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

PRESENT: Freedman Justice

PART 39

Index Number : 600583/2006

ROSENAU BECK

VS.

ARAZI, FRANCES

SEQUENCE NUMBER : 004

PARTIAL SYMMARY JUDGMENT

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion is decided in accordance w the accompanying memorandum of law

FILED
AUG 29 2007
NEW YORK
COUNTY CLERK'S OFFICE

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

Dated: 8/27/07

J.S.C.

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 39

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ROSENAU BECK, INC. and M ENTERPRISES TOO, INC.,

Plaintiffs/Counterclaim Defendants, Index No.: 600583/06

-against-

FRANCES ARAZI and MARMELLATA CORP.,

Defendants/Counterclaim Plaintiffs,

-against-

TOM ROSENAU and BARRY RICHMAN,

Additional Counterclaim Defendants.

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Helen E. Freedman, J.:

In this action concerning the break-up of what plaintiffs deem a children's clothing joint venture and what defendants deem a financing relationship, defendants seek leave to amend its counterclaims to add an eighth counterclaim for conversion. Plaintiffs and counterclaim defendants include Rosenau Beck, Inc. ("RBI"), a Pennsylvania children's clothing company, and its affiliate, M Enterprises Too, Inc. ("METI"). Additional counterclaim defendants are RBI's principals and owners, Tom Rosenau ("Rosenau") and Barry Richman ("Richman"). Defendants and counterclaim plaintiffs include Marmellata Corp. ("MAR"), a New York children's clothing company, and Frances Arazi ("Arazi"), MAR's designer and its sole owner during the relevant time period. RBI and MAR manufacture children's clothing that they sell to retailers such as Wal-Mart, J.C. Penny, Costco, and Target.

On June 9, 1998, RBI and MAR executed the Partnership/Business Agreement signed by Arazi and RBI's owners and principals, Tom Rosenau ("Rosenau") and Barry Richman ("Richman")

(the "Business Agreement") under which MAR designed the clothing and RBI provided financial and "back office" support. MAR terminated the agreement in December 2005.

Plaintiffs claim that MAR and Arazi wrongfully terminated the Business Agreement and that they owe RBI a portion of the proceeds from MAR's clothing sales after the termination. RBI and METI assert causes of action for breach of contract, conversion, breach of fiduciary duty, and plaintiffs seek monetary and injunctive relief, imposition of a constructive trust, and an accounting. Defendants claim that RBI and METI improperly accounted for their share of profits and overcharged MAR, fraudulently induced plaintiffs to execute a supplemental agreement, and improperly interfered with MAR's customer and factoring relationships. Defendants assert counterclaims for interference with advantageous business relationships, breach of contract, fraud, fraudulent inducement, breach of fiduciary duty, and they seek money damages and an accounting.

Here, defendants move for leave to amend their counterclaims pursuant to CPLR 3025(b) to add a conversion counterclaim related to$1.6 million that RBI and METI allegedly misappropriated with the aid of plaintiffs' factor, Capital Factors, Inc. Defendants also seek partial summary judgment on the proposed counterclaim and an order directing plaintiffs to pay defendants $1.6 million. For the reasons stated below, the motion is denied.

Background:

The purpose of the 1998 Business Agreement was "to finance the orders held by MAR and develop an ongoing business initially as a division of Rosenau Beck (NMAR)." Under the Business Agreement, MAR operated a sales, design, and production company, and RBI paid MAR's weekly expenses based on bills due or paid as transmitted by MAR. MAR reimbursed RBI for direct costs plus interest at rate of 10% or prime plus 2.5%, whichever was greater. MAR was entitled to 33.3%

of NMAR's profits, and RBI was entitled to 66.6% of the profits..

