

Brio Capital, L.P. v Sanswire Corp.
2013 NY Slip Op 31067(U)
May 9, 2013
Supreme Court, New York County
Docket Number: 650830/2011
Judge: Marcy S. Friedman
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: MARCY S. FRIEDMAN
Justice

PART 60

BRIO CAPITAL, L.P.,

Plaintiff,

INDEX NO. 650830/2011

-against-

MOTION DATE _____

SANSWIRE CORP., et al.,

Defendants.

MOTION SEQ. NO. 003

The following papers, numbered 1 to _____ were read on this joint motion for approval of a settlement agreement.

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ... No (s). _____

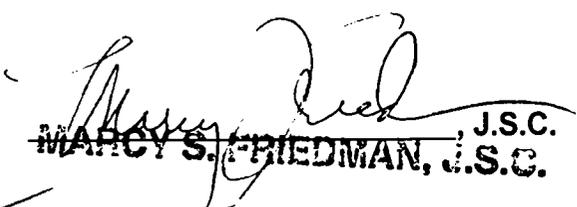
Answering Affidavits — Exhibits _____ No (s). _____

Replying Affidavits _____ No (s). _____

Cross-Motion: Yes No

Upon the foregoing papers,

It is ordered that this motion is decided in accordance with the accompanying decision/order dated May 9, 2013.

Dated: 5-9-13  J.S.C.
MARCY S. FRIEDMAN, J.S.C.

- 1. Check one: CASE DISPOSED NON-FINAL DISPOSITION
- 2. Check as appropriate:.....Motion is: GRANTED DENIED GRANTED IN PART [] OTHER
- 3. Check if appropriate:..... SETTLE ORDER SUBMIT ORDER
- DO NOT POST FIDUCIARY APPOINTMENT REFERENCE

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: HON. MARCY FRIEDMAN, J.S.C.

_____ x
BRIO CAPITAL, L.P.,

Plaintiff,

Index No.: 650830/2011
Motion Seq. 003

- against -

DECISION/ORDER

SANSWIRE CORP. f/k/a/ GLOBETEL
COMMUNICATIONS CORP., GLENN D.
ESTRELLA, and DOES 1 through 50, inclusive,

Defendants.

_____ x

This is an action brought by plaintiff Brio Capital, L.P. (Brio) against defendant Sanswire Corp. (Sanswire), now known as World Surveillance Group, Inc. and defendant Glenn Estrella, its Chief Executive Officer (collectively WSGI), alleging defendants’ breach of contractual obligations and fiduciary duties for failure to comply with Brio’s warrant exercise demands. (Compl., ¶ 1.) The parties now jointly move for approval “as fair” of the terms of a settlement of this action, pursuant to section 3(a)(10) of the Securities Act of 1933. (15 USC § 77c[a][10].)

By order dated December 21, 2011, this Court (Fried, J., now retired) granted Brio summary judgment on its first cause of action for declaratory relief, holding that Sanswire was contractually obligated to honor Brio’s Notice of Exercise of certain warrants dated November 17, 2010, and to issue the shares requested therein. It is undisputed that on January 28, 2012 WSGI issued 6,215,643 shares of WSGI stock to Brio and paid Brio’s attorney’s fees in a

stipulated amount. After issuance of the shares, WSGI sought an order of the court clarifying the December 21, 2011 order to provide that the issuance of stock and payment of attorney's fees satisfied any claim by Brio for damages on its first cause of action and, in particular, eliminated a claim for consequential damages based on WSGI's delay in issuing the shares. (See parties' letters to Justice Fried, both dated June 29, 2012.) By order dated July 12, 2012, the Court (Fried, J.) rejected WSGI's request and held that Brio's "damages claim in the first cause of action, is continued unless rendered moot by the value of the shares."

The parties subsequently reached a settlement of this action by agreement entered into as of December 31, 2012 (Agreement or Settlement Agreement). The Agreement provides for WSGI to issue to Brio's designee, Brio Capital Master Fund Ltd., shares of its common stock valued at \$375,000 and exempt from registration. The stock is to be issued in 12 monthly installments, with the number of shares issued each month to be calculated at \$31,250 (1/12 of \$375,000) divided by the price that is the average of the closing bid price of WSGI's common stock for the last three trading days of the month immediately preceding the month in which the shares are due to be issued. (Settlement Agreement, ¶ 3.) The Agreement contains a leakout provision for the protection of WSGI, restricting the amount of shares that Brio may sell on any given trading day. (Id., ¶ 4.) It also provides for a "Stipulated Judgment" for the protection of Brio in the amount of \$400,000 which will be returned or destroyed, and will not be filed in the event that WSGI complies with its obligations under the agreement, including its obligations under paragraph 3 to issue the shares with a value of \$375,000. (Id., ¶ 1[b], 2.) The Agreement is expressly made subject to the approval of the court. (Id., ¶ 1[c].)

