GORALSKI, INC.,	:	SUPERIOR COURT OF NEW JERSEY
	:	LAW DIVISION: BERGEN COUNTY
Plaintiff,	:	
	:	DOCKET NO.: BER-L-89-01
Vs.	:	
	:	Civil Action
BETSY ROSS MANUFACTURING CO., DIANE PALUGHI, et al.,	:	
	:	
Defendants.	:	
	:	

BRIEF OF DEFENDANT, DIANE PALUGHI, IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT DISMISSING PLAINTIFF'S AMENDED COMPLAINT

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PRELIMINARY STATEMENT & FACTUAL BACKGROUND

The individually named defendant, Diane Palughi ("Ms. Palughi") moves for summary judgment to dismiss plaintiff's Amended Complaint in its entirety and with prejudice. In further support of the motion, defendant submits her Statement of Material Facts, Affidavit of Stephen B. Ravin, Esq., Certification of Glenn R. Reiser, Esq., and Certification of Diane Palughi.

Plaintiff seeks to collect a $14,412.30 corporate debt from Ms. Palughi in her individual capacity. Ms. Palughi maintains that this lawsuit is frivolous, and that plaintiff is attempting to extort money from her by falsely claiming that she committed fraud in her operation of the corporate defendant, Betsy Ross Manufacturing ("Betsy Ross"). Ms. Palughi's late husband was the owner of this company for over 26 years. She neither personally guaranteed plaintiff's debt nor ever served as an officer, shareholder or director of her husband's company. In reality, plaintiff is merely a creditor of Betsy Ross, not of Ms. Palughi. Plaintiff's claim against Ms. Palughi is a collateral attack on the outcome of a judicially ordered sale of Betsy Ross' assets to co-defendant, National Flag & Banner Display Co., Inc. ("National Flag") for the sum of $50,000.00. Betsy Ross' assignee, Stephen B. Ravin, Esq., submitted the offer of sale by Order to Show Cause on notice to all known creditors of Betsy Ross, including the plaintiff named herein. The assignee's pleadings included a petition that annexed copies of all pertinent agreements comprising National Flag's offer, including a consulting agreement between National Flag and Ms. Palughi that would pay her a yearly salary of $30,000.00 for five (5) years.

The assignee's petition to sell Betsy Ross' assets came before the Honorable Susan L. Reisner, J.S.C., Passaic County. On January 19, 2001, Judge Reisner entered the Order to Show Cause and set a return date of February 9, 2001. In compliance with the Order to Show Cause, the assignee advertised the sale in the Bergen Record and served his pleadings on several other flag manufacturing companies in an effort to solicit higher and better offers. Plaintiff's counsel

appeared at the sale hearing held on February 9, 2001 and voiced his client's objections to the sale and consulting agreement. However, Judge Reisner approved the sale notwithstanding such objections. An Order Authorizing Sale of Assets was entered on February 9, 2001.

Judge Reisner was very familiar with the plight of Betsy Ross, as Her Honor was the presiding judge in related foreclosure proceedings involving efforts to evict Betsy Ross as a tenant of commercial premises. At the time of the judicial sale, Betsy Ross was insolvent, had ceased operations, and was under court order to vacate its premises in the context of the foreclosure proceedings. Between the period of August 11, 2000 through December 15, 2000 Judge Reisner granted Betsy Ross three (3) extensions of the lockout date so that the company could comply with applicable environmental laws and dispose of its assets in an orderly fashion. Ms. Palughi submitted several Affidavits in the foreclosure proceedings, whereby she informed Judge Reisner, among other facts: (i) that her late husband, Michael Palughi, Sr., who was the sole shareholder and president of Betsy Ross, recently died and left behind a business with substantial back taxes and other debts; (ii) that she assumed the position of General Manager and tried to continue the business out of loyalty to its 35 employees; (iii) that she personally borrowed $165,000.00 from a close family friend and loaned those monies to the company in an effort to keep the business afloat; (iv) that she was in her early sixties and had no source of income other than her limited employment by Betsy Ross; and (v) that she was attempting to sell the business to salvage some value for the creditors. These Affidavits dated August 9, 2000 and September 27, 2000 are annexed as Exhibits to Ms. Palughi's Certification submitted herewith.

Plaintiff alleges that Ms. Palughi committed a fraud upon the creditors of Betsy Ross by transferring its assets for less than fair market value, and receiving preferential treatment by means of the consulting agreement from National Flag. Plaintiff also challenges the sale price paid by National Flag. Before assigning its assets to Mr. Ravin, Betsy Ross obtained a forced sale appraisal of its assets from a reputable appraisal company located in New Jersey. The

appraisal valued the physical assets of Betsy Ross, excluding cash and accounts receivable, at $15,000.00. In the exercise of his business judgment, the assignee determined that National Flag's offer was an arms length transaction and he sought Court approval of the sale subject to higher and better offers. The assignee disclosed the consulting agreement to the Court and Betsy Ross' creditors, and thus Judge Reisner was required to pass upon the validity of that agreement in approving the sale to National Flag.

Plaintiff filed its initial Complaint on January 4, 2001. After Judge Reisner approved the sale to National Flag, plaintiff filed an Amended Complaint on February 20, 2001 challenging the validity of the sale. After all parties answered, the matter was submitted to non-binding arbitration on October 22, 2001, and the arbitrator found no cause of action in favor of plaintiff. Plaintiff filed a *trial de novo* of the arbitrator's decision. No trial date is presently scheduled.

