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

PRESENT: SHIRLEY WERNER KORNREICH J.S.C. PART 54

Index Number : 124493/2001

DAY, FRANKLIN

VS

ZWIRN, GERARD, ESQ.

Sequence Number : 016

SUMMARY JUDGMENT

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

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

| | PAPERS NUMBERED |
|---|---|
| Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ... | 1,2 |
| Answering Affidavits — Exhibits | 3,4,5 |
| Replying Affidavits Exhibits | 6,7,8 |

**Cross-Motion:** ☒ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.**



Dated: 8/28/06

SHIRLEY WERNER KORNREICH J.S.C.

J.S.C.

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

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

----------X

FRANKLIN DAY

Plaintiff,

Index No.: 124493/01

**DECISION and ORDER**

-against-

GERARD ZWIRN, ESQ.
and JOSEPH PASSARELLI,,

Defendants,

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KORNREICH, SHIRLEY WERNER, J.:

This is an action to recover for an alleged fraudulent transfer. In a prior action for legal malpractice, plaintiff obtained a judgment against defendant Gerard Zwirn in the amount of $131,021.74.[1] In the present action, plaintiff alleges that defendant Zwirn avoided payment of the judgment by fraudulently transferring approximately $925,000 of his assets by purportedly purchasing interests in two entities held by defendant Joseph Passarelli: Danjo Automotive Corp., d/b/a Koeppel Mazda Hyundai ("Danjo"), and Bronx Volkswagen Corp., a/k/a City Line Auto Mall ("Bronx VW"). According to the complaint, Mr. Passarelli subsequently issued false (and undocumented) capital calls to Mr. Zwirn on behalf of these entities, resulting in the purported loss of Zwirn's interests in the entities. Plaintiff contends this was done by Zwirn and Passarelli as part of a scheme to avoid payment of the judgment. By Order dated June 20,

[1] *Good Old Days Tavern v. Zwirn,* Sup. Ct. New York County, Index No. 11465/93.

2005, this Court granted plaintiff's motion for leave to amend the complaint to include Danjo and Bronx VW as defendants.

*The Bankruptcy Proceeding*

On November 2, 2004, defendant Zwirn voluntarily filed a bankruptcy petition in the United States Bankruptcy Court in the Southern District of Florida, Case No. 04-40306-BKC-AJC (Cristol, J., presiding)(the "Bankruptcy Court"). The Bankruptcy Court designated Joel L. Tabas ("Trustee") to be the Chapter 7 administrator of the bankruptcy estate. On November 19, 2004, Trustee sent a letter to plaintiff by fax, referencing "Franklin Day vs. Gerald Zerwin [sic], et al.[,] Case No. 124493/2001 [and] Gerald [sic] Zwirn[,] Case No. 04-40306-BKC-RAM" in the subject line, and stating, "The automatic stay does not apply to any other defendants and we have no objection with your proceeding against any other defendants."

Sometime in 2005, plaintiff made an adversary complaint to the Bankruptcy Court, objecting to plaintiff's discharge on the basis of the alleged continued concealment of funds by defendant Zwirn (there, the debtor) through his transfer to Danjo. *Day v. Zwirn*, United States Bankruptcy Court in the Southern District of Florida, Adv. No.: 05-1036 BKC-AJC-A (Squires, J., presiding)(the "Discharge Objection Proceeding"). The trial transcript for the Discharge Objection Proceeding reflects that Judge Squires limited the scope of the Discharge Objection Proceeding at the outset of trial, announcing, "The only thing we're here to try is whether or not the debtor concealed, transferred or destroyed property within the year before the filing of the petition and . . . [w]e don't need to go through a lot of history on the pre-petition litigation in other fora [because] a lot of it is not relevant to the issues drawn here in this matter." Defendant Passarelli failed to appear at the trial, despite his intimate knowledge of the matter, leaving defendant Zwirn as the only person with knowledge of the events to testify. This

testimony was, in the words of Judge Squires, "sparse and negligible." The transcript shows that only "an hour or so [was] allotted" for the trial, during which defendant Zwirn was uncooperative in the extreme. Judge Squires issued a ruling on the trial on August 15, 2005, overruling the objections to defendant-debtor's discharge due to the failure of plaintiff (there, the complainant) to muster sufficient evidence to establish the required elements of fraudulent conveyance under 11 U.S.C. § 727(a)(2)(A).

