

**Bristol Investment Fund, Ltd. v Smartire Systems,
Inc.**

2005 NY Slip Op 30241(U)

December 23, 2005

Supreme Court, New York County

Docket Number: 0601442/2005

Judge: Richard B. Lowe

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

HON. RICHARD B. LOWE, III
PRESENT: Hon. LOWE
Justice

PART 56m

Bristol Investment Fund, LTD

INDEX NO. 601442105

MOTION DATE 5/5/05

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

- v -

Smartice Systems, Inc.

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE DATED: _____ J.S.C.

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

FILED
DEC 29 2005
COUNTY CLERKS OFFICE
NEW YORK

HON. RICHARD B. LOWE, III
[Signature]

Dated: 12/23/05

Check one: FINAL DISPOSITION

NON-FINAL DISPOSITION J.S.C.

SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: IAS PART 56

-----X
 BRISTOL INVESTMENT FUND, LTD.,

Plaintiff,

-against-

Index No.: 601442/05

SMARTIRE SYSTEMS, INC.,

Defendant.

-----X
HON. RICHARD B. LOWE, III:

In this action, plaintiff Bristol Investment Fund, Ltd. alleges that defendant SmarTire Systems, Inc. (SmarTire) defaulted on a convertible debenture, and that, based on the default and SmarTire's weak financial condition, plaintiff is entitled to a preliminary injunction directing defendant to issue to plaintiff 9,268,875 shares of defendant's common stock, providing that if plaintiff sells the shares, it places the proceeds in escrow pending the Court's determination of plaintiff's right to this distribution.

BACKGROUND

Plaintiff is an investment fund which purchased a convertible debenture from SmarTire, a Canadian company whose common stock is registered with the Securities and Exchange Commission (SEC), and whose shares trade in the over-the-counter market. Along with a group of other investors referred to in the motion papers as the "HPC Investors," on or about December 24, 2003, plaintiff purchased a convertible debenture maturing on April 1, 2006, in the principal amount of \$350,000 (the Debenture). The Debenture required SmarTire to make payments of principal on a monthly basis in the amount of \$14,583.33, in cash or stock, on the first day of each month. A key feature of the Debenture is the plaintiff's right to convert all or part of the

outstanding balance into shares of SmarTire common stock at an agreed conversion price, as adjusted from time to time (the Set Price).

Defendant failed to make the payment due August 1, 2004. Plaintiff contends that SmarTire defaulted in another respect, namely by failing to honor a notice of conversion dated August 20, 2004 in the principal amount of \$25,000, then entitling plaintiff to 500,000 shares of SmarTire's common stock within five trading days. Accordingly, in September 2004, plaintiff commenced an action against SmarTire in this Court under Index No. 602874/04 to enforce its rights under the Debenture. In order to resolve that action, the parties entered into a Forbearance and Escrow Agreement.

Pursuant to the terms of the Forbearance and Escrow Agreement, SmarTire was to register shares of its common stock with the SEC on or before January 1, 2005, to the extent necessary to have registered enough stock to meet its obligations on the debentures and warrants issued to plaintiff and the other HPC Investors. Section 1.3 of the Forbearance and Escrow Agreement states that, except as specifically amended by that agreement, the prior agreements between the parties, including the Debenture, shall remain unmodified and in full force and effect. Plaintiff alleges that SmarTire breached the terms of the Forbearance and Escrow Agreement by failing to register the necessary amount of common stock by January 1, 2005.

On March 23, 2005, SmarTire entered into a financing agreement with Cornell Capital Partners, L.P., pursuant to which SmarTire sold an aggregate of \$4,000,000 of its preferred stock. In conjunction with that financing, SmarTire issued preferred stock that is convertible to common stock at \$0.01. Plaintiff alleges that, pursuant to the anti-dilution provisions of the Debenture, the Set Price of its outstanding Debenture was reduced to \$0.01. The \$0.01 Set Price

was, in fact, confirmed in two e-mails sent by SmarTire's Chief Financial Officer, Jeffrey Finkelstein, on March 30 and 31, 2005. Accordingly, plaintiff delivered notices of conversion to SmarTire on April 11 and 18, 2005 for 1,625,000 and 7,643,875 shares of common stock, respectively, at \$0.01. However, SmarTire refused to honor the conversions at that price.

Plaintiff submits an affidavit from its in-house counsel, Amy Wang, Esq., in which she states that, due to SmarTire's default, Sections 3(b) and 10 of the Debenture entitle plaintiff to accelerate the full principal balance of the Convertible Debenture and to receive the "mandatory prepayment amount," along with interest and attorneys' fees. Section 4(b)(ii) also authorizes plaintiff to seek a decree of specific performance and/or injunctive relief to enforce its rights under the Debenture. Ms. Wang alleges that since SmarTire's stock opened the day trading at \$0.26 a share on April 20, 2005, to date, plaintiff's monetary damages exceed \$2,409,907.50, exclusive of interest and attorneys' fees.

