SIVAULT SYSTEMS, INC. v. WONDERNET, LTD., Dist. Court, SD New York 2005

(2005)
SIVAULT SYSTEMS, INC., Petitioner,
v.
WONDERNET, LTD., Respondent.

05 Civ. 0890 (RWS).
United States District Court, S.D. New York.

March 25, 2005.
THOMAS G. AMON, ESQ., Attorney for Petitioner, HERRICK, FEINSTEIN, Attorneys for Respondent, New York, NY, By: BARRY WERBIN, ESQ., Of Counsel.

KIRTON & McCONKIE, Co-Counsel for Respondent, Princeton, NJ, By: KEVIN F. CUNNINGHAM, ESQ., Of Counsel.

OPINION

ROBERT SWEET, Senior District Judge.

By a petition filed on January 26, 2005 the petitioner SiVault Systems, Inc. ("SiVault") has moved pursuant to Rule 64 of the Federal Rules of Civil Procedure and Section 7502(c) of the New York Civil Practice Law and Rules for an order of attachment directing the Sheriff of the City of New York or the Sheriff of any county of the State of New York, to levy within the Sheriff's jurisdiction upon certain shares of stock in SiVault held by the respondent WonderNet, Ltd. ("WonderNet") evidenced by a certificate bearing the number 3281. For the reasons set forth below, SiVault's petition for attachment is granted, secured by a mandatory undertaking in the form of a $225,000.00 bond.

The Parties

According to the petition, SiVault is a corporation organized under the laws of the State of Nevada with its principal place of business in New York, New York. SiVault was formerly known as Security Biometrics, Inc.

WonderNet is alleged to be a corporation organized under the laws of the country of Israel. Shai Waisel, the Chief Executive Officer of WonderNet ("Waisel"), has testified by affidavit that WonderNet's principal place of business is in Kibbutz Givat Hashlosha, Israel. Wayne Taylor, Chief Financial Officer of SiVault ("Taylor"), has testified by affidavit that WonderNet is not qualified to conduct business in New York.

Background and Prior Proceedings

According to the petition, on January 13, 2005, SiVault filed a demand for arbitration against WonderNet with the American Arbitration Association (the "AAA") in New York, New York. The arbitration relates to a dispute concerning a contract entered into by SiVault and WonderNet on August 15, 2003 (the "2003 agreement").

It is alleged that, by the 2003 agreement, WonderNet licensed SiVault, under its former name "Security Biometrics, Inc.", to exploit certain technology and proprietary property related to a software product that enables computers to analyze handwritten signatures, enabling such signatures to be captured and crypto-graphically bound to an electronic document, capable of authentication. According to the petition, SiVault delivered 2,500,000 shares of SiVault's restricted stock (pre-reverse split) to WonderNet along with certain cash payments in connection with the 2003 agreement.

According to SiVault's demand for arbitration, after entering into the 2003 agreement, SiVault discovered that WonderNet did not have the right to the technology within the relevant territory because the technology at issue infringed existing patents and the technology was otherwise without value. Through the arbitration, SiVault seeks rescission of its agreement with WonderNet and the return of the money and the restricted stock. Taylor has testified that SiVault's claim for damages in the arbitration exceeds $350,000.

Waisel has testified that the money and stock placed at issue in SiVault's petition and demand for arbitration were not, contrary to SiVault's representations, the subject of the 2003 agreement but, instead, were addressed in a prior agreement entered into in April 2002 (the "2002 agreement") by the parties. In a supplemental affidavit, Igor J. Schmidt, Chief Strategic Officer of SiVault ("Schmidt"), has acknowledged that the shares in question were issued in consideration of the rights granted by the 2002 agreement. Under the 2002 agreement, any controversy or claim arising under the agreement is to be settled by arbitration to be held in the courts of arbitration in London.

Following the parties' entry into the 2002 agreement and prior to the formation of the 2003 agreement, SiVault received notice from Communication Intelligence Corporation ("CIC") that SiVault was developing and marketing various applications alleged to fall within CIC's intellectual property rights, including CIC's patents.

According to Waisel, between December 2003 and March 2004, SiVault conducted extensive due diligence investigations of WonderNet in furtherance of an acquisition agreement entered into by the parties in December 2003, by which SiVault was to acquire WonderNet. On March 23, 2004, SiVault, under its former name, informed WonderNet that it would not be proceeding with the acquisition.

