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First Judicial Department

Preliminary Injunction Denied

New York County
IA Part 11

Justice Baer

* THE SEQUOR GROUP, INC., V. FINANCIAL CLEARING & SERVICES CORP.—Plaintiff moves for a preliminary injunction restraining defendants from making any transfer of any capital or assets of defendant Financial Clearing & Services Corp., ("FiCS") and for an attachment. FiCS provides wholesale clearing and execution services for institutional and retail securities broker-dealers. FiCS is a wholly-owned subsidiary of defendant Integrated Resources Life Insurance Company and the latter is a wholly-owned subsidiary of the defendant Integrated Resources, Inc. This last company is now in bankruptcy and proceedings as to it are accordingly stayed.

In February 1988, plaintiff sold the stock of FiCS to Integrated Life. As part of this transaction, FiCS undertook to pay rent to plaintiff pursuant to an operating lease agreement. Pursuant to a separate agreement, plaintiff assigned to FiCS a lease for office space and FiCS assumed all of plaintiff's obligations, with plaintiff remaining liable on the lease as guarantor. Integrated Life lent FiCS $20 million pursuant to a cash subordination agreement. Among other things, this agreement provided that FiCS's obligation to repay this loan would be subordinated to claims of other creditors. Thus plaintiff's claims under the lease agreement and office space assignment agreement are senior to any claim of Integrated Life for repayment of the subordinated loan.

When this motion was first brought on in December 1989 (it was adjourned a number of times until April 1990), Integrated Resources had not yet gone bankrupt, but its woes were great and apparent. Plaintiff claims that Integrated Resources and Integrated Life, in an effort to stave off the former's bankruptcy, have looked to FiCS as a source of liquidity. FiCS allegedly allowed the transfer of various of its accounts to another entity. Plaintiff claims that defendants effectively sold FiCS's assets by October 1989, which, plaintiff contends, constituted a liquidation or transfer of assets within the meaning of the operating lease agreement. Because plaintiff did not consent to the transfer of assets, FiCS, plaintiff contends, became obligated to pay over $2.5 million in rent. In addition, plaintiff asserts that it has an unmatured claim for $6.5 million, a sum plaintiff will owe as guarantor of the assignment agreement if FiCS abandons the office space, as plaintiff claims it has indicated its intention to do.

Plaintiff claims that FiCS plans to withdraw its capital and transfer it to the other defendants. This so-called proposed conveyance apparently was to have occurred by a sale of FiCS's assets to J.T. Moran and Co. In connection with this transaction, plaintiff asserts, FiCS would repay the $20 million subordinate loan without fair consideration. This would be in violation of plaintiff's rights as a senior creditor.

Plaintiff sues for breach of the lease agreement and demands over $2.5 million, and for a declaratory judgment that the proposed conveyance would violate plaintiff's rights as third party beneficiary of the subordination agreement and the Debtor and Creditor Law. Plaintiff also demands injunctive relief and an attachment.

Mr. Justice Martin Evans of this court granted plaintiff a temporary restraining order that (after modification) barred

defendants from repaying the subordinate loan, prevented FiCS from reducing its cash below the amount of $22.4 million and barred the transfer of the equipment covered by the lease agreement.

Plaintiff claims that recent events have made the need for a preliminary injunction and an attachment more pressing. Since the order to show cause was signed, Integrated Resources has gone bankrupt. So too, has Moran, a major source of business for FiCS, thereby worsening FiCS's financial posture. Clearly, plaintiff argues, FiCS is now insolvent and has essentially seized business. Therefore, plaintiff claims, the Proposed Conveyance is even more imminent. The staff of FiCS has been cut and FiCS desirous, plaintiff asserts, or reducing its cash to $15 million, which, but for the restraining order, it would have already done.

FICS responds that it has never defaulted in its obligation to pay rent on the leased space and insists that it has intention to do so. It asserts that it was and is solvent. FICS denies that the transfer of customer accounts constituted a transfer or a sale of assets so as to provide acceleration of payment obligations under the operating lease agreement. FICS states that these accounts are assets of the customers and are not listed as assets on FiCS's balance sheet. FiCS argues that the Proposed Convenience concerns a transaction with Moran and is therefore moot. FiCS contends that it has claims against plaintiff in excess of plaintiff's claims against it, which have now been asserted. As counter claims.