In support of this motion for approval of the Settlement Agreement, Brio contends that

“because the stock price of WSGI’s shares declined substantially from the price that Brio would have been able to sell its shares at had they been timely delivered, and the price that Brio actually was able to sell its shares it following the January 28, 2012 issuance,” Brio is entitled to damages in an amount exceeding \$750,000. (Supp. Memo. In Support of Joint Motion [Supp. Memo.] at 2.) WSGI acknowledges that a substantial claim for money damages is bona fide, but disputes the amount of the claim. (Id. at 3.)

The Securities Act of 1933 (Securities Act) provides, in pertinent part, for the exemption from registration of:

“any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, . . . where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by an official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval.”

(15 USC § 77c[a][10].) As interpreted by Securities & Exchange Commission Staff Legal Bulletin No. 3A(CF), dated June 18, 2008 (SEC Staff Bulletin), this provision requires that the court or authorized governmental entity must “find, before approving the transaction, that the terms and conditions of the exchange are fair to those to whom securities will be issued”; that “[t]he fairness hearing must be open to everyone to whom securities would be issued in the proposed exchange”; and that “[a]dequate notice must be given to all those persons.”

As a threshold matter, the court holds that adequate notice of the hearing was given to plaintiff Brio Capital, L.P. Shaye Hirsch, Managing Member of Brio Capital Management LLC, the General Partner of plaintiff, has had notice of the hearing and has submitted affidavits in

support of the motion. (Hirsch Aff. In Support, ¶ 1.) Personal service upon any domestic or foreign limited partnership may be made by delivering a copy personally to a general partner of the limited partnership in this state. (CPLR 310-a.) As service on the general partner would be sufficient to confer personal jurisdiction, it is also sufficient to give “adequate notice” of the fairness hearing to the partnership.

The court cannot find, however, that adequate notice of the hearing was given to Brio Capital Master Fund Ltd. (Master Fund), plaintiff’s designee to which the shares were to be issued under the Settlement Agreement. The sole evidence as to notice to the designee is Mr. Hirsch’s statement that both entities – i.e., plaintiff Brio Capital, L.P. and Master Fund – “are managed by me.” (Hirsch Supp. Aff. In Support, ¶ 4.) He does not provide any information as to the structure or ownership of Master Fund or any authorized or designated agent for service of process or receipt of notice. Moreover, this entity is not a party to this action and has not received notice of the hearing in that capacity. Nor is it represented by counsel in connection with the hearing.

However, as Mr. Hirsch has represented that plaintiff Brio Capital, L.P. will stipulate to amend the Settlement Agreement to provide for issuance of the shares to it rather than Master Fund in the event the court does not approve the transfer to Master Fund (*id.*, ¶ 4), the court will address the remaining issues as to fairness of the settlement.

In determining the fairness of a settlement involving issuance of exempt shares under the Securities Act, the totality of the circumstances should be considered. According to the SEC Staff Bulletin, the court must make an affirmative finding that the exchange is fair to the shareholders (SEC Staff Bulletin § 4[B][1]), and the reviewing court “must have sufficient

information before it to determine the value of both the securities, claims or interests to be surrendered and the securities to be issued in the proposed transaction.” (Id., § 4[B][2] [internal quotation marks and footnote omitted]; see Matter of Board of Directors of Multicanal S.A., 340 BR 154,168 [SD NY 2006] [describing the SEC Staff Bulletin as “[t]he most authoritative description of the requirements of § 3[a][10].”].) In making such findings, factors to be considered include the extensiveness of the litigation to date, the likelihood of success on the merits of the claims and defenses, the availability of public information about the financial condition of the defendant, the ability to precisely value the stock at issue, and the costs of ongoing litigation. (See Matter of Trade Partners, Inc. Investor Litigation, 2008 WL 4911797 [WD Mich 2008]; Continental Assur. Co. v Macleod-Stedman, Inc., 694 F Supp 449 [ND Ill 1988].)

