

Stevelman v B'Way.Net, Inc.

2007 NY Slip Op 32656(U)

August 16, 2007

Supreme Court, New York County

Docket Number: 0604201/2006

Judge: Shirley W. Kornreich

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

PRESENT: SHIRLEY WERNER KORNREICH
Justice

PART 54

Ian Stevelman

INDEX NO. 604201/06

MOTION DATE 6/21/06

- v -

B'Way. Net, Inc., Open Net, Inc.,
and Kate Lynch

MOTION SEQ. NO. 3

MOTION CAL. NO. _____

The following papers, numbered 1 to 3 were read on this motion to/for _____

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

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

1, 2

3

FILED

AUG 24 2007

NEW YORK
COUNTY CLERK'S OFFICE

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: 8/16/07

HON. SHIRLEY WERNER KORNREICH
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

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 54

-----X
IAN STEVELMAN

Plaintiff,

Index No.: 604201/06

-against-

DECISION
and ORDER

B'WAY.NET, INC., OPEN NET, INC.,
and KATE LYNCH

Defendants.

-----X
KORNREICH, SHIRLEY WERNER, J.:

FILED
AUG 24 2007
NEW YORK
COUNTY CLERK'S OFFICE

This fraudulent conveyance action arises from an alleged scheme orchestrated by defendants to evade paying plaintiff amounts owed under a prior judgment. Plaintiff here moves: (1) to be appointed as temporary receiver over the affairs of defendants B'Way.Net, Inc. ("B'Way") and Open Net, Inc. ("Open Net") during the pendency of this action; and (2) pursuant to Judiciary Law § 753 to hold defendants in contempt of court. Defendants oppose.

I. *Background*

A. *The Initial Action*

B'Way is a closely held corporation formed by plaintiff Ian Stevelman and defendant Kate Lynch, as co-equal shareholders, for the purpose of providing Internet services. In 2001, Lynch terminated plaintiff and B'Way filed suit seeking to permanently bar him from its operations and to buy back his shares of stock. Stevelman asserted several counterclaims relating to his wrongful termination as President and to enforce the terms of a severance note. Following a trial, on January 26, 2005, the court awarded a judgment of \$476,500.72 (the "prior judgment") in favor of Stevelman against B'Way. The court also terminated Stevelman from his

employment and as a shareholder of B'Way.

B'Way failed to make any payments in satisfaction of the prior judgment. Therefore, B'Way and Stevelman entered into a settlement agreement on August 25, 2005 ("the settlement"). Pursuant to the terms of the settlement, B'Way agreed to pay Stevelman an initial lump sum of \$100,000 and an additional \$200,000, payable in monthly installments of \$3,500 beginning on September 1, 2006. If B'Way were to default on any monthly installment, Stevelman would be entitled to an entry of judgment in the amount of \$200,000, less any monthly installments paid, plus interest at a rate of 9% per annum on the remaining balance as well as reasonable attorneys' fees. B'Way made the initial \$100,000 payment on August 25, 2005.

B. *The Songbird Loan*

B'Way obtained the funds to pay the initial \$100,000 to Stevelman through a \$150,000 loan (the "Songbird Loan") provided by non-party the Songbird Company ("Songbird"). Songbird is a private investment fund run by Lynch's childhood friend Peter S. Frane. The Songbird Loan was memorialized in a promissory note and security agreement dated August 15, 2005 executed by Lynch on behalf of B'Way. These agreements called for B'Way to pay off the \$150,000 principal on August 15, 2010 with interest payable monthly commencing on September 1, 2005. Songbird was also afforded a security interest in B'Way's assets and the right to take immediate possession if B'Way defaulted. Stevelman was not given any notice as to Songbird's security interest.

On September 1, 2005, B'Way defaulted in making its first interest payment due under the Songbird Loan. Lynch avers that to date no payments to Songbird have been made. Lynch

further avers that in response to this default, Songbird foreclosed on its lien of B'Way's assets. According to Lynch, Frane contacted her by phone in early September 2005 and instructed her to transfer B'Way's assets to Open Net. Following this phone call, Lynch avers she began to transfer B'Way's assets. Many of B'Way's employees were laid off and subsequently rehired by Open Net. Both companies now operate out of the same location using the same trade name "B'Way.Net". Lynch is currently an officer of Open Net and, pursuant to a verbal agreement with Songbird, managed the business for eighteen (18) months through March 2007. According to Lynch, in return for these services, Songbird paid off some of her personal debts that she assumed for "B'Way.Net" regarding bank loans and payroll taxes. Songbird, through Open Net, paid \$118,000 to Lynch's creditors including the IRS. No documents have been offered as evidence of the transfer of assets from B'Way to Open Net or the additional \$118,000 used to pay Lynch's personal debts.

However, Frane avers that Songbird neither acquired any ownership interest in Open Net nor gave any notice of foreclosure. Frane further avers that Songbird never foreclosed on any of B'Way's assets and did not tell Lynch to transfer any assets from B'Way to any other entity.

