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SUPREME COURT-STATE OF NEW YORK
SHORT FORM ORDER
Present:

HON. TIMOTHY S. DRISCOLL
Justice Supreme Court

STEVEN KOENIG, on Behalf of Himself as a Director, and as a Shareholder of MEL SOBEL MICROSCOPES LTD,	**TRIAL/IAS PART: 22** **NASSAU COUNTY**
Plaintiff,	**Index No: 021401-09** **Motion Seq. Nos: 1 & 3** **Submission Date: 2/8/10**
-against-	
FRED KOENIG, OSSNAT KOENIG, BETTY KERET, NEW YORK MICROSCOPE COMPANY, INC., DENNIX, INC., WARD WOLFF and MEL SOBEL MICROSCOPES LTD,	
Defendants.	

Papers Read on these Motions

Notice of Motion, Affirmation in Support and Exhibits.....x
Memorandum of Law in Support of Wolff Motion.....x
Notice of Motion, Affidavit of D. Hujic,
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Affirmation in Opposition to Dennix Motion,
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Affirmation in Opposition to Wolff Motion,
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This matter is before the court on the motions 1) filed by Defendant Ward Wolff ("Wolff") on December 1, 2009, and 2) filed by Defendant Dennix, Inc. ("Dennix") on January 7, 2010, both of which were submitted on February 8, 2010. For the reasons set forth

below, the Court denies the motions in their entirety.

BACKGROUND

A. Relief Sought

Wolff moves for an Order, pursuant to CPLR § 3211(a)(7), dismissing the claims in the verified complaint ("Complaint") against him.

Dennix moves for an Order, 1) pursuant to CPLR §§ 3211(a)(1), (3) and (7), [1] dismissing the fifth cause of action in the Complaint against Dennix; and 2) imposing sanctions against Plaintiff for his allegedly frivolous conduct. Wolff submits an Affirmation in Support of Dennix' motion in which he submits that the arguments propounded by Dennix are equally applicable to Wolff's motion.

Plaintiff opposes the motions.

B. The Parties' History

This is a shareholder derivative action for conversion and breach of fiduciary duty. Plaintiff Steven Koenig ("Steven") owns 50% of the voting shares of Mel Sobel Microscopes Ltd. ("Company"). Defendant Fred Koenig ("Fred"), Steven's brother, owns the other 50% of the voting shares. Defendant Ossnat Koenig ("Ossnat"), Fred's wife, maintains the Company's financial records. Defendant Wolff is the Company's accountant.

The Company was originally in the business of servicing and repairing microscopes. Around 1995, the company became a wholesale and retail distributor of microscopes. The repair business has represented a smaller portion of the Company's sales since that time. In 1998, the Company launched a website and began conducting business over the internet. The Company also developed a used microscope business in which it purchased used equipment on the internet auction site e-Bay, refurbished the microscopes, and then resold them through the Company's website.

Steven alleges that in early 2009 he discovered that Fred or Ossnat had electronically transferred large sums of company money to Bank of America and American Express to make

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[1] The Court gleans that Dennix' reference to CPLR § 3211(a)(2), which relates to dismissal for lack of subject matter jurisdiction, was erroneous and that Dennis intended to refer to CPLR § 3211(a)(3) with respect to Plaintiff's alleged lack of standing/legal capacity to sue.

payments on Ossnat's personal credit card accounts. Steven also alleges that the Company's books and records were being kept at Fred's home, in violation of the terms of a shareholder agreement.

On July 28, 2009, Fred commenced a proceeding for judicial dissolution ("Dissolution Proceeding") of the Company on the ground of shareholder deadlock pursuant to Business Corporation Law ("BCL") § 1104(a)(3). By Amended Order to Show Cause dated the same date (Ex. B to Wolff motion), Fred requested that a temporary Receiver be appointed for the Company. Pursuant to a stipulation ("Stipulation") dated September 15, 2009, Steven and Fred agreed to the appointment of a receiver of the Company's property and to proceed with the Dissolution. By Order dated October 8, 2009 ("Appointment Order") (Ex. B to Dennix motion), the Court appointed Michael Cardello as temporary Receiver ("Receiver") of the Company. In addition to the powers granted by Business Corporation Law § 1206(b), the Appointment Order authorized the Receiver to "conduct an audit of all withdrawals and electronic transfers [from] the corporation's operating account and all other business activities that occurred after the dissolution process began on September 16, 2009, and based on such audit, to take any action [he] deems necessary to preserve, protect or recover the corporation's assets[.]"