Plaintiff commenced this action on April 21, 2005. The complaint sets forth a cause of action for a decree of specific performance directing SmarTire to deliver to plaintiff 9,268,875 shares of its stock, and a second claim for attorneys' fees incurred as a result of defendant's alleged dishonor of the notices of conversion. Contrary to the claim made in Ms. Wang's affidavit, paragraph 26 of the complaint states that SmarTire's stock opened the day trading at \$.083 on April 20, 2005.

In support of its claim for preliminary injunctive relief, Ms. Wang alleges that SmartTire has been encountering severe financial difficulties since its inception, which is allegedly demonstrated by SmarTire's own quarterly filings with the SEC. Ms. Wang avers that SmarTire's "precarious" financial picture is demonstrated by the fact that: (1) the company has

an accumulated deficit of \$65,506,096.00 as of January 31, 2005; (2) SmarTire suffered a net loss of \$6,487,840 in the last six months ending January 31, 2005; and (3) its cash on hand decreased from \$1.8 million to \$285,000 between April 2003 and April 2004. Ms. Wang alleges that SmarTire's losses are continuing and that there is no doubt that it would be unable to satisfy any monetary judgment entered against it. Ms. Wang further alleges that SmarTire is currently surviving by selling shares of its common stock to a major investor under a line of credit, and that SmarTire has issued nearly 200 million shares, the majority of which remain outstanding and have diluted the value of shares held by investors like the plaintiff.

In opposition to plaintiff's motion for a preliminary injunction, SmarTire submits an affidavit from its CFO, Jeffrey Finkelstein, in which he denies that his company's financial condition is poor, and asserts that it is more favorable than at any other time since October 2002, despite the fact that the company has been in development for most of its 18-year existence. He contends that SmarTire's common stock price has risen from 2.8 cents on March 31, 2005 to 16.5 cents on May 3, 2005, and that investor activity has increased SmarTire's market capitalization from \$6,713,041 as of March 31, 2005 to \$43,253,386 as of May 3, 2005, representing a 544% increase. Mr. Finkelstein points to the recent financing agreement with Cornell Capital Partners as reflecting the company's continuing ability to attract capital, in addition to a \$15 million equity line of credit, of which only \$3.5 million has been drawn down. He further avers that the company's growth prospects are very good. Recently, SmarTire has concentrated on developing and marketing tire monitoring systems designed for improved vehicle safety. Growth in this area has been fueled by U.S. legislation passed in 2000, which empowers the National Highway Traffic and Safety Administration to enact regulations requiring

the installation of warning systems in new vehicles to indicate when tires are significantly under-inflated. Mr. Finkelstein claims that plaintiff is the only member of the HPC Investors that has not agreed with SmarTire in writing or in principal to redeem its debenture, convert into shares and/or exercise its warrants. Finally, he contends that if plaintiff is successful in securing nine million shares prior to judgment, it will flood the market and further depress the price of SmarTire's stock price.

Mr. Finkelstein further contends that SmarTire may have counterclaims against plaintiff for conspiring with the other HPC Investors to drive down the price of SmarTire's publicly-traded common stock in order to lower the price at which they could convert their debentures and warrants. He bases this claim on the fact that the HPC Investors, including plaintiff, were aware at the time of their investment that SmarTire needed additional funding for its operations and that such financing would likely involve the issuance of additional shares. A lower market price for SmarTire stock would necessarily be reflected in the issue price of the additional shares, which would, in turn, lower the "set price" of the HPC Investor's debentures and warrants, thus enabling the HPC Investors to obtain more stock when they converted their debentures and exercised their warrants. Mr. Finkelstein claims that, beginning in early 2004, the market price of SmarTire's stock came under attack from plaintiff and the other HPC Investors who began to sell large amounts of stock, which allegedly caused the market price of SmarTire's stock to decline to below \$0.10 a share.

Mr. Finkelstein avers that SmarTire was represented in the March 2005 transaction with Cornell Capital Partners by the law firm of Sichenzia Ross Friedman Ference LLP, but that the Sichenzia law firm did not disclose to SmarTire "that it would also represent the HPC Investors."

Finklestein 5/4/05 Aff., ¶ 41. He further asserts that SmarTire understood that the anti-dilution provisions of the HPC Investors' debentures would be triggered only when Cornell Capital Partners exercised its right to convert SmarTire stock, not merely by SmarTire's entering into the transaction. He blames the Sichenzia firm for not correcting this misunderstanding, and contends that the March 2005 e-mails he sent to Ms. Wang and the other HPC Investors advising that the Set Price on the HPC debentures had been adjusted to \$0.01 was based on later, contrary, and incorrect advice from the Sichenzia firm. Finally, he submits a letter dated April 15, 2005 from plaintiff asking SmarTire to confirm to plaintiff's auditor, Rothstein, Kass & Co., that the Set Price at which the Debenture could be converted into SmarTire shares is \$0.28, rather than \$0.01, as plaintiff contends in this lawsuit.

