affirmative defense was raised concerning Castle Oil's lack of standing to assert such a counterclaim. The significance is that some nine months later, in connection with the present motions, Petitioners and Third Party Petitioners take issue with Castle Oil's standing to raise such a counterclaim, contending that it belongs to the Controlling Shareholders, rather than to Castle Oil.

The hearing did not commence on December 5, 2011 as scheduled. The Court was advised the previous day that Respondent Jack Romita had died. While counsel appeared as scheduled, a discussion occurred as to the impact that the death of a Respondent would have on the Court's ability to proceed. After discussion with counsel, and in the absence of any disagreement from counsel, the Court concluded that the action had to be stayed pending substitution of Jack Romita's estate in the action.

On January 17, 2012, the Estate of Jack Romita, Jack Romita, Jr., and his co-executors in their representative capacities for the Estate of Jack Romita (Jack Romita, Jr., Maura J. Romita Skrapits and Isabelle Romita) were substituted for Jack Romita (*see* Stipulation of Substitution dated January 13, 2012 and so-ordered on January 17, 2012 [the "January 2012 Stipulation"]). The Court held a conference on February 3, 2012, the purpose of which was to set a new hearing date on dissolution. Although the Court offered February 15, 2012 or March 5, 2012 as possible dates, neither date worked for counsel. As there were no other available dates in the Court's near-term calendar, the Court scheduled the hearing date for September 10, 2012.

As will be gleaned later, because the allegations of the Amended Petition and Third Party Petitioners' Pleading have set the stage for many of the issues to be addressed in this Decision and Order, a brief recitation of those allegations is set forth below.

THE ALLEGATIONS OF THE AMENDED PETITION AND THIRD PARTY PETITIONERS' PLEADING

According to the Amended Verified Petition, Castle Oil was formed in 1928 by Mauro Romita, Sr. ("Mauro Sr."), its founder and original sole shareholder. When Mauro Sr. passed away in 1969, he owned 1,000 Class A Voting Shares, and he left an equal 20% of these Class A Voting shares to each of his five children, Michael Romita (a Controlling Executive), Mary Romita Digirolamo, Louis Romita, Jack Romita (now deceased but at the time of the Amended Petition, described as a Controlling Executive), and Mauro Christopher Romita (a Controlling Executive) ("Mauro Jr.").[3]

Petitioners Lisa Romita, Louis C. Romita and Lynda Romita ("Petitioners") are Louis Romita's children and the current holders of the 20% interest (200 Class A Voting Shares) left to Louis by Mauro Sr. Third Party Petitioner, Mary Digirolamo, who is 86 years old, is alleged to be the beneficial owner of 200 Class A Voting Shares, presumably those that were left to her by her father, Mauro Sr. Third Party Petitioner, V. Anthony Digirolamo is Mary Digirolamo's oldest son and her attorney-in-fact pursuant to a general durable power of attorney duly executed and witnessed on October 24, 2003 (Verified Answer and Cross-Claims at ¶¶ 11-12).

It is alleged that Michael, Mauro Jr. and prior to his death, Jack Romita, who collectively own 60% of Castle Oil, led, controlled and made all the material decisions regarding Castle Oil (Amended Petition at ¶¶ 7-8). According to the Amended Petition, the Controlling Executives (and their families) have frozen out the minority shareholders and have engaged in looting of the corporate assets (*id.* at ¶ 8). The Individual Respondents are identified as follows: Michael Romita, Chairman of the Board and CEO (father of Respondent Mauro Charles Romita and uncle of Petitioners); Mauro Jr., President, COO, and Director (father of Respondents Michael Nicholas Romita and Carla L. Romita, and uncle of Petitioners); Jack Romita (now deceased), former Senior VP and Director (father of respondent Jack Romita, Jr. and uncle of Petitioners); Mauro Charles Romita (Director and son of Michael Romita); Carla L. Romita, Senior VP and Director (engaged to be married to Brian Eccleston, Partner of BDO USA, LLP [Castle Oil's auditors], Mauro Jr.'s daughter and Petitioners' cousin); Michael N. Romita, Executive VP and Director (Mauro Jr.'s son and Petitioners' cousin); Jack Romita, Jr. (Director and son of Jack Romita); and Respondent Michael Meadvin (Castle Oil's General Counsel, Senior VP and Corporate Secretary).

According to the Third Party Petitioners, since 1969, Mauro Jr. and Michael have controlled Castle Oil making all the material decisions concerning, *inter*

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[3]According to the Third Party Petitioners' Pleading, the siblings were each given 20% of the 9,000 shares of Castle Oil's non-voting Class B common stock (Third Party Petitioners' Pleading at ¶ 29) and 20% of the 900 issued and outstanding shares of Castle Oil's Preferred Stock (Third Party Petitioners' Pleading at ¶ 28).

alia, the appointment and compensation of the officers and executives of the Company and the selection of the independent auditor (Third Party Petitioners' Pleading at ¶ ¶ 31, 33). It is further alleged that 60% of the Class A voting shares held by Michael, Mauro Jr., and Jack "must be voted as a single majority block pursuant to a voting trust or shareholder agreement that has been in effect since at least 2004" (*id.* at ¶ 36) and that this practice occurred for many years prior to 2004, though not pursuant to a formal voting trust (*id.*).

The Third Party Petitioners allege that Digirolamo and "her branch of the Romita family have been frozen out of the affairs of Castle Oil by the Controlling Shareholders since on or about June 26, 1993, when she was ousted from the Company's board of directors at what, upon information and belief, was the first formal annual meeting of the shareholders of the Company" (*id.* at ¶ 39). It is alleged that at that meeting, the Controlling Shareholders also voted to amend the by-laws so that only a majority of the Class A Voting Shares could call a special meeting – effectively denying Digirolamo's right to call a special meeting. Moreover, Digirolamo and V. Anthony Digirolamo were not re-elected as officers of the Company and were further fired as employees (*id.* at ¶ 42). Digirolamo contends that at the time she was fired, she had been employed by Castle Oil for over 50 years and her son had been employed for over 8 years (*id.* at ¶¶ 43-44). About a month earlier, Digirolamo's husband had been terminated after his 44 years of service. At the time, Digirolamo's daughter Silvia Mullens was working as an administrative assistant earning less than $25,000 and while she was not fired, in reaction to what was done to her family members, Mullens resigned (*id.* at ¶ 46).

The acts of oppression conducted by the Controlling Executives are alleged in the Amended Petition as follows:

> (1) During the fiscal year ending March 31, 2012, the Controlling Executives, without notice to and/or approval from the Board, increased the compensation paid to Castle Oil's officers and office by approximately $2,600,000 from the prior year. This amount was more than 10X the dividend paid to all shareholders ($250,000) for fiscal year ending March 31, 2010. In addition, during the four year period from March 31, 2006 to March 31, 2010, the compensation paid to Castle Oil's officers and office increased 45% which was 4X the aggregate dividends paid to all shareholders during the period (Amended Petition at ¶21 [a, b]); [4]

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[4]Third Party Petitioners allege that the amount paid to the employees in the "officers and office" category was increased 32% from 2009 to 2010. It is alleged that this officers and office category is substantially comprised of the Controlling Shareholders, their families "and others whom they favor from time to time." This

(2) During the fiscal year ending March 31, 2010, the Controlling Executives made, without notice to and/or approval from the Board, $1,238,000 in charitable donations to local charities in which the Controlling Executives were involved to enhance the personal standing of the Controlling Executives within their communities rather than for a corporate purpose. Such dividends were 5X the dividends paid to all shareholders of Castle Oil for fiscal year 2010 (Amended Petition at ¶21 [d]);

(3) During the fiscal years ending March 31, 2009 and March 31, 2010 the Controlling Executives paid, without consulting with or obtaining approval from the Board, (1) $269,000 for dues and subscriptions to private social and golf country clubs for the Controlling Executives and their families in 2009; and (2) $328,000 for dues and subscriptions to private social and golf country clubs for the Controlling Executives and their families in 2010 (Amended Petition at ¶21 [e]);

(4) The nepotism engaged in by the Controlling Executives by their hiring family members of Mauro Jr. without consulting with and/or obtaining Board approval, *i.e.*, (1) Carla Romita, (2) Michael N. Romita, and (3) Melissa Percherski Romita (Michael N. Romita's wife). It is alleged that the hiring of these family members was made to benefit and unjustly enrich Mauro Jr. to the detriment of the minority shareholders, including Petitioners, "and in one or more cases, productive and experienced Corporation employees were passed over for promotion, left the employ of the Corporation and took clients of the Corporation to a competitor of the Corporation"(Amended Petition at ¶21 [f]);

(5) In 2008, Michael N. Romita "informed a select group of the Corporation's shareholders and their family members that the Corporation's future was in doubt and the Corporation would solicit third-party offers to purchase the Corporation" (Amended Petition at ¶21[g]). It is alleged that both the decision to sell and the subsequent decision to reject all offers were made by the Controlling Executives without consulting with and/or obtaining Board approval;

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increase occurred at the same time Castle Oil was reducing the number of its employees in order to reduce expenses (Third Party Petitioners' Pleading at ¶¶ 53-55).

(6) The freezing out of Petitioners of the affairs of Castle Oil both economically based on the allegedly deficient dividends together with the failure to provide any information such that Petitioners do not know the value of Castle Oil or its properties such as the Castle North Terminals Property (Amended Petition at ¶22);

(7) The termination of Lisa Romita as a director on July 29, 2011 at a Special Meeting of the Shareholders called for the sole purpose of terminating Lisa Romita even though Lisa Romita had just been re-elected a director a month earlier on June 23, 2011 at a General Meeting of the Shareholders. It is alleged that the termination was in retaliation of Lisa Romita's requests to obtain documents and inspect the books and records of Castle Oil (Amended Petition at ¶23);

(8) The termination of Mary Digirolamo as a Director and Secretary/Treasurer in June 1993 and the termination of her son, V. Anthony Digirolamo as General Counsel, Vice President (Amended Petition at ¶24);

(9) The Controlling Executives' provision of misleading information and their attempt to sell off the Castle North Terminals Property to the detriment of the minority shareholders (Amended Petition at ¶26-45);

(10) The Controlling Executives' failure to submit budgets to the Board for consideration and approval (Amended Petition at 67[i]);

(11) The Controlling Executives' Failure to provide financial and other information to Lisa Romita for the period she was on the Board (*id.* at ¶ 67[j] & [k]); and

(12) The election of an eighth director on June 23, 2011 without following the proper procedure (*id.* at ¶ 67[l]).

Petitioners assert five causes of action:

(1) a First Cause of Action for dissolution pursuant to BCL § 1104-a on the grounds that "[l]iquidation ... is the only feasible means whereby the Petitioners, as minority shareholders of the Corporation, may reasonably expect to obtain a fair return on their ownership interests in the Corporation" (*id.* at ¶ 69);

(2) a Second Cause of Action for an accounting;

(3) a Third Cause (Derivative) of Action for violations of BCL § 720 requiring each respondent to (i) account for their official misconduct, and (ii) set aside any unlawful conveyances, assignments or transfer of corporate assets, and enjoin any impending unlawful conveyance, assignment or transfer of corporate assets, including the Castle North Terminals Property to the entity controlled by the Controlling Executives, Eleven River Street LLC;

(4) a Fourth (Derivative) Cause of Action for breach of fiduciary duty to recover from the Individual Respondents for the damages they caused to Castle Oil; and

(5) a Fifth (Individual) Cause of Action for breach of fiduciary duty to Petitioners seeking an award of damages to Petitioners individually.

For the most part, the Third Party Petitioners' Pleading parrots the Amended Petition and alleges the same "pattern of self-dealing, fiduciary breaches and misappropriation of corporate assets and opportunities" by the Controlling Shareholders. These breaches by the Controlling Shareholders are alleged to be undertaken to enrich themselves and their families to the detriment of Castle Oil and the minority shareholders. Additional allegations include that Digirolamo has not received the same financial statements as those provided to the Controlling Shareholders (and even third parties such as banks and insurance companies) (Third Party Petitioners' Pleading at ¶ 49). Further, that in 2007 and 2008, a Castle Oil Family Advisory Committee ("COFAC") was formed by the Controlling Shareholders but "only certain holders of the Company's Class B shares who were not employed by Castle Oil" were invited to participate. It is alleged that Mary Digirolamo and her three children who were non-employee owners of the Class B shares were not invited to participate (*id.* at ¶ 69). According to Third Party Petitioners, the Class B shareholders who were invited to participate only had to attend 4-5 meetings and as a result of that attendance, were given substantial fees as a means of providing these family members with *de facto* dividends. Third Party Petitioners allege this practice ceased out of fear that "disguising the payment of *de facto* dividends as deductible business expenses could violate federal tax regulations" (*id.* at ¶ 74).

Third Party Petitioners allege that the Controlling Shareholders and their families use Castle Oil employees to perform personal services for them during the hours that they are to be working on Castle Oil business such as performing services on their summer homes and driving them to the airport or other personal appointments. Third Party Petitioners allege that the Controlling Shareholders also allowed Petitioners during the past six years to "use Castle Oil employees to provide services for their personal benefit at the Company's expense ...." (*id.* at ¶ 78). Third Party Petitioners further allege that the Controlling Shareholders have provided "non-employee

shareholders ... and their family members with credit cards in the Company name ... to purchase gasoline for their personal vehicles at the Company's expense" and "to take gasoline from tanks owned and maintained by the Company to fuel their personal vehicles at the Company's expense" (*id.* at ¶ 80).

Third Party Petitioners contend that on September 6, 2002, the Controlling Shareholders advised Digirolamo that they had decided to create a captive insurance company (Citadel Insurance Company) and offered Digirolamo the opportunity to participate by investing $200,000 on or before September 17, 2002. However, the letter provided no details and did not provide her with enough time to choose to participate whereas the other members of the Romita family were provided enough time and details to decide whether to participate in this venture (*id.* at ¶¶ 83-85). It is alleged that this sham offer was made under circumstances to ensure Digirolamo would not participate. Similar to the sham offer to participate in Citadel Insurance Co., the Third Party Petitioners allege that in 2006, the Controlling Shareholders created another company, Atimor Tank Assets LLC to build storage tanks on Castle Oil's property that Atimor would then lease to Castle Oil. It is alleged that again, a sham offer was made to Digirolamo for her to participate in the venture but she was only provided two weeks notice and insufficient information to make a decision whether to participate in this venture whereas the more favored members of the Romita family were given the information and the time necessary to make an informed decision to participate.

Another transaction for which the Third Party Petitioners take issue is an attempt in "late 2006 or early 2007" by the Controlling Shareholders to sell off a valuable one-acre parcel of property owned by a subsidiary of Castle Oil (Castle North Terminals, Inc.) to an LLC under the Controlling Shareholders' control named Sleepy Hollow River Associates ("Sleepy Hollow"). The properly is located on the Hudson River in Sleepy Hollow and is known as Castle North Terminals Property. Under the Operating Agreement for Sleepy Hollow, all management decisions were to be made by its managing member, Michael N. Romita (Mauro, Jr.'s son). It is alleged that Castle North Terminals, Inc. gave Sleepy Hollow an option to purchase the property for $2,250,000 and in 2007, the managing member caused Sleepy Hollow to enter into a joint venture ("Sleepy Hudson Development LLC" - "Sleepy Hudson") with Ferry Landings North LLC to develop the property. According to the Third Party Petitioners, the Controlling Shareholders again made a sham offer to Digirolamo to participate in this venture (*id.* at ¶¶ 93-99).

According to Third Party Petitioners, Sleepy Hudson was required to seek zoning changes and other approvals for the property, which Sleepy Hudson obtained in 2009, yet on or about March 10, 2010, Michael N. Romita falsely represented to Sleepy Hudson's members that it had not been able to secure the zoning change and other approvals for residential use (*id.* at ¶¶ 100-102). The Controlling Shareholders thereafter terminated the option to purchase by Sleepy Hollow and the capital that the members had contributed was returned (*id.* at ¶¶ 103-104). Third Party Petitioners

allege that following the filing of the Petition on July 26, 2011, "the Controlling Shareholders attempted again to sell the property to an entity under their control, Eleven River Street LLC ('ERS')" for $1,560.000 and again made a sham offer to Digirolamo to participate (*i.e.*, Digirolamo received a letter on August 30, 2011 with no information provided requiring her to make the investment by September 15, 2011) (*id.* at ¶¶ 105-111). When Digirolamo requested additional information concerning this deal, instead of providing her with the additional information, on September 30, 2011, Digirolamo was advised by Mr. Meadvin that Castle Oil had decided against doing the deal.[5]

The Third Party Petitioners explain that in May 2011, Mauro Christopher Romita and Michael N. Romita met with Mauro J. Digirolamo (Digirolamo's son) and offered to purchase the stock owned by the Digirolamo's for $3.5 million. To show that this offer was wholly inadequate, Third Party Petitioners point out that it was one-half the amount that was expected to be received on the Castle North Properties alone (*id.* at ¶ 116).