On September 21, 2004, SiVault informed WonderNet that it was revoking a portion of the 2003 agreement, and on September 23, 2004 SiVault informed WonderNet that the 2003 agreement was being cancelled. On November 21, 2004, WonderNet advised SiVault that unless a sum of $575,000 — including, inter alia, $200,000 in fees under the aborted acquisition agreement as well as two quarterly payments under the 2003 agreement of $120,000 each — was paid no later than December 31, 2004, WonderNet would be pursuing legal options related to SiVault's alleged breach of the 2003 agreement. Schmidt has testified that after SiVault "terminated" the 2003 agreement, SiVault entered into a license agreement with CIC. (Supplemental Affidavit of Igor J. Schmidt, sworn to Febuary 23, 2005 ("Schmidt Aff."), at ¶ 16.)

According to Waisel, on December 21, 2004, WonderNet began to take steps to remove the restrictive legend on its SiVault shares so that it could, at an appropriate time, sell the stock. On January 4, 2005, SiVault filed a form SB-2 registration statement with the Securities and Exchange Commission (the "SEC") to authorize the issuance of over 21 million new shares

of common stock. SiVault commenced the present proceeding three weeks later with the filing of its petition.

In connection with the order to show cause issued by this Court and dated January 26, 2005, Bear, Stearns Securities Corp. and Interwest Transfer Co., Inc., inter alia, were temporarily enjoined and restrained from removing any restrictive legends from the certificate at issue and from otherwise taking any action to allow the shares to be sold or otherwise transferred to WonderNet. SiVault posted an undertaking in connection with the order to show cause and temporary restraining order in the amount of $15,000. The temporary restraint was continued by agreement of the parties and further extended by this Court by order dated February 16, 2005. Waisel has testified that the value of SiVault's shares has decreased substantially, falling from the closing price of $2.77 identified in the petition as of January 14, 2005 to $1.90 as of March 8, 2005, which difference amounts to a loss of some $92,000 in the value of the 106,250 shares at issue.

Following an adjournment at the request of the parties, a hearing on SiVault's petition was held on February 16, 2005, after which the return date for the petition was adjourned to permit further briefing. The petition was deemed fully submitted on March 9, 2005.

Applicable Legal Standards

Pursuant to Rule 64, Fed. R. Civ. P.,

At the commencement of and during the course of an action, all remedies providing for seizure of person or property for the purposes of securing satisfaction of the judgment ultimately to be entered in the action are available under the circumstances and in the manner provided by the law of the state in which the district court is held, existing at the time the remedy is sought ... .
Fed. R. Civ. P. 64. SiVault's petition for an order of attachment is, accordingly, governed by New York law.

Under New York law,

The supreme court in the county in which an arbitration is pending ... may entertain an application for an order of attachment or for a preliminary injunction in connection with an arbitrable controversy, but only 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 (arbitration shall be deemed an action for this purpose) if the application is made before commencement, except that the sole ground for the granting of the remedy shall be as stated above... . N.Y. C.P.L.R. § 7502(c).
Articles 62 and 63, rendered applicable to petitions brought under Section 7502(c) by the terms of that section, set forth the rules pertaining to prejudgment attachments and preliminary injunctions, respectively. See N.Y. C.P.L.R. § 6201 et seq.; N.Y. C.P.L.R. § 6301 et seq.
Article 62 provides, in pertinent part, that a party seeking to obtain an order of attachment must show,

by affidavit and such other written evidence as may be submitted, that there is a cause of action, that it is probable that the plaintiff will succeed on the merits, that one or more

grounds for attachment provided in section 6201 exist, and that the amount demanded from the defendant exceeds all counterclaims known to the plaintiff.
N.Y. C.P.L.R. § 6212(a); cf. SG Cowen Secs. Corp. v. Messih, 224 F.3d 79, 83-84 (2d Cir. 2000) (noting disagreement among New York state courts but concluding that Article 63 criteria must be applied in considering motions for preliminary injunctions brought under Section 7502(c)). Thus, pursuant to Section 7502(c), the standard articulated in Section 6212(a) applies to SiVault's application for an order of attachment, except insofar as Section 6212(a) requires the party seeking an attachment to demonstrate the existence of "one or more grounds for attachment" identified in N.Y. C.P.L.R. § 6201.[1] The sole ground relevant to an application for an order of attachment brought under Section 7502(c) is "that the award to which the applicant may be entitled may be rendered ineffectual without such provisional relief." N.Y. C.P.L.R. § 7502(c).