DISCUSSION

CPLR 6301 provides, in pertinent part, that a preliminary injunction may be granted in any action where it appears that the defendant is doing something in violation of the plaintiff's rights respecting the subject of the action and tending to render the judgment ineffectual. In order to be entitled to a preliminary injunction, a movant must clearly demonstrate: (1) a likelihood of success on the merits, (2) irreparable injury absent granting of the preliminary injunction, and (3) a balancing of the equities in the movant's favor. Nobu Next Door, LLC v Fine Arts Housing, Inc., 4 NY3d 839, 840 (2005); Doe v Axelrod, 73 NY2d 748, 750 (1988); Olympic Tower Condominium v Coccoziello, 306 AD2d 159, 160 (1st Dept 2003). "A mandatory injunction should not be granted, absent extraordinary circumstances, where the status quo would be disturbed and the plaintiff would receive the ultimate relief sought, pendente lite." St. Paul Fire and Marine Ins. Co. v York Claims Serv., Inc., 308 AD2d 347, 348 (1st Dept 2003),

quoting Rosa Hair Stylists, Inc. v Jaber Food Corp., 218 AD2d 793, 794 (2d Dept 1995); see also Times Square Stores Corp. v Bernice Realty Co., 107 AD2d 677, 682 (2d Dept 1985). While ordinarily injunctive relief to preserve the assets of a potential judgment debtor is not available in an action for money damages only, if the action is directed to a specific fund which can be regarded as the "subject of the action," injunctive relief can issue. Credit Agricole Indosuez v Rossiyskiy Kredit Bank, 94 NY2d 541, 547 (2000).

Although plaintiff has demonstrated a likelihood of success on the merits of its claim that an event of default has occurred with respect to the Debenture, it has not eliminated every factual issue sufficient to justify this type of mandatory injunction. To be sure, Mr. Finkelstein completely fails to expound upon the basis for a conflict of interest created by the Sichenzia firm's representation of SmarTire in connection with the March 2005 financing with Cornell Capital Partners. Nor does he adequately explain how the March 2005 e-mails, advising that plaintiff could convert its Debenture at \$.01 a share, was the result of incorrect legal advice. Nevertheless, plaintiff does not adequately explain why its auditor asked SmarTire to confirm in writing on or about April 15, 2005 that the Set Price of the Debenture was \$0.28, not \$0.01 as demanded in the notices of conversion dated April 11 and 18, 2005. In addition, SmarTire contends that it has counterclaims against plaintiff for predatory trading practices, which have depressed the price of SmarTire's stock to the benefit of plaintiff and the other HPC Investors.

The motion must also be denied because plaintiff has failed to demonstrate that it will suffer irreparable harm in the absence of the requested mandatory injunction. The harm alleged here is that delivery of the stock after trial will likely be a meaningless event because of SmarTire's allegedly fragile financial condition. However, plaintiff has not seen fit to provide

the Court with copies of the financial reports upon which this bleak assessment is allegedly based. Proof establishing the three elements of the preliminary injunction standard “must be by affidavit and other competent proof, with evidentiary detail.” Scotto v Mei, 219 AD2d 181, 182 (1st Dept 1996); accord Faberge Intl. Inc. v Di Pino, 109 AD2d 235, 240 (1st Dept 1985).

In addition, there are disputed issues of fact as to whether SmarTire’s financial condition is as precarious as plaintiff claims. The company is still in business and, rather than being on the verge of insolvency, the company was able to raise \$4 million in new financing shortly before this lawsuit was commenced. SmarTire’s CFO avers that the company’s growth prospects are very good due to recent federal legislation requiring new passenger vehicles to be equipped with the tire monitoring systems that SmarTire is now selling.

Plaintiff principally relies on Castle Creek Tech. Partners, LLC v Cellpoint Inc. (2002 WL 31958696 [SD NY 2002]), in which the federal court granted a preliminary injunction compelling the defendant to deliver shares of its common stock after it defaulted in honoring a convertible note. Irreparable harm was demonstrated in that case, because the plaintiff had “provided ample and specific evidence that CellPoint is at the brink of insolvency, and that by the conclusion of the litigation, CellPoint may be in no position to satisfy a money judgment or an injunction.” 2002 WL 31958696 at *4. Specifically, the court found that the company had recurring significant losses and a large capital deficiency, was spending more money than it was receiving through operations, had had a bankruptcy forced on its Swedish subsidiary, and had suffered a drop in its stock price from \$94.50 in February 2000 to \$0.20 by December 2002. Here, in contrast, the price of SmarTire’s stock has held steady since this lawsuit was commenced and plaintiff has failed to show, as was the case in Castle Creek, that the company

cannot raise any new financing and, therefore, there is an "actual and imminent threat of" SmarTire's insolvency.


Nor do the equities necessarily favor the plaintiff here. As of April 15, 2005, SmarTire owed plaintiff only \$142,689 on the Dcbenture (Finkelstein 5/4/05 Aff., Exh. B thereto), and yet asks the Court for a mandatory injunction requiring the turn over of 9,268,875 shares which amounts to approximately \$722,972 at today's current market price. SmarTire alleges that plaintiff's trading practices have already battered the company's stock price, and the granting of the requested relief may be detrimental to other investors.

For the foregoing reasons, it is hereby

ORDERED that plaintiff's motion for a preliminary injunction is denied.

Dated: December 23, 2005

ENTER:



J.S.C.

FILED
DEC 29 2005
COUNTY CLERK'S OFFICE
NEW YORK