C. *B'Way's Default as to Plaintiff Stevelman*

By letter dated September 1, 2006, Lynch informed Stevelman that B'Way could not make any payments under the settlement. In her letter, Lynch stated that B'Way:

was unable to begin repayment of a loan from Songbird Company (which had financed the lump sum payment to Ian Stevelman) and therefore defaulted on that note. Songbird had secured and perfected a lien on all Bway assets, which they had foreclosed on in Sept. 2005. Since that time Songbird has had ownership and control of all Bway assets (but not the liabilities, which they did not assume) and they have contracted me [Lynch] to run the business.

On September 28, 2006, a judgment by confession was entered in favor of Stevelman against B'Way for \$219,183.56 by reason of B'Way's default under the settlement. Stevelman then commenced efforts to enforce this judgment. He issued a subpoena for B'Way to provide all banking and other financial information related to its transactions with Open Net. During her examination before trial, Lynch averred that Stevelman was not entitled to these documents because his judgment was against B'Way, not Open Net.

D. *The Instant Action*

Stevelman thus filed suit alleging that since September 2005, B'Way, Open Net, and Lynch engaged in a scheme to defraud him by: depleting B'Way's assets via a "phantom foreclosure" by Songbird; transferring assets out of B'Way into Open Net; and Lynch using loan proceeds to satisfy personal debts arising out of her control and operation of B'Way. On December 14, 2006, a So Ordered Stipulation of plaintiff's December 7, 2006 Order to Show Cause ("the So Ordered Stipulation") preliminarily enjoined defendants from transferring any assets during the pendency of this action, other than in the ordinary course of business and ordered defendants to provide copies of all books and records relating to: the day-to-day operations of B'Way and Open Net; the transfer of funds from Songbird to Lynch; and Lynch's use of the Songbird Loan by January 17, 2007.

In a letter dated January 18, 2007, defendants turned over some of the requested items including: B'Way's 2003 through 2005 federal tax returns; a chart comparing B'Way's revenue and profit and loss from 1996 through 2005; Lynch's bank receipts from the Songbird Loan; a January 2007 invoice from Covad Communications to "Open Net, Inc. dba Bway.net"; a credit card statement showing a \$20,000 cash advance made to B'Way on September 14, 2006; and a

30-day bank summary for Open Net dated January 16, 2007. In this letter, defendants' counsel explained that B'Way's accountant took all of the financial records belonging to B'Way and Open Net with him when he quit in October 2006. As a result, defendants claim they were having difficulty complying with all of plaintiff's discovery demands.

In a letter dated February 7, 2007, defendants produced some additional documents including: B'Way's balance sheet as of October 31, 2005; B'Way's profit and loss statement from January 1, 2005 through October 1, 2005; Open Net's online bank statement from November 6, 2006 through February 7, 2007; New York State Department of Labor correspondence to "Open Net Inc dba Bway.Net"; correspondence from a tenant of Open Net regarding termination of a rental agreement; and Lynch's personal bank statements from May 20, 2005 through September 23, 2005. During a compliance conference on February 8, 2007, defendants were directed to produce all remaining records in accordance with previous court orders by February 22, 2007.

Songbird, initially a defendant in this action, has entered into a stipulation of settlement with plaintiff dated May 10, 2007. In the stipulation, Songbird consented that it would join in any motion made to appoint plaintiff as temporary receiver over the affairs of B'Way and Open Net during the pendency of this action "on the grounds, inter alia, that the [r]emaining [d]efendants have not been forthcoming with respect to their operations and the nature of the Judgment, and have failed to address Stevelman's and Songbird's claims as creditors."

Pursuant to the terms of its settlement with plaintiff, Songbird produced documents in its possession relating to its transactions with B'Way. Included in this production was a string of emails between Lynch and Frane. In a May 12, 2005 email, Lynch requested that Songbird

transfer funds to her personal account "because [Stevelman] could still potentially place a lien on the corporate bank account." Frane then wired \$50,000 from Songbird to her personal account on May 13, 2005.

In emails dated May 17 and May 24 2006, Lynch told Frane "I'm gradually winding down use of Bway.net, Inc. and I will soon need to set up payroll and unemployment accounts for the corporation I'm using to run the business (Open Net, Inc. a NY corp.)..." and "I have been slowly moving all of our accounts to Open Net in order to avoid my former partner being able to attach any assets." Regarding the Songbird lien on B'Way's assets, Lynch stated her "idea was to transfer the assets/exercise the lien effective 1-1-06 so that it will have taken place 9 months before he [Stevelman] is due any payment and hopefully be less suspicious." Regarding repayment of the Songbird Loan, Frane responded "its really up to you when you see that revenues/profits are at a level where you have the available cash flow."

In an email dated August 31, 2006, one day before she was to begin her monthly payments to Stevelman under the settlement, Lynch told Frane the following:

I just got off the phone with my attorney, with whom I have been discussing what to do since I am obligated to begin paying my former business [partner] the remainder of what's owed (\$200K) as of Sept. 1. My plan was to inform them that Bway's assets had been foreclosed on and that there was nothing left in the corporation to satisfy their judgment. The attorney raised several questions and possible legal issues, so before I do anything I wanted to find out if you (Songbird) would be willing to assume and retain ownership of the assets - with day to day operations contracted out to myself and the staff? We have been doing business as Open Net, Inc., but the attorney believes that things will be much cleaner if Songbird forecloses on Bway (as of Sept. last year) and retains ownership, as opposed to my original idea of having Songbird transfer the assets to Open Net. The atty. is concerned about the lack of documentation and money trail, while at least the Songbird lien has been filed and the loan can be tracked (albeit with a few different names involved...)

