

**Cit Group/Commercial Servs., Inc. v Star City
Sportswear, Inc.**

2008 NY Slip Op 33339(U)

December 9, 2008

Supreme Court, New York County

Docket Number: 100823/08

Judge: Joan A. Madden

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

PRESENT: Hon. Joann A. W. Elder

PART 11

Index Number : 100823/2008
THE CIT GROUP/COMM. SERVICES
vs
STAR CITY SPORTSWEAR, INC.
Sequence Number : 001
TURNOVER PROCEEDING

INDEX NO. _____
MOTION DATE: 4-2-08
MOTION FILE NO. _____
MOTION CAL. NO. _____

Where appropriate, please indicate the date of this motion to the

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 granted and costs are awarded to the movant and discovery is ordered.

FILED
APR 2 2008
CLERK OF COURT

Dated: December 9, 2007

[Signature]
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

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

SUPREME COURT OF THE CITY OF NEW YORK
COUNTY OF NEW YORK: PART 11

-----x
THE CIT GROUP/COMMERCIAL SERVICES, INC.,

Petitioner,

Index No.: 100823/08

-against-

DECISION AND ORDER

STAR CITY SPORTSWEAR, INC. ROBERT
KLEIN, ALAN COHEN, ROSALIE COHEN,
JASON COHEN, APPAREL CUTTING EXPERTS,
INC., PIERMONT FARMS, INC, and FORTIS
BUSINESS HOLDINGS, LLC,

Respondents.

-----x
JOAN A. MADDEN, J.

FILED
DEC 15 2008
COUNTY CLERK'S OFFICE
NEW YORK

In this turnover proceeding, petitioner seeks to set aside transfers from respondent Star City Sportswear, Inc. (Star City) to the other respondents. Respondents oppose the petition and cross move to dismiss it. As set forth below, the cross motion is denied, and the petition is granted to the extent of setting the matter down for a hearing to resolve the factual issues delineated below.

Petitioner is a factor and Star City is a clothing manufacturer. Robert Klein (Klein) was a 50% owner, director and officer of Star City; Alan Cohen (A.Cohen) was a 50% owner, director and officer of Star City; Rosalie Cohen (R.Cohen) is the wife of A.Cohen, and allegedly a creditor of Star City; Jason Cohen (J.Cohen) is the son of A.Cohen, and

allegedly a creditor of Star City; Apparel Cutting Experts, Inc. (Apparel) is another corporation in which A.Cohen and Klein are 50% shareholders and officers; and Piermont Farms, Inc. (Piermont) is a corporation owned by A.Cohen, R.Cohen, J.Cohen, and another son of A.Cohen. By stipulation dated April 15, 2008, petitioner has discontinued the action against Fortis Business Holdings, LLC, with prejudice.

Between June and December 2006, Star City transferred funds to the other respondents, allegedly to repay loans with interest, as well as weekly consulting fees of \$6,800 each to Klein and A.Cohen, paid through Apparel. The consulting fees were paid in addition to Klein's and A.Cohen's salaries. Petitioner alleges that these transfers were made at a time when Star City was insolvent, and made to the detriment of other creditors.

Petitioner bases its argument on Star City's 2005 income tax return, in which Star City indicated that its liabilities exceeded its assets by \$142,830. Petitioners also point out that on November 10, 2006, Star City acknowledged in writing to another creditor, Rosenthal & Rosenthal, Inc. (R&R), that it was unable to meet its financial obligations, and on December 11, 2006, one week after two of the transfers subject to this turnover proceeding took place, Star City entered into a Peaceful Possession Agreement with R&R, divesting itself of what remained of its property.

On November 30, 2006, petitioner instituted suit against Star City for the Star City debt it had acquired. On January 5, 2007, petitioner obtained a default judgment against Star City in the amount of \$194,694.54, plus interest of \$7,861.83, and costs of \$550, for a total of \$203,106.37.

