

Motions, Pleadings and Filings

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United States District Court, S.D. New York.
Mark BUTLER, Plaintiff,

v.

PHLO CORPORATION, Defendant.
No. 00 CIV. 1607(NRB).

April 5, 2002.

[Patrick W. Begos, Esq.](#), Bronxville, Counsel for Plaintiff.

[Samuel L. Newman, Esq.](#), New City, Counsel for Defendant.

MEMORANDUM AND ORDER

[BUCHWALD](#), District J.

*1 Plaintiff Mark Butler brings this motion for contempt and other relief against his former employer, Phlo Corporation ("Phlo"), on the grounds that Phlo violated this Court's July 31, 2001, Memorandum and Order that set out the conditions under which defendant must issue shares to plaintiff. For the reasons discussed below, plaintiff's motion is denied, but plaintiff is directed to submit a supplemental judgment.

BACKGROUND

This case originates out of plaintiff's Employment Agreement with Phlo, which is discussed at length in our July 31, 2001, Memorandum and Order. The parties entered into several stock option agreements. The first three were issued in consideration for plaintiff's continued employment with Phlo. The fourth involved an arrangement by which plaintiff received an option to purchase 425,000 shares of Phlo stock for \$.05 per share in exchange for returning 250,000 Phlo shares he already owned.

In our earlier decision, we made several rulings: first, that defendant had violated section 5 of the Securities Act, § 77(1), by issuing unregistered securities to plaintiff; second, that Phlo had not breached its contract with plaintiff because plaintiff had not validly exercised his options; and finally, that

defendant was obligated to issue registered securities to plaintiff. As we also discussed in our prior Memorandum and Order, plaintiff made four attempts to exercise his options in 1999 and 2000. Plaintiff succeeded in exercising his options on one of those occasions, receiving 20,000 restricted shares in October 1999 for \$1,000.

Each of plaintiff's stock option agreements contained a "cashless" exercise provision, which would enable plaintiff to receive the shares without having to provide defendant with cash prior to their issuance. The cashless exercise required that plaintiff notify defendant of his intent to exercise and provide notice of an irrevocable order to the broker to whom his shares were to be issued to sell sufficient shares to repay the total exercise price and to forward those proceeds to Phlo. The agreements also grant defendant the right to approve all documentation procedures in connection with this procedure. In our earlier Memorandum and Order, we ruled that plaintiff had not validly exercised his options under the cashless exercise provisions because he had not executed a promissory note as defendant had requested. Therefore, his breach of contract claim was denied.

We stated that "if [Mark Butler] validly exercises his [stock] options, [Phlo Corporation] is obligated to deliver shares to him." [Butler v. Phlo Corp., 2001 WL 863426, at *9 \(S.D.N.Y. July 31, 2001\)](#). Since July 31, 2001, plaintiff has made additional efforts to exercise his options. On September 14, 2001, he attempted to exercise his options by sending a notice of exercise, orders to his broker to sell sufficient shares to pay the exercise price, an irrevocable order to deliver sufficient proceeds to defendant to pay for the exercise price plus any withholding taxes, a promissory note in the amount of the exercise price, and a collateral agreement giving Phlo a security interest in the securities in his brokerage account at Charles Schwab. Plaintiff sent this notice, via certified mail, return receipt requested, which, under the option agreement, made it effective upon deposit in the mail. [\[FNI\]](#) Defendant purports to have never received this letter because it changed its address on September 7. On September 17, 2001, plaintiff's counsel faxed a copy of the notice and supporting documents to defendant's counsel. Having heard no response, plaintiff's counsel sent another fax, on October 2, 2001, to defendant's counsel requesting a

response from Phlo.

[FN1](#). There is some discrepancy in the record as to the date plaintiff sent this notice. The letter attached to plaintiff's motion (Begos Decl. Ex. C) is dated September 4, 2001. However, throughout its papers, plaintiff states that it sent the letter September 14, 2001. Accordingly, we will assume that the letter was signed and dated on September 4 but not sent until September 14.

*2 Defendant's counsel responded on October 5, 2001, requesting verification from Schwab of the details of the assets plaintiff held in his account. Plaintiff responded with faxes dated October 15 and 19, 2001, which contained the holdings of his account at Schwab. The account contained \$6,175 in securities and \$53,437.95 in cash. Neither defendant nor its counsel responded to those letters. On November 9, 2001, plaintiff's counsel faxed defendant's counsel a letter stating that, unless defendant responded by November 14, 2001, with a commitment to issue the stock, plaintiff would seek relief from the Court. On November 21, 2001, plaintiff filed this motion seeking a contempt citation against defendant and its officers, James and Anne Hovis, for violating the Court's July 31, 2001, Memorandum and Order, and other relief. [\[FN2\]](#)

[FN2](#). Plaintiff's motion also seeks costs and attorneys' fees for all stages of this litigation. However, as the issue of attorneys' fees is only mentioned in passing by the parties and plaintiff has not submitted any documentation regarding its attorneys' fees, we will not address that request at the present time.