I don't know if this is a big problem, but I will ask for your assistance in creating the

original note between Bway and Songbird and deciding on a foreclosure date - and determining whether you are willing to 'own' Open Net, Inc. until this is resolved. I realize that this could have tax or other implications for Songbird, but at least Open Net is up to date on taxes and has not shown any income prior to 2006. On a more positive note, I hope we can begin repaying you by the end of this year - so long as I don't have to waste all of my resources in court.

Songbird then advised Lynch on October 12, 2006, that the loan documents were prepared and ready for her review. Lynch received them the next day.

II. *Conclusions of Law*

A. *Receiver*

Upon motion by a judgment creditor the court may appoint a receiver authorized to administer, collect, or sell any real or personal property in which the judgment creditor has an interest for the purpose of satisfying a judgment. CPLR 5228(a). In determining whether to appoint a receiver, the court will consider the: (1) alternative remedies available to the creditor; (2) the extent to which receivership will enhance the likelihood of satisfaction of the judgment; and (3) the risk of fraud or insolvency if a receiver is not appointed. *Chlopecki v. Chlopecki*, 296 A.D.2d 640, 641 (3rd Dept 2002). If the judgement creditor is appointed receiver, he is not entitled to compensation. *See* CLPR 5228(a).

Here, plaintiff has pursued several alternative remedies to enforce his judgment against B'Way. When B'Way could not make any payments in satisfaction of the prior judgment, plaintiff entered into the August 2005 settlement. B'Way defaulted under the terms of the settlement on September 1, 2006. Plaintiff then obtained a judgment by confession on September 28, 2006. In his efforts to enforce this judgment, plaintiff issued a subpoena for all of B'Way's banking and financial information related to its transactions with Open Net. When

Lynch refused to comply, he commenced the instant action. Defendants argue that the So Ordered Stipulation adequately protects plaintiff in this action. However, defendants are still permitted to transfer and remove assets in the “ordinary course of business”. The emails sent by Lynch to Frane display the possibility that Lynch fraudulently set up Open Net in order to prevent enforcement of plaintiff’s prior judgment. Further, Frane’s testimony that Songbird never acquired any ownership interest in Open Net, foreclosed on any of B’Way’s assets, or authorized the transfer of any assets adds further credence to the possibility that Lynch set up Open Net only to avoid paying the prior judgment. Any transactions that take place inside of Open Net would thus be relevant to the enforcement of plaintiff’s prior judgment. Stevelman would need to see exactly what is moving in and out of Open Net, B’Way, and “Open Net d/b/a B’Way”, especially those in the “ordinary course of business” to see if Lynch is fraudulently transferring and/or removing assets. As a result, plaintiff’s motion to be appointed as a temporary receiver is granted.

B. *Contempt of Court*

To prevail on a motion for civil contempt the movant must show that the party charged violated a clear, unequivocal court order, thereby prejudicing the rights of another party to the litigation. *Goldsmith v. Goldsmith*, 261 A.D.2d 576, 577 (2nd Dept 1999); Judiciary Law § 753(A)(3). The contempt must be proven by clear and convincing evidence. *Gloveman Realty Corp. v Jeffreys*, 29 A.D.3d 858, 859 (2nd Dept 2006).

Plaintiff argues that defendants have ignored prior court orders pretending “as if they do not exist.” However, defendants have provided documentation in response to the So Ordered Stipulation. Further, plaintiff has not demonstrated by clear and convincing evidence that

defendants have transferred or removed any assets in violation of the So Ordered Stipulation. Defendants also stated in their letter dated January 18, 2007, that B'Way's accountant removed all of B'Way's and Open Net's financial records when he quit in October 2006, thus making it difficult for defendants to comply with many of the discovery demands outlined in the So Ordered Stipulation. Plaintiff argues that this explanation is not "plausible", but offers no evidence to refute defendants' claim. In sum, plaintiff has not offered clear and convincing evidence that defendants willfully violated the So Ordered Stipulation thereby prejudicing his rights in the instant action. Accordingly, it is

ORDERED that plaintiff Ian Stevelman is appointed as a temporary receiver to monitor the administration of any and all transactions arising out of both the real and personal property of defendants B'Way.Net, Inc., and Open Net, Inc., including those in the ordinary course of business, during the pendency of this action; and it is further

ORDERED that notice of the appointment of plaintiff Ian Stevelman as receiver shall be provided to all known judgment creditors by certified mail; and it is further

ORDERED that plaintiff Ian Stevelman's motion for civil contempt pursuant to Judiciary Law § 753 is denied.

DATE: August 16, 2007
New York, N.Y.

FILED
AUG 24 2007
ENTER: NEW YORK
COUNTY CLERK'S OFFICE
J.S.C.