The Third Party Petitioners also take issue with a proposal that was made in June 2009 by the Controlling Shareholders and Michael N. Romita to Digirolamo and her three children to enter into a shareholders' agreement to cause the Company to be taxed under Subchapter S of the Internal Revenue Code. It is alleged that the proposal was one sided in that the Controlling Shareholders and shareholders with management roles in the Company had the sole authority to decide how much cash would be distributed to the shareholders and would have allowed them to divert more of the Company's assets to themselves at the expense of the Company and the minority shareholders. The shareholders' agreement would have further prevented the shareholders from transferring their shares without the affirmative vote or written consent of the shareholders holding a majority interest in the Class A voting shares of Castle Oil (*id.* at ¶¶ 117-121).

The final alleged breach of fiduciary duty concerns the Controlling Shareholders' decision in 2008 to solicit offers from third parties to purchase Castle Oil without approval from the Board and without informing Digirolamo. It is alleged that despite having received offers from third parties to purchase Castle Oil or substantially all of its assets, the Controlling Shareholders rejected the offers without presenting them to the Board or seeking Board approval (*id.* at ¶ 126).

Third Party Petitioners assert that the Controlling Shareholders have engaged in oppressive actions against Digirolamo in looting and wasting the Company's

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[5]As reported by Mr. Meadvin at a conference before this Court on September 9, 2011, this deal involved ERS purchasing the property from Castle Oil for $1,560,000 and then leasing it to an undisclosed third party for $400,000 a year with an option to that third party to purchase it for $5.2 million (Third Party Petitioners' Pleading at ¶ 113).

assets to benefit themselves and their families and have failed to act in accordance with their duty of good faith, fair dealing and candor toward Digirolamo. They assert that the only feasible means for Digirolamo to obtain a fair return on her investment is for the Company to be liquidated pursuant to BCL § 1104-a (First Cross-Claim against Respondent Castle Oil).The Second Cross-Claim is a derivative claim on behalf of Castle Oil for breach of fiduciary duty against the Individual Respondents, as officers and directors of Castle Oil. The Third Cross Claim is an individual direct claim on behalf of Third Party Petitioners against Michael Romita, Mauro Christopher Romita, and Jack Romita based on their breach of fiduciary duty to Digirolamo based on their position as Controlling Shareholders.

THE CONTEXT OF THE PRESENT MOTIONS

The primary issue raised on the motions now before the Court is the propriety of the payment by Castle Oil of the legal fees incurred by Holland & Knight for services rendered in connection with this litigation.

As mentioned, the issue was first raised at the conference on September 9, 2011. It came up again during a conference call with Chambers in June 2012. Third Party Petitioners' counsel stated that Third Party Petitioners did not believe it was proper for Castle Oil to be advancing the monies to pay for the Individual Respondents' legal fees and that they wanted to move to enjoin the payment of these fees. Third Party Petitioners' counsel further stated that he believed that the attorney client privilege had been waived by Holland & Knight representing Castle Oil and the Individual Respondents. After a brief discussion, it was determined that a pre-motion conference should be conducted.

At the pre-motion conference held on July 19, 2012, the Court addressed Third Party Petitioners' request to move to enjoin the payment of legal fees on behalf of the Controlling Shareholders. The Court suggested that payment of fees in a dissolution might not be permissible, it might be permissible in a derivative action, with the present action being a hybrid. Despite the Court's caution that the pursuit of formal motion practice would likely require that the dissolution hearing be adjourned pending the determination of the motion, and the suggestion that the issue of responsibility for fees already paid could be addressed in the accounting aspect of the action (should liability be established), Third Party Petitioners' counsel made clear that it was an important issue to Third Party Petitioners and that if the making of the motion ended up adjourning the dissolution hearing, so be it.

Third Party Petitioners and Petitioners thereafter filed 6 motions – only one of which involved the issue over the payment of legal fees on behalf of the Controlling Shareholders for which Petitioners and Third Party Petitioners sought the

pre-motion conference.[6] At the pre-trial conference held on August 31, 2012, the Court attempted to have the parties resolve their motions based on the offers that had been made by the Controlling Shareholders in their oppositions to Third Party Petitioners' and Petitioners' motions so that the hearing could proceed as scheduled. However, no resolution was possible and, therefore, the Court took the motions on submission and adjourned the hearing date pending decision.

THE MOVANTS' CONTENTIONS IN SUPPORT OF MOTION SEQ #2 AND CROSS MOTION SEQ #8

In support of their motion, Third Party Petitioners submit an affirmation from counsel (Thomas E. Thornhill, Esq.) and a memorandum of law. The sole purpose of Mr. Thornhill's affirmation is to submit (1) excerpts from the September 9, 2011 conference, (2) affidavits of service of the OTSC and Verified Petition upon Jack Romita, Mauro Christopher Romita, and Michael Romita, (3) affidavit of the publication of the OTSC in the Journal News for the three weeks prior to the OTSC's return date, (4) Admission of Service of Process pursuant to CPLR 306(e) on behalf of Michael, Romita, Mauro Christopher Romita, Jack Romita, Mauro Charles Romita, Carla L. Romita, Michael Nicholas Romita, Jack Romita, Jr., and Michael M. Meadvin, by Holland & Knight effective October 7, 2011 of Petitioners' Amended Complaint, (5) selected pages of Castle Oil's Answer to the Verified Petition, including the signature line of Holland & Knight on behalf of only Castle Oil, (6) the first two pages of the "Collective Objections of Castle Oil Corporation to Third Party Petitioners' Interrogatories to Additional Respondents" which includes the above referenced Disclaimer and Reservation of Rights' language, (7) Castle Oil's Privilege Log, (8) two unpublished decisions from Supreme Court, Queens County, and Supreme Court, Nassau County, in which the courts enjoined the entities' payment of legal fees on behalf of shareholders in connection with dissolution proceedings, and (9) excerpts from the deposition of Michael Meadvin (Affirmation of Thomas E. Thornhill, Esq. Dated July 24, 2012 ["Thornhill Aff."], Exs. A-L).

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[6] The Controlling Shareholders made two separate motions *in limine* to preclude the introduction of certain evidence at the dissolution hearing. They moved (Motion Seq. # 6) for an order precluding the introduction of evidence concerning the current or historic value of Castle Oil. They also moved (Motion Seq. # 7) for an order precluding the introduction of wrongdoing alleged to have occurred prior to 2005. As discussed in a separate Decision and Order being filed contemporaneously with this Decision and Order, the Court views the latter motion as a disguised summary judgment motion, rather than as a request for an advance ruling on the admissibility of evidence. Because discovery is not complete in this action and no Note of Issue has been filed, the Controlling Shareholders will have the opportunity to seek to address the issue of statute of limitations in the context of a future motion for summary judgment.

In support of their cross-motion, Petitioners submit an affirmation from their counsel, Brian D. Graifman, Esq., and a memorandum of law. The purpose of Mr. Graifman's affirmation is to submit: (1) a letter dated December 2, 2011 from Castle Oil's counsel addressed to the Court enclosing the Enterprise Valuation prepared by Castle Oil's former investment banker (Merrill Lynch) prepared February 2009 and an Enterprise Valuation prepared by Castle Oil's CFO, Paul Conley for *in camera* review; (2) excerpts from the deposition transcript from Paul Conley concerning these Enterprise Valuations; (3) an *errata* sheet from Paul Conley changing his prior allegedly incorrect testimony to the effect that the Enterprise Valuations were not presented outside of Castle Oil; (4) the January 2012 Stipulation; (5) the July 2012 Stipulation; (6) a stipulation adjourning Castle Oil's time to oppose the Third Party Petitioners' claw back motion; (7) a Notice of Appearance dated August 9, 2012; (8) the Amended Verified Petition; (9) the Third Party Petitioners' Pleading; (10) the "Corrected Memorandum in Support of Motion in Limine to Preclude Petitioners and Third Party Petitioners from Introducing Evidence Concerning Corporate Valuation and Opposition to that Portion of Third Party Petitioners' First Motion in Limine that Seeks to Admit Valuation Evidence" dated August 9, 2012; and (11) Paragraph 28 of Castle Oil's Response to Petitioners' Notice to Admit (Affirmation of Brian D. Graifman, Esq. dated August 14, 2012 ["Graifman Aff."], Exs. 1-12).

The crux of the legal argument on the branches of Third Party Petitioners' motion seeking to enjoin the continued payment of legal fees by Castle Oil on behalf of the Controlling Shareholders and to require their repayment of the legal fees paid to date is that the hiring of Holland & Knight to represent the interests of both Castle Oil and the Controlling Shareholders in this dissolution proceeding was improper. According to Third Party Petitioners, in a dissolution, the corporation is to take a neutral role[7] (*Petition of Levitt*, 109 AD2d 502 [1st Dept 1985]) and should not to take sides since the real parties in interest are the shareholders who have chosen to oppose dissolution. Third Party Petitioners contend that New York courts have held that it is "unfair and inequitable for corporate insiders like the Controlling Shareholders to engage in looting by using the Company's money (and indirectly the money of the petitioning minority shareholders) as a war chest to oppose serious and specific allegations that they looted, self-dealt and oppressed the Company's minority shareholders"; therefore, this Court should (like other courts in New York[8]) issue an injunction and any money

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[7]In this regard, Third Party Petitioners contend that counsel representing Castle Oil's sole task is to render Castle Oil amenable to orders of the Court and to respond to discovery requests directed to it (Third Party Petitioners' Mem. at 10).

[8]The cases cited by Third Party Petitioners are: *Matter of Park Inn Ford, Inc. v Willis*, 249 AD2d 307 [2d Dept 1988]; *Matter of Penepent Corp.*, 198 AD2d 782 [4th Dept 1993], *lv denied* 83 NY2d 797 [1994]; *Matter of Rappaport*, 110 AD2d 639 [2d Dept 1985]; *Matter of Reinschreiber v Lipp*, 70 AD2d 596 [2d Dept 1979], *lv denied* 48 NY2d 603 [1979]; *Matter of Cantelmo*, 278 AD 800 [1st Dept 1951]; *Fuiaxis v 111 Huron*

paid out should be clawed back (Third Party Petitioners' Mem. at 3). Third Party Petitioners point out that Holland & Knight also represents Castle Oil and the Controlling Shareholders in connection with the derivative claims, "which allege improper diversion of corporate assets, self-dealing and breach of fiduciary duties owed to the Company and minority shareholders" (*id.* at 3, n.1).

Third Party Petitioners argue that the Controlling Shareholders cannot have their legal fees advanced or indemnified by Castle Oil in the dissolution because

> Among other things, the dissolution proceeding does not implicate any of the individual respondents in their capacity as officers and directors of Castle Oil, as required by Section 722 of the BCL – the Controlling Shareholders oppose dissolution in their capacity as shareholders. Additionally, the BCL only permits indemnification of officers and directors who have been "made or threatened to be made a party to an action or proceeding." None of the individual respondents were made or threatened to be made a party to the dissolution proceeding. In fact, although the Controlling Shareholders each were served with the initial order to show cause, none of them have appeared in the case or answered the petition. Instead, they improperly have used the Company as their proxy to oppose dissolution (*id.* at 4).

Third Party Petitioners contend that the showing necessary to issue the injunction and claw back is not controlled by the injunction standard of CPLR 6301, but instead, may be issued pursuant to this Court's authority under BCL § 1113 and § 1115 to guard the assets of Castle Oil during this dissolution proceeding (*id.* at 9, *citing Matter of Schwartzreich*, 136 AD2d 642 [2d Dept 1988]).

Third Party Petitioners argue that the Court should issue an injunction since it would preserve Castle Oil's assets during the pendency of this action and put the Controlling Shareholders and insider respondents on an equal footing with the Third Party Petitioners. Further, it is Third Party Petitioners' position that if it is later determined that they should be indemnified, Castle Oil will have the means to do just that whereas if the injunction is not issued, Castle Oil and the minority shareholders will have to try to recover the sums paid from the Individual Respondents, which will only prolong this litigation.

Street, LLC, 2007 WL 6937929 [Sup Ct Queens County 2007]; *Matter of Vafianderis*, No. 307/2006 [Sup Ct Queens County 2007]; *Matter of Marciano*, No. 001264/2006 [Sup Ct Nassau County 2006]; *Matter of Angiolillo*, 1993 WL 13714819 [Sup Ct Kings County 1993]).

In support of their request for an order directing that the funds already paid by Castle Oil for legal fees on behalf of the Individual Respondents be reimbursed, Third Party Petitioners argue that pursuant to BCL § 1113, the Court has authority to preserve Castle Oil's assets if there is evidence that they are being wasted and it is contended that, in this case, Castle Oil's assets are being improperly diverted to oppose dissolution and defend actions taking by the Individual Respondents "that were inimical to the interests of both the petitioning minority shareholders and Castle Oil itself," which itself constitutes another act of oppression under BCL § 1104-a (*id.* at 13). According to Third Party Petitioners, the right to indemnification or advancement provided for by the BCL §§ 721 - 725 does not include dissolution proceedings, since such matters need not be opposed and "[a]nyone opposing dissolution affirmatively chooses to appear (or not appear) in the case. No officer or director can be 'made or threatened to be made' a party to a statutory dissolution proceeding 'by reason of the fact' of their office" (*id.* at 14-15).

With regard to the right to advancement or indemnification of legal fees in connection with the derivative claims, according to Third Party Petitioners, where the corporate charter and by-laws are silent, the requirements of the BCL must be satisfied before the corporation may either advance legal fees or indemnify its officers and directors for the legal fees they incur. Thus, they argue that, under BCL § 722, a corporation may indemnify officers and directors for legal expenses after the litigation is over as long as the officers and directors acted in good faith and in the best interests of the corporation or "prior to judgment **if the shareholders** or a quorum of a disinterested board of directors find that the officers or directors acted in good faith and for corporate purposes" (*id.* at 15 [emphasis added]). Here, the litigation is ongoing, the good faith and motives of the officers and directors are hotly contested, and the minority shareholders are not aware of a determination being made by a neutral litigation committee that the Individual Respondents have acted in good faith to benefit Castle Oil (*id.*). Furthermore, they claim that BCL § 723 (c) has not been satisfied since it requires that an undertaking be posted and that approval be obtained by the shareholders or disinterested members of the board – neither of which has occurred here.

According to Third Party Petitioners, indemnification under BCL § 724(c) is not available because it requires that the Court approve the payment of reasonable attorneys' fees during the pendency of the action if the Court finds that "'defendant has by his pleadings or during the course of the litigation raised genuine issues of fact or law" and here, the Individual Respondents have neither appeared in this action nor petitioned the Court for such indemnification.

Third Party Petitioners assert that if indemnification is made by a corporation voluntarily pursuant to BCL § 725, the corporation must mail to its shareholders a statement setting forth the amounts paid and to whom, not later than the next annual meeting of shareholders, unless that meeting was held within three months of the date of indemnification (BCL § 725[c]), and no such notification has been

provided despite that the fact that the litigation has been ongoing since July 2011 and there was an annual shareholders' meeting on June 21, 2012.[9]

With regard to the branch of their motion which seeks the disclosure of all documents listed on Castle Oil's privilege log, the Third Party Petitioners build on this theme and argue

> [t]his failure (or calculated refusal) to recognize the critical difference between the Company's interests and the conflicting interests of the Controlling Shareholders who allegedly violated their duties both to the Company and to the minority shareholders has resulted in a waiver of Castle Oil's attorney-client privilege and work product protections. No privilege exists with respect to any once-privileged document or communication that has been disclosed to a third party, yet counsel for the named respondents has reviewed every single allegedly privileged document Castle Oil withheld from petitioners. And because the interests of the Company and Controlling Shareholders are dramatically different, there can be no rational claim of common or joint interest to support a claim of joint defense privilege. For purposes of this dissolution proceeding, the minority shareholders should have at least as much access to Castle Oil's documents as the Controlling Shareholders and the individual respondents. Further, under the well-established fiduciary exception to a corporation's attorney-client privilege, the minority shareholder petitioners – collectively owners of 40% of the outstanding shares of the corporation – have a right to even privileged communications involving Castle Oil. The individual respondents cannot subordinate the interests of the minority shareholders to their separate individual interests under the guise of the Corporation's attorney-client privilege (*id.* at 6).

The Third Party Petitioners assert that Holland & Knight is representing both the Castle Oil and the Individual Respondents as evidenced by the fact that on the return date of the OTSC, Holland & Knight stated that they were representing Castle Oil (*citing* Tr. of September 9 conference, Thornhill Aff., Ex. A) whereas subsequent to the return date, Holland & Knight acted as though they were also representing the interests of the Individual Respondents (*i.e.*, the Admission of Service of Process [Thornhill Aff.,

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[9]As Third Party Petitioners have not provided an affidavit from a person with personal knowledge of this fact and have simply made this statement in their memorandum of law, the Court has not accepted this fact for purposes of its analysis.