Defendant's attempts to delay issuing the shares continued. On December 7, 2001, the deadline for defendant's response to this contempt motion, Phlo's counsel requested, with plaintiff's consent, additional time to respond to the motion because Phlo had decided to substitute counsel. Plaintiff consented to this request, and we granted Phlo an extension of its time to file until January 7, 2002. On January 4, 2002, defendant asked for another extension of time, to January 31. This time, plaintiff did not consent to the request. Noting the length of time defendant had known about plaintiff's attempts to exercise his options, we granted Phlo one additional week to respond, which it did.

DISCUSSION

From the factual recitation above, it is obvious that despite the clear import of our earlier decision Phlo Corporation and its principals will not abide by that decision unless the consequences of not doing so are decidedly enhanced. [\[FN3\]](#) Based on the record, however, plaintiff's motion for contempt is denied. Plaintiff has not yet validly exercised his options. Under the cashless exercise provision, defendant has the right to request collateral before issuing shares. Plaintiff has offered collateral, but the security agreement he sent to defendant only applies to the securities in his Schwab account, not the cash. In effect, he has only offered approximately \$6,000 in assets to secure a \$53,000 loan. The insufficient security appears to be the result of plaintiff's drafting error. While defendant should have informed plaintiff of the basis for its failure to issue the stock, its obstruction does not rise to the level of contempt.

[FN3](#). On March 13, 2002, Judge Denny Chin held Phlo, as well as its officers, James and Anne Hovis, in contempt of Court for violating his order to appear, pay damages to the defendant, and convey shares of stock in Phlo. *Phlo v. Stevens*, No. 00 CV 3619.

To ensure the effectuation of this Court's earlier decision and judgment and to have available the remedy of contempt if necessary, see e.g. [Fed.R.Civ.P. 70](#), plaintiff is instructed to submit on notice a supplemental judgment which will detail both plaintiff's precise obligations and what actions the defendant must perform if plaintiff meets the requirements to fulfill the cashless exercise provision of the option agreement and the tendering of his 20,000 unregistered shares. The ordering paragraphs in the supplemental judgment shall include precise timetables.

*3 Phlo has contended in response to this motion that it cannot issue registered shares even if plaintiff validly exercises his options because it cannot afford the cost of issuing a registration statement. We address this argument now so that there will be no further delay in effectuating the clear intent of our July 31, 2001, Memorandum and Order. Phlo's contention is insufficient to meet its burden of production to demonstrate impossibility. See [United States v. Rylander, 460 U.S. 752, 757, 103 S.Ct. 1548, 75 L.Ed.2d 521 \(1983\)](#) (holding that the party opposing a motion for contempt has the burden of production in demonstrating impossibility). The party seeking to meet this burden must prove that all available avenues for complying with the Court's

directions are impossible. See [United States v. City of Yonkers](#), 856 F.2d 444, 458 (2d Cir.1988) (holding that defendant had obligation to attempt every available action to comply with Court's order), *rev'd on other grounds sub nom. Spallone v. United States*, 493 U.S. 265, 110 S.Ct. 625, 107 L.Ed.2d 644 (1990) (holding that Court should have imposed contempt sanctions on city alone before holding individual City Council members in contempt). Here, defendant has not acted on plaintiff's suggestion that Phlo could issue registered shares pursuant to an S-8 short-form registration, which plaintiff alleges would cost substantially less than the \$150,000-\$200,000 defendant alleges a registration would cost. Pl. Reply Br., at 5. Therefore, we find that, on the evidence currently before us, defendant has not met its burden of production on its defense of impossibility. [\[FN4\]](#)

[FN4](#). Defendant also makes vague allegations about defenses and counterclaims available to it if plaintiff were to bring a "plenary action" to enforce our declaratory judgment. Def. Opp. Br., at 8. Defendant's claims that Mr. Butler has committed securities fraud and has breached his fiduciary duty to Phlo are unsubstantiated and are therefore not considered here. Aff. of Anne Hovis, Jan. 14, 2002, at ¶ 12. Moreover, defendant was required to have asserted any such claim under [Fed.R.Civ.P. 13\(a\)](#). Having not done so and not having appealed this Court's Memorandum & Order of July 31, 2001, defendant has waived any such argument.

CONCLUSION

For the reasons set forth above, plaintiff's motion for contempt is denied. However, as it is beyond cavil that plaintiff is entitled to receive 625,000 shares if he properly exercises his cashless option and \$1,000 cash if he tenders the 20,000 unregistered shares he currently owns, plaintiff is directed to submit a precise and comprehensive supplemental judgment to remove the possibility of continued maneuvering by Phlo to avoid the legal responsibilities that flow from our July 31, 2001, Memorandum and Order.

IT IS SO ORDERED.

Not Reported in F.Supp.2d, 2002 WL 523283
(S.D.N.Y.)

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- [2000 WL 34634908](#) (Trial Pleading) Amended and Supplemental Complaint (Oct. 16, 2000)Original Image of this Document (PDF)

- [1:00cv01607](#) (Docket) (Mar. 02, 2000)

- [2000 WL 34634910](#) (Trial Motion, Memorandum and Affidavit) Memorandum of Law In Opposition to Plaintiff's Motion for Summary Judgment (2000)Original Image of this Document (PDF)

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