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

PRESENT: HON. RICHARD B. LOWE III Justice

PART 27 56M

In the Matter of the Application of James C. Witham Petitioner

- v -

Ufinance Investments Inc and National Financial Services, LLC Respondent

INDEX NO. 603378/07

MOTION DATE 10/17/07

MOTION SEQ. NO. 001

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 ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

FILED

NOV 28 2007

NEW YORK COUNTY CLERK'S OFFICE

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

Dated: 11/21/07

HON. RICHARD B. LOWE, III

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: IAS PART 56

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JAMES C. WITHAM,

Index No: 603378/07

Petitioner,

Pursuant to CPLR § 7502(c) for an Injunction in Aid of Arbitration

/DECISION/

- against-

VFINANCE INVESTMENTS, INC. and
NATIONAL FINANCIAL SERVICES, LLC,

Respondents.

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RICHARD B. LOWE III, J:

Petitioner James C. Witham ("Petitioner") seeks a preliminary injunction in aid of arbitration pursuant to CPLR 7502(c) to enjoin Respondents VFinance Investments, Inc. ("VFinance") and National Financial Services, LLC ("NFS") (collectively "Respondents") from the sale or other disposition of Petitioner's common stock in AquaCell Technologies, Inc. ("AquaCell") held in a brokerage margin account with VFinance.

BACKGROUND

Petitioner is the Chief Executive Officer and Chairman of the Board of AquaCell. VFinance is a brokerage firm, which holds 1.5 million shares of Petitioner's restricted common stock in AquaCell in a margin brokerage account (the "Witham Account"). NFS is the current clearing agent of VFinance that seeks repayment of the loan collateralized by 82,050 shares of stock in the Witham Account.

The grounds for the Arbitration action occurred in 2001 when Non-party Nicholas Patrick Thompson ("Thompson") and Non-party Douglas J. Toth ("Toth"), then officers of

Somerset Financial Group, Inc. ("Somerset"),[1] approached Petitioner asking for a loan of $100,000 to serve as a bridge loan so that Somerset could structure its own private placement.[2]

Petitioner did not have the requested amount on hand. Allegedly, on the advice of Thompson and Toth, he opened a brokerage account with Somerset and transferred 1.5 million shares of his AquaCell stock. The Witham Account was later transferred to VFinance[3]. Petitioner claims that he never gave his consent for such transfer. The purpose of the Witham Account was for Petitioner to margin a portion of the stock (namely 82,050 shares) as collateral for a loan in the amount of $100,000 from Correspondent Services Corp. ("CSC"), then the clearing agent of Somerset, which later became associated with NFS (collectively "CSC/NFS"). Petitioner used this money to make his loan to Somerset. Petitioner also obtained a promissory note for $100,000 signed by Thompson on behalf of Somerset. The loan was to be paid after 30 days with ten percent interest. Somerset failed to pay the loan back to Petitioner when it became due and it remains unpaid.

After the loan to Somerset, the price of AquaCell stock started to decline rapidly from $4.70 per share on October 31, 2001 to $0.01 per share in November 2006 and was trading below $0.10 per share for most of December 2006. Thus, the collateralized shares of stock in the Witham Account became insufficient to secure the loan from CSC (and later NFS) to Petitioner.

CSC/NFS made a number of calls to cover the loan from 2002 through 2006. Petitioner never paid on the calls. He alleges that Thompson and Toth promised him that Somerset would "take care" of his loan to CSC/NFS and his stock would not be sold. Since 2001, Petitioner failed to pay on the calls and CSC/NFS never tried to sell the collateralized stock. Petitioner

[1] Somerset was the brokerage firm that acted as the underwriter for the initial public offering of AquaCell Stock on the American Stock Exchange in 2001. Somerset is a party neither to the Arbitration nor to the instant motion.
[2] Somerset, its officers and Petitioner had prior business relations, as Somerset was the brokerage firm for AquaCell.