"[E]ven if the plaintiff satisfies all of the statutory requirements for an order of attachment, the issuance of relief remains in the discretion of the Court, because attachment is recognized to be a harsh and extraordinary remedy." JSC Foreign Economic Ass'n Technostroyexport v. Int'l Dev. & Trade Servs., Inc., 306 F. Supp. 2d 482, 485 (S.D.N.Y. 2004) (citing Bank of China v. NBM L.L.C., 192 F. Supp. 2d 183, 186 (S.D.N.Y. 2002); Buy This, Inc. v. MCI Worldcom Communications, Inc., 178 F. Supp. 2d 380, 383, 384 n.8 (S.D.N.Y. 2001)). "Attachment is considered a harsh remedy and the statute is strictly construed in favor of those against whom it may be employed." Glazer & Gottlieb v. Nachman, 234 A.D.2d 105, 105, 650 N.Y.S.2d 717, 717 (N.Y. App. Div. 1st Dept. 1996) (internal citations omitted).

Discussion

Turning to the first condition set forth in Section 6212(a), SiVault has demonstrated by documentary evidence and affidavits the existence of a cause of action pertaining to the alleged falsity of certain representations made by WonderNet in connection with the 2003 Agreement, representations concerning WonderNet's ownership of intellectual property rights in the underlying technology. SiVault has offered testimony from which an inference may be drawn that these allegedly false representations were knowingly made and that SiVault relied upon the representations to its detriment. Contrary to WonderNet's suggestion, SiVault's knowledge of CIC's allegations of infringement prior to entry into the 2003 agreement does not preclude SiVault from asserting the instant claim, whatever the ultimate effect of that knowledge on the determination of SiVault's arbitration claim may be.

There is relatively little in the record to demonstrate the likelihood that SiVault will succeed on the merits of its claim against WonderNet,[2] the second condition set by Section 6212(a). Notwithstanding the sparsity of the record, however, the Court is mindful that,

[A]rbitration is frequently marked by great flexibility in procedure, choice of law, legal and equitable analysis, evidence, and remedy. Success on the merits in arbitration therefore cannot be predicted with the confidence a court would have in predicting the merits of a dispute awaiting litigation in court, and it can be expected that when the merits are in the hands of an arbitrator, this element of the analysis will naturally have greatly reduced influence.
SG Cowen Secs., 224 F.3d at 84. Accordingly, SiVault's application for an order of attachment will not be denied for failure to establish the likelihood of success on the merits in the underlying arbitration.

With respect to the third condition, the ground for attachment, SiVault has offered testimony to the effect that WonderNet possesses no assets in the United States other than the shares at issue here, that WonderNet had a negative net worth as of the end of 2002, and that WonderNet has borrowed $1,000,000 from a bank in Israel, a loan secured by all of WonderNet's assets. On this record which suggests WonderNet's potential insolvency, SiVault has established that a ground for an attachment exists insofar as the award to which SiVault may be entitled may be rendered ineffectual without the attachment sought. See N.Y. C.P.L.R. § 7502(c). WonderNet's assertions that SiVault's claims, if found to be meritorious, would be fully compensable in money damages rather than in the form of shares and that arbitration awards rendered in the United States are fully enforceable in Israel under the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, do not undermine this conclusion.

With respect to the fourth and final condition for an order of attachment, the record demonstrates that WonderNet informed SiVault of certain demands against SiVault in November 2004, including demands in the amount of $240,000 arising out of the 2003 agreement as well as an additional $200,000 pursuant to the aborted acquisition agreement between the parties. In its papers submitted in opposition to SiVault's petition, WonderNet has asserted that these demands "will be filed in the underlying arbitration," (Resp. Opp. Mem. at 5), thereby demonstrating that the informal demands have yet to take shape as formal counterclaims in the underlying arbitration. In view of this acknowledgment that no counterclaims have yet been filed in the underlying arbitration, the record establishes that "the amount demanded from the defendant exceeds all counterclaims known to the plaintiff." N.Y. C.P.L.R. § 6212(a).[3]

In an exercise of the Court's discretion, SiVault's application for an order of attachment is, accordingly, granted, provided that SiVault posts an undertaking in the amount of $100,000.00 within five (5) days of entry of this opinion and order.