The transfers that are subject to this turnover proceeding consist of the following:

1. On December 4, 2006, Star City repaid a loan from Klein of \$261,627.99, and a loan from A.Cohen of \$121,172.99, by transferring funds to Apparel;

2. Between June 1, 2006 and October 19, 2006, Star City paid a total of \$55,463.50 in interest checks to A.Cohen/R.Cohen, presumably as interest on a loan R.Cohen took out for the benefit of Star City;

3. Between June 30, 2006 and September 21, 2006, Star City issued checks to Klein, presumably as interest on a loan, for a total amount of \$17,032.09;

4. Between August 24, 2006, and December 5, 2006, Star City paid \$21,613.05 each to Klein and A.Cohen, over and above their salaries;

5. Between June 5, 2006, and August 21, 2006, Star City wire transferred a total of \$61,835.68 to Piermont;

6. On or about July 6, 2006, Star City paid \$400,000 to J.Cohen, allegedly as repayment of a loan.

Additionally, petitioner initially alleged certain transfers to Fortis Business Holdings, LLC, but those are now moot, pursuant to the stipulation referred to above.

Petitioner now seeks to recover from respondents the amount of its judgment, plus interest from January 5, 2007, and reasonable attorney's fees. Respondents oppose the petition and have cross-moved to dismiss it, arguing that none of the transfers were fraudulent, that all of the transfers were made for fair consideration, and that Star City was solvent at the time the transfers were made.

DISCUSSION

CPLR 5225(b) authorizes a special proceeding against transferees from a judgment debtor "where it is shown that the judgment debtor is entitled to such property or that the judgment creditor's rights to the property are superior to that of the transferee." Further, CPLR § 5227 authorizes such proceedings against "any person who it is shown is or will become indebted to the judgment debtor." The determination as to whether the judgment creditor's rights are superior to the rights of the transferee is conditioned upon whether the transfer is deemed to be a "fraudulent conveyance" under the New York Debtor Creditor Law (DCL).

In order to have a transfer set aside in a turnover proceeding, the petitioner must prove either that: one, the

judgment debtor's transfer was fraudulent as to creditor without regard to actual intent as it lacked "fair consideration," pursuant to DCL §§ 273, 274, or 275; or two, the judgment debtor actually intended to defraud the judgment creditor by the transfer, pursuant to DCL § 276.

Primarily at issue here is whether the relevant transfers were fraudulent under Debtor and Creditor Law § 273. Under this section, "a conveyance made and every obligations incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made without fair consideration."¹ Thus, for a transfer to be fraudulent under DCL § 273, it must have been made without fair consideration, and must have been made by a transferor who was insolvent or rendered insolvent by the transfer. Petitioner has the burden of proving, by clear and convincing evidence, that the transfers were fraudulent conveyances as defined under DCL § 273. *Farkas v. D'Oca*, 305 AD2d 237 (1st Dept 2003); *but see, In re Borriello*, 329 BR 367, 373 (Bankr. ED NY 2005) (bankruptcy trustee seeking to set aside a conveyance as fraudulent under DCL § 273 has the burden of proof by a

¹Also fraudulent are transfers made without fair consideration which would leave the transferor with an unreasonably small amount of capital with which to operate the business (DCL § 274); or the transfer was made when the transferor knew that debts would be incurred beyond its ability to pay (DCL § 275).

preponderance of the evidence).

"Fair consideration" exists "when in exchange for such property or obligation, as a fair equivalent therefor, and in good faith property is conveyed or an antecedent debt satisfied." (DCL § 272 [b]), or "[w]hen such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compare to the value of the property or obligation obtained" (DCL § 272 [b]). Notably, "fair consideration requires that the exchange not only be for equivalent value, but also that the conveyance be made in good faith." *Ede v Ede*, 193 AD2d 940 (3d Dept 1993).

With respect to the issue of insolvency, DCL § 271 provides that:

"A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."

Grace Plaza of Great Neck, Inc. v Heitzler, 2 AD3d 780 (2d Dept 2003).