Ex. F], the answer by Castle Oil to the Third Party Petitioners' Pleading which purports to extend the time for the Individual Respondents to answer [Thornhill Aff., Ex. G], the objection interposed by Holland & Knight to the Interrogatories to the Individual Respondents which contends that they were not parties to the dissolution proceeding and would only respond when and if the claims against them were restored [Thornhill Aff., Ex. H], and a document produced purportedly on behalf of Castle Oil that contains a personal brokerage statement from one of the Controlling Shareholders but is bates stamped Castle 00047518-29, thereby indicating that it is part of Castle Oil's production).

Third Party Petitioners complain that Castle Oil has kept them in the dark as to how much it has paid in legal fees to date by refusing to respond to discovery concerning this issue.

On the issue of the requirements not having been met for indemnification, Third Party Petitioners assert that an hour before a conference call scheduled with the Court on July 18, 2012, Holland & Knight produced a Resolution Adopted by Written Consent of the Board of Directors of Castle Oil Corporation dated November 1, 1993, which states that Castle Oil

> shall indemnify each person made or threatened to be made a party to any civil or criminal action or proceeding by reason of the fact that he or she, or his or her testator or intestate, is or was a director or officer of the Corporation ... [and] shall pay the expenses referred to ... in advance of final disposition of the action or proceeding in question, upon receiving from the indemnified person or persons an undertaking to repay such expenses to the corporation, as provided by § 725(a) of the Business Corporation Law (*id.* at 8).

Third Party Petitioners argue that Castle Oil has not complied with this Resolution in that it has not provided evidence of an undertaking by the Individual Respondents as required by BCL § 723(c) nor has it provided any information of the advancement or indemnification in advance of the June 21, 2012 annual meeting as required by BCL § 725.

On the issue of Castle Oil's right to assert a privilege as to the documents contained on its privilege log, it is the Third Party Petitioners' position that Castle Oil's disclosure of documents to Holland & Knight, counsel not only to Castle Oil but also to the Controlling Shareholders with whom Castle Oil's interests are not aligned,[10] means

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[10]Third Party Petitioners argue that since the derivative claims are asserted for the benefit of Castle Oil, it stands to benefit from any recovery and, therefore, any

that any privilege has been waived and these conflicts also extend to documents disclosed to Michael Meadvin (*id.* at 17).

The Third Party Petitioners quote from the Restatement (Third) of the Law Governing Lawyers, which states that with regard to the idea of dual representation of the corporation and the defendant officers/directors named in a derivative action, ***"[e]ven with informed consent of all affected clients, the lawyer for the organization ordinarily may not represent an individual defendant as well.*** *If, however, the disinterested directors conclude that no basis exists for the claim that the defending officers and directors have acted against the interests of the organization, the lawyer may, with the effective consent of all clients, represent both the organization and the officers and directors in defending the suit ..."* (*id.* at 19, *quoting* Restatement [Third] of the Law Governing Lawyers § 131 cmt. [g] [2000] [emphasis in original]).[11] Third Party Petitioners contend that the exception has not been satisfied because there has been no vote of disinterested directors since (1) there are no disinterested directors, and (2) the claims not baseless. Accordingly, they contend that Castle Oil has waived the privilege as to documents sent to counsel for the Individual Respondents.

As an alternative argument for why these privileged documents must be produced, Third Party Petitioners contend that they are entitled to the documents based upon the shareholder-fiduciary exception to the attorney-client privilege. It is the Third Party Petitioners' position that they have established the elements required for good cause for the turning over of these documents. Third Party Petitioners describe the material withheld as communications among the Individual Respondents concerning: (1) responses to questions for requests for information received from the minority shareholders; (2) shareholder agreements drafted by the Company's corporate secretary; (3) efforts to sell the Company; (4) appraisals of the Company's assets; and (5) the Company's relationships with related entities controlled by the Individual Respondents. Third Party Petitioners argue that they and Petitioners, as holders of 40% of Castle Oil, were affected by the decisions made based on these privileged communications. Further, they claim, the information is highly relevant and may be the

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confidential information disclosed to Holland & Knight that helps establish the fiduciary duty breaches against the Individual Respondents benefits Castle Oil.

[11]While Third Party Petitioners cite the proscription of dual representation in support of their privilege waiver argument, they have not actually sought to disqualify Holland & Knight on the ground of conflict of interest, a point they themselves make in their reply to the Controlling Shareholders' argument, made in opposition to the Claw Back Motion, that disqualification efforts have been waived. Third Party Petitioners rejoin that they not seeking to disqualify Holland & Knight. But, then, if they are not seeking to disqualify Holland & Knight on the ground of conflict in representation, it is, in this Court's view, inconsistent to argue that Holland & Knight brought about a waiver of attorney-client privilege by conflict in representation.

only evidence available on whether the Individual Respondents' actions were done in furtherance of Castle Oil's interests or that of the Controlling Shareholders. They assert that their claims of self-dealing, looting and oppression are more than colorable

In their memorandum of law, Petitioners join the arguments made by the Third Party Petitioners in their motion. To support the idea that Holland & Knights has been representing the interests of both Castle Oil and the Individual Respondents, Petitioners attach as exhibits to the Graifman affirmation: (1) the January 2012 and June 2012 Stipulations; (2) the July 2012 Stipulation of Adjournment; and (3) Holland & Knight's filing of the Notice of Appearance on behalf of the Controlling Shareholders.

Petitioners reject the offer made in the Controlling Shareholders' opposition (*i.e.*, that the Controlling Shareholders would pay their own way going forward) as an insufficient half-measure and argue that the Controlling Shareholders should be made to pay back the fees paid on their behalf to date.

Petitioners argue that any attorney-client privilege has been waived by sharing the discovery materials with Holland & Knight because the Individual Respondents (or Controlling Shareholders) do not share common interests so there is no joint or common privilege as a matter of law (*id.* at 5).

In support of the branch of the motion seeking to compel the production of the Enterprise Valuations, Petitioners rely on the testimony provided by Paul Conley and Michael N. Romita at their depositions. According to Petitioners, at first, Paul Conley denied that Merrill Lynch had done an appraisal but later admitted that Merrill Lynch performed an Enterprise Valuation calculation and that Conley later performed his own valuation based on the Merrill Lynch methodology by updating the numbers. Further, that Conley "use[d] that model that was presented for our meetings with those [outside prospective purchasing] companies that I just cited" (Petitioners' Mem. at 3, *citing* Conley Tr. at 85-86, 158-159, 162-163, 166-167). Conley further testified that he showed his Enterprise Valuation to Michael N. Romita who "included it in his presentations" to the prospective purchasers, but Michael N. Romita denied that he even knew that Conley had performed an Enterprise Valuation.

Petitioners state that pursuant to a conference call with Chambers, Castle Oil's counsel agreed to produce the Enterprise Valuations for *in camera* inspection, and on the same day that they were submitted to the Court (December 2, 2011), Castle Oil submitted an *errata* sheet wherein Conley changed his testimony to say that his Enterprise Valuation had not been shown to companies outside of Castle Oil. Petitioners contend that due to the stay of the proceedings as a result of Jack Romita's death, this issue has not been resolved.

On the branch of their motion seeking to compel the production of the Enterprise Valuations, Petitioners argue that they are relevant to show how the

Individual Respondents breached their fiduciary duties by not treating all shareholders equally, *i.e.*, minority shareholders were not privy to this information that was provided to other shareholders and the Individual Respondents attempted to use this information to "squeeze the minority shareholders out of the company with unfairly low bids, and selective use of valuations" (*id.* at 6). The valuations are also relevant, the argument goes, since Castle Oil has put its value in issue by arguing dissolution is improper where as here, the corporation has increased in value. Moreover, its is Petitioners' position that they need these valuations to show the depths of deceit engaged in by the Individual Respondents through their failure to provide full information to Lisa Romita even while she was a director. Petitioners provide as an example, a comparison of the final response made to Lisa Romita while she was a director of Castle Oil concerning the value of certain Castle Oil properties versus a draft of the same response. Evidently the final response contained only the lowest valuations associated with these properties rather than the range of values set forth in a draft of that response. Likewise, these valuations are relevant, say Petitioners, to show that the $3.5 million offer made to the Digirolamos to buy out their 20% interest was woefully inadequate and fraudulent. Petitioners posit that the Individual Respondents' decision to reject all of the offers by third parties to purchase Castle Oil (without board approval) may have been "motivated by the controlling majority's plan first to take out the minority at an artificially reduced price, based on their misrepresentations concerning valuations, and without conveying the interest of third parties to Castle" (*id.* at 9).

Petitioners dispute the premise for why the Enterprise Valuation has been withheld by Castle Oil – *i.e.*, that based on a confidentiality agreement with Merrill Lynch, Castle Oil was precluded from producing it. Petitioners proceed to speculate that the Confidentiality Agreement does not apply to this situation even though this Court has already expressed at a conference and through Chambers on phone conferences that the language of the Confidentiality Agreement precludes its voluntary production without Merrill Lynch's prior consent. Alternatively, Petitioners contend for the same reasons the privileged documents should be produced under the shareholder-fiduciary exception, Petitioners and Third Party Petitioners should be deemed one with Castle Oil such that the Enterprise Valuations may be produced to them without breaching the Confidentiality Agreement. In further support, Petitioners rely on the Controlling Shareholders' argument that the fiduciary exception only applies where there is a mutuality of interest and argue that at the time of the Enterprise Valuations, Lisa Romita was a Castle Oil director and, therefore, the Enterprise Valuations must be produced.

Finally, Petitioners argue that the confidentiality has already been waived through its disclosure to third parties as set forth in Conley's first testimony (before it was recanted in the Errata sheet) that the model was used in the presentations with third parties and that Michael N. Romita was shown the Enterprise Valuation and used it in his presentations. And even if the Enterprise Valuation had not been disclosed to the potential suitors, it was disclosed to Holland & Knight, counsel to the Controlling Shareholders, and, therefore, any confidentiality has been waived.

THE THIRD PARTY PETITIONERS' CONTENTIONS IN SUPPORT OF THEIR MOTIONS TO (1) STRIKE CASTLE OIL'S ANSWERS AND FOR PROTECTIVE ORDER AGAINST FURTHER DISCOVERY SOUGHT FROM CASTLE OIL AND (2) FOR A DEFAULT JUDGMENT AGAINST THE CONTROLLING SHAREHOLDERS

A. *The Motion to Strike Castle Oil's Answers and For a Protective Order*

Third Party Petitioners contend that Castle Oil must remain a neutral party in this dissolution proceeding and it was improper for it to have taken an adversarial stance by siding with the Controlling Shareholders. By Notice of Motion dated August 1, 2012 (Seq. No. 4), Third Party Petitioners request that Castle Oil's answers be stricken and the real parties in interest (*i.e.*, the Controlling Shareholders) should be required to file their responsive pleadings. Indeed, it is their position that Castle Oil has no standing to litigate the issue of dissolution by interposing an answer opposing dissolution and raising affirmative defenses and should have simply filed a notice of appearance (Third Party Petitioners' Mem. at 9, *citing Matter of Clemente Bros., Inc.*, 19 AD2d 568 [3d Dept 1963], *affd* 13 NY2d 963 [1963]; *Matter of Angiolillo*, 1993 WL 13714819 [Sup Ct NY County 1993]). In this motion, they assert that Petitioners "are entitled to an answer from each of the parties that oppose dissolution" (Mem. of Law in Support at 10). At this juncture, the Court notes that by Notice of Motion dated August 23, 2012 (Seq. No. 9), Third Party Petitioners move for a default judgment against the Controlling Shareholders based on their failure to interpose answers.

On Motion Sequence No. 4, it is also Third Party Petitioners' position that Castle Oil's Counterclaim against Petitioners is defective because Castle Oil has no standing to raise it. Third Party Petitioners also seek a protective order to prevent Castle Oil from seeking further discovery from Third Party Petitioners and Petitioners in this action.

In support of Motion Sequence No. 4, Third Party Petitioners submit an affirmation from counsel attaching the affidavits of service of the OTSC on Castle Oil and the Controlling Shareholders, the affidavit of publication of the OTSC in the Journal News for three weeks prior to the return date, Castle Oil's answers, and correspondence between the parties' counsel concerning (1) deficiencies found in Castle's production, and (2) deficiencies and requests to supplement the Third Party Petitioners' production (Thornhill Protective Order Aff., Exs. C-O). Also attached are (1) a letter from Petitioners' counsel dated July 30, 2012 indicating that they were joining Third Party Petitioners in this application; (2) a letter dated **July 27, 2012 (Friday)** from Third Party Petitioners' counsel (Victor J. Rocco, Esq.) advising Castle Oil's counsel of his intent to make this motion and stating that "[i]n light of Justice Scheinkman's comments at our conference last week encouraging us to discuss issues like this before engaging in motion practice, please let me know if you have any suggestions that might

moot the motion" (the motion which was then filed on **Wednesday August 1, 2012**) (Thornhill Protective Order Aff., Exs. A&B).

In their Memorandum of Law, Third Party Petitioners argue that a statutory dissolution proceeding is, at its essence, a dispute between the shareholders who are seeking dissolution and the shareholders who oppose it, and here, the real parties in interest are the Controlling Shareholders who have not appeared and have not filed any responsive pleadings; instead, they have sought to oppose the dissolution by proxy through Castle Oil. However, they contend that, because it is black letter law that the corporation is to remain neutral in this proceeding, it is wholly improper for its General Counsel, Mr. Meadvin, to have answered the allegations concerning the wrongdoing by the Controlling Shareholders, especially since some of the events happened before he joined the Company and others concerned events he testified to having no knowledge about. Third Party Petitioners seek to have Castle Oil's answers stricken so as to require the Controlling Shareholders to come out from the shadows and openly oppose the dissolution as opposed to their stealth defense to date. They further request that the Court issue a protective order precluding Caste Oil from propounding further discovery requests in the action (Third Party Petitioners' Mem. at 3).

According to Third Party Petitioners, the counterclaim for indemnification made by Castle Oil against the Petitioners, to the extent the Third Party Petitioners establish their claim, is frivolous since it is only the Individual Respondents – not Castle Oil – who would have a basis for a claim of indemnification (*id.* at 5).

Third Party Petitioners further point out that the Individual Respondents have not participated in discovery at all (no documents, no interrogatory responses and no depositions) and Castle Oil has not been forthcoming with discovery (even with the most basic discovery such as financials) when it should really have no stake in what discovery is being produced given its neutral role. In this regard, Third Party Petitioners point to the latest failure to produce documents requested concerning the 1993 Board Resolution permitting the advancement and indemnification of legal fees, including (1) minutes of the board or committee proceeding with which this document was kept (required by BCL § 708[b]); (2) statements specifying the amounts and persons paid by Castle Oil for indemnification of officers and directors (required by BCL § 725[c]); (3) all undertakings received by Castle Oil with respect to expenses or other amounts paid by Castle Oil for indemnification of officers and directors (required by the Resolution and BCL § 723[c] and BCL § 725[a]); (4) statements regarding any D&O insurance Castle Oil has purchased or renewed (required by BCL § 726[d]); and (5) statements explaining amounts paid by Castle Oil for legal services rendered in connection with this matter (*id.* at 7).

Relying on Castle Oil's refusal to produce to produce much of the discovery requested by Petitioners and Third Party Petitioners, Third Party Petitioners argue "to add insult to injury," the Controlling Shareholders recently through Castle Oil,

requested additional documents from Petitioners and Third Party Petitioners (Thornhill Protective Order Aff., Exs. L & M) yet "it is inconceivable that the requested documents could serve Castle Oil's interests in this matter, as Castle Oil's interests are non-existent" (*id.*). And it is for this reason that movants request a protective order precluding Castle Oil from making any further demands. They argue that once the Controlling Shareholders have filed their responsive pleadings, they are free to seek the discovery requests in their own name and at their own expense.

B. The Third Party Petitioners' Motion for a Default Judgment

In support of the Third Party Petitioners' motion for a default judgment (Mot. Seq. No. 9), they submit another affirmation from their counsel, Thomas E. Thornhill, Esq., attaching almost all of the same exhibits as were attached to their motion to strike and for a protective order. The only additional documents are (1) the Admission of Service of Process pursuant to CPLR 306(e) dated November 1, 2011 by Holland & Knight (Affirmation of Thomas E. Thornhill, Esq. in Support of Third Party Petitioners' Motion for a Default Judgment dated August 23, 2012 ["Thornhill Default Aff."], Ex. J); (2) letter dated June 28, 1993 from Castle Oil's then counsel (Phillip Shatz, Esq. of McCabe & Mack) to Digirolamos' then counsel (James P. Conroy, Esq. of Windels, Marx, Davies & Ives) concerning the departure of the Digirolamos as employees and officers of Castle Oil (*id.*, Ex. L); (3) Castle Oil's Privilege Document Log (*id.*, Ex. M); (4) the January 2012 Stipulation (*id.*, Ex. N); (5) the July 2012 Stipulation (*id.*, Ex. O); (6) the transcript of the July 19, 2012 conference (*id.*, Ex. P); and (7) correspondence between counsel at end of June 2012 to the beginning of August 2012) concerning additional discovery demands being made by Castle Oil and deficiency letters concerning Castle Oil's document production (*id.*, Exs. Q-V).