[3] The facts surrounding the transfer are unclear. However, Thompson and Toth, originally officers of Somerset, became associated with VFinance at the time the Witham Account was transferred.

alleges that Somerset and VFinance were wrongfully using the accounts of other Somerset clients to cover the margin calls on the Witham Account. Petitioner also alleges that the loan he made to Somerset was not used for the purposes that were represented to him. Instead, the loan was allegedly used to keep Somerset afloat.

In the past year, AquaCell stock began to increase in value once again and, at the time of filing this motion, was selling for approximately $0.50 per share. Petitioner alleges that despite the oral agreement between him and Somerset not to sell the stock, NFS made a house call on September 18, 2007 and threatened to sell enough stock in the Witham Account to cover the call if Petitioner did not cover it. Petitioner's new clearing agent gave him 30 days to cover the calls or seek an injunction from the court to prevent the transfer of stock in the Witham Account.

Petitioner initiated an Arbitration action against VFinance, Thompson, NFS and Stephan John Cucchia ("Cucchia") alleging that he was fraudulently induced into margining his AquaCell stock and giving a loan to Somerset. Cucchia, originally an officer of CSC, is an officer of NFS. Petitioner alleges that Cucchia, Thompson and Toth worked together in devising a scheme to fraudulently induce Petitioner to provide a loan to Somerset. Petitioner seeks, inter alia: (a) a declaration that Petitioner is not responsible for covering any calls on his stock held in an account by VFinance and (b) a permanent injunction enjoining VFinance and NFS from enforcing any calls on the account and from selling, transferring and/or otherwise seeking to dispose of any stock held in this account.

In the instant motion, Petitioner seeks a preliminary injunction in aid of arbitration pursuant to CPLR §7502(c). He seeks to enjoin VFinance and NFS from the sale or other disposition of stock in the Witham Account. Petitioner argues that a denial of the relief sought in this motion would permit exactly what the declaratory and injunctive relief sought in

Arbitration is meant to prevent – a transfer of the stock in the Witham Account. He argues that without the requested temporary and preliminary injunctive relief any award in Arbitration would be rendered ineffectual. Petitioner also argues that this is the only applicable standard to the motion pursuant to §7502(c).

Respondents oppose, saying that all the general standards for a preliminary injunction are applicable and argue that Petitioner fails to meet such standards.

DISCUSSION

1. *Standard for Granting a Preliminary Injunction Pursuant to CPLR 7502(c)*

CPLR 7502(c) provides for provisional relief in aid of arbitration in the form of an attachment or preliminary injunction. The relief may only be granted "upon the ground that the award to which the applicant may be entitled may be rendered ineffectual without such provisional relief. The provisions of articles 62 and 63 of this chapter shall apply to the application, including those relating to undertakings and to the time for commencement of an action ..., except that the sole ground for granting of the relief shall be as stated above." (CPLR 7502(c).)

Traditionally, the Courts, in considering provisional remedies pursuant to CPLR 7502(c), looked exclusively to whether the arbitration award would be ineffectual without the grant of an injunction. In *Natl. Telecom. Assoc. v Natl. Communications Assoc.* (189 AD2d 573, 573 [1st Dept 1993]), the court held that irreparable harm and a likelihood of success on the merits are an inappropriate standard for deciding a motion for preliminary injunction pursuant to CPLR 7502(c) because the only grounds for such a motion is whether the award may be rendered ineffectual without it. (*See also H.I.G. Capital Management, Inc. v Ligator*, 233 AD2d 270, 271 [1st Dept 1996] (holding that the courts may issue a preliminary injunction in aid of arbitration

"but only upon the ground that the award to which the applicant may be entitled may be rendered ineffectual without such provisional relief. This is the sole applicable standard."); *County Natwest Sec. Corp., USA v Jesup, Josephthal & Co.*, 180 AD2d 468, 469 [1st Dept 1992]; *Drexel Burnham Lambert Inc. v Ruebsamen*, 139 AD2d 323, 327-328 [1st Dept 1988].) These cases support Petitioner's position that the sole applicable standard for a motion for a preliminary injunction in aid of arbitration is that the arbitration award would be ineffectual without the grant of such an injunction.