Plaintiff commenced this action on October 27, 2009. In the Complaint, Plaintiff alleges that, one day after the execution of the Stipulation, Fred formed a new corporation, Defendant New York Microscope Company, Inc. ("New York Microscope"). Plaintiff alleges that Fred transferred the Company's assets including its customer list, website, and other intangible property to New York Microscope. Plaintiff alleges that Dennix, an integrated technology company, assisted Fred in appropriating the Company's website and other property.

In the first cause of action, Plaintiff alleges that Fred and Ossnat converted Company funds to pay their personal expenses. The motion papers address Fred and Ossnat's use of credit cards that they used, in part, to pay for the Company's advertising on the Google website. According to Plaintiff's forensic accountant, David S. Marcus ("Marcus"), Fred and Ossnat also used the credit cards to charge over $1 million in personal expenses during the period January 2005 through August 2009. Marcus concludes that the over one-million dollars in credit card charges on the Company's operating account "appears to be solely for the personal expenses of

[Fred] and his family, inasmuch as no documentation has ever been provided to support that any credit card charge was an ordinary and necessary business expense" (Marcus Aff. in Opp. to Wolff motion at ¶ 11). Plaintiff also alleges that the electronic transfers to the credit card companies violated a provision in the shareholder agreement that all withdrawals from the company bank account would be by "check made in the name of the corporation" (Ex. A to Complaint at ¶ 5(b)).

In the second cause of action, Plaintiff alleges that Fred, Ossnat, and Ossnat's mother, Defendant Betty Keret ("Betty"), converted Company funds by issuing paychecks to Betty although she performed little or no work for the Company. Plaintiff alleges that Betty paid a portion of the funds over to Fred and Ossnat and that Wolff aided and abetted the fraudulent scheme.

In the third cause of action, Plaintiff alleges that Fred fraudulently induced Steven to lend $125,000 to the Company by falsely representing that the Company needed money for working capital. Plaintiff alleges that Fred and Ossnat used most of the proceeds of the loan to pay personal expenses. In the fourth cause of action, Plaintiff alleges that Fred breached his fiduciary duty to Steven by using Company funds for personal expenses and fraudulently inducing Steven to lend money to the Company.

In the fifth cause of action, Plaintiff alleges that Dennix aided and abetted Fred in converting the Company's assets, including its website and e-mails, to New York Microscopes. Plaintiff submits a domain name registration report (Ex. 5 to Reddola Aff. in Opp. to Dennix motion) reflecting that New York Microscope maintains a website whose domain name is nyscopes.com and whose administrator is Dzeni Hujic, the president of Dennix. The report reflects that the website was created on September 26, 2009.

In the sixth cause of action, Plaintiff alleges that Wolff aided and abetted Fred in converting Company funds and breaching his fiduciary duties to the Company and to Steven. Plaintiff alleges that Wolff was aware of this conversion because he prepared the Company's tax returns and regularly reviewed the Company's bank statements and books and records. In the seventh cause of action, Plaintiff seeks an accounting of the assets of the Company from Fred, Ossnat, and New York Microscope.

Plaintiff purports to sue on his own behalf and also as a shareholder on behalf of the Company. Plaintiff alleges that a demand upon Fred to bring this action would have been futile because Fred participated in the wrongful acts that form the basis of the derivative claims.

C. The Parties' Positions

Wolff moves to dismiss the Complaint for failure to state a cause of action pursuant to CPLR § 3211(a)(7). Wolff argues that the allegations of the Complaint are conclusory. Wolff also asserts that Plaintiff has not alleged facts from which it may be inferred that Wolff had knowledge of the conversion or substantially assisted Fred in converting funds or breaching his fiduciary duty. Defendant Wolff further moves to dismiss the Complaint for lack of standing on the ground that Plaintiff failed to make a demand upon the Receiver to sue the Company.

Dennix moves to dismiss the Complaint on the grounds of a defense founded upon documentary evidence, lack of capacity, and failure to state a cause of action. Dennix provides an invoice ("Invoice") on Dennix letterhead dated July 2, 2009 (Ex. A to Hujic Aff.) reflecting total charges of $40,732.50 for services that Dennix provided to the Company. Those services included the creation of the Company's website and migration and configuration of database records. The Invoice shows an unpaid balance of $35,732.50. Under the words "Conditions of Sale," the Invoice contains language including the following: "Ownership of all products is retained by [Dennix] until this invoice is paid in full." Dennix argues that because the Company did not pay the Invoice in full, it "never owned or had possessory dominion over the subject literary property and has no right of action for conversion against [Dennix] or [Fred and his family] for conversion" (Aff. in Support of Dennix motion at ¶ 9). Additionally, Dennix argues that Plaintiff lacks standing to bring this action because he does not allege that he made a demand upon the Receiver.