On January 26, 2006, Trustee's counsel sent an email message to plaintiff, reaffirming,

> The Trustee will not agree to lift the automatic stay in the state court case you have pending, but will allow you to litigate your claims to settlement or final judgment provided that the gross proceeds of any recoveries from the litigation are held in trust for the benefit of the bankruptcy estate, and you shall notify the Trustee immediately when such funds are received by your firm.

Subsequently, on July 12, 2006, Judge Cristol entered a Stipulation to Sever Claims and Order Approving Same (the "Severance Order"), which approved the severance of "all issues and claims arising out of and relating to the claims against Day. . . ." (Severance Order, para. 4.) On August 1, 2006, plaintiff and Trustee entered into a Stipulation for Relief from the Automatic Stay Nunc Pro Tunc to November 2, 2004 (the "Stay Relief Stipulation"). The Stay Relief Stipulation released the automatic stay so as to permit the instant proceeding against Danjo and Bronx VW; the stay relief was retroactively granted to cover the entire period that defendant's financial affairs was under the purview of the Bankruptcy Court. Furthermore, the Stay Relief Stipulation reiterated the obligation of plaintiff to hold any recovery in trust for the bankruptcy estate, and contained reservations of the Trustees rights which reaffirmed those already expounded by the January 26, 2006 email.

*Prior Developments in the Instant Action*

Plaintiff alleges that over the tumultuous course of discovery for this case before Special Referee Steven E. Liebman, defendants have consistently defied court orders, and engaged in other extreme behavior, warranting severe discovery sanctions. To that end, plaintiff applied to Referee Liebman to hear and take on submission a motion for sanctions under CPLR 3126. On or about March 6, 2006, shortly after Referee Liebman put a schedule on his calendar for the CPLR 3126 motion, defendant served the instant summary judgment motion.

***Conclusions of Law***

As a threshold matter, this Court must consider plaintiff's argument that the motion for summary judgment is premature because defendants appear to have made this motion to inappropriately preempt plaintiff's CPLR 3126 motion before Referee Liebman. Plaintiff contends (in Part I of its opposition affirmation) that the 3126 motion may very well be dispositive, and should therefore take precedence over the instant motion. In a related argument (Part II of his opposition affirmation), plaintiff argues that the facts withheld by defendants, through the course of conduct that is the basis of plaintiff's 3126 motion, are necessary to the proper determination of the instant motion for summary judgment. Read together, Parts I and II of plaintiff's opposition/cross-motion papers argue that Passarelli's recalcitrance to comply with discovery orders has obstructed the progress of the overall litigation, and that by entertaining defendants' motion this Court would be running the risk of rewarding defendants' wrongful withholding of evidence, which if revealed would provide essential guidance on the merits of this motion. However, defendant's motion is solely grounded on contentions of law, and therefore no further facts thus far held secret by defendants are necessary for this Court to

evaluate the motion for summary judgment. Therefore, this Court declines to "strike" the instant motion or to deny it for being "premature."

A. Defendant's First Legal Claim: Plaintiff's Standing

The question presented is whether clear permission given by the Trustee to a creditor to pursue claims against the alleged recipients of fraudulent conveyances, coupled with a court order from the bankruptcy judge approving a stipulation that the claims regarding said alleged fraudulent conveyance are severed from the bankruptcy proceeding, is sufficient to allow said creditors to pursue such claims in state court, in the absence of a court order explicitly granting creditor standing to sue on behalf of the Trustee.

Defendant argues that the Trustee alone has standing to bring any fraudulent conveyance action, unless the creditor had obtained a court order specifically countenancing the prosecution of the action by the plaintiff. But by virtue of severing the fraudulent conveyance claims from the Bankruptcy Court proceedings, Judge Cristol empowered the Trustee to pursue or delegate the claim in whatever way he saw fit. Since the claims were now outside the ambit of the Bankruptcy Court, and hence untethered from the typical restrictions on the creditors' ability to bring suit, no court order specifically authorizing the creditors to prosecute the claim is necessary. Defendant's instinct is correct that, had the claims not been severed, plaintiff would have needed to move for authorization from the Bankruptcy Court. *See, e.g. In re Natchez Corp.*, 953 F.2d 184, 187 (5th Cir. 1992). Here, however, the severance of the claim serves to free the Trustee to delegate prosecution of the fraudulent conveyance claim.