In October 2003, RBI and other companies that Richman owned restructured. METI formed with Richman as its sole owner. At that time, RBI executed factoring and security agreements with Capital Factors, Inc. ("Capital Factors") in order to finance RBI's manufacture, purchase, and sale of inventory, including inventory bearing the "Marmellata" name. MAR consented to these factor and security agreements in a letter agreement to Capital Factors dated October 22, 2003 ("the Supplemental Agreement"). The Supplemental Agreement provided that MAR understood that Capital Factors and RBI had entered into factoring and security agreements to finance RBI's manufacture, purchase, and sale of inventory "including but not limited to inventory bearing the 'Marmellata' name (hereinafter 'Articles') ... as such exclusive rights were granted to RBI" in the Business Agreement. MAR recognized in the Supplemental Agreement that any claims that Capital Factors has or may have against the "Articles" under the RBI and METI security agreements "are superior to any lien or claim of any nature which the undersigned now has or may hereafter have to such Articles by statute, agreement, otherwise." With defendants' consent, Capital Factors advanced money to Rosenau Beck and METI against an account funded by MAR's accounts receivable, which were used as collateral. This account was known as the "METI Account." MAR instructed its customers to directly pay Capital Factors the accounts receivable against which Capital Factors advanced loans to Rosenau Beck and METI.

On December 7, 2005, MAR sent letters to Rosenau Beck's principals and to Capital Factors, informing them that MAR intended to terminate the Business Agreement as of December 9, 2005. The termination letter to Capital Factors stated that MAR withdrew the consent that it had provided in the Supplemental Agreement and stated that "Capital Factors will no longer factor any receivables

generated by Marmellata Corp."

In order to obtain new financing after its termination, MAR entered into a factoring relationship with Westgate Financial Corporation ("Westgate"). MAR instructed its customers not to pay Capital Factors and to directly pay its new factor, Westgate.

On January 30, 2006, Richman requested that Capital Factors transfer $2.28 million out of the METI Account. Since the METI Account contained $567,000, this transfer left a negative balance of $1.6 million. In order to recover the $1.6 million, Capital Factors asserted a lien on MAR's accounts receivable, including accounts receivable due from Wal-Mart.

In February 2006, Rosenau Beck commenced this action against MAR and Arazi. MAR and Arazi then commenced litigation against Capital Factors, seeking to vacate Capital Factors' lien on MAR's accounts receivable. At that time Wal-Mart owed MAR approximately $4.5 million, and Capital Factors asserted a lien on all of the accounts receivable until it received $1.6 million. Westgate, MAR's new factor, also claimed a right to collect from Wal-Mart. Facing potential claims from both Capital Factors and Westgate for the same goods, Wal-Mart waited for clear direction from court order or party agreement before making any payment. MAR contended that Capital Factors no longer had the right to its accounts receivable and instead its customers should directly pay Westgate. MAR also sought an accounting from Capital Factors related to the $1.6 million. Rosenau Beck and METI sought to intervene in that case because they were the entities that had contractual relationships with Capital Factors. This Court granted the motion to intervene and ordered Rosenau Beck and METI to provide an accounting to Marmellata. On March 10, 2006, they provided an accounting for the time period January 1, 2005 to March 9, 2006.

On March 30, 2006, the parties entered into a stipulation, which the Court "so-ordered" on

April 11, 2006 (the "2006 Stipulation"). The parties agreed to consolidate the actions and release the factors, Capital Factors and Westgate, as parties. The parties to the 2006 Stipulation signed a joint direction letter instructing customers to remit payment to Westgate for invoices dated after December 8, 2005 and to remit payment to Capital Factors for invoices dated before December 8, 2005. With respect to the disputed accounts receivable totaling $1.6 million, Westgate would pay that amount to Capital Factors at which time Capital Factors would release MAR's assets and, in its sole discretion, apply the $1.6 million to METI's outstanding obligations to Capital Factors. Upon "final resolution of the consolidated action" and

> to the extent that RBI and METI are awarded a judgment, or determined to recover nothing, or less than $1.6 million (the 'Lower Amount'), from the Marmellata Parties, then the difference between the Lower Amount and the $1.6 million, or the $1.6 million in its entirety, as the case may be, shall be promptly remitted by Capital Factors to Westgate on account of Marmellata.

Contentions:

MAR contends that plaintiffs' January 2006 transfer of $2.28 million out of the METI Account, which left a $1.6 million deficit in that account, constituted a conversion of $1.6 million because plaintiffs knew that Capital Factors would pursue MAR for the $1.6 million deficit. Although Richman attests that $1.6 million was the sum that he estimated MAR owed plaintiffs at the time of MAR's termination, MAR contends that the financial documents do not demonstrate an outstanding debt of $1.6 million, and that the March 2006 accounting contains discrepancies and improper charges. Defendants aver that they had no choice but to sign the 2006 Stipulation providing for Capital Factors' receipt of the $1.6 million in order to vacate the lien and to stay in business. MAR contends that it has not only stated a prima facie case for conversion, but that no material issues of fact remain, warranting partial summary judgment on that counterclaim.