Petitioner alleges that all of the transfers made by Star City lacked "fair consideration" since they were made to the benefit of officers, directors and shareholders, or those person's family members, or companies controlled by those persons, of the insolvent transferor in derogation of the interests of other creditors. *P.A. Building Company v Silverman*, 298 AD2d 327 (1st Dept 2002) (preferential transfers to directors,

officers and shareholders of insolvent corporation in derogation of rights of other creditors are not made in good faith).

In addition, petitioner assert that the record--including Star City's 2005 tax returns and its written acknowledgment dated November 11, 2006 to its creditor, R&R, that it was unable to meet its financial obligations and its Peaceful Possession Agreement with R&R dated December 11, 2006 in which Star City agreed to divest itself of its remaining property--demonstrates that the transfers at issue were made while Star City was insolvent.

Respondents counter that Star City was not insolvent at the time the transfers were effectuated, and therefore the transfers were not prohibited under the Debtor and Creditor Law. Specifically, respondents state that the 2005 income tax return upon which petitioner bases its assertion of Star City's insolvency indicates assets at their book, not salable value. In his affidavit, A.Cohen states that during 2005, and most of 2006, Star City's assets, valued at their "salable" value, indicate that Star City was solvent. Further, A. Cohen states that petitioner ignores that he and Klein provided a shareholder loan of \$1 million in early 2006, before the transfers were made, which increased Star City's value and liquidity.

Respondents also submit the affidavit of their controller, Bernard Stern ("Stern"), who states that the presumed transfers

to Klein and A.Cohen were not in fact transfers, but were merely book entries made for the sole purpose of reconciling Star City's financial records at the end of 2006. According to Stern, the debts were not repaid to Klein and A.Cohen, but were written off as a set off against a credit Apparel owed Star City.

Respondents also assert that the loan repayment to J.Cohen was not an intrafamily transfer, but was an antecedent debt obligation evidenced by a promissory note.² Likewise, respondents assert that the transfers to R. Cohen were made in connection with an antecedent debt in connection with a \$300,000 loan made by her to Star City years earlier and submit a closing statement for the loan in support of this assertion.

"A determination of insolvency and what constitutes fair consideration are generally questions of fact." *Epstein v. Nieves*, 258 AD2d 436, 436 (2d Dept 1999). See also, *Quality Jewelry Co. v. Genevit Creations, Inc.*, 248 AD2d 103, 106 (1st Dept 1998); *49-50 Associates v. Free-Tan Corp.*, 248 AD2d 128 (1st Dept 1998); but see, *CIT Group/Commercial Services, Inc. v 160-09 Jamaica Avenue Limited Partnership*, 25 AD3d 301 (1st Dept 2006).

²The court notes, however, that the copy of the alleged promissory note attached as an exhibit to respondents' papers contains a few questionable items. For instance, the note is a commercially produced form with information filled in. The date appearing on the note is May 5, 2006. The note says the money was loaned on July 6, 2006, two months after the note was presumably executed. The repayment date for the alleged \$400,000 loan is July 6, 2006, the same day as the alleged loan.

Here, while petitioner has provided evidence, including the timing of the alleged transfers at issue and the relationship between the Star City and transferees, which suggests that the transfers in question were made without fair consideration or not in good faith and therefore were fraudulent under DCL § 273, such evidence is insufficient to meet petitioner's burden. In any event, the evidence submitted by respondents raise factual questions as to these issues.

Similarly, issues of fact exist as to whether the transfers were fraudulent under DCL § 275, which would require a showing that the transfers at issue were made without fair consideration when Star City intended or believed that it would incur debts beyond its ability to pay as they matured.³ Likewise, it cannot be determined on this record if the transfers were made without fair consideration when Star City had unreasonably small capital for its business or a transaction.⁴

³DCL § 275 provides that:

a conveyance made without fair consideration at a time when the person making the conveyance intends or believes that he [or she] will incur debts beyond his [or her] ability to pay as they mature, is fraudulent as to both present and future creditors. Pursuant to this constructive fraud provision, a conveyance made by a person who has a good indication of oncoming insolvency is deemed to be fraudulent [internal quotation marks and citation omitted].

⁴DCL § 274 provides that:

Next, issues of fact exist as to whether the transfers were fraudulent under DCL § 276, which provides that "[e]very conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors."