Two underlying policies of the Bankruptcy Code are implicated in the general rule foreclosing direct suits by creditors once a bankruptcy proceeding has begun: "First, the Code

allows only the trustee or debtor-in-possession to sue on a preference because only that trustee or debtor-in-possession represents the interests of all the creditors in maximizing the estate. Second, permitting trustees alone to sue on a preference facilitates the prime bankruptcy policy of equality of distribution among creditors . . . ." *In re Vogel Van & Storage, Inc.*, 210 BR 27, 33 (Bankr. N.D.N.Y. 1997)(internal citations and quotations omitted). In other words, giving a trustee the exclusive power to sue for preferences prevents draining the estate and prevents a new preference from occurring.

Here, allowing plaintiff to maintain this suit creates no danger of either subtracting from the ultimate recovery of the estate or creating a preference. Plaintiff's suit will not harm the policies of the Bankruptcy Code or damage the estate because the Trustee's agreement with the creditors, as memorialized by the Stay Relief Stipulation, requires plaintiff to hold any proceeds from this action in trust, to be distributed by an order of the Bankruptcy Court. As in *Vogel*, "The estate stands to maximize its recovery, and there is no danger of inequitable recovery." *Id.* Such a delegation of power to sue serves the interests of the estate by placing the risk and cost of litigating the fraudulent conveyance claim on the creditor, rather than the Trustee. *Id.*

> Nothing in this arrangement threatens the equitable distribution of the estate's assets. The Trustee retains control over the claim and over any assets which are brought into the estate through the preference action. The proceeds of the action will be added to the estate and the estate as a whole will be divided between creditors according to the dictates of the Code.... This Court finds no reason not to allow trustees to "deputize" a creditor to sue to avoid preferences on the trustee's behalf, as long as the fruits of the action belong to the estate, and the trustee retains control over the action.

*Id.* at 33–34.

Furthermore, contrary to defendant's suggestion, there is no evidence here that allowing the plaintiff to continue this suit would create a danger of double recovery, since the claims have

been severed from the Banckruptcy Court proceeding and the Trustee's communications to plaintiff have made abundantly clear that it intends and expects that plaintiff shall independently persist in the state-court claim. *Contrast In re Daley*, 224 B.R. 307, 310-11 (Bankr. S.D.N.Y. 1998)(where trustee had given no permission to creditors who attempted to bring suit that actually requested double recovery).

Defendant counters that the rule of *In re Parametric, Inc.*, 199 F.3d 1029, 1031 (9th Cir. 1999), which allowed the Trustee to delegate authority to a creditor to pursue a claim for fraudulent conveyance, prohibits such an arrangement in the absence of a court order specifically approving it. However, *Parametric* does not purport to circumscribe the method for a trustee to delegate its powers. *Id.* There is no functional difference between the route chosen by the trustee in *Parametric* and that chosen by the Trustee here. Both methods serve to carve out the creditor-led action from the exclusive control of the trustee and the bankruptcy court. Thus, this Court finds it appropriate to apply the permissive approach of *Vogel* and *Parametric* here.

Finally, defendant argues that the limiting language of the January 26, 2006, email from the Trustee to the plaintiffs (which limiting language is effectively reified by the wording of the Stay Relief Stipulation) contradicts plaintiff's claim that the Trustee granted plaintiff standing to pursue the claims against Danjo and Bronx VW on the Trustee's behalf. This Court disagrees. It reads the language as patently permissive toward plaintiff's claims against the non-bankrupt defendants, while scrupulously reserving all of the Trustee's legal rights in the judgment which may be recovered. As a result, defendant's challenge to plaintiff's standing to maintain this suit is denied.[2]

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[2]Although defendant's motion does not advance an argument based on the automatic stay imposed by 11 U.S.C. § 362 during bankruptcy proceedings, plaintiff raises the issue in its

B. Defendant's Second Legal Claim: Issue Preclusion

Defendants further argue that the collateral estoppel effect of Judge Squires' decision in the Discharge Objection Proceeding mandates summary judgment. Collateral estoppel is founded on the principle that a party should not be permitted to relitigate an issue decided against it in a court of competent jurisdiction. *Harvester Chem. Corp. v. Aetna Casualty & Sur. Co.*, 212 A.D.2d 392, 393-94 (1st Dept. 1995)*; citing D'Arata v. New York Cent. Mut. Fire Ins. Co.*, 76 N.Y.2d 659, 664 (1990). While it is true that a decision of a federal bankruptcy court may potentially preclude relitigation of identical issues (*See Guiliano v. Richardson*, 278 A.D.2d 453 (2nd Dept. 2000)), this Court must decide whether the doctrine is implicated here.