RULING OF THE COURT

A. Dismissal Standards

A complaint may be dismissed based upon documentary evidence pursuant to CPLR § 3211(a)(1) only if the factual allegations contained therein are definitively contradicted by the evidence submitted or a defense is conclusively established thereby. *Yew Prospect, LLC v. Szulman*, 305 A.D.2d 588 (2d Dept. 2003); *Sta-Bright Services, Inc. v. Sutton*, 17 A.D.3d 570

(2d Dept. 2005).

CPLR § 3211(a)(7) provides that a party may move for judgment dismissing one or more causes of action asserted against him on the grounds that the pleading fails to state a cause of action. It is well-settled that the Court must deny a motion pursuant to CPLR § 3211(a)(7) if the factual allegations contained in the Complaint constitute a cause of action cognizable at law. *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268 (1977); *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144 (2002). When entertaining such an application, the Court must liberally construe the pleading, accept the facts alleged as true and accord to the Plaintiff every favorable inference which may be drawn from the pleadings. *Leon v Martinez*, 84 N.Y.2d 83 (1994).

B. Derivative Suits

When a shareholder brings a derivative suit on behalf of a corporation, the Complaint must set forth with particularity plaintiff's demand upon the board of directors to bring the action, or the reasons that a demand would have been futile. BCL § 626(c); *Bansbach v. Zinn*, 1 N.Y.3d 1, 8 (2003). Shareholder derivative suits are not favored because they ask courts to second-guess the business judgment of the individuals charged with managing the company. *Id.* On the other hand, derivative actions protect minority shareholders against officers and directors who place other interests ahead of the corporation. *Id.* Thus, a demand is futile when the complaint alleges with particularity that 1) a majority of the board of directors is interested in the challenged transaction; 2) the board members did not fully inform themselves about the challenged transaction to the extent reasonably appropriate in the circumstances; or 3) the transaction was so egregious on its face that it could not have been the product of sound business judgment. *Bansbach*, 1 N.Y.3d at 9.

There is significant hornbook jurisprudence regarding the appropriateness of a derivative action when the Court has appointed a receiver:

> A stockholder is entitled to bring an action in behalf of a corporation notwithstanding the fact that a receiver has been appointed for the corporation. However, it is generally held that the action cannot be maintained without the permission of the court which appointed the receiver. Moreover, before bringing an action in the right of, or for the benefit of, the corporation in receivership, the stockholder must show a demand upon the receiver to bring the action, unless the circumstances were such that a demand

would have been futile.

20 Carmody-Wait 2d § 121:166 (2005)

Unless a demand would have been futile, the better practice is for the stockholder to make a demand upon the receiver to bring suit and then move for leave to bring suit, on notice to the receiver. *See Craig v James*, 71 A.D. 238 (1st Dept. 1902) (plaintiff, as a stockholder, would be invested with cause of action on failure of receivers to bring action to redress wrong alleged in complaint).

In this case, Plaintiff has not demonstrated that a demand upon the Receiver would have been futile. The court notes, however, that Defendants have not served their motions to dismiss upon the Receiver or offered any evidence that the Receiver would have a legally cognizable objection to Plaintiff's bringing this action. The Court concludes, under all the circumstances, that demand and notice to the Receiver is unnecessary. Accordingly, the Court denies the motions of Defendants Wolff and Dennix motions to dismiss the Complaint for lack of capacity.

C. Applicable Causes of Action

A cause of action for aiding and abetting a breach of fiduciary duty requires a showing of a fiduciary duty owed to plaintiff by another, a breach of that duty, defendant's substantial assistance in effecting the breach, together with resulting damages. *Keystone Int'l v. Suzuki*, 57 A.D.3d 205, 208 (1st Dept. 2008). Although a plaintiff is not required to allege that the aider and abettor had an intent to harm, there must be an allegation that the defendant had actual knowledge of the breach of duty. *Kaufman v. Cohen*, 307 A.D.2d 113, 125 (1st Dept. 2003). Constructive knowledge of the breach of fiduciary duty by another is legally insufficient to impose aiding and abetting liability. *Id.*

Wolff argues that he did not provide substantial assistance to Fred in breaching his fiduciary duty because he did not have knowledge that Fred and Ossnat were using Company funds to pay personal expenses. In his Affidavit in Opposition, Marcus affirms, *inter alia*, that 1) Wolff did not prepare a complete or accurate tax return from the books and records of the Company; 2) Wolff wrote up cash receipts and cash disbursement books, and reconciled bank accounts, in a way that misclassified personal expenses and helped conceal wrongful distributions to Fred; and 3) it would have been impossible for Wolff, as the accountant responsible for reconciling the records of and filing the tax returns for the Company, not to notice

a dramatic increase in purchases and promotional expenses unless Fred told him to classify his family's personal expenses as purchases and promotional expenses of the Company. Giving Plaintiff the benefit of every possible favorable inference, the court must assume that Wolff had actual knowledge that Fred and Ossnat were converting Company funds to pay personal expenses.