"DCL § 276 addresses actual fraud, as opposed to constructive fraud, and does not require proof of unfair consideration or insolvency," and the pleader is permitted to rely on "badges of fraud" such as a close relationship between the parties involved in the transfer, to show actual intent to defraud or hinder present or future creditors. *Wall Street Associates v Brodsky*, 257 AD2d 526, 529 (1st Dept 1999). At the same time, however, such "badge[s]" of fraud "merely permit[] an inference of fraudulent intent [and]..[are] not conclusive," and to set aside a conveyance as fraudulent it must be shown by clear and convincing evidence that there was an actual intent to defraud. *Sybax, Inc. V. Bingaman*, 219 AD2d 552 (1st Dept 1995);

Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in the hands after the conveyance is unreasonably small capital, is fraudulent as to the creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to actual intent.

Jamaica Avenue Limited Partnership, 25 AD3d at 306; see also, *Guerrand-Hermes v. Guerrand-Hermes*, 30 AD3d 339 (1st Dept 2006) (fact question as to whether borrower-son had "honest purpose" in making a judgment by confession in favor of lender-father warranted a hearing on motion by borrower's ex-wife to vacate judgment by confession as a fraudulent conveyance under DCL § 276).

In the instant case, while the relationship between the Star City and the transferees may constitute "a badge of fraud, placing a heavier burden on transferee[s] to establish fairness" (*Jamaica Avenue Limited Partnership*, 25 AD3d at 306), it cannot be said on this record that the transfers were made with the intent to defraud. In particular, the evidence submitted by respondents, including the affidavit of A. Cohen, raise factual and credibility issues that cannot be resolved without a hearing.

Finally, as there are factual questions as to whether the conveyances were fraudulent under DCL § 276, petitioner's request for reasonable attorneys' fees and cost, as permitted pursuant to DCL § 276-a, is held in abeyance pending a determination of whether the transfers were fraudulent under DCL § 276.

CONCLUSION

Based on the foregoing, it is hereby

ORDERED that petition is granted only to the extent of referring the issues set forth below to a Special Referee to hear

and report with recommendations except that, in the event of and upon the filing of a stipulation of the parties, as permitted by CPLR 4317, the Special Referee, or another person designated by the parties to serve as referee, shall determine these issues; and it is further

ORDERED that the Special Referee will hear and report, or if stipulated between the parties, determine the following issues based on the law as set forth in this decision and order whether petitioner has shown, by clear and convincing evidence, that the transfers at issue:

(1) were made without fair consideration and were made when Star City was insolvent, and or rendered Star City insolvent as required to demonstrate a fraudulent conveyance under DCL § 273;

(2) were made without fair consideration and were made when Star City intended or believed that it would incur debts beyond its ability to pay as they matured as required to demonstrate a fraudulent conveyance under DCL § 274;

(3) were made without fair consideration and were made when Star City had unreasonably small capital for its business or a transaction as required to demonstrate a fraudulent conveyance under DCL § 275;

(4) were made with the intent to hinder, delay or defraud present or future creditors as required to demonstrate a fraudulent conveyance under DCL § 276.

and it is further

ORDERED that counsel for the petitioner shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet⁵

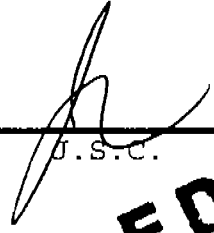
⁵Copies are available in Rm. 119 at 60 Centre Street, and on the Court's website.

upon the Special Referee Clerk in the Motion Support Office in Rm. 119 at 60 Centre Street, who is directed to place this matter on the calendar of the Special Referee's Part (part 50R) for the earliest convenient date; and it is further

ORDERED that the cross motion to dismiss the petition is denied; and it is further

ORDERED that counsel for the parties shall contact the court to set up a conference call with the court (646-386-3190) to discuss procedures in connection with the referral of this matter to a Special Referee.

Dated: December 9, 2008



J.S.C.
FILED
DEC 15 2008
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NEW YORK