> The two requirements that must be satisfied [for collateral estoppel] are (1) proof that the identical issue was decided in the prior action and is decisive in the present action, and (2) the party to be precluded must have had a full and fair opportunity to contest the prior determination, the burden of showing the absence of such opportunity being on the party attempting to defeat the estoppel. Moreover, since collateral estoppel is grounded on concepts of fairness, it should not be rigidly or mechanically applied.

*Harvester*, 212 A.D.2d at 393-94 (citations omitted).

1. First Prong of Defendant's Preclusion Claim: Equivalence of Issue

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opposition papers, claiming that the stay does not apply. Defendant's reply is correct that the §362 stay does, under typical circumstances, cover creditors' claims against nonbankrupt defendants alleged to be recipients of fraudulent transfers, because such claims involve property belonging to the bankruptcy estate (as far as creditors are concerned). *Golden v. Moscowitz*, 194 A.D.2d 385 (1st Dept. 1993)(citing *CenTrust Services, Inc. v. Guterman*, 160 A.D.2d 416, 418 (1st Dept. 1990)); *In re MortgageAmerica*, 714 F.2d 1266, 1275 (5th Cir. 1983). However (as defendant acknowledges), §362 does not affect the grounds for summary judgment, and is therefore extraneous to the analysis of this motion. But for the sake of completeness, this Court must note that §362 does not bar the instant suit because the stay was effectively lifted as to plaintiff by the express permission of the Trustee to pursue the claim, memorialized by the Stay Relief Stipulation.

Although related to the same set of facts, the issue of defendant Zwirn's alleged fraudulent conveyance is not identical to the matter decided by Judge Squires in the Discharge Objection Proceeding, for the purposes of precluding plaintiff's claims against defendants Danjo and Bronx VW. Critically, although the central requirement of intent in 11 U.S.C. § 727(a)(2)(A) matches that in Debtor and Creditor Law § 276, the federal statute, unlike New York law, entails only a one-year "look back" period. This means that the scope of Judge Squires' inquiry was limited to what could be proven regarding the intent of the parties during the period beginning one year prior to defendant Zwirn's filing his bankruptcy petition. Plaintiff's case against Zwirn's co-defendants, on the other hand, will comprise an investigation into the entire period of the alleged conveyance. To preclude plaintiff's New York claim, thus, would be an unjustified curtailment of plaintiff's right to a fair forum in which to seek resolution of his complaints.

Moreover, in order to have preclusive effect on an action under Debtor and Creditor Law § 276, a decision from a bankruptcy court must decide "the issue of whether the subject conveyance was a fraudulent transfer under New York State law." *Barristers Abstract Corp. v. Caulfield*, 241 A.D.2d 472, 473 (2nd Dept. 1997). In *Barristers Abstract*, the Appellate Division upheld a denial of summary judgment on collateral estoppel grounds, despite the fact that the judge in the defendant's bankruptcy proceeding had denied an application to block defendant's discharge due to a fraudulent conveyance. The *Barristers Abstract* Court held that the bankruptcy judge's decision had reserved the issue of the transferor's intent for trial in state court. *Id.* Although Judge Squires did make a finding regarding intent within the one-year period prior to Zwirn's filing for bankruptcy, many issues remain for the instant proceeding (not

the least of which is the intent of all the defendants in the time period preceding the one-year look-back of §727(a)(2)(A)). Additionally, Judge Squires' opinion pointed out that "[o]bjections to discharge under 11 U.S.C. § 727 should be liberally construed in favor of debtors and strictly against objectors in order to grant debtors a fresh start." Memorandum Opinion, *Day v. Zwirn*, Adv. No.: 05-1036 BKC-AJC-A, Squires, J. presiding (Aug. 15, 2005)(citing *In re Petersen*, 323 B.R. 512, 516 (Bankr. N.D. Fla. 2005); *In re Whitehead*, 278 B.R. 589, 594 (Bankr. M.D. Fla. 2002)). This interest is not implicated in the present matter under New York Debtor and Creditor Law, and further distances the analysis of Judge Squires' ruling from the relevant considerations at hand.