However, the Courts later began to consider the general criteria under Articles 62 and 63 for granting a preliminary injunction (likelihood of success on the merits, irreparable injury and a balance of the equities) in conjunction with the ground of an ineffectual award at arbitration under Article 75. In *Matter of Cullman Ventures*, 252 AD2d 222, 230 [1st Dept 1998], the court held:

> "[W]e apply the general criteria governing the issuance of injunctive relief to an application for a preliminary injunction under CPLR 7502 (c) [citations omitted], and, on this record, petitioners have failed to demonstrate a likelihood of success on the merits, irreparable injury, or that the equities balance in their favor."

(*See also New York City Off-Track Betting Corp. v New York Racing Assn.*, 250 AD2d 437, 440-441 [1st Dept 1998]; *Koob v IDS Fin. Servs.*, 213 AD2d 26, 32-33 [1st Dept 1995].) Thus, Respondents' position that the traditional criteria for a preliminary injunction must be shown when applying CPLR §7502(c) also has support in New York law.

The United States Court of Appeals, Second Circuit noticed this ambiguity in New York case law, stating that:

> "Notwithstanding [the decisions where the Appellate Court held an ineffectual arbitration award the sole ground under CPLR 7502(c)], New York caselaw is at best ambivalent about whether or not Section 7502(c) requires that traditional equitable criteria for the granting of temporary relief be met, and several cases

hold or imply that Article 63 criteria must be applied to a motion under Section 7502(c)." (*SG Cowen Securities Corp. v Messih*, 224 F.3d 79, 82 [2d Cir 2000].)

Although the decisions of this Court vary on the applicable standard under CPLR 7502(c), (*compare GBI Capital Partners, Inc. v Aivaliotis*, 2001 WL881105 [Sup Ct, New York County 2001], *with CanWest Global Communications Corp. v Mirkaei Tikshoret Ltd.*, 9 Misc.3d 845 [Sup Ct, New York County 2005]), we are bound by the most recent decisions of the Appellate Division, holding that the traditional elements of a preliminary injunction (irreparable harm, likelihood of success on the merits and a balance of the equities) are necessary in conjunction with a determination that the arbitration award would be rendered ineffectual without provisional remedies. (*See e.g. Founders Ins. Co. v Everest Natl. Ins. Co.*, 41 AD3d 350, 350 [1st Dept 2007]; *Erber v Catalyst Trading, LLC*, 303 AD2d 165 [1st Dept 2003] ("the criteria for provisional relief set forth in CPLR articles 62 and 63 are not relaxed when such relief is sought in aid of arbitration pursuant to CPLR 7502 (c).").)

Therefore, an appropriate standard of review for granting a preliminary injunction in aid of arbitration for this court is, first, whether the arbitration award would be rendered ineffectual without injunctive relief. Then, the Court must consider: (1) likelihood of petitioner's success on the merits; (2) danger of irreparable harm to the petitioner if the preliminary relief is denied; and (3) a balance of the equities in the petitioner's favor. The burden of proof all of the elements rests with the petitioner.

2. *Whether the Arbitration Award Will Be Rendered Ineffectual*

As stated above, the first consideration for determining whether a preliminary injunction under CPLR 7502(c) should be granted is if the arbitration award would be rendered ineffectual without provisional relief. Petitioner argues that without provisional relief Respondents are

permitted to do exactly what he seeks to prevent in Arbitration, transfer the stock in the Witham Account. Aside from the financial benefits of stock ownership, there are also corporate control rights associated. Petitioner argues, and the Court agrees, that control of the company through stock is an important aspect. The arbitration panel will determine who has rightful ownership of the stock, or portions thereof, in the Witham Account. If a transfer occurs prior to an arbitration determination of who rightfully has ownership of the stock, then the control of the company would be transferred prior to figuring out who has the rights to it. Thus, an arbitration award would be rendered ineffectual without provisional relief because Petitioner would lose the right to control his stock and the company through voting the shares, a right he would be unable to regain with an arbitration award in his favor.