The Memorandum of Law repeats many of the same arguments already raised in the other motions – namely, despite having been personally served with the OTSC back in July 2011, the Controlling Shareholders have opted to disregard their obligation to answer the Petition and have used Castle Oil improperly as their proxy for fighting this dissolution contest.

In addition to discussing the procedural history of this action and the Controlling Shareholders' and Individual Respondents' decision not to file responsive pleadings even after they were individually named and served, the other basis for the motion revolves around Castle Oil's alleged discovery transgressions, including its production on the eve of the first scheduled hearing date in December 2011 of damaging emails, and its woefully deficient privilege log as detailed in Third Party Petitioners' motion to strike and for a protective order. Third Party Petitioners further rely on this Court's and the parties' actions at the December 6 hearing date, when all concerned acknowledged that due to the death of a party to this action (Jack Romita), the action had to be stayed. Based on this conference, Third Party Petitioners argue that "[n]o one in court on December 6 could doubt that the Court considered the

Controlling Shareholders to be parties to the dissolution. On January 17, 2012, the caption of the case was changed to reflect the substitution of the executors of Jack Romita's estate .. [and again by stipulation on July 16, 2012 to] add[ ]the Michael Romita Revocable Trust and the Mauro C. Romita Revocable Trust and their trustees as additional respondents" (Third Party Petitioners' Mem. at 9). Third Party Petitioners also rely extensively on the discussions held during the conference on July 19, 2012, where the Court invited responsive pleadings from the Controlling Shareholders and the Controlling Shareholders' counsel suggested that they would look into it and would be happy to brief the issue (*id.* at 9). At the conference, Third Party Petitioners' counsel represented he did not intend to move for a default against the Controlling Shareholders, but stated he believed it was time for them to appear and file responsive pleadings.

According to Third Party Petitioners, a default judgment is proper because the Controlling Shareholders have failed to respond to the petitions for dissolution or the direct and derivative claims against them within any reasonable time period and even a mistaken belief that no answer was necessary is no excuse for their default (*id.* at 16, *citing U.S. Bank Natl. Assn. v Slavinski*, 78 AD3d 1167 [2d Dept 2010]).

As to the propriety of the initial caption, Third Party Petitioners argue that the "BCL does not require that a petition for dissolution be captioned in any particular fashion. Even if it did, the Controlling Shareholders have been expressly named in the caption of the case since September 16, 2011, and their counsel filed a responsive pleading on behalf of Castle Oil on October 5, 2011 that lists them by name in the caption of the case. Moreover, they stipulated to changing the caption of the case to reflect the substitution of the executors of Jack Romita's estate as additional respondents on January 17, 2012" (Third Party Petitioners' Mem. at 17). They further note that section 1105 of the BCL requires the petition to be verified and, therefore, any responsive pleading should likewise have been verified (CPLR 3020[a]).[12]

They further rely on Professor Siegel, who notes in his treatise that the Court has the discretion in a special proceeding to decide whether there should be notice at all because in certain special proceedings, "'there may be no adverse party'" (Siegel, New York Practice, §551 [5th ed], quoted in Third Party Petitioners' Mem. at 17). In this regard, BCL § 1106 provides that "[u]pon the presentation of such a petition, ***the court shall make an order requiring the corporation and all persons interested in the corporation to show cause before it ... why the corporation should not be dissolved***" (*id., quoting* BCL § 1106 [emphasis added]). The Third Party Petitioners note the Controlling Shareholders' default by pointing out that the Court ordered notice by publication and the Controlling Shareholders were personally served with both the

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[12]While it is true at the time of this motion there were no verified answers filed on behalf of the Individual Respondents, the answers for Castle Oil had been verified by its General Counsel, Michael M. Meadvin, Esq.

Amended Verified Petition and the Digirolamos' cross-claims, yet have not served/filed a responsive pleading.

Third Party Petitioners argue that they have met the requirements of CPLR 3215(f) based on the Amended Verified Petition and the Third Party Petitioners' Pleading that assert valid claims for dissolution pursuant to BCL §1104-a. Further, Third Party Petitioners have provided proof of service of the initial Order to Show Cause on the Controlling Shareholders (Thornhill Default Aff., Exs. B-F) and further, the Individual Respondents acknowledged service of the Amended Verified Petition (*id.*, Ex. J). Finally, Third Party Petitioners contend that the service of the Third Party Petitioners' Pleading was served via NYSCEF on October 12, 20122 (*id.*, Ex. V).

In support of their position that the Controlling Shareholders will not be able to establish a reasonable excuse for their default, Third Party Petitioners argue that while the Controlling Shareholders appear to be arguing that they did not know they needed to appear based on the colloquy that transpired at the conference held on July 19, 2012, they have now known for over a month that a responsive pleading was required, yet they continue to shirk their responsibility by failing to file a responsive pleading. It is Third Party Petitioners' position that because confusion or ignorance of the law is no excuse, and because it is evident that the decision has been purely a strategic one after the problem was brought to their attention repeatedly, the entry of a default judgment is proper.

THE CONTROLLING SHAREHOLDERS' OPPOSITION

A. *The Opposition to the Injunction/Claw Back Motion/Cross-Motion and The Motion to Strike Castle Oil's Answer and For a Protective Order*

In opposition to the motions, the Controlling Shareholders provide: (1) an Affirmation of Robert J. Burns, Esq. dated August 9, 2012 together with attached exhibits; (2) an Affirmation of Benjamin R. Wilson, Esq. dated August 16, 2012 together with attached exhibits; (3) an Omnibus Memorandum of Law in Support of the Controlling Shareholders' Opposition to the Third Party Petitioners' Motion, and (4) a Memorandum of Law in Opposition to Petitioners' Cross-Motion.

The essence of the opposition is that the present procedural posture of this case has been occasioned by the acts of Petitioners and Third Party Petitioners based on Petitioners' naming of only Castle Oil as the respondent on the dissolution cause of action and Third Party Petitioners' naming of Castle Oil as the sole respondent on their cross-claim for dissolution, and then proceeding for the past year with knowledge of Holland & Knight's representation of Castle Oil in the dissolution proceeding, without protesting up until now (*i.e.*, six weeks before the dissolution

hearing was scheduled to start) to Castle Oil's participation as the sole party respondent or to Holland & Knight's representation of Castle Oil (Omnibus Opp. Mem. at 2). In this regard, at the September 9, 2011 conference, it is pointed out, Petitioners' counsel raised the issue and was invited by the Court to make an application to address the issue[13] and instead, for the next 284 days, they actively engaged Castle Oil's "participation in this case, and readily accepted the fruits thereof" (*id.*). The Controlling Shareholders argue that as such, it was perfectly appropriate for Castle Oil to pay for Holland & Knight's defense of it in the dissolution proceeding as the sole respondent. (*id.*). The Controlling Shareholders assert that every argument that is now being raised "could, and should have been raised many months ago. Each has now been abandoned by waiver and by *laches*" (*id.* at 5). Nevertheless, in an effort to expedite the proceedings and put an end to what they contend is a "side show of motions," the Controlling Shareholders propose that they would be willing to do the following should the Court so order: (1) Holland & Knight would appear for the Individual Respondents with Castle Oil retaining its own new counsel; (2) the Controlling Shareholders would file an answer to the Amended Petition and Third Party Petitioners' Pleading; (3) Castle Oil would withdraw its answers and instead, would file a notice of appearance as a nominal party for the sole purpose of making itself amenable to jurisdiction; and (4) the Controlling Shareholders would pay for their legal fees going forward (Omnibus Opp. Mem. at 5). However, with regard to the request for disgorgement of past fees, the Controlling Shareholders, relying on the Appellate Division, Second Department case of *Dukas v David Aircraft Prods. Co.* (123 AD2d 304 [2d Dept 1986]), argue that the "Third Party Petitioners' longstanding course of action, and their recent tactical about faces [discussed *infra*], require denial of Third Party Petitioners' request for disgorgement of legal fees paid to Holland & Knight by Castle to date" (*id.* at 16).

The Controlling Shareholders point out that all the answers and discovery requests were made to[14] and on behalf of Castle Oil (with the reservation of rights on behalf of the Controlling Shareholders to answer after the dissolution was concluded) and Petitioners even answered the counterclaim for indemnity propounded by Castle Oil and at no time did Petitioners or Third Party Petitioners either (1) object that Castle Oil was not the proper party to propound to or to respond to discovery, or (2) object or even

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[13]According to the Controlling Shareholders, Petitioners' counsel responded to the Court that he would consider the issue and discuss it with Castle Oil's counsel and would approach the Court again if necessary (September 9, 2011 Tr. at 44). "It is undisputed that neither Petitioners nor Third Party Petitioners at any time approached the Court again on this issue until the instant Motions" (Omnibus Mem. at 7-8).

[14]In this regard, the Controlling Shareholders point out that the only discovery not propounded solely to Castle Oil was Petitioners' Notice to Admit (Affirmation of Robert J. Burns, Esq. dated August 9, 2012 ["Burns Opp. Aff."], Ex. 8) and the Third Party Petitioners' Interrogatories to the Individual Respondents (*id.*, Ex. 9) (Omnibus Opp. Mem. at 9-10 and n.1).

question the reservation of right to answer at a later date by the Controlling Shareholders (*id.* at 9-11; and Exs. 10-27 to the Affirmation of Robert J. Burns, Esq. dated August 9, 2012 ["Burns Opp. Aff."]). With regard to the discovery that occurred from September 9, 2011 to the December 6, 2011 hearing date, the Controlling Shareholders assert that while it was primarily focused on the dissolution hearing, much of it is relevant to the derivative claims[15] and "will be used when and if those claims proceed" (*id.* at 9).

With regard to Petitioners' noticing of 13 depositions, the Controlling Shareholders assert that this issue was addressed by the Court at the October 20, 2011 conference at which Castle Oil proposed (and this Court endorsed) that it would produce on its behalf pursuant to CPLR 3016(d), Paul Conley (Castle Oil's Senior VP and Chief Financial Officer), Michael Meadvin (Castle Oil's Senior VP and General Counsel), and Michael N. Romita (Castle Oil's Executive VP and Director). According to the Controlling Shareholders, at each of these depositions, Holland & Knight represented that it was appearing on behalf of Castle Oil and no objection was lodged by Petitioners or Third Party Petitioners. Further, the "Third Party Petitioners stated that they would not depose Michael Romita, Mauro C. Romita or Jack Romita ... based on Castle's statements that it would not call any of the foregoing as witnesses at the dissolution hearing" (*id.* at 11). And again, with regard to the depositions noticed by Castle Oil of Petitioners and Third Party Petitioners, Holland & Knight appeared on behalf of Castle Oil and no objection was lodged on behalf of Petitioners or Third Party Petitioners (*id., citing* Burns Opp. Aff., Exs. 29-30).

The Controlling Shareholders point out that this course of no objections having been raised proceeded up to the day of the December 6, 2011 hearing at which "[n]o protest was heard ... regarding Castle's active participation to date, Holland & Knight's representation of Castle, or Castle's expenditure of corporate funds to defend itself in this proceeding. No application was made challenging the legal sufficiency of Castle's responsive pleadings, its privilege log entries, its requests for discovery, or its pre-hearing submissions. Instead, Petitioners and Third Party Petitioners entered the courthouse on December 6, 2011 with a phalanx of attorneys, crates of trial exhibits, and witnesses, ready to try the dissolution claims on that date with Castle as the sole party respondent" (*id.* at 12). And when the hearing was postponed to September 2012 due to Jack Romita's death and the parties' inability to appear for two dates in February and March offered by the Court, "Petitioners and Third Party Petitioners again declined to pursue the relief now requested in the instant Motions" (*id.*).

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[15]The Court is aware that Petitioners and Third Party Petitioners have asserted individual claims based on the Controlling Shareholders alleged breaches of fiduciary duties. Although it is not determining the viability of such individual claims, they would appear to be improperly cast as such and will need to be recast derivatively. However, the Court is making no determination on this issue at the present time.

It is the Controlling Shareholders' position that it was not until June 2012, during a conference call with the Court, that this issue concerning the payment of attorneys' fees was again raised and it was since then that the "Third Party Petitioners have been engaged in a course of about-faces, systematically attempting to reverse the very procedural posture they themselves created and in which they have repeatedly acquiesced" (*id.*). As an example, Controlling Shareholders point out that in response to a discovery deficiency letter sent to Third Party Petitioners concerning deficiencies in their production in response to Castle Oil's discovery demand of November 2, 2011, the Third Party Defendants stated that they had no obligation to respond to Castle Oil's "additional discovery" demands as Castle Oil was a neutral party in the dissolution proceeding with no standing to litigate it (*id.* at 13, *citing* Affirmation of Thomas E. Thornhill, Esq. dated August 1, 2012 ["Thornhill Protective Order Aff."], Exs. L and O). The Controlling Shareholders argue that this response is wholly improper as (1) these were not additional requests, and (2) this "about face" is disingenuous given Third Party Petitioners having repeatedly responded to Castle Oil's discovery demands over the past year.

With regard to the Third Party Petitioners' motion for a Protective Order, the Controlling Shareholders first argue that it is procedurally improper because prior to making the motion, the Third Party Petitioners made no effort to consult with counsel in good faith to resolve the issues raised by the motion (*id.* at 17, n.2, *citing Gonzalez v International Business Machine Corp.*, 236 AD2d 363 [2d Dept 1997]). Second, the Controlling Shareholders point out that these are not new demands, but instead, involve Castle Oil's request that Third Party Petitioners supplement the inadequate discovery they had provided. As such, "because Third Party Petitioners knowingly accepted and affirmatively engaged Castle's active involvement and the procedural posture of this case for the past year, they may not now be permitted to avoid their outstanding discovery obligations by producing only what they choose to produce, and to thereafter claim that Castle lacks standing to complain" (*id.* at 17-18). Based on the foregoing, the Controlling Shareholders argue that the motion for a protective order should be denied.

With regard to the branch of the motion which seeks the production of the documents on the privilege log, the Controlling Shareholders argue that this motion should be adjourned until Castle Oil retains new counsel and new counsel has time to get up to speed and then oppose the motion. In any event, the Controlling Shareholders argue that this motion has no merit since as the Third Party Petitioners concede

> waiver of the attorney-client privilege is premised on the sharing of confidences to third parties that are not entitled to such confidences. However, where, as here, the Majority Voting Shareholders in a closely-held corporation are virtually indistinguishable from the corporation, the concern of the disclosure of confidences to a third party does not exist as a practical matter ... The individual respondents

> sued ... are those responsible for Castle's affairs and day-to-day management, comprising the entire Board of Directors, nearly all of upper management, and Castles' General Counsel. These are the very individuals responsible for receiving, maintaining, and preserving Castle's privileged communications. To find that Castle's privilege was waived by disclosure from these individuals to themselves is beyond absurd and would produce the farcical result that Castle's directors, senior management, and general counsel cannot give or receive any legal advice without waiving the privilege *ipso facto* (*id.* at 18-19).

The Controlling Shareholders assert the waiver argument also fails because there is likely a common interest privilege between Castle Oil and the Controlling Shareholders and to the extent Castle Oil "has disclosed confidences to third parties, such disclosure was inadvertent and not made with the requisite intent necessary to find waiver" (*id.* at 19, n.4).

Further, with regard to the Third Party Petitioners' reliance on the fiduciary exception to the privilege, the Controlling Shareholders point out that "the exception is premised upon common purposes and common interests, ... [and] 'once those purposes and interests diverge, the exception no longer applies'"; therefore, the documents they seek were not created at a time when there was a mutuality of interest between Third Party Petitioners, Castle Oil and the Controlling Shareholders (*id.* at 9, *quoting Beck v Manufacturers Hanover Trust Co.*, 218 AD2d 1, 17-18 [1st Dept 1995]).

The Controlling Shareholders point out that all of the documents sought to be produced were created at a time when Petitioners and Third Party Petitioners were in an adversarial stance with the Controlling Shareholders. Furthermore, the Controlling Shareholders argue that the decision principally relied on by Third Party Petitioners and Petitioners, *Garner v Wolfinbarger* (430 F2d 1093 [5th Cir 1970], *cert denied* 401 US 974 [1971]) is of questionable value since a recent New York decision has noted its exception is controversial and its application to New York law unsettled (*Nunan v Midwest, Inc.*, 2006 NY Slip Op 50188[U], 11 Misc 3d 1052[A] [Sup Ct Monroe County 2006]) and Petitioners and Third Party Petitioners have provided no authority for why such an exception would be extended from a derivative suit to a dissolution proceeding. Finally, "the Garner exception has been held not to apply where, as here, the shareholders assert claims principally to benefit themselves" (*id.* at 23) and "the derivative suit is primarily to benefit the Third Party Petitioners and Petitioners personally, to the detriment of the other shareholders who are respondents" (*id., citing Nunan, supra* 2006 NY Slip Op 50188[U] at *11, and *Milroy v Hanson*, 875 F Supp 646, 651 [D Neb 1996]).