After argument, counsel for plaintiff submitted a copy of paper filed in the bankruptcy court on behalf of Integrated Resources. Those papers indicate that FiCS has been and is pursuing a program of liquidation and that its debts exceed its assets by more than $23 million because of the Moran failure and other losses. FiCS rejoined that those papers indicate at over $31 million of FiCS indebtedness constitutes a debt owed to Integrated Resources and affiliates that is subordinated to claims of all other creditors of FICS, including plaintiff, so that the $31 million can not be considered a liability for present purposes. FiCS also accuses plaintiff of ignoring the purpose of the bankruptcy motion—approval for Integrated Resources forgiveness of certain indebtedness and the extension of the maturity of other FiCS obligations, which, FiCS claims, would provide additional insurance for plaintiff's claim.

Under CPLR §6301, a preliminary injunction may be granted only if the movant meets the burden of establishing the existence of each of the three familiar elements: (1) that there is a likelihood of success on the merits; (2) that the movant will suffer irreparable injury in the absence of a preliminary injunction; and (3) that the balance of the equities tips in movant's favor. 7A Weinstein, H. Korn & A. Miller, New York Law Civil Practice ¶6301.13a (1989).

Plaintiff contends that the Proposed Conveyance would be a fraudulent conveyance within the meaning of the Debtor and Creditor Law §§273, 274 and 276. The last section requires intent to hinder, delay, or defraud present or future creditors; the other two sections do not. Insofar as the Proposed Conveyance described by plaintiff involved a "scheme and plan to withdraw capital from FiCS" for the benefit of the other defendants (Complaint, ¶122) by means of a sale of assets to Moran (Complaint, ¶135)) ,it has become moot because of the intervening bankruptcy of the unfortunate Moran. FiCS seems at places in its papers to suggest that this is the end of the matter. The Proposed Conveyance sketched by plaintiff (Complaint, ¶134) is not, however, simply co-extensive with a specific transaction involving Moran, but was intended to embrace any withdrawal of capital from FiCS and transfer thereof to the other defendants, perhaps through the device of the prepayment of the subordinated loan to Integrated Life.

A critical problem with plaintiff's demand for preliminary injunction concerns precisely this—the likelihood or imminence of the Proposed Conveyance. Plaintiff has fairly established by its last submission that FiCS is engaging in a liquidation. Integrated Resources acknowledges this and FiCS does not deny this now, though its earlier papers were noticeable reticent as regards the transfer of customer accounts and the sales of assets to Moran. However, a thoughtful liquidation is not the same as the Proposed Conveyance. Plaintiff's proof that FiCS intended to sell its assets and transfer resources to Integrated Life or Integrated Resources for inadequate consideration, including a prepayment of the subordinated loan, is scant. Plaintiff speaks of a "scheme and plan to withdraw capital from FiCS" but the skull-duggery that plaintiff implies is undemonstrated. Plaintiff refers to a number of steps suggestive of the liquidation, e.g. the transfer of customer accounts, the reduction in FiCS's clearing business, the reduction in FiCS's staff. These events, however, are not proof of the Proposed Conveyance. They are proof of a plan of liquidation, not of a "plan or scheme" aimed at "withdrawing capital for the benefit of Integrated Resources and Integrated Life." (Complaint ¶¶23, 24) Plaintiff's Chief Operating Officer, Sal Ricca, refers to a conversation in October 1989 with a FiCS official in which is was suggested that FiCS would transfer its assets to Integrated Life and/or Integrated Resources through a prepayment of the subordinated loan. Mr. Ricca

appears to have been given to understand that the prepayment would occur "in connection with" the proposed transaction with Moran (Ricca Aff'd ¶¶34-35) In addition to the fact that the Moran deal is defunct, Mr. Ricca does not indicated that he was told that this winding down was to occur in derogation of or without regard to the rights of FiCS's creditors, such as plaintiff. Plaintiff has not shown that FiCS plans to use the proceeds of its liquidation to avoid payments to its creditors, nor that it intends to pay the subordinated loans in violation of its obligation first to pay off entities like plaintiff, which obligation FiCS continues to acknowledge.