3. *Likelihood of Success on the Merits*

A party moving for a preliminary injunction need not establish a certainty of success. (*See Props for Today, Inc. v Kaplan,* 163 AD2d 177, 178 [1st Dept 1990].) Rather, a *prima facie* showing of an entitlement to relief is sufficient. (*See Parkmed Co. v Pro-Life Counseling, Inc.*, 91 AD2d 551, 553 [1st Dept 1982].) Respondents argue that Petitioner failed to make such showing. In particular, they argue that "[t]he only issue that Respondents need prevail on is the fact that they are authorized to sell the stock at issue" and "[t]he margin agreement executed by petitioner clearly gives Respondents this right." (Respondents' Affirmation in Opposition, ¶ 16.)

Petitioner does not dispute terms of contract, but rather argues that he was fraudulently induced into the contract. In the Arbitration complaint, Petitioner raises a number of causes of action. Among them he claims he was defrauded into transferring his AquaCell stock into the Witham Account, margining his shares and loaning the proceeds of the loan to Somerset; that

CSC/NFS were aiding and abetting this fraud and thus that the margin agreement with CSC/NFS was an element in the fraudulent scheme.

Rescission of a contract may be granted when a party was induced to enter into it by fraud or misrepresentation. If Petitioner can establish fraud during the Arbitration proceedings, then the whole margin agreement would be void. This means that the claims of fraud, aiding and abetting fraud, and breach of fiduciary duty have an effect on Respondents' rights to liquidate the stock. Therefore, contrary to defendants' argument, Petitioner needs to show a likelihood of success on his arbitration claims in general.

Petitioner alleges that CSC/NFS either played an active role in the fraudulent scheme or, alternatively, aided and abetted the fraud and the breach of fiduciary duty. Petitioner alleges that a fiduciary relationship developed between him, Thompson, Toth and VFinance as well as between him, CSC/NFS and Cucchia. (Petitioner's Statement of Claim, ¶¶ 72-75.) The relationship then developed during the long business relations with Respondents. He also alleges that Thompson and VFinance breached their fiduciary duties when they induced him to collateralize his AquaCell stock to CSC/NFS, loan the proceeds to Somerset and never intended to repay the loan. (Petitioner's Statement of Claim, ¶ 76.) (*See Apple Records, Inc. v Capital Records, Inc.*, 137 AD2d 50, 57 [1st Dept 1988].)

Petitioner also claims that CSC/NFS aided and abetted the breach of fiduciary duty by Thompson and VFinance. In particular, CSC/NFS knowingly participated in such breach when it allowed Thompson and VFinance to use assets of other VFinance clients improperly to collateralize the Witham Account. Petitioner argues that he would not have entered into the margin agreement but for the misrepresentation and/or omissions made by Thompson and CSC/NFS had knowledge of such misrepresentation and/or omissions.

Furthermore, petitioner argues that he was fraudulently induced into the agreement and therefore it is unenforceable. Respondent does not present any arguments that there was no fraudulent inducement scheme involved other then saying that it is "not relevant" because it has an absolute right under the agreement to sell the shares. Such claims are relevant however in that if the petitioner was fraudulently induced into the agreement, the defendant may not exercise his rights under the agreement.

The elements of fraudulent inducement are: (1) a misrepresentation of material existing fact, (2) which is false and known to be false by the defendant when made, (3) for the purpose of inducing plaintiffs' reliance, (4) plaintiffs' justifiable reliance on the alleged misrepresentation or omission and (5) injury. (*Century 21, Inc. v F.W. Woolworth Co.,* 181 AD2d 620, 620 [1st Dept 1992].)