SiVault consistently has consented to securing the sought after attachment with a bond, first suggesting a bond in the amount of $15,000.00, five percent of the approximate $300,000.00 value of WonderNet's shares (Order To Show Cause, Jan. 19, 2005, at ¶ 10), and then subsequently increasing the suggested bond amount to $50,000.00, to "protect WonderNet from any diminution of the share price during the arbitration" (Supplemental Affidavit of Wayne Taylor, sworn to Feb. 23, 2005, at ¶ 12). Given the need to secure WonderNet's shares from substantial loss in value pending arbitra-tion, a premise which SiVault does not contest, an undertaking in the amount of $100.000.00 adequately protects WonderNet from market volatility and any possible dilution.[4]

The grant of SiVault's petition should not be construed to limit or otherwise express any view as to the facts that may be found in the arbitration between the parties or the ultimate disposition of the parties' arguments by the arbitration panel.

It is so ordered.

[1] The grounds for attachment set forth in Section 6201 are, by the express terms of Section 7205(c), inapplicable to petitions for orders of attachment brought pursuant to that latter section. See N.Y. C.P.L.R. § 7502(c) ("The provisions of articles 62 and 63 of this chapter shall apply to the application . . . except that the sole ground for the granting of the remedy shall be as stated above.") (emphasis supplied); see also County Natwest Secs. Corp. USA v.

Jesup, Josephthal & Co., Inc., 180 A.D.2d 468, 469, 579 N.Y.S.2d 376, 377 (N.Y. App. Div. 1st Dept. 1992) (observing that "the standards generally applicable to attachments pursuant to [N.Y. C.P.L.R. §] 6201(3), such as sinister maneuvers or fraudulent conduct, are not required to be shown in an application pursuant to [N.Y. C.P.L.R. §] 7502(c)") (citing Drexel Burnham Lambert Inc. v. Ruebsamen, 139 A.D.2d 323, 531 N.Y.S.2d 547 (N.Y. App. Div. 1st Dept. 1988)); Erickson v. Kidder Peabody & Co., 166 Misc.2d 1, 4, 630 N.Y.S.2d 861, 862 (N.Y. Sup. Ct. N.Y. Cty. 1995) ("By its terms, [section] 7502(c) replaces only the `grounds' which must be established for a grant of an attachment or injunctive relief, which are set forth in sections 6201 and 6301 respectively. The remainder of these articles still apply. Therefore, a party seeking provisional relief under [section] 7502(c) must still establish, among other things, the existence of a valid cause of action and grounds for relief.") (citing N.Y. C.P.L.R. §§ 6212(a), 6312(a)).

[2] There is no indication in the record that CIC pursued its initial allegations of infringement after its initial notice sent to SiVault in September 2002. There are also no allegations suggesting, much less facts demonstrating, how WonderNet's technology infringes CIC's patents, only Schmidt's testimony that SiVault's management, through its own due diligence, is "of the opinion that the marketing and sale of WonderNet's technology and products would significantly expose the company to a lawsuit from CIC for such an offering." (Schmidt Aff. at ¶ 20.) Although SiVault has offered documentary evidence attesting to a poor performance evaluation for WonderNet's technology, there is nothing in the record to suggest that the technology is, as SiVault has asserted in its demand for arbitration, without value.

[3] Insofar as SiVault has argued in its supplemental papers that it will suffer irreparable harm if an attachment is not granted and that the balance of equities tips in its favors, these factors are relevant only where an application for injunctive relief has been brought, as demonstrated by the authorities SiVault has cited. SiVault has sought no injunctive relief here apart from the temporary injunctive relief requested pending a hearing on the application for an attachment, which request has been granted.

[4] At the end of closing on March 11, 2005, SiVault stock was trading at $1.85 per share, down from $2.77 per share at which SiVault stock was trading when the TRO first was issued. Currently, according to SiVault's most recent amended 10-K filed with the SEC, dated October 28, 2004, SiVault has 14,011,693 outstanding shares of common stock. The authorization process for the issuance of an additional 20 million shares has been commenced.