The bankruptcy of Integrated Resources subsequent to the signing of the order to show cause herein does not, as plaintiff contends, necessarily increase the need for injunctive relief. Previously, Integrated Resources was tottering on a precipice and its danger purportedly provided it a motive, in Mr. Ricca's words, "to look to FiCS as a source of liquidity…" (Aff'd, ¶21). Now, however, Integrated Resources has toppled over that precipice and the capital of FiCS cannot help it to avoid its fate. Since Integrated Resources lives now under the watchful eye of the bankruptcy court, the company is hardly in a position to be looting related companies, even if it had a motive to do so.

Plaintiff is understandably concerned about the lease of office space of which it is a guarantor. But plaintiff does not show that there is a likelihood or serious risk that FiCS will abandon the lease and leave it in the hands of the plaintiff. Plaintiff has not shown that FiCS's liquidation will proceed without efforts to dispose of the space and protect plaintiff. Most of plaintiff's claim (amounting to $6.5 million) is thus only "unmatured," or, to put it another way, purely hypothetical and uncertain. FiCS has never failed to make a payment on the least, through April 1990, the most recent date for which information is available. FiCS's officials on this motion insist that they will continue to make payment. These assertions on the FiCS track record alone must not be written off as worthless.

Indeed, during the long gestation of this motion prior to its argument on April 16, 1990, plaintiff and FiCS were engaged in a joint effort to resolve the entire problem. An initial attempt concerned a transaction of which Moran would have been part. After Moran's bankruptcy, plaintiff and FiCS entered into negotiations anew with other parties that would resolve the present controversy. These negotiations are in progress now. This is hardly a picture of a company intent upon defrauding its creditors for the benefit of an affiliated enterprise. Counsel for plaintiff no doubt would respond that consultation with plaintiff has been forced upon an unwilling and ne'er-do-well FiCS by the restraining order of my brother Justice Evans. In fact, though the record reveals that prior to entry of that order, FiCS was pursuing a similar course. FiCS's former president met with Mr. Ricca prior to commencement of this action, advised him of the contemplated sale of stock to Moran, indicated that the negotiations contemplated covering plaintiff's claims and that any sale would require plaintiff's approval and sought plaintiff's approval. Plaintiff in fact approved the transaction, which shortly thereafter had to be aborted by Moran's demise. Other officials of FiCS informed Mr. Ricca that the subordinated loan to Integrated Life would not be paid until plaintiff consented or steps were taken to satisfy FiCS's obligations to plaintiff and other creditors, as required by the loan itself. (McCann Aff'd., ¶¶8-14)

Plaintiff thus has not shown that the harm alleged—the Proposed Conveyance – is other than hypothetical. A preliminary injunction may not issue to protect against speculative contingencies. "An additional and persuasive factor to be considered is the presence of an immediate need, supported by a factual demonstration that acts are occurring or are threatened and fairly certain to occur. Speculation as to what *might* occur will not justify the grant of such a drastic remedy." (City of Yonkers v. Dyl & Dyl Development Corp., 67 Misc.2d 704, 325 N.Y.S.2d 206, 209 (Sup. Ct.), aff'd., 38 A.D.2d 691, 328 N.Y.S.2d 1023 (2d Dep't 1971) (citations omitted) (emphasis in original). See Atlantic Beach Property Owners' Association v. Nautilus Management Corp., 11 Misc.2d 262, 171 N.Y.s.2d 658 (Sup. Ct. 1958); Attinson v. Consumer-Farmer Milk Cooperative, Inc., 197 Misc. 336, 94 N.Y.S.2d 891, 893 (Sup. Ct. 1950).

The gravamen of this action clearly is money damages. In such actions, preliminary injunctive relief is not normally granted. 7A J. Weinstein, H. Korn & A. Miller, supra, ¶6301.10. Plaintiff's argument, though is that the straitened financial circumstances in which FiCS finds itself justify a preliminary injunction. In Rosenthal v. Rochester Button Co., 148 A.D.2d 375, 539 N.Y.S.2d 11, 13 (1st Dep't 1989), the Court rejected as unpersuasive the claim that defendants "are suffering or may suffer financial reverses pendent elite, and therefore may be unable to satisfy a subsequent judgment." The Court found that it had not been shown that the defendant would likely be unable to pay a future judgment. But the Court went on to say: "If such injunctive relief is granted on a simple showing that a defendant may at some future date be unable to pay a judgment, it would amount to a de facto judicial amendment of the requirements set forth in

CPLR §6201 for attachment of assets."