On the other hand, if Wolff did not have actual knowledge that Fred and Ossnat were using company funds to pay personal expenses, he may be liable for accounting malpractice. A claim of malpractice requires proof that there was a departure from the accepted standards of practice and that the departure was a proximate cause of the injury. *Kristina Denise Enterprises v. Arnold*, 41 A.D.3d 788 (2d Dept. 2007). On this motion to dismiss, the Court must assume that a reasonably prudent accountant would have determined that the personal expenses of a 50% shareholder and his wife were not properly chargeable to the Company. As the sixth cause of action states a claim for aiding and abetting breach of fiduciary duty or, alternatively, accounting malpractice, the Court denies Wolff's motion to dismiss the Complaint for failure to state a cause of action.

A conversion takes place when defendant, intentionally and without authority, assumes or exercises control over personal property belonging to someone else, interfering with that person's right of possession. *Colavito v. Organ Donor Network*, 8 N.Y.3d 43, 49-50 (2006). The two key elements of conversion are 1) plaintiff's possessory right or interest in the property, and 2) defendant's dominion over the property or interference with it, in derogation of plaintiff's rights. *Id* at 50. The original common law rule was that intangible property could not be the subject of a conversion action because there is no physical item than can be misappropriated. *Thyroff v. Nationwide Mut Ins. Co.*, 8 N.Y.3d 283, 289 (2007). Where, however, an intangible property right is merged into a document, such as a stock certificate, conversion will lie if defendant exercises dominion over the document representing the property interest. *Id.* at 292. Although electronically stored data is not "merged" into a written document, it is property subject to conversion because of the intrinsic value of the stored information and society's substantial reliance on this method of storing data. *Id.* at 291-92. Given the intrinsic value of information acquired through a website and society's reliance on the internet as a means of doing business, the Court holds that a website is also a form of intangible property subject to a

conversion claim.

Dennix's Invoice states that it designed and implemented a "new website interface" for the Company as well as related pages for a "shopping cart experience." Giving Plaintiff the benefit of every possible favorable inference, the Court must assume that Dennix developed an interactive website, through which customers actually placed orders, as opposed to a merely passive website. The Invoice states that the website development included "migration and configuration of database records" and refers to Dennix having created an "administrative portion" to "facilitate order overview" on the "back end" of the website. Thus, the Court must further assume that Dennix used the administrative portion of the Company's website to divert orders to New York Microscope and misappropriate the Company's customer data. The Court concludes that Plaintiff has sufficiently alleged that Dennix provided substantial assistance to Fred in exercising dominion over the Company's website and other electronic property.

A purchaser who is not in default may sue the seller or secured party for conversion of his special interest in the property. *Becker v. Gardner*, 235 A.D. 91 (4th Dept 1932). As New York Microscope's website was created on September 26, 2009, after dissolution of the Company had already begun, the Court must assume that the misappropriation of the Company's orders and customer data occurred at that time. The Invoice contains a "payment date" of October 21, 2009. Thus, the Court must assume that the Company was not in default of its payment obligations at the time that Dennix assisted Fred in converting its website and customer data. Accordingly, the Court denies Dennix' motion to dismiss the Complaint based on a defense founded upon documentary evidence or failure to state a cause of action.

D. Sanctions are not Warranted

Conduct is frivolous if it is completely without merit in law and cannot be supported by a reasonable argument for an extension, modification or reversal of existing law. 22 NYCRR § 130-1.1(c)(1); *Carniol v. Carniol*, 288 A.D.2d 421 (2d Dept. 2001); *Baghaloo-White v. Allstate Ins. Co.*, 270 A.D.2d 296 (2d Dept. 2000); or if it was undertaken primarily to harass another litigant. 22 NYCRR § 130-1.1(c)(2); *Carniol v. Carniol, supra.* The Court concludes that Defendant has not established frivolous conduct by Plaintiff and denies Dennix' application for the imposition of sanctions.

Plaintiff is directed to serve a copy of this order upon the Receiver within ten (10) days of

the imposition of sanctions.

Plaintiff is directed to serve a copy of this order upon the Receiver within ten (10) days of the date of this Order.

All matters not decided herein are hereby denied.

This constitutes the decision and order of the Court.

The Court reminds all counsel of their required appearance before the Court on April 7 at 9:30 a.m.

ENTER

DATED: Mineola, NY
April 6, 2010

HON. TIMOTHY S. DRISCOLL
J.S.C.