The Controlling Shareholders alternatively argue that even if the *Garner* exception applied, Petitioners and Third Party Petitioners have not established the good cause necessary to pierce the privilege. In this regard, the Controlling Shareholders contend that the documents sought relating to "valuations and appraisals, proposed offers to purchase the shares of the minority interests ... and unconsummated transactions do not relate to claims of shareholder oppression and corporate waste" (*id.* at 24). And Petitioners and Third Party Petitioners have not articulated how these communications furthered corporate wrongdoing or the Controlling Shareholders' interests. Finally, almost all of the documents sought were sent or received by the three Castle Oil deponents that have been deposed and Petitioners and Third Party Petitioners "had ample opportunity to depose each of these individuals on the subjects and issues – none of which were unknown at the time these individuals were deposed ... This raises serious doubt whether the information and documents sought is the only evidence available 'on whether the insider respondents' actions on these matters were in further[ance] of the interests of the Company and of the petitioner minority shareholders, or primarily for their own interests'" (*id.* at 25).

In opposition to the cross-motion by the Petitioners which seeks to join the Third Party Petitioners' Motion Sequence #2 and to compel the production of the Enterprise Valuations, the Controlling Shareholders contend that this cross-motion should be denied for the simple reason that it is procedurally defective because it was served on three days notice under CPLR 2215. According to the Controlling Shareholders, because the Controlling Shareholders were not the moving party, such a cross motion is improper since it can only be sought against the party making the original motion and the Appellate Division, "Second Department has expressly rejected attempts by litigants, such as Petitioners here, to denominate a motion as a "cross-motion" against a non-moving party in an effort to obtain untimely relief or to circumvent adequate notice provisions under CPLR § 2214(b)" (Controlling Shareholders' Opp. Mem. at 3).

Addressing the motion on its merits, the Controlling Shareholders adopt the arguments they made in opposition to the Third Party Petitioners' motion. In opposition to the Petitioners' additional branch, which seeks an order compelling the production of the Enterprise Valuations, the Controlling Shareholders dispute that they are relevant to the issue of oppression since it is black letter law that the failure to provide passive shareholders with corporate records and financial information does not constitute oppression for BCL 1104-a purposes. Further, a low ball offer to purchase the Third Party Petitioners' stock (which admittedly was considered for a half of a second by the Third Party Petitioners) does not constitute oppression (*id.* at 6).

The Controlling Shareholders further assert that contrary to Petitioners' representations that the issue of the Enterprise Valuations was put on hold due to the death of Jack Romita, in actuality, the Court has twice advised Petitioners that since the Enterprise Valuations were subject to a Confidentiality Agreement, Merrill Lynch's

consent would be required to overcome the restrictions. Despite Petitioners' representations that they would contact Merrill Lynch and seek their consent to disclosure, Petitioners have refused to answer the Controlling Shareholders' question over whether or not that contact was actually made and instead, filed this cross-motion. The Controlling Shareholders note that this Court has already determined that Castle Oil cannot waive the protections afforded by the Confidentiality Agreement on behalf of Merrill Lynch. Further, because Conley's Enterprise Valuation "rests solely upon the methodology and content proffered in the Merrill Lynch valuation ... its disclosure, too, implicates the Merrill Lynch confidentiality protection recognized by the Court" (*id.* at 7, n.3).

In response to Petitioners' waiver arguments, it is the Controlling Shareholders' position that the opposition on behalf of Castle Oil will have to await Castle Oil's retention of its separate counsel. However, in addressing the arguments posed, the Controlling Shareholders contend that (1) the shareholder-fiduciary exception – to the extent it is even viable under New York law – applies only to piercing privileged communications, not to invalidate bargained for confidentiality provisions, and (2) even if it did apply to confidentiality agreements, the exception has no application here because there was "a lack of mutuality of interest at the time the Merrill Lynch and Paul Conley enterprise valuations were prepared" and there has been an insufficient showing of good cause to pierce the confidentiality agreement.

Further, Conley corrected his prior deposition testimony and made it clear that these valuations were not disclosed to parties outside of Castle Oil. In response to the argument that the confidentiality was waived through the disclosure to the Controlling Shareholders and Mr. Meadvin, the Controlling Shareholders contend that it too is misplaced for the same reason the argument concerning waiver of the attorney client privilege is misplaced – these people are the individuals at Castle Oil "responsible for receiving, maintaining, and preserving the information subject to Castle's confidentiality obligations to Merrill Lynch. It is beyond absurd to argue that the privilege was waived because these individuals disclosed the information *to themselves*" (*id.* at 9 [emphasis in original]).

B. The Opposition to the Motion for a Default Judgment Against the Controlling Shareholders

In opposition to the motion, the Controlling Shareholders submit a memorandum of law asserting several arguments. The Controlling Shareholders first assert that this motion was filed not in accordance with the Commercial Division Rules since it was filed without first (1) conferring with counsel to see if could be resolved, and (2) obtaining leave of Court. Second, that the present procedural posture of the case was caused by (1) the pleadings themselves, which made the dissolution claims solely against Castle Oil, and (2) the failure of Petitioners and Third Party Petitioners to object, throughout the entire year of litigation, to Holland & Knight's repeated appearance at

conferences, pleadings and the aborted December 6, 2011 hearing, solely on behalf of Castle Oil as the sole respondent to the dissolution. The Controlling Shareholders further point out that in the answers filed on behalf of Castle Oil, there was a reservation of rights to file responsive pleadings on behalf of the Individual Respondents once the claims against them had been reinstated by the Court (since they had been stayed pending the dissolution). Third, that it was only on July 19, 2012 that Petitioners and Third Party Petitioners decided that they wanted Castle Oil to be a nominal party in the case and that the Controlling Shareholders should have been named as respondents to the dissolution. It was at that time that they explained that they wanted to reset the procedural posture of the case but they "expressly disclaimed any intention of seeking a default against the Majority Voting Shareholders" (Controlling Shareholders' Opp. Mem. at 3).

Following that conference, and in opposition to the injunction/claw back motion, the Controlling Shareholders made an offer to agree to reset the procedural posture of the case if ordered by the Court. Then, without the courtesy of a call or in accordance with this Court's rules, the Third Party Petitioners filed this motion on August 23, 2012. The Controlling Shareholders then did what they would have done had opposing counsel given their counsel Holland & Knight the courtesy of a phone call – "they filed Verified Answers to Petitioners' and Third Party Petitioners' pleadings" (*id.* at 4). They point out that since their filing of a notice of appearance on August 9, 2012, Holland & Knight has been acting solely on behalf of the Controlling Shareholders[16] and has expressly reserved consideration and response by Castle Oil's independent counsel, should the Court require such retention.

On the merits, the Controlling Shareholders first argue that the motion is moot because since the filing of the motion, they have filed responsive pleadings. Second, that no prejudice would inure to Petitioners and Third Party Petitioners because (1) the case has proceeded to date without the need for their appearance, (2) the Controlling Shareholders have compelling and meritorious defenses to the dissolution, and (3) public policy favors resolution of cases on their merits. Third, the default should be excused because it was caused by the unorthodox pleadings filed by Petitioners and Third Party Petitioners, because they have accepted to date Castle Oil as the sole party respondent for dissolution for over a year, and because the Controlling Shareholders have now submitted responsive pleadings within 20 days of their expressing their willingness to reset the procedural posture of this case.

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[16]The Controlling Shareholders further represent that since the filing of the Notice of Appearance on August 9, 2012, "not a single minute of Holland & Knight's time ... has been paid for by Castle" (Controlling Shareholders' Opp. Mem. at 5).

THIRD PARTY PETITIONERS' REPLY
IN FURTHER SUPPORT OF CLAW BACK MOTION

In further support of the injunction/claw back branches of their motion, the Third Party Petitioners repeat their mantra that in a dissolution proceeding, a corporation is required to stay neutral and may not pay the fees of the majority shareholders actually opposing the dissolution. The Third Party Petitioners distinguish the cases cited by the Controlling Shareholders because they involve cases in which the courts found a waiver of a right to seek disqualification against a law firm that was dually representing the corporation and the majority shareholders based on failure to timely raise the issue. Third Party Petitioners contend that because they have not formally sought disqualification of Holland & Knight, these cases have no bearing on this issue (Third Party Petitioners' Reply at 10).[17] They further categorize the one case in which a court found the payment of legal fees proper as an anomaly (*Markdikos v Arger*, 116 Misc 2d 1028 [Sup Ct NY County 1982]).

In response to the Controlling Shareholders' argument that Petitioners and Third Party Petitioners cannot undo what's been done since it was caused by their failure to raise this issue timely, the Third Party Petitioners argue that to begin with, it was raised at the September 9, 2011 conference. Second, Castle Oil and the Controlling Shareholders were required to know the law and Petitioners and Third Party Petitioners were under no obligation to advise them and to allow them to profit from their failure to follow the law "turns the law very much on its head" (Third Party Petitioners' Reply at 8). Third Party Petitioners contend that even if the law permitted a corporation to pay the fees of majority shareholders in a dissolution, the Resolution itself only authorizes the fees to be paid on behalf of officers/directors made a party to the action and here, "[n]one of the individual respondents were made or threatened to be made a party to the dissolution proceeding - to the extent they ever appear, they choose to do so voluntarily" (*id.* at 8, n.2).

With regard to the difficulty in parsing out the fees paid on behalf of the defense of Castle Oil in the dissolution (which should be relatively minor given the neutral role it is required to take) versus the fees paid on behalf of the Controlling Shareholders, the task should not be too difficult, they suggest, but, in any event, the costs for the task should be borne by Holland & Knight.

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[17]The Court has some difficulty with the fine tightrope that Third Party Petitioners are trying to walk on. On the one hand, they want the Court to conclude that Holland & Knight is involved in the improper representation of conflicting interests and yet, by refraining from a formal disqualification motion, they are presumably willing to tolerate the impropriety, provided that the Controlling Shareholders, and not the Corporation, pay Holland & Knights' fees. More to the point, it would appear that the absence of a disqualification motion is simply a tactical measure, aimed at trying to avoid dealing with the waiver issue.

In response to the offer to pay the future fees incurred by the Controlling Shareholders in the dissolution, Third Party Petitioners assert that this offer fails to explain how it would be proper for Castle Oil to pay the Controlling Shareholders' legal fees in connection with the derivative action (*i.e.*, how it complies with BCL §§ 721 to 724 and the November 1993 Resolution since unlike the Controlling Shareholders in *Lemle v Lemle* (92 AD3d 494 [1st Dept 2012]) the Controlling Shareholders here have not moved for relief under BCL § 724[c]). Further, it is argued, the Controlling Shareholders have not yet even appeared,[18] making the prospect of indemnification all the more unreasonable. And further, because indemnification can only involve the repayment of reasonable legal fees, and because the Controlling Shareholders have not disclosed the fees paid (despite repeated requests that they be provided to the shareholders in accordance with BCL § 725[c]), there is no basis from which to determine whether the fees were reasonable.

In further support of a finding of waiver of the attorney client privilege, Third Party Petitioners argue that the common interest privilege does not apply because it only applies to "'parties facing common problems in pending or threatened civil litigation'" (id., at 11, *quoting Stenovich v Wachtell, Lipton, Rosen & Katz,* 195 Misc 2d 99 [Sup Ct NY County 2003]). Thus, since Castle Oil stands to gain by showing the malfeasance of the Individual Respondents, it has no interest in shielding these documents in discovery. Thus, "[w]aiver could have been avoided if the Company had taken the prudent, and quite common, step of retaining independent counsel, separate from the Controlling Shareholder's counsel. It elected not to do so, it now must live with the consequences" (*id.* at 11).

Finally, Third Party Petitioners' repeat their argument for why the shareholder-fiduciary exception to the attorney client privilege applies and both elements are met because the evidence sought is highly relevant to whether the transactions and buy out "proposals were fair to the minority shareholders' interests, and may be the 'only evidence available' about the issue'" (*id.* at 13).

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[18]As noted previously, the Controlling Shareholders appeared through Holland & Knight shortly after the filing of the motion. Moreover, to the extent that the Third Party Petitioners are asserting that the real parties in interest in the dissolution are the Controlling Shareholders, the prior absence of an appearance would appear to be a formality.

THIRD PARTY PETITIONERS' REPLY IN FURTHER SUPPORT OF MOTION TO STRIKE PLEADINGS AND PROTECTIVE ORDER

In further support of their motion to strike and for a protective order, Third Party Petitioners view the offer made by the Controlling Shareholders as a half measure that is not really an offer at all since it is made subject to the intervention of the court through an order.

Third Party Petitioners disparage the Controlling Shareholders' alleged confusion as to the need for them to appear based on their argument that the caption only listed Castle Oil as the respondent since the OTSC was specific in requiring a response by "all persons interested in Castle Oil Corporation" as to why Castle Oil should not be dissolved. According to Third Party Petitioners, this was not an oversight but a strategic choice to not join as respondents in this action.

It is Third Party Petitioners' position that this strategy of using the Company as the front for the Controlling Shareholders in opposing dissolution and not having independent counsel represent the interests of Castle Oil has led to "a far more contentious discovery process than otherwise would have occurred" (Third Party Petitioners' Reply Mem. at 7).

Third Party Petitioners review the points already made concerning the privilege document log and the assertions of privilege contained therein (based on, *inter alia*, inadequate descriptions) involving documents that they say relate to key issues in the case.

Third Party Petitioners conclude by arguing that unless the Court issues a protective order to preclude the Controlling Shareholders from pressing for additional discovery through Castle Oil, "the petitioners will continue to be prejudiced by the Controlling Shareholders' improper gamesmanship, and the issues for trial will be further muddied" (*id.* at 11-12).

EVENTS SINCE THE FILING OF THE MOTIONS

Since the filing of the first round of the eight motions filed about a month before the dissolution hearing, on August 9, 2012, Holland & Knight appeared on behalf of the Controlling Shareholders (*i.e.*, Respondents Michael Romita, Mauro Christopher Romita, The Estate of Jack Romita (through its co-executors Jack Romita, Jr., Isabelle Romita, and Mauro J. Romita Skrapits and the Michael Romita Revocable Trust and the Mauro Christopher Romita Revocable Trust). Then, on August 28, 2012, following the motion for a default judgment filed against the Controlling Shareholders, Holland & Knight filed: (1) a Verified Answer to Amended Petition on behalf of the Controlling

Shareholders; and (2) a Verified Answer to Third Party Petitioners' Cross-Claims on behalf of the Controlling Shareholders.

As a result of the Holland & Knight's recent appearance on behalf of the Controlling Shareholders and what Holland & Knight views as the uncertainty surrounding its continued representation of Castle Oil given the varied objections that have been raised to such representation in these motions (which objections have fallen short of moving for Holland & Knight's disqualification), Holland & Knight has only provided opposition to these motions on behalf of the Controlling Shareholders. While Mr. Meadvin represented at the August 30, 2012 conference (discussed below) that if directed by this Court, Castle Oil would retain new counsel and Holland & Knight would solely represent the Controlling Shareholders and possibly the remaining Individual Respondents, at present there is no motion for disqualification and Holland & Knight has not formally withdrawn from its representation of Castle Oil either through the filing of a notice of substitution of counsel or an Order to Show Cause seeking to be relieved as counsel. Accordingly, for the purposes of resolving these motions, the Court views Castle Oil as continuing to be represented by Holland & Knight and will not defer (as requested by Holland & Knight on behalf of the Controlling Shareholders in opposition to these motions) the resolution of these motions until the representation of Castle Oil is settled.

The Court does not view the dual representation inherently problematic and such dual representation (while not necessarily the most prudent course) occurs in cases such as this on a fairly regular basis. For example, in its affirmance of a denial of a motion to disqualify counsel representing both the corporation and the non-petitioning shareholder in a BCL 1104-a dissolution proceeding that also included derivative claims, the Appellate Division, First Department noted that where the shareholder and the corporation consented to the dual representation and thereby waived any potential conflict,[19] it was "not objectively unreasonable to believe that one law firm can adequately represent both [the non-petitioning shareholder] and [the corporation] under these circumstances" (*Ferolito v Vultaggio*, 99 AD3d 19, 28 [1st Dept 2012][20]; *see also*

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[19]In that case, there was a potential conflict over whether the non-petitioning shareholder or the corporation would exercise the right to buy out the petitioning shareholder under BCL § 1118.

[20]In *Zedeck v Derfner Mgt., Inc.* (98 AD3d 925 [1st Dept 2012]), the Appellate Division held that a law firm could not simultaneously represent, in a derivative action, both a 50% owner of the real property, the managing agent, and the managing agent's owner. The First Department found *Ferolito* distinguishable on the ground that there was no evidence in the record that the clients given written, informed consent to the concurrent representation. The Appellate Division also held that the fact that the law firm could not represent all of these clients did not necessarily preclude the law firm from representing any of them.

Dukas v Davis Aircraft Prods. Co., 123 AD2d 304 [2d Dept 1986]; *Solomon v Hirsch*, 35 Misc 2d 716 [Sup Ct NY County 1962]).