It is also worth noting that the court distinguished cases like Pando v. Fernandez , 124 A.D.2d 495, 508 N.Y.S.2d 8 (1st Dep't 1986), in which an injunction was granted by underscoring that at issue in such cases was a specific sum of money that was the subject of the action. The Rosenthal court emphasized that §6301 refers to acts in violation of a plaintiff's rights with respect to "the subject of the action." 539 N.Y.S.2d at 13. The sums that plaintiff here wishes to tie up are not the subject of the action; rather, plaintiff merely seeks any monies it can get its hands on as security in the event that a Proposed Conveyance should cause it to become liable on the lease of space.

An order of attachment is the more appropriate remedy in an action seeking primarily monetary relief. D. Siegel, New York Practice §327 (1978). In order to obtain an attachment, a plaintiff must show that the defendant has "assigned, disposed of, encumbered or secreted property, or removed it from the state or is about to do any of these acts…" CPLR §6201. In a lawsuit such as this, such conduct, however, must be engaged in by defendant "with intent to defraud his creditors or frustrate the enforcement of a judgment…" Id. In Rosenthal, the Court found insufficient the claim that the defendant's "financial condition has been rapidly deteriorating and that… [it] has disposed of assets located in New York and removed them from this state." 539 N.Y.S.2d at 12. In short, an attachment cannot be granted merely because a debtor has liquidated or disposed of assets; it must in addition by shown that in so acting the debtor was endeavoring to defraud its creditors. Eaton Factors Co. v. Double Eagle Corp., 17 A.D. 2d 135, 232 N.Y.S.2d 901 (1st Dep't 1962); Dickey v. Findeisen & Kropf Mfg. Co., 177 A.D. 861, 164 N.Y.S. 989 (1st Dep't 1917); Ladew v. Hudson River Boot & Shoe Mfg. Co., 15 N.Y.S. 900 (1st Dep't, 1981).

Plaintiff has, as indicated, shown that FiCS is in financial trouble. This is not sufficient either for an injunction or an attachment. FiCS has not been attempting to deceive or defraud its creditors. From all that appears, FiCS has been trying to pursue an orderly liquidation in 'an effort to reap the greatest possible compensation, with attention being paid to the concerns of plaintiff. Contrast Mishkin v. Kenney & Branisel, inc. 609 F. Supp. 1254 (S.D.N.Y.) (Weinfield, J.), aff'd., 779 F.2d 35 (2d Cir. 1985); Board of Education v. Treyall 86. A.D.2d 639, 446 N.Y.S.2d 417 (2d Dep't), appeal dismissed, 56 N.Y.2d 683, 803, motion for leave to appeal dismissed, 57 N.Y.2d 670 (1982).

Neither the precise financial condition of FiCS nor the effect of the current state of the economy on its business, should that be a relevant consideration, is known to this court; neither side has produced much detail on these questions. The most recent information presented is that FiCS's liabilities exceed assets by more than $23 million. However, $31 million of debt is subordinated to claims of other creditors such as plaintiff. But even If the solvency of FiCS is in doubt, plaintiff's claims under the Debtor & Creditor Law are problematic, rather than giving rise to a clear likelihood of success on the merits. Section 273 declares fraudulent any conveyance by a person who is or will thereby be rendered insolvent if the conveyance is made "without a fair consideration." Lack of fair consideration is also essential to a violation of Section 274. Plaintiff has not established that there is a likelihood of any Proposed Conveyance involving a transfer of assets for inadequate consideration. Section 276 requires intent to "hinder, delay, or defraud" creditors. As indicated, plaintiff has not established a likelihood that FiCS is proceeding with such intent. Should FiCS, despite its current protestations, engage in a Proposed Conveyance or other transfer in violation of the Debtor & Creditor Law, the conveyance will be subject to attack by plaintiff. FiCS is fully on notice of plaintiff's position, as no doubt any transferee will be. Neither FiCS nor any putative transferee is likely to wish to incur plaintiff's wrath and consequent legal entanglements by engaging in a fraudulent transfer.

Accordingly, the motion for a preliminary injunction is denied. The temporary restraining order will continue for two business days to permit plaintiff to seek relief from a higher authority. This constitutes the decision and order of this court.

Richard A. Roth, of Littman Krooks & Roth, was counsel for the Plaintiff.