A final and essential barrier to summary judgment is the inclusion in plaintiff's complaint of claims under Debtor and Creditor Law §§ 273 and 273-a, which both feature elements widely distinct from the elements of 11 U.S.C. §727(a)(2)(A). These sections expressly exclude the actual intent of the party charged with a fraudulent transfer, which is the element that formed the basis of Judge Squires' decision to overrule the objections in the Discharge Objection Proceeding. Section 273 specifically hinges on whether a transferor is "rendered insolvent" by the disputed transfer "without regard to his actual intent." Section 273-a, in turn, focuses on whether "fair consideration" was given in exchange for the disputed transfer, again "without regard to the actual intent of the defendant." Therefore, Judge Squires' circumspectly narrow application of §727(a)(2)(A) has no bearing on plaintiffs claims under sections 273 and 273–a.

2. Second Prong of Defendant's Preclusion Claim: Full and Fair Opportunity

Nor do defendants satisfy the second requirement for issue preclusion. "In order to determine whether the party was provided a full and fair opportunity to litigate, the court must

consider the realities of the prior litigation, including the context and other circumstances which, although not legal impediments, may have had the practical effect of discouraging or deterring a party from fully litigating the determination which is now asserted against him." *People v Plevy*, 52 N.Y.2d 58, 65 (1980)(quoted in *Gilberg v. Barbieri*, 53 N.Y.2d 285, 292 (1981)). "Such circumstances might include: (1) the size of the claim, (2) the forum of prior litigation, (3) the use of initiative, (4) the extent of the litigation, (5) the competence and experience of counsel, (6) the availability of new evidence, (7) indications of a compromise verdict, (8) differences in the applicable law and (9) a foreseeability of future litigation." *Gilberg*, 53 N.Y.2d at 292.

The failure of the prior trial to exhaustively vet plaintiff's claim stems primarily from consideration #4 of the *Gilberg* test. The extent of the litigation regarding plaintiff's case in Bankruptcy Court was unduly hampered by multiple circumstance. Most of all, the proceedings were impeded by Passarelli's failure to appear to testify (and be cross-examined) at trial. The trial transcript further indicates that very little time was given in the Bankruptcy Court to the issue of the disputed transfers, that no opening statements were permitted, and that defendant was obstructively uncooperative in his own testimony.

In sum, this Court finds that the Bankruptcy Court's decision did not and was not intended to forever foreclose inquiry into the disputed transfer. By severing the claims of plaintiff in its order of May 10, 2006, the Bankruptcy Court effectively acknowledged that plaintiff did indeed still have claims that were yet to be resolved, notwithstanding Judge Squires' overruling of plaintiff's earlier objection to the discharge of defendant's debt in the bankruptcy proceeding. Judge Cristol's order approving the severance acknowledged that the Trustee was still "seeking...to recover certain property alleged to be property of the estate from the

Debtor...and certain corporations alleged to be the alter ego of [Debtor]." (Severance Order, para. 1.) Judge Cristol further includes the instant plaintiff's claims in the group of claims before the Bankruptcy Court which it orders severed from the Adversary Complaint, suggesting that the §727 Order was not intended to bar claims by plaintiff on other grounds in another forum.[3]

C. Plaintiff's Cross-Motion: Discovery Sanctions

Papers submitted by Plaintiff include a cross-motion for the Court to strike defendants' answers, based on alleged misconduct by defendants over the course of discovery. This cross-motion is based upon allegations substantially similar to those giving rise to the motion for sanctions under CPLR 3126 that is currently held in abeyance by Referee Liebman. This Court declines to address the merits of plaintiff's cross-motion at present, and defers the issue to Referee Liebman, who is better acquainted with the nuances of the claim and who can resolve the issue by addressing the motion already before him. Accordingly, it is

ORDERED that defendant's motion for summary judgment dismissing the action is denied; and it is further

ORDERED that plaintiff's cross-motion to strike plaintiff's answer is denied without prejudice; and it is further

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[3]This conclusion is further supported by Judge Squires' limiting language at the Discharge Objection Proceeding trial (including the statement that the pre-petition litigation was "not relevant"), which strongly suggested that he intended to leave the claims made in state court to determination in state court, and that the resulting decision would have only a narrow effect on the adversary proceeding.

ORDERED that plaintiff and defendants Passarelli, Danjo, and Bronx VW shall appear before Special Referee Steven E. Liebman on September 29, 2006, at 1:00 p.m.

Date: August 28, 2006
New York, New York

SHIRLEY WERNER KORNREICH