Here, the complaint was filed on March 28, 2011 and the parties litigated for nearly two years before settling the action. As noted above, the Settlement Agreement was not reached until after Brio brought a motion for summary judgment that resulted in a judgment as to liability against Sanswire. The parties then continued to litigate as to the scope of Brio’s damages claim based on WSGI’s delay in issuing the stock. (See supra at 2.) Indeed, Brio moved to punish WSGI for contempt after rendition of the December 21, 2011 order, based on WSGI’s delay in complying with the directive of that order to issue the shares. The settlement is thus recommended by counsel for plaintiff and defendants after vigorous, arms length litigation. Further, there is no evidence in the record to suggest that the litigation was collusive. On the contrary, the parties have attested that apart from the stock ownership by Brio in WSGI, there is no direct, indirect or other relationship between them. (See Hirsch Supp. Aff., ¶ 3; Aff. of Glenn

Estrella In Support of Joint Motion, ¶ 4.)

As to the likelihood of success on the merits, while Brio has a judgment in its favor as to liability, its claim for consequential damages of \$1,240,000, based on WSGI's delay in issuing the shares after Brio's exercise of the warrants, is wholly speculative. (See Hirsch Supp. Aff., ¶ 11.) Its claim for consequential damages of \$750,000, calculated using "[a] less aggressive" methodology (*id.*, ¶ 12), is also susceptible to challenge as speculative. In asserting an element of these damages for lost profits in the amount of \$411,000 (*id.*, ¶ 15), Brio contends that if the shares had been timely issued, it would have sold the shares in the same pattern as it sold the shares after they were ultimately issued in January 2012, and would have realized more profit. That contention is based on hindsight and unsupported by any showing that the post-January 2012 pattern was consistent with Brio's trading strategy at the time the shares should have been issued or that the market at such time would have supported sale of that additional number of shares by Brio. Brio also has not submitted any expert testimony as to the proper methodology for calculating damages as a result of the delay in issuing the shares. Under these circumstances, the court finds that the compromise amount of \$375,000 is reasonable and fair.

Brio also seeks as a major element of damages the costs of preparing for trial, including attorney's fees for which it claims WSGI would likely be required to indemnify it pursuant to the parties' Subscription Agreement, which provides for the "prevailing party" to recover attorney's fees and costs. (See Hirsch Supp. Aff., Ex. 1, ¶ 15[e].) The amount claimed for this item appears to be in the \$200,000 to \$300,000 range. (*Id.*, ¶ 8.) Substantial attorney's fees and expert fees would be incurred if the case were prepared for trial. However, Brio's status as a prevailing party may depend on whether it asserts damages claims on which it does not prevail. (See generally

Sykes v RFD Third Ave. I Assocs., LLC, 39 AD3d 279 [1st Dept 2007].) This element of damages is therefore uncertain.

As to the benefits of settlement, the Settlement Agreement provides for stock of a fixed value (\$375,000 over a 12 month period) to be issued to Brio, with the equivalent of a confession of judgment in the event stock of that value is not issued. Approval of the settlement therefore does not present any factual issues as to the proper valuation of the stock. In addition, as WSGI's stock is publicly traded, the price per share is readily ascertainable, assuring that Brio can verify compliance with the Settlement Agreement. In contrast, as discussed above, continued litigation would require Brio to incur substantial expense to prove damages claims that present problems of proof, and would delay recovery by Brio. Finally, the court cannot find that it was unreasonable for Brio to accept stock as an alternative to further litigation, given WSGI's assertion that it was in weak financial condition and Brio's ability to verify that claim from publicly available filings.

Taking into account the totality of the evidence, the court holds that exchange of Brio's claims for WSGI's shares, as set forth in the Settlement Agreement, is fair to Brio as the party to which the shares will be issued, and that the Settlement Agreement should be approved to the extent set forth in the ordering provision below. The court declines, however, to make a finding that the new shares are exempt from registration. Section 3(a)(10) does not require such a finding but, rather, requires the court's approval of the fairness of the exchange. "[A]n express determination as to the necessity for registration is more appropriately left for the SEC. . . ."

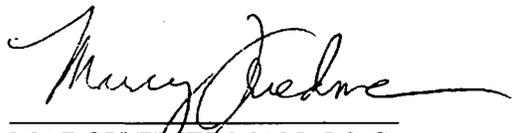
(Continental Assur. Co., 694 F Supp at 467.)

It is accordingly hereby ORDERED that the Settlement Agreement is approved, provided that: The shares that the Settlement Agreement requires to be issued shall issue to plaintiff Brio

Capital, L.P. rather than to its designee, and any required express finding that the shares are exempt from registration shall be made by the Securities & Exchange Commission.

This constitutes the decision and order of the court.

Dated: New York, New York
May 9, 2013



MARCY FRIEDMAN, J.S.C.