At a conference held on August 30, 2012, the Court and counsel engaged in a lengthy discussion to try to resolve some of these motions so that the September 19 hearing could go forward. Despite this Court's best efforts to negotiate a compromise of these motions along the lines proposed by the Controlling Shareholders in their Omnibus Opposition, the Court and counsel could not come to a resolution. As such, the Court adjourned the dissolution hearing without date until the Court could dispose of the 8 motions.

At the beginning of November, Petitioners and Third Party Petitioners requested a conference call with Chambers, which occurred on November 8, 2012. The primary purpose of the call was to enlist the Court's assistance in requiring that Castle Oil provide to Merrill Lynch copies of the Confidentiality Agreement between Castle Oil and Merrill Lynch and the Enterprise Valuation since Merrill Lynch had been unable to locate its copies of these documents and Merrill Lynch needed to review them in order to evaluate whether it would consent to the valuation being turned over. Counsel for Petitioners and Third Party Petitioners further requested that the Court reconsolidate the dissolution claims with the derivative claims so that discovery could proceed on all claims and a combined trial on all claims could occur.

As to the Merrill Lynch Enterprise Valuation, the Court advised that it would not intervene in this dispute at this time given the numerous substantive motions that had been made including the cross-motion to compel the production of this Enterprise Valuation. With regard to the request for the Court to reconsolidate the claims, the Court stated that it too would have to await the disposition of these motions but if the parties wished to agree that the claims be reconsolidated and provided this Court with a stipulation to be so-ordered, the Court would entertain such a stipulation. No such stipulation has been provided to date but the Court sees numerous reasons for reconsidering its earlier informal bifurcation of the issues.

First, while a primary purpose of the bifurcation was to streamline this action and to have the issue concerning the continued viability of Castle Oil resolved as expeditiously as possible, despite this Court's best efforts, this case has been mired by

issues[21] and at present, given the Court's calendar, a hearing on the dissolution claims cannot occur until the late Spring of 2013.

Second, based on the allegations of Amended Petition and the Third Party Petitioners' Pleading, the predicate for the dissolution claims (*i.e.*, oppression of the minority shareholders by the Controlling Shareholders and looting by the Controlling Shareholders of the Castle Oil's assets to their personal benefit and to the detriment of Castle Oil and the minority shareholders) is the same predicate for the derivative and direct claims. Therefore, the same facts, witnesses and evidence needed to support the dissolution claims will be needed to support the derivative claims. While the Court originally perceived that bifurcation would aid in this regard, with the factual findings on dissolution being binding on the same issues in the derivative context, the Court is now convinced that it would be fairer to the parties, and in the interest of judicial economy, to hear all of the claims together.

Third, the bifurcation of the dissolution aspect from the derivative aspect has caused a delay in the right of the Petitioners and Third Party Petitioners to obtain access to discovery directly from the Individual Respondents. The Court originally perceived that the parties would be able to complete discovery on the dissolution aspect with dispatch, bearing in mind that all discovery is subject to leave of court. Nonetheless, to date, the Controlling Shareholders have not submitted to the depositions noticed by Petitioners and Third Party Petitioners. Accordingly, since there is now plenty of time for the parties to complete discovery on all of the issues prior to trial, and since the Court deems it prudent to have only one trial in this matter given that the facts underlying all of the claims are inextricably tied to one another, the Court shall vacate its bifurcation so that all matters will be heard together. The remaining Individual Respondents who have not yet submitted answers to the Amended Petition and Third Party Petitioners' Pleading shall do so within 30 days of this Decision and Order.

REASONS FOR THE CONFUSED PROCEDURAL STANCE OF THIS ACTION

The current procedural posture of this case, with the Controlling Shareholders only recently having (1) appeared through Holland & Knight, and (2) filed their answers, is largely a function of the manner in which the Petitioners and Third

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[21]The December 5 hearing date got postponed due to the death of Jack Romita. There was no activity with regard to the case from December 5, 2011 until January 17, 2012, when the Estate of Jack Romita (through its co-executors) was substituted in on behalf of Jack Romita. At the status conference held on February 3, 2012, the Court tried to schedule a prompt hearing for either February or March, but the efforts were rebuked by counsel who were unavailable for the proposed hearing dates and, as a result, the hearing was scheduled for September 2012.

Party Petitioners have pursued this lawsuit. It is undisputed that the only respondent in the original Petition for dissolution under BCL § 1104-a was Castle Oil. While the OTSC provided that any person with an interest in Castle Oil should appear on the return date and assert why dissolution should not be had, and while the Controlling Shareholders were all served with the OTSC, they were under no compulsion to appear as they had not been named. It was also not illogical for the Controlling Shareholders to perceive that, since Castle Oil was the only named respondent and that it was opposing dissolution, there was nothing further that they need do.

The Petition was subsequently amended to include the additional Individual Respondents in connection with the derivative and individual claims for breach of fiduciary duty based on, *inter alia*, oppression, looting and corporate waste. In the Amended Petition, the only respondent named in the dissolution cause of action was Castle Oil. In October 2011 when the Third Party Petitioners filed their cross-claims for dissolution, again only Castle Oil was named as a respondent with regard to that claim. These pleadings coupled with the Court's bifurcation direction which informally stayed the direct/derivative claims until after a resolution of the dissolution hearing scheduled for December 5, 2011, made it understandable for Holland & Knight to take the position that the Individual Respondents (including the Controlling Shareholders) had no reason to be involved in this action and they acted appropriately in reserving their right to respond to the Amended Petition and Third Party Petitioners' Pleading until after the Court resolved the dissolution claims and lifted the stay of the derivative claims. This posture was known to counsel for Petitioners and Third Party Petitioners from the outset and no objection was taken until the conference held on July 19, 2012. Thus, up until July 2012, other than the issue of the payment of attorneys' fees that was briefly raised and then indefinitely deferred at the September 9, 2011 conference, counsel did not raise any issue concerning (1) the propriety of Castle Oil being the only respondent in the dissolution proceeding (*i.e.*, that the real parties in interest were the Controlling Shareholders and that their appearance and responsive pleadings were required); or (2) the propriety of only Castle Oil having propounded discovery requests to Petitioners and Third Party Petitioners and its having responded to the discovery sought in connection with the dissolution proceeding. Indeed, the Court had no contact from counsel during the period February 2012 until June 2012, the first contact being in June 2012 when Chambers was enlisted to resolve a discovery dispute and was advised that Third Party Petitioners' counsel wanted a pre-motion conference for leave to move for an injunction against the payment of legal fees on behalf of the Controlling Shareholders.

Even in context of the present motions, Third Party Petitioners raise seemingly inconsistent positions. For example, in connection with the injunction/claw back motion, Third Party Petitioners strenuously argue that there is no right to indemnification for attorneys' fees under the BCL because "[n]one of the individual respondents were made or threatened to be made a party to the dissolution proceeding" (Third Party Petitioners' Mem. at 4). Third Party Petitioners, however, take a

diametrically opposed position in their motion to strike Caste Oil's answers and for a protective order as well as their motion for a default judgment. In those motions, Third Party Petitioners argue that the Controlling Shareholders are the real parties in interest and, in essence, that they have improperly failed to appear and file responsive pleadings in this action.

With this backdrop, the Court will turn to disposing of these prolix and, for the most part, redundant motions.

LEGAL ANALYSIS

1. *The Third Party Petitioners' Motion to Strike Castle Oil's Answer and to Issue a Protective Order Against Further Discovery (Motion Seq. # 4) and the Third Party Petitioners' Motion for a Default Judgment Against the Controlling Shareholders (Motion Seq. # 9)*

The predicate for the Third Party Petitioners' motion to strike Castle Oil's Answer and for a Protective Order against further discovery has been rendered moot by the appearance of the Controlling Shareholders and their filing of Answers to the Amended Petition and the Third Party Petitioners' Pleading. As Third Party Petitioners described it, the primary purpose of their motion was to bring the Controlling Shareholders out of the shadows and require that they fight their own battle rather than have Castle Oil, an entity that should remain neutral in a dissolution, fight their battle for them. This purpose has unquestionably been achieved. Now that the Controlling Shareholders have joined the action, the follow up discovery sought by Castle Oil with regard to its original discovery demands may be deemed to have been made by the Controlling Shareholders and all responses may be provided to the Controlling Shareholders rather than Castle Oil (now a nominal respondent to the dissolution proceeding).[22] To the extent Castle Oil's answer contests the dissolution by siding with the Controlling Shareholders, the Court hereby grants Castle Oil leave to amend its answer to assert a neutral position in this action. Accordingly, the Court shall deny the branch of Third Party Petitioners' Motion Sequence #4 as seeks to strike the answer of Castle Oil as academic, on condition that Castle Oil serve an amended answer within twenty (20) days of this Decision and Order.

The Court next addresses the Third Party Petitioners' motion for a default judgment against the Controlling Shareholders.

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[22]The Court finds the protective order aspect to this motion to be without merit since for the past year, the parties have proceeded with propounding discovery requests to Castle Oil and with accepting responses from Castle Oil without objection until now.

While Petitioners and Third Party Petitioners satisfied their *prima facie* burden for the entry of a default judgment against the Controlling Shareholders, the Controlling Shareholders have established a reasonable excuse for the default and a meritorious defense to the action (*Grinage v City of New York*, 45 AD3d 729 [2d Dept 2007], *citing Giovanelli v Rivera*, 23 AD3d 616 [2d Dept 2005]; *Zino v Joab Taxi, Inc.*, 20 AD3d 521, 522 [2d Dept 2005]; *Pampalone v Giant Bldg. Maintenance, Inc.*, 17 AD3d 556 [2d Dept 2005]; *Ennis v Lema*, 305 AD2d 632, 633 [2d Dept 2003]). The determination of what constitutes a reasonable excuse lies within the sound discretion of the court (*id.* at 730, *citing Juseinoski v Board of Educ. of City of N.Y.*, 15 AD3d 353, 356 [2d Dept 2005]; *Ennis, supra*, 305 AD2d at 633). Here, given the fact that the original petition, the Amended Petition and the Third Party Petitioners' Pleading did not name the Controlling Shareholders as parties to the dissolution claim, and given that this Court bifurcated the dissolution claims from the derivative/direct claims pending the resolution of the dissolution proceeding,[23] the Controlling Shareholders have established a reasonable excuse for their failure to submit answers to the Amended Petition and Third Party Petitioners' Pleading. As to their meritorious defense, given that the Controlling Shareholders have now submitted Verified Answers to the Amended Petition and Third Party Petitioners' Pleading which contest the factual allegations of the Petitioners' and Third Party Petitioners' pleadings, the Controlling Shareholders have established a meritorious defense, (*Avery v Caldwell*, 55 AD3d 473 [1st Dept 2008]; *Juseinoski, supra*).

Moreover, the absence of formal appearances by the Controlling Shareholders has not caused any prejudice in terms of the prosecution of the case in that, as Third Party Petitioners themselves argue, the Controlling Shareholders were the real parties in interest on the dissolution and the dissolution was being vigorously defended. Further, in the context of Motion Sequence No. 4, Third Party Petitioners indicated that they were willing, if not desirous, of receiving answers from the Controlling Shareholders. The Third Party Petitioners asserted that they were "entitled to an answer from each of the parties that oppose dissolution" and that "[r]equiring responsive pleadings from them at this point will put the parties on a more equal footing, limit further discovery disputes, focus the issues remaining for hearing, and prevent the Controlling Shareholders from litigating their defense to dissolution disguised as Castle Oil" (Mem. of Law at 10). While Third Party Petitioners moved for a default judgment a few weeks later, the Court perceives that, in the interest of having this matter resolved on the merits, no default should be entered.

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[23]The Court does not agree that the non-dissolution portion of the case was completely stayed. The Court issued a Preliminary Conference Order at about the timing of this so-called stay, which called for the conclusion of **all discovery** in this action by March 29, 2012. Nevertheless, the Court accepts Holland & Knights' reservation of rights to answer at a later date on behalf of the Individual Respondents, especially given Petitioners' and Third Party Petitioners' failure to object to this stance until July 2012.

Accordingly, the Third Party Petitioners' motion for a default judgment against the Controlling Shareholders shall be denied.

2. *The Movants' Motion to Enjoin the Payment of Legal Fees and to Claw Back Legal Fees Already Paid on Behalf of the Controlling Shareholders*

"Under the general rule in New York, attorneys' fees are ordinary incidents of litigation and a prevailing party may not collect from the losing party unless such an award is authorized by agreement between the parties, statute, or court rule" (*Bourne Co. v MPL Communications, Inc.*, 751 F Supp 55, 57 [SD NY 1990], *citing Matter of A.G. Ship Maintenance Corp. v Lezak*, 69 NY2d 1 [1986]; *Mighty Midgets, Inc. v Centennial Ins. Co.*, 47 NY2d 12 [1979]).

The Court shall look at the realities of this case and not the artificial (and at times inconsistent) positions taken by the parties with regard to this issue.

The Court does not accept the Third Party Petitioners' position that indemnity and advancement provisions of the BCL are unavailable because the Individual Respondents were not made a party to the dissolution claims. It is undisputed that the Individual Respondents were eventually named as parties to the derivative piece of this litigation. If their submission of formal answers was delayed and arguably belated, they are still parties to the action and the indemnification/fee advancement positions of the BCL are fully in play.

The Court does not accept the concept that the only aspect of this case for which attorneys' fees have been incurred is the dissolution proceeding. The Court's bifurcation of the action was to expedite the dissolution hearing but given that the dissolution claims piggyback on the facts supporting the derivative claims, the work to date has necessarily involved the derivative claims. As noted previously, had the dissolution claims been determined at the first phase of the bifurcated matter, the findings made would have been binding on the second phase. Indeed, because the Petitioners and Third Party Petitioners have framed the dissolution issue largely, if not exclusively, on the back of the oppression and looting allegations supporting the derivative claims, the fees incurred by Holland & Knight have necessarily involved not only the dissolution aspect of the case, but also the derivative claims. Nor does the Court perceive it apparent to penalize Castle Oil or the Controlling Shareholders by reason of the Court's initial invocation of the procedural device of issue bifurcation.

On the other hand, the Court does not accept the Controlling Shareholders' position that the fees paid to date have been solely on behalf of Castle Oil (the only named respondent in the dissolution) and, therefore, there is no basis for

an injunction or a claw back. Since a company in a dissolution proceeding should remain neutral and the real parties in interest are the majority shareholders opposing the dissolution, it is apparent that, at least to some extent, Castle Oil has expended fees on behalf of the Controlling Shareholders --the real parties in interest opposing the dissolution and defending this action. While Castle Oil and the Controlling Shareholders did not create the ambiguity stemming from the Amended Petition's and Third Party Petitioners' Pleading's naming of only Castle Oil as the respondent on the dissolution claims and cross claims, the Company and the Controlling Shareholders were only too willing to exploit the opportunity thus handed to them.

The Court cannot turn a blind eye to the reality of the situation, which is that Castle Oil has been fronting the money to pay for the defense of this action on behalf of the Controlling Shareholders. The question is whether these payments were proper based on their standing as Castle Oil's officers and directors, based on relevant case law, a November 1, 1993 Resolution by the Castle Board of Directors, and the provisions of the BCL.

If this were solely a dissolution proceeding, there would be no question that an injunction should issue against the future advancement of such legal fees on behalf of the Controlling Shareholders. Movants are correct that the overwhelming authority in straight dissolution actions is for courts to enjoin the payment of legal fees by corporations on behalf of their majority shareholders (*see, e.g., Matter of Schwartzreich*, 136 AD2d 642 [2d Dept 1988]; *Matter of Levitt,* 109 AD2d 502 [1st Dept 1985]). However, as already explained, this is not simply a dissolution action and the prior bifurcation directive did nothing to change this fact.

As noted by the Petitioners and Third Party Petitioners, there is a Resolution adopted by written consent of the Board of Directors of Castle Oil Corporation dated November 1, 1993, which provides:

> RESOLVED, that to the fullest extent permitted by law, the Corporation shall indemnify each person made or threatened to be made a party to any civil or criminal action or proceeding by reason of the fact that he or she, or his or her testator or intestate, is or was a director or officer of the Corporation ... from an against all expenses (including without limitation, reasonable attorneys' fees, costs, judgments, fines, penalties, impositions, and settlements) which may be actually paid or incurred by such person in connection with or arising out of such action or proceeding or appeal therein, provided that such person acted in good faith, for a purpose which he or she reasonably believed to be in ... the best interests of the Corporation ... and further

> RESOLVED, that the Corporation shall pay the expenses referred to in the preceding paragraph, in advance of the final disposition of the action or proceeding in question, upon receiving from the indemnified person or persons an undertaking to repay such expenses of the Corporation, as provided by § 725(a) of the Business Corporation Law (Resolution dated November 1, 1993 ["November 1993 Resolution"]).

Under the BCL, corporations are authorized to advance the legal fees of their officers and directors during the pendency of an action and may also indemnify their officers and directors following the conclusion of an action provided the requirements of the BCL are met.