Petitioner alleges that Respondents misrepresented material existing facts, which were false and known to be false by Respondents. Specifically, Petitioner argues that Thompson, Toth and CSC/NFS misrepresented to him the true purpose of getting the loan. Additionally, Petitioner argues that Thompson, Toth and CSC/NFS knew that the money was not going to be used to help fund a Somerset "offering", rather they all were aware that the money would be used to keep Somerset afloat and meet its "net capital" requirements. Further, Petitioner claims that the purpose of the misrepresentation was to induce reliance. Thompson and Toth issued a promissory note to repay the loan in 30 days thereby inducing Petitioner to justifiably rely on the misrepresentation. Finally, Petitioner claims that he was injured because the loan remains unpaid. Moreover, when the calls were made on his AquaCell stock, Petitioner was in a position where he might lose his stock. Thus, Petitioner makes a prima facie showing of fraudulent inducement into the contract.

Additionally, Petitioner is arguing that Thompson and Toth fraudulently induced him into the contract by promising to repay the loan in 30 day when, in fact, they never intended on repaying the loan. (Witham Affidavit, ¶ 17). However, recent cases from the Appellate Division First Department state the exact opposite: a "cause of action for fraud does not arise, where ... the only fraud alleged merely relates to a contracting party's alleged intent to breach a contractual obligation." (*Caniglia v Chicago Tribune-New York News Syndicate, Inc.*, 204 AD2d 233, 234 [1st Dept 1994] citing *Comtomark, Inc. v Satellite Communications Network*, 116 AD2d 499, 500 [1st Dept 1986].) As a result, Petitioner's argument is not a strong support of his position, but a likelihood of success on the fraudulent inducement claim still exists on other grounds, as discussed above.

Therefore, based on the foregoing, it appears that Petitioner has sufficiently established a likelihood of success on the merits on his claims.

4. *Irreparable Injury*

Irreparable injury is found where an award for monetary damages is not adequate compensation. (*See Credit Agricole Indosuez v Rossiyskiy Kredit Bank*, 94 NY2d 541, 544-545 [2000].) Petitioner argues, and VFinance agrees, that if the stock in the Witham Account is transferred to VFinance, an arbitration award in his favor will only permit him to recover the amount the stock was sold after the transfer. However, in the event the stock is at a higher price, Petitioner will have to reinvest more money into re-purchasing the amount of shares liquidated by VFinance even though it did not have the right, as per the arbitration determination, to liquidate the shares. In that instance, money damages would not be an adequate remedy.

Moreover, Petitioner, as a director and officer of AquaCell, would not appear to have an adequate remedy for an improper transfer due to the loss of rights associated with the stock.

Although AquaCell is a publicly traded company, AquaCell, as a small business, is similar to a close corporation where control of the company through stock ownership is very important. Due to the importance of control, "damages would thus not appear to be an adequate remedy for an improper transfer." (*Kurtz v Zion*, 61 AD2d 778, 779 [1st Dept 1978].) Therefore, an improper transfer would not only cost Petitioner money, but rights in the company.

5. *Balance of Equities*

Finally, Petitioner is merely seeking to maintain the status quo until a determination is made with respect to his claims in Arbitration. Without a preliminary injunction, VFinance can transfer the stock at issue in Arbitration, which may then be liquidated in order to cover the margin calls of the loan at issue. If an arbitration award is in Respondents' favor, they will be able to sell any stock necessary to cover the loan and will be unaffected by the issuance or not of a preliminary injunction. If an arbitration award is in Petitioner's favor, without a preliminary injunction, he will have already lost control of his stock and all rights associated with it. VFinance contends that they will bear the risk of the loan without transfer of the stock. However, pursuant to CPLR 7502(c) and 6312, this court will require Petitioner to post an undertaking in conjunction with preliminary injunction in the amount of $37,500. Therefore, the balance of the equities is in Petitioner's favor.

CONCLUSION

For the reasons stated above, it is

ORDERED that petitioner's motion for a preliminary injunction in aid of arbitration is granted and it further

ORDERED Petitioner to post an undertaking in conjunction with preliminary injunction

in the amount of $37,500.

Dated: November 21, 2007

ENTER:

J.S.C.