Plaintiffs contend that the motion to amend is untimely, and it is not based on new information. Plaintiffs aver that the 2006 Stipulation already resolved defendants' claim for $1.6 million against Capital Factors and precludes an additional claim for conversion against plaintiffs. Plaintiffs contend that no conversion claim is stated because no specific fund is identified, Capital Factors, not plaintiffs, took possession of the funds, and MAR assigned any right that it had to the $1.6 million to its factor Westgate. Plaintiffs further contend that summary judgment on that issue is premature because issue has not been joined, and material factual issues exist regarding the remaining accounting issues.

Discussion:

Although leave to amend should be liberally granted (CPLR 3025(b)), the merits of the proposed pleadings must state viable causes of action. *See DiPasquale v. Security Mut. Life Ins. Co. of New York,* 13 A.D.3d 100 (1st Dept. 2004). Here, the proposed amendment does not state a meritorious claim.

Conversion is "an unauthorized assumption and exercise of the right of ownership over goods belonging to another to the exclusion of the owner's rights." *Peters Griffin Woodward, Inc. v. WCSC, Inc.*, 88 A.D.2d 883 (1st Dept. 1982). Money, if specifically identifiable, may be the subject of a conversion claim. However, there is no conversion claim stated where the damages sought duplicate breach of contract damages, *Retty Financing, Inc. v. Morgan Stanley Dean Witter & Co.*, 293 A.D.2d 341 (1st Dept. 2002), or where the party asserting the claim "never had ownership, possession, or control of the disputed monies," *Whitman Realty Group, Inc. v. Galano,* 41 A.D.3d 590 (2nd Dept. 2007).

Here, defendants' proposed conversion counterclaim is based on defendants' assertions that

(1) plaintiffs had no right under the Business Agreement to transfer money out of the METI Account after MAR's termination, despite Richman's contention that MAR owed plaintiffs approximately $1.6 million at the time of MAR's termination, and (2) plaintiffs knew that Capital Factors would pursue MAR for the $1.6 million debt caused by plaintiffs' transfer. To the extent the proposed conversion counterclaim is based on allegations that plaintiffs breached their contractual and fiduciary duties by transferring money out of the METI Account, the proposed counterclaim duplicates defendants' breach of contract and fiduciary duty counterclaims. To the extent the proposed counterclaim is based on Capital Factors' pursuit of MAR's accounts receivable, the 2006 Stipulation already resolved that issue, at least until "final resolution" of this action.

Additionally, the money allegedly converted is not a specifically identifiable fund in which defendants have a possessory interest. Capital Factors sought to collect an amount of money from MAR's customers, not proceeds from specific sales. See *Independence Discount Corp. v. Bressner*, 47 A.D.2d 756 (2nd Dept. 1975)(finding no conversion claim stated where defendant debtor had no obligation to pay plaintiff secured creditor specific proceeds from specific sales or to segregate proceeds from defendant's general corporate fund). Also, if MAR's allegations are true and Capital Factors did not have a right to its accounts receivable after the December 2005 termination, then it is Westgate that has a possessory interest in the fund. When MAR commenced litigation against Capital Factors to vacate the lien on MAR's accounts receivable, the dispute was whether Capital Factors or Westgate had a right to collect the accounts receivable. The 2006 Stipulation resolved the dispute between the factors. Paragraph 18 of the 2006 Stipulation provides that Westgate has a senior and properly perfected security interest in all of MAR's assets including the disputed accounts receivable. Under the 2006 Stipulation if upon final resolution plaintiffs do not recover or

they recover less than $1.6 million from defendants (referred to as the "Lower Amount" in the 2006 Stipulation), Capital Factors will remit the difference between $1.6 million and the Lower Amount to Westgate.

Since there is no claim stated for conversion, the branch of defendants' motion seeking summary judgment on the proposed counterclaim is denied.

Accordingly, it is

ORDERED that defendants' motion to amend its counterclaim and for summary judgment on its proposed claim is denied.

Parties are directed to appear for a status conference in Room 208 on September 18, 2007 at 9:30 a.m. as previously scheduled.

DATED: August 27, 2007 ENTER:

Helen E. Freedman, J.S.C.