"Indemnification of officers or directors ... may be made voluntarily by resolution of the directors or shareholders in actions brought directly by the corporation against the officers or directors, 'if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in ... the best interests of the corporation ...'" (Ennico, Business Corporation Law § 5:122). Alternatively, if a corporation chooses not to voluntarily pay such fees, the corporation may be compelled to pay such fees under BCL § 724. Here, since the payment of fees to Holland & Knight was done voluntarily by Castle Oil, the controlling provisions of the BCL are §§ 721, 722, 723 and 725.[24]

BCL § 721 provides that the indemnification and advancement of expenses granted pursuant to BCL Article 7 (Directors and Officers) are "not to be deemed exclusive of any other rights to which a director or officer seeking indemnification or advancement of expenses may be entitled, whether contained in the certificate of incorporation or the by-laws or, when authorized by such certificate of incorporation or by-laws, (i) a resolution of the shareholders, (ii) a resolution of directors, or (iii) an agreement providing for such indemnification, provided that no indemnification may be made to or on behalf of any director or officer if a judgment or other final adjudication adverse to the director or officer establishes that his acts were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled ...."

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[24]BCL § 724 only applies where the corporation declines to afford advancement or indemnification of fees pursuant to BCL § 722 or § 723, and therefore, indemnification is sought by court order (*Mercado v Coes FX, Inc.*, 12 Misc 3d 766 [Sup Ct Nassau County 2006]). BCL § 724 is not implicated here because no one has sought a court order authorizing Castle Oil's advancement of these fees.

BCL § 722 (a) and (c) provide for the indemnification of legal fees in connection with third party actions, and derivative actions, respectively (*Baker v Health Mgt. Sys.*, 98 NY2d 80, 84, n.1 [2002]; *Biondi v Beckman Hill House Apt. Corp.*, 94 NY2d 659 [2000]). Here, since there are direct as well as derivative claims (in addition to the dissolution claims), BCL §§ 722(a) and (c) are implicated. The language of these sections is virtually identical to the language contained in the November 1993 Resolution.

BCL § 722 (a) provides that "a corporation may indemnify any person made, or threatened to be made, a party to an action or proceeding ... by reason of the fact that he, or his testator or intestate, was a director or officer of the corporation ... against judgments, fines, amounts paid in settlement and reasonable expenses including attorneys' fees actually and necessarily incurred as a result of such action or proceeding, or any appeal thereon, if such director or officer acted in good faith, for a purpose which he or she reasonably believed to be in ... the best interests of the corporation ...." (BCL § 722[a]).

BCL § 722 (c), the provision applicable to derivative claims,[25] excludes from its coverage actions that are settled or otherwise disposed and "any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation, unless and only to the extent that the court in which the action is brought, or, if no action was brought, any court of competent jurisdiction, determines upon application that, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for such portion of the settlement amount and expenses as the court deems proper" (BCL § 722[c]).

BCL § 723(b)[26] provides that "any indemnification under section 722 or otherwise permitted by section 721 ... shall be made by the corporation, only if authorized in the specific case:"

> (1) By the board acting by a quorum consisting of directors who are not parties to such action or proceeding upon a finding that the director or officer has met the standard of conduct set forth in section 722 or established pursuant to section 721, as the case may be, or,

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[25]BCL § 722(c) applies to any action "by or in the right of the corporation to procure a judgment in its favor" (BCL § 722[c]).

[26]BCL § 723(a) is not applicable since it may only be invoked once a person has been wholly successful on the merits or otherwise in the defense of actions covered by BCL § 722.

> (2) If a quorum under subparagraph (1) is not obtainable or, even if obtainable, a quorum of disinterested directors so directs;
>
> > (A) By the board upon the opinion in writing of independent legal counsel that indemnification is proper in the circumstances because the applicable standard of conduct set forth in such sections has been met by such director or officer, or
> >
> > **(B) By the shareholders upon a finding that the director or officer has met the applicable standard of conduct set forth in such sections.**
>
> (c) Expenses incurred in defending a civil ... action or proceeding may be paid by the corporation in advance of the final disposition of such action or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount as, and to the extent, required by paragraph (a) of section 725[27](BCL § 723[b] & [c] [emphasis added]).
>
> Finally, section 725(a) provides
>
> All expenses incurred in defending a civil ... action or proceeding which are advanced by the corporation under paragraph (c) of section 723 (Payment of indemnification other than by court award) .... shall be repaid in the case the person receiving such advancement or allowance is ultimately found ... not to be entitled to such indemnification .... (BCL § 725[a]).

An explanation of how these provisions interrelate was set forth in *Wasitowski v Pali Holdings, Inc.* (2010 WL 1459767 [SD NY 2010]) as follows:

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[27]The reference to an undertaking does not necessarily equate with the CPLR's meaning of an undertaking (Article 25). While it has been construed to mean an agreement by the officer or director to repay the fees if it is ultimately determined that the officer or director was not entitled to such advancement or indemnification (*see Benjamin v Carusona,* 2010 WL 1645047 [SD NY 2010]), it appears that a court may order the giving of a bond if it appears that the promise of repayment is insufficient (*Pilipiak v Keyes,* 286 AD2d 231 [1st Dept 2001], *lv dismissed* 97 NY2d 653 [2001]).

> The BCL establishes a statutory framework for a corporation's indemnification of officers and directors, whether made voluntarily or by court order ... Sections 722 "permits but does not require" a corporation's bylaws to provide for director and officer indemnification ... Section 723 establishes the procedures by which shareholders or boards of directors may elect to provide indemnification. See BCL § 723(b). Although the text of section 722(a) is phrased permissively ("may"), BCL § 723(a) states that "[a] person who has been successful, on the merits or otherwise, in the defense of a civil or criminal proceeding of the character described in section 722 *shall* be entitled to indemnification as authorized in such section" (emphasis added). Thus, if a corporation provides for indemnification to its directors and officers consistent with section 722, section 723 binds the corporation to its promise to indemnify (*id.* at * 3).

As noted previously, courts have enjoined corporations' payments of legal fees on behalf of their shareholders in dissolution proceedings. However, in cases involving derivative claims or in hybrid cases such as this one involving both dissolution and derivative claims, courts have denied motions to enjoin the advancement of legal fees (*see Lemle v Lemle*, 92 AD3d 494 [1st Dept 2012]; *Benjamin v Carusona*, 2010 WL 1645047 [SD NY 2010]; *Benjamin v Carusona*, 2010 WL 4448213 [SD NY 2010]; *cf. Van Der Lande v Stout*, 2003 WL 25519857 [Sup Ct NY County 2003], *affd* 13 AD3d 261 [1st Dept 2004]; *Fuiaxis v 11 Huron Street, LLC*, 2007 WL 6937929 [Sup Ct Queens County 2007]).

Since the Controlling Shareholders have represented to the Court that they will pay (and indeed have been paying since the beginning of August)[28] their future legal fees in defending this action, the motion for a preliminary injunction enjoining the future payment of such fees has been rendered moot.[29]

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[28] The Court assumes that this payment is nevertheless subject to any rights the Individual Respondents may have to seek indemnification under the Resolution and the BCL from Castle Oil should the action be resolved in their favor and they are found to have engaged in no wrongdoing.

[29] In their Omnibus Opposition Memorandum, in an effort to reset the procedural stance of this action, the Controlling Shareholders offered to pay for their future legal fees and have represented that since Holland & Knight's filing of the Notice of Appearance, all of Holland & Knight's fees have been paid for by the Controlling Shareholders (*see* Majority Voting Shareholders' Memorandum in Opposition dated August 29, 2012 at 5). While this offer is worded as "[t]he Majority Voting Shareholders would pay Holland & Knight's legal fees incurred in defense of the dissolution claims

With regard to Petitioners' and Third Party Petitioners' request that the Controlling Shareholders be required to pay back such fees under the claw back branch of this motion, based on the foregoing provisions of the BCL, Petitioners and Cross-Petitioners have not satisfied their burden of showing that the fees paid to Holland & Knight were unauthorized under the BCL because (1) the payment is likely proper under BCL § 721[30] since there is the November 1993 Resolution permitting the advancement of such fees where approved by a vote of the shareholders upon their finding that the officer or director acted in good faith and for a purpose he or she reasonably believed to be in the interests of Castle Oil, Inc. and the officer or director provides an undertaking as required by BCL § 725 (a); and/or (2) the payment may also be proper under BCL §§ 722 and 723, which provide for advancement of such fees prior to the final disposition upon approval of the shareholders upon their finding that the director or officer has met the applicable standard of conduct set forth in such sections and upon "receipt of an undertaking by or on behalf of the director or officer in question, and with shareholder or board approval" (*Donovan v Rothman*, 253 AD2d 627, 629 [1st Dept 1998]).

Since the Controlling Shareholders are the respondents on whose behalf these legal fees have been paid, it is undeniable that Castle Oil's payment of these fees have been approved, at least tacitly, by the majority of the voting shareholders of Castle Oil. Further, it is the Controlling Shareholders, not this Court, who decides whether or not they were acting (in their roles as the officers and directors of Castle Oil) in good faith and for a purpose they reasonably believed to be in the best interests of the

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going forward" (Omnibus Opp. Mem. at 5), it would appear that the offer was so limited because as of the date of their omnibus opposition memorandum, the dissolution claims were still subject to bifurcation. The Court assumes that the offer to pay their own way would still stand in this action's new procedural stance, which is that the claims have been reconsolidated such that the discovery and trial will proceed on all claims. Should the Controlling Shareholders change their mind and retreat to Castle Oil's advancing the payment of their fees, then the injunction aspect of this motion would no longer be moot and the movants could see to revisit the issue. However, given this Court's determination that Petitioners and Third Party Petitioners have not established a likelihood of success on their request for a mandatory injunction requiring the pay back of the legal fees already paid for on behalf of the Controlling Shareholders, the Court presently perceives that little would be gained by revisiting the issue and that the proper place for addressing any adjustment of fees would be at the conclusion of this action where it can be determined if such a payment of fees complied with the BCL or if the Controlling Shareholders would be required to pay back any of fees to Castle Oil, either in connection to the disposition of the dissolution or the derivative claims.

[30]*See Donovan v Rothman*, 253 AD2d 627, 629 (1st Dept 1998) ("under BCL § 721, the corporation itself may make provisions for indemnification, whether by charter, by-laws or resolution or agreement of the shareholders or directors").

corporation. Although the Controlling Shareholders have not provided evidence of the undertaking required by BCL § 723(c), it would seem that, in short order, the Controlling Shareholders would agree to do so since all that would be required for such undertaking is an agreement from the Controlling Shareholders to repay the funds *(see, e.g., Benjamin, supra)* paid on their behalf if it turns out that their actions are found to have not been taken in good faith and in the best interests of the corporation, if such an agreement is not currently in existence. While it appears that a court may provide for a bond as security for the promise of repayment (see *Pilipiak v Keyes,* 286 AD2d 231 [1st Dept 2001], *lv dismissed* 97 NY2d 653 [2001]), it would also seem that it is up to the shareholders or board in the first instance to decide whether to require a bond and, if so, in what amount.

With regard to Petitioners' and Third Party Petitioners' contention that the Controlling Shareholders' have failed to satisfy the requirements of BCL § 725 (c), that provision simply states that if expenses are paid by way of voluntary indemnification, **otherwise than by court order or action by the shareholders**, the corporation shall mail to its shareholders a statement specifying the persons paid, the amounts paid, and the nature and status at the time of such payment. Here, the Controlling Shareholders of Castle Oil have presumably approved Castle Oil's payment of the fees to Holland & Knight since they are the named respondents herein. Accordingly, BCL § 725 is no bar to the indemnification provided.

Because there is no present threat that the Controlling Shareholders will be using Castle Oil's funds in the future to pay for their legal fees incurred to defend the dissolution and derivative claims since they have represented that they will not do so, the Court shall deny the motion for a preliminary injunction on grounds that this branch of the motion is moot.

With regard to the request that the Court require the Controlling Shareholders pay back to Castle Oil the fees that have already been paid, based on the foregoing provisions of the BCL and the November 1993 resolution, the Court finds that the Petitioners and Third Party Petitioners have failed to meet their burden of showing a likelihood of success that these fees were improperly paid. This determination, however, is without prejudice to this Court's shifting of the responsibility for the payment of such fees onto the Controlling Shareholders at the time of the final disposition of this action. The denial is further conditioned on the Controlling Shareholders' provision of evidence that they have provided an undertaking to Castle Oil in accordance with the requirements of BCL § 723(c) within 10 days of the date of this Decision & Order.[31]

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[31]In the event, as seems likely, that no undertaking is provided or the amount of the undertaking is deemed by movants to be inadequate (see *Pilipiak v Keyes,* 286 AD2d 231 [1st Dept 2001], *lv dismissed* 97 NY2d 653 [2001]), movants may, if they be so advised, renew their injunction application on the ground that no undertaking was provided or that the undertaking is inadequate.

CROSS-MOTION TO COMPEL THE DISCLOSURE OF THE ENTERPRISE VALUATIONS AND MOTION TO COMPEL THE PRODUCTION OF DOCUMENTS ON CASTLE OIL'S PRIVILEGE LOG

With regard to the cross-motion to compel the production of the Enterprise Valuations,[32] it is procedurally defective in that it was made against a nonmovant on merely three days notice (*Gaines v Shell-Mar Foods, Inc.*, 21 AD3d 986 [2d Dept 2005]; *Williams v Sahay*, 12 AD3d 366 [2d Dept 2004]; *Mango v Long Island Jewish-Hillside Med. Ctr.*, 123 AD2d 843 [2d Dept 1986]; CPR 2215 and 2214). For this reason, the motion shall be denied.

Moreover, the cross motion is denied for the further reason that the Court has already addressed through Chambers in numerous conference calls and at conferences with the parties, how this discovery dispute had to be handled, which was that the input from Merrill Lynch would be required before the Enterprise Valuations would be produced based on this Court's *in camera* review of the Confidentiality Agreement entered into between Castle Oil and Merrill Lynch. It is very simple really: either Merrill Lynch consents to the disclosure or else an appropriate application is made with the papers having been duly served on Merrill Lynch.

The Court has already given Petitioners and Third Party Petitioners a roadmap for how the Court would deal with the issue if the voluntary consent of Merrill Lynch could not be obtained, which is that a subpoena to Merrill Lynch (or its successor Bank of America) should be issued demanding the production such that Merrill Lynch would be afforded the due process right of objecting to the production of this document if it did not want it turned over (*see* Tr. of 8/31/12 Conference at 19, 21-23, 46).[33] To date, no such subpoena has been issued.

Accordingly, the cross motion to compel shall be denied, without prejudice, to Petitioners' and Third Party Petitioners' issuance of a third party discovery subpoena *duces tecum* to compel Merrill Lynch's production of the Enterprise

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[32]The Court will consider the cross-motion to the extent Petitioners merely joined the arguments made by Third Party Petitioners in Motion Seq. #2 to enjoin the payment of legal fees, claw back the fees already paid, and seeking to compel the production of the privileged documents.

[33]While the Court was technically referring to a trial subpoena, the due process requirement would also be satisfied through the issuance of a subpoena *duces tecum*, since if Merrill Lynch objects to the production, it may move to quash the subpoena.

Valuation.[34] If it is ultimately resolved that Merrill Lynch has no objection to the production of the Enterprise Valuation, or if the Court decides to order its production over Merrill Lynch's objection, the production of the Conley Enterprise Valuation, which is based on the Merrill Lynch methodology, will necessarily follow.

The motion and cross motion to compel the documents on the privilege document log are procedurally defective because there has been no showing that Petitioners and Third Party Petitioners made a good faith effort to resolve their disputes prior to the making of this motion (22 NYCRR 202.7; *Gonzalez v International Business Machines Corp.*, 236 AD2d 363 [2d Dept 1997]). Instead, the Court understands based on the representations of Mr. Burns from Holland & Knight at the August 31, 2012 conference that despite the fact that Castle Oil's privilege log was produced some eight months earlier, these motions were the first time Petitioners and Third Party Petitioners had raised any issues concerning its deficiencies (Tr. of 8/21/12 Conf. at 51-53). The Court's Practice Guide and its Preliminary Conference Order are explicit in how discovery disputes, such as the withholding of privileged documents, must be handled. This procedure follows the requirements of Commercial Division Rules 14 and 24.[35] Thus, not only are the parties required to engage in good faith negotiations in an attempt to resolve or at least narrow their differences, they are also required to contact the Court once those negotiations have been exhausted so that the Court's Chambers may engage in a conference call to attempt to resolve the remaining issues.[36] In the event the Court is unable to resolve the dispute (which occurs in less than 10% of the cases), the Court will set a briefing schedule for any motion that is required. Here, none of these preconditions to the filing of this motion occurred.

The Court shall not address Petitioners' and Third Party Petitioners' vague

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[34]The Court understands based on a recent conference call that Merrill Lynch may not be able to find the document. If that is the case, the Court expects that the Company will provide a copy of the Enterprise Valuation to Merrill Lynch so that it may evaluate their position as to its disclosure to Petitioners and Third Party Petitioners.

[35]Commercial Division Rule 14 provides that "Counsel must consult with one another in a good faith effort to resolve all disputes about disclosure ... Except as provided in Rule 24 hereof, if counsel are unable to resolve any disclosure dispute in this fashion, the aggrieved party shall contact the court to arrange a conference as soon as practicable to avoid exceeding the discovery cutoff date. Counsel should request a conference by telephone if that would be more convenient and efficient than an appearance in court."

[36] The only communication with the court was in a call to Chambers in mid July 2012 to schedule the pre-motion conference in which counsel made a vague reference that he believed the attorney client privilege had been waived by Holland & Knight's representation of both Castle Oil and the Individual Respondents.

objections to the inadequacy of the descriptions found in the privilege log since any deficiencies could easily be addressed through discussions with counsel. With regard to the larger issue of whether any of these documents are even privileged based on the arguments raised (*i.e.*, (1) waiver based on Holland & Knight's dual representation, and (2) fiduciary exception to the attorney client privilege), because the Court envisions that it highly unlikely that the parties will come to a meeting of the minds on this larger issue even with good faith discussions, and because it is Petitioners' and Third Party Petitioners' contention that no such a privilege exists, the Court will briefly address whether these documents on the privilege log must be produced.

The common law attorney client privilege, which exempts communications between an attorney and his/her client from disclosure, is codified in CPLR 4503(a).[37] CPLR 3101(b) further shields such attorney client communications with absolute immunity from disclosure.

Because the attorney-client privilege constitutes an obstacle to the truth-finding process, "its 'invocation ... should be cautiously observed to ensure that its application is consistent with its purpose'" (*Hoopes v Carota*, 142 AD2d 906, 908-909 [3d Dept 1988], *affd* 74 NY2d 716 [1989], *quoting Matter of Jacqueline F.*, 47 NY2d 215, 219 [1979]). The attorney client privilege "enables one seeking legal advice to communicate with counsel ... secure in the knowledge that the contents of the exchange will not be revealed against the client's wishes (*People v Osorio*, 75 NY2d 80, 84 [1989]). It must be demonstrated that the information that is claimed to be protected from discovery was in fact a confidential communication made to counsel for the purpose of obtaining legal services or advice in the course of a professional relationship (*Rossi v Blue Cross & Blue Shield of Greater N.Y.*, 73 NY2d 588, 593 [1989]; *All Waste Sys., Inc. v Gulf Ins. Co.*, 295 AD2d 379 [2d Dept 2002]). When deciding whether an attorney-client privilege attaches to a document, "the burden of establishing any right to protection is on the party asserting it; the protection claimed must be narrowly construed; and its application must be consistent with the purposes underlying the immunity" (*Spectrum Sys. Intl. Corp. v Chemical Bank*, 78 NY2d 371, 377 [1991]). When viewing the communication as a whole, as long as it is "primarily or predominately of legal character" the privilege remains, even if it communication refers to non-privileged information (*Rossi, supra,* 73 NY2d at 593).

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[37]CPLR 4503(a) provides

> an attorney or his or her employee, or any person who obtains without the knowledge of a client evidence of a confidential communication made between the attorney or his or her employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication nor shall the client be compelled to disclose such communication.

The privilege must include all persons who act as the attorney's agents (*U.S. v Kovel*, 296 F2d 918, 921 [2d Cir 1961], *citing* 8 Wigmore, Evidence, § 2301). "[P]rivilege covers communications to non-lawyer employees with 'a menial or ministerial responsibility that involves relating communications to an attorney'" (*Kovel*, 296 F2d at 921). It is well settled that disclosure of an attorney-client communication to a third party or communications with an attorney in the presence of a third party, not an agent or an employee of counsel, vitiates the confidentiality required for asserting the privilege (*Doe v Poe*, 92 NY2d 864 [1998]; *Aetna Cas. & Sur. Co. v Certain Underwriters at Lloyd's, London*, 176 Misc 2d 605, 610 [Sup Ct NY County 1998], *affd* 263 AD2d 367 [1st Dept 1999], *lv dismissed* 94 NY2d 875 [2000]).

In *Charter One Bank, F.S.B. v Midtown Rochester L.L.C.* (191 Misc 2d 154 [Sup Ct Monroe County 2002]), the court recognized the existence of a privilege with respect to communications between corporate employees and corporate counsel, since the purpose of the communication was to facilitate legal advice. There, the court stated that whether something is a protected legal communication or an unprotected business communication depends whether the communication was between counsel and client, whether it was intended to be and was kept confidential, and whether it was made to assist in obtaining or providing legal advice or service to the client (*Charter One Bank F.S.B.*, 191 Misc 2d at 166).

Here, the vast majority of the communications on the privilege log are either communications directly between Castle's in-house counsel, Mr. Meadvin, and his client (Castle Oil through its executives) or communication between Castle Oil and outside counsel concerning legal advice on varied issues.

The Court does not agree with the underlying predicate for the waiver argument asserted by Petitioners and Third Party Petitioners. The fact that Holland & Knight may have been representing the interests of the Controlling Shareholders and Castle Oil at the same time does not mean Castle Oil's disclosure of these privileged documents to Holland & Knight was a disclosure to a third party based on their representation of the Controlling Shareholders. It is true that unless a joint defense privilege exists, the production of documents to counsel for a co-defendant waives the privilege of the documents produced. However, here, while the Court has not been apprised of a formal retention of Holland & Knight on behalf of the Controlling Shareholders, from the outset of this case, for all intents and purposes, Holland & Knight was representing the interests of Castle Oil and the Controlling Shareholders throughout the duration of this case, as movants themselves have at least impliedly acknowledged through their assertions that the Controlling Shareholders have been the real parties in interest in the dissolution proceeding. As there is authority from the Appellate Division, First Department, that such dual representation in a similar factual scenario is acceptable provided there is a knowing waiver of any conflict of interest (*Ferolito v Vultaggio*, 99 AD3d 19, 28 [1st Dept 2012]), the Court concludes that the production of these documents to Holland & Knight should not result in any waiver since

at the time, Holland & Knight was representing both Castle Oil and the Controlling Shareholders so there was no disclosure to a third party.

Accordingly, this branch of Third Party Petitioners' motion and Petitioners' cross motion shall be denied.

The Court now addresses Third Party Petitioners' and Petitioners' alternative argument – that the documents must be turned over based on the fiduciary exception set forth in *Garner v Wolfinburger* (430 F2d 1093 [5th Cir 1970], *cert denied* 401 US 974 [1971]). In *Garner*, the United States Court of Appeals for the Fifth Circuit

> held that a corporation's right to assert the attorney-client privilege against its shareholders, in a shareholder derivative action where the corporation is in suit against its stockholders on charges of acting "inimically to stockholders interests," is "subject to the right of stockholders to show why it should not be invoked in the particular instance" ... The court reasoned that management and shareholders had a "mutuality of interest" in management's "freely seeking advice when needed and putting it to use when received," and that management did not manage for itself: "the beneficiaries of its actions are the stockholders" .... Thus, "management judgment must stand on its merits and not behind an ironclad veil of secrecy which under the circumstances preserves it from being questioned by those for whom it is, at least, in part exercised" ... The Court remanded the case to the district court for a finding of whether there was good faith reason to prevent the invocation of the privilege (*Stenovich v Wachtell, Lipton, Rosen & Katz*, 195 Misc 2d 99, 111 [Sup Ct NY County 2003], *quoting Garner*, 430 F2d at 1103-1104).

New York courts have recognized the fiduciary exception under the rationale that "when a trustee obtains legal advice concerning matters impacting upon the interests of the beneficiaries seeking disclosure ... that ... 'fiduciary has a duty of disclosure to the beneficiaries ... directly affected by the advice sought ...'" (*Delta Fin. Corp. v Morrison*, 12 Misc 3d 807, 811 [Supt Ct Nassau County 2006], *quoting Hoopes v Carota*, 142 AD2d 906, 910-911 [3d Dept 1988], *affd* 74 NY2d 716 [1989]). However, as noted by Hon. Kenneth Fisher, J.S.C., while the application of *Garner* is unsettled in New York, the New York authorities at least "agree that *Garner* should not be applied when the plaintiff is 'in a[n] adversary relation' with the corporation's current

management'" (*Nunan, supra*, 2006 NY Slip Op 50188[U] * 7, *citing Beck v Manufacturers Hanover Trust Co.*, 218 AD2d 1, 17-18 [1st Dept 1995]; *Hoopes, supra*, 142 AD2d at 910-911). Thus, "[i]n order for the plaintiffs to take advantage of the fiduciary exception, the documents which they seek must have been created while they had 'mutuality of interest' with the LLC ... 'Because the exception is premised upon common purpose and common interest, once those purposes and interests diverge, the exception no longer applies'" (*Delta Fin. Corp.*, 12 Misc 3d at 430, *quoting Metropolitan Bank & Trust Co. v Dovenmuehle Mtge. Inc.*, 2001 WL 1671445 at 3-4 [Del Ch Ct 2001]). Thus, mutuality of interest will "'be found to have lapsed ... [when a] director can reasonably anticipate litigation about an identified dispute'" (*id.*).

Even where the fiduciary exception applies, the party seeking the disclosure must establish good cause for the turnover of the documents. Factors to be considered in determining good cause include:

> the number of shareholders and the percentage of stock they represent; the bona fides of the shareholders; the nature of the shareholders' claim and whether it is obviously colorable; the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources; whether, if the shareholders' claim is of wrongful action by the corporation, it is action of criminal, or illegal but not criminal, or of doubtful legality; whether the communication related to past or to prospective actions; whether the communication is of advice concerning the litigation itself; the extent to which the communication is identified versus the extent to which the shareholders are blindly fishing; the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons (*Fausek v White*, 965 F2d 126, 130 [6th Cir 1992], *cert denied* 506 US 1034 [1992]).

Based on the foregoing, the Court concludes that the Controlling Shareholders have established that these documents are protected by the attorney client privilege. Further, the Court also concludes that Third Party Petitioners and Petitioners have not established either that there was a mutuality of interest at the time these documents were created or that good cause exists for their production, the two requirements under *Garner*. Indeed, the predicate for *Garner* is not as evident in a case such as this where the minority shareholders have brought direct claims as well, for dissolution and for breach of fiduciary duty, since those claims do not stand to benefit Castile Oil, unlike, theoretically, the derivative claims (*see, e.g., Beck v Manufacturers Hanover Trust Co.*, 218 AD2d 1 [1st Dept 1995]; *Milroy v Hanson*, 875 F Supp 646, 651

[D Neb 1996]).

Accordingly, the movants' motion to compel the production of documents contained on Castle Oil's privilege log is denied, with leave to renew at a future date after counsel have complied with this Court's rules and the Commercial Division Rules regarding disclosure motions and after discovery is otherwise completed so that the Court may ascertain when mutuality of interest existed and whether good cause exists for some or all these documents disclosure under the fiduciary exception to the attorney client privilege.

CONCLUSION

The Court has considered the following papers in connection with these motions:

Motion Seq. #s 2, 4 & 8

1) Notice of Motion dated July 24, 2012; Affirmation of Thomas E. Thornhill, Esq. dated July 24, 2012, together with the exhibits annexed thereto;

2) Memorandum of Law in Support of Third Party Petitioners' Motion to Enjoin Payment, Claw Back Legal Fees, and to Compel Disclosure July 24, 2012;

3) Notice of Petitioners' Cross-Motion Joining Third-Party Petitioners' Motion to Enjoin Payment, Claw Back Legal Fees and Compel Disclosure, and for Production of Enterprise Valuations dated August 14, 2012, together with the exhibits annexed thereto;

4) Petitioners' Memorandum of Law in Support of Cross-Motion Joining Seq. #2 and For Production of Enterprise Valuations dated August 14, 2012;

5) Notice of Motion dated August 1, 2012; Affirmation of Thomas E. Thornhill, Esq. dated August 1, 2012 together with the exhibits annexed thereto;

6) Memorandum of Law in Support of Motion to Strike Answer and for a Protective Order dated August 1, 2012;

7) Affirmation of Robert J. Burns, Esq. in Support of Majority Voting Shareholders' Omnibus Opposition to Third Party Petitioners' Motions to Enjoin Payment, Claw Back Legal Fees, Compel Disclosure, Strike Answer, and for a Protective Order, together with the exhibits annexed thereto;

8) Omnibus Memorandum of Law of Majority Shareholders in Opposition to Third Party Petitioners' Motion to Enjoin Payment, Claw Back Legal Fees, Compel Disclosure, Strike Castle's Answer and for a Protective Order dated August 9, 2012;

9) Affirmation of Benjamin R. Wilson in Support of Majority Voting Shareholders' Opposition to Petitioners' "Cross-Motion" Joining Motion Seq. No. 2 and For Production of Enterprise Valuations dated August 16, 2012 together with the exhibits annexed thereto;

10) Memorandum of Law of Majority Voting Shareholders in Opposition to Petitioners' "Cross-Motion" Joining Motion Sequence No. 2 and For Production of Enterprise Valuations;

11) Third Party Petitioners' Reply Memorandum of Law in Support of Motion to Enjoin Payment, Claw Back Legal Fees, and to Compel Disclosure dated August 16, 2012;

12) Third Party Petitioners' Reply Memorandum of Law in Support of Motion to Strike Answer and For a Protective Order dated August 16, 2012; and

13) Resolution Adopted by Written Consent of the Board of Directors of Castle Oil Corporation dated November 1, 1993 provided to the Court at the Conference held on July 19, 2012 and referred to in the Petitioner' and Third Party Petitioners' memoranda of law;

Motion Seq. # 9

1) Notice of Motion dated August 23, 2012; Affirmation of Thomas E. Thornhill, Esq. in Support of Third Party Petitioners' Motion for Default Judgment dated August 23, 2012 together with the exhibits

annexed thereto;

2) Memorandum of Law in Support of Third Party Petitioners' Motion for Default Judgment dated August 23, 2012; and

3) Majority Voting Shareholders' Memorandum in Opposition to Third Party Petitioners' Motion for Default Judgment dated August 29, 2012.

Accordingly, for the reasons stated and based upon the papers aforesaid, it is hereby

ORDERED that the Court's prior oral bifurcation directive which bifurcated the dissolution claims from the direct and derivative claims and cross claims is hereby vacated and all claims and cross claims in this action are hereby reunited for purposes of discovery and trial and any respondent who has not yet submitted an answer to the Amended Verified Petition and the Verified Answer and Cross Claims shall do so within 30 days of the date of this Decision and Order; and it is further

ORDERED that the branches of the motion (Seq. # 2) made on behalf of Third Party Petitioners for an order (1) enjoining the payment of legal fees by Castle Oil, Inc. on behalf of the Controlling Shareholders (as defined in this Decision and Order); (2) clawing back on behalf of Castle Oil, Inc. the attorneys' fees paid to date to Holland & Knight, LLP on behalf of the Controlling Shareholders, which motion was joined by Petitioners in their cross-motion (Seq. # 8), are denied as academic, without prejudice to this shifting of the responsibility for the payment of such fees onto the Controlling Shareholders at the time of the final disposition of this action and upon condition that the Controlling Shareholders' submit evidence that they have provided an undertaking to Castle Oil, Inc. in accordance with the requirements of BCL § 723(c) within 10 days of the date of this Decision and Order, and Third Party Petitioners and Petitioners are granted leave to renew their motion and cross-motion, if they be so advised, by motion made within 10 days of the submission of evidence by the Controlling Shareholders; and it is further

ORDERED that the branches of the motion (Seq. # 2) and cross motion (Seq. # 8) made on behalf of Petitioners and Third Party Petitioners for an order compelling the production of documents contained on the privilege document log of Castle Oil, Inc. are denied without prejudice as set forth more fully in this Decision and Order; and it is further

ORDERED that the branch of the cross motion (Seq. # 8) made on behalf of Petitioners for an order compelling the production of the Enterprise Valuations are denied, without prejudice, and with leave to counsel for Petitioners to serve a discovery subpoena *duces tecum* on Merrill Lynch (or its successor in interest) seeking the production of the Enterprise Valuation; and it is further

ORDERED that the motion (Seq. # 4) made on behalf of Third Party Petitioners for an order: (1) striking the answers of Castle Oil, Inc.; and (2) precluding Castle Oil, Inc. from requesting any further disclosure in this action, are denied, except that the branch of the motion as seeks to strike the answers of Castle Oil Co., Inc. is denied as academic, on condition that Castle Oil, Inc. serve an amended answer within twenty (20) days of this Decision and Order; and it is further

ORDERED that the motion (Seq. # 9) by Third Party Petitioners for a default judgment is denied; and it is further

ORDERED that counsel shall appear for a conference in this matter on January 11, 2013 at 9:30 a.m., the purpose of which is to discuss a schedule for the remaining discovery to be had in this action and other matters of procedure, which conference shall not be adjourned without the prior written consent of this Court.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, New York
December 7, 2012

E N T E R:

ALAN D. SCHEINKMAN
Justice of the Supreme Court

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