Plaintiff has not responded to defendant's outstanding demand for production of documents that would evidence the existence of plaintiff's long-standing business relationship with Betsy Ross, and that plaintiff had an outstanding account receivable with Betsy Ross long before Ms. Palughi became involved in its operations.

STATEMENT OF FACTS

To avoid imposing an undue burden upon the Court and opposing counsel, Ms. Palughi adopts and incorporates by reference each and every fact set forth in her Statement of Material Facts. For the benefit of the Court, the most salient facts are succinctly set forth below.

Betsy Ross was a family owned business formed in 1973 by the late Michael Palughi, Sr., who was the president, sole shareholder and husband of defendant Diane Palughi. (Statement of Material Facts, at ¶ 1). At all times, Betsy Ross was engaged in manufacturing flags from commercial/industrial premises located at 85-99 Hazel Street, Paterson, New Jersey (the "Paterson Property"). (*Id.*, at ¶ 2). Mr. Palughi died in 1999, leaving a business that owed substantial back taxes and other debts. (*Id.*, at ¶¶ 8, 13-17). Ms. Palughi, who had never worked for the company before her husband's death, assumed the position of General Manger and attempted to continue the business in his absence. (*Id.*, at ¶ 13). With such a large debt load to carry, however, Ms. Palughi was unable to make the business succeed. (*Id.*, at ¶ 20). She borrowed $165,000.00 from a close family friend and infused those funds as fresh capital so that Betsy Ross could continue funding its operations. (Certification of Diane Palughi dated February 11, 2002, at ¶ 14). However, not even Ms. Palughi's infusion of substantial capital and 3-month salary deferment was enough to turn the business around. (Statement of Material Facts, at ¶ 20).

In late 1999 and continuing throughout the year 2000, Ms. Palughi tried to find a buyer for Betsy Ross. (*Id.*, at ¶ 24). After months of negotiations with a flag manufacturing company in Massachusetts known as New England Flag & Banner ("New England Flag"), on or about June 13, 2000 Ms. Palughi signed a letter of to sell the business for $250,000.00. (*Id.*, at ¶ 25). The contract was contingent on a number of things, including a due diligence period for New England Flag to investigate the financial condition of Betsy Ross and its business operations. (*Id.*, at ¶). On August 17, 2000 and within the due diligence period, New England Flag notified

Betsy Ross that it was terminating the letter of intent. (*Id.*, at ¶ 32). Ms. Palughi promptly renewed efforts to locate another buyer for Betsy Ross. (*Id.*, at ¶ 33). In the meantime, Betsy Ross had received a notice of eviction in foreclosure proceedings instituted by the mortgagee of the Paterson Property. (*Id.*, at ¶¶ 27-28). The eviction initially was scheduled for August 11, 2000. (*Id.*, at ¶ 28).

In several hotly contested Orders to Show Cause hearings initiated by Betsy Ross in the foreclosure proceedings, Judge Reisner extended the eviction date on three (3) occasions predicated on Betsy Ross' payment of use and occupancy rent to the owner. (*Id.*, at ¶ 28). So long as Betsy Ross was not getting a "free ride" for continuing to occupy the Paterson Property, Judge Reisner was willing to give the company a chance to comply with environmental regulations and dispose of its assets in an orderly fashion for the benefit of its creditors. (*Id.*, at ¶ 31). The first extension of the lockout was from August 11, 2000 to October 11, 2000; the second extension was to November 9, 2000; and the third and final extension was to December 15, 2000. (*Id.*, at ¶¶ 31, 35 & 44). With time being of the essence for Betsy Ross, only two (2) other flag companies expressed interest in purchasing its assets; namely, Flag Zone, and co-defendant National Flag. (*Id.*, at ¶ 33). Ultimately, National Flag emerged as the interested party and began negotiations with Betsy Ross in late October 2000. (*Id.*, at ¶ 39).

On December 15, 2000, Betsy Ross ceased operating. (*Id.*, at ¶ 49). On January 4, 2001, plaintiff instituted this action by filing a Complaint against Betsy Ross and Ms. Palughi (incorrectly spelled in the caption as "Diane Paluki"). In the Fifth Count of the Complaint, plaintiff vaguely alleged that Ms. Palughi acted willfully and maliciously in an attempt to defraud creditors. Upon information and belief, plaintiff never served Ms. Palughi with its initial Complaint.

On January 11, 2001, Ms. Palughi, in her capacity as administratrix of her late husband's estate, executed a Deed of Assignment of Betsy Ross' assets to Stephen B. Ravin, Esq.. (*Id.*, at ¶

54). Mr. Ravin is an experienced practitioner in the bankruptcy and insolvency practice. (Affidavit of Stephen B. Ravin dated January 24, 2002, at ¶ 7). The Deed of Assignment was recorded in the Passaic County Surrogate's Office on January 12, 2001. (Statement of Material Facts, at ¶ 54).

Before Mr. Ravin agreed to serve as assignee of Betsy Ross, he knew about National Flag's existing offer to purchase Betsy Ross' assets for $50,000 and that the offer included a consulting/non-competition agreement between National Flag and Ms. Palughi. (Affidavit of Stephen B. Ravin, at ¶¶ 3-4). Upon his designation as assignee of Betsy Ross, Mr. Ravin negotiated an agreement with the landlord of the Paterson Property that allowed him to preserve the value of the assets pending court approval of the sale. (*Id.*, at ¶ 8). This agreement required Mr. Ravin to pay post-assignment rent at the rate agreed upon by Betsy Ross in the foreclosure proceedings and stipulate to pay a landlord's lien for $15,000.00 - the amount of the assets' estimated forced sale value. (*Id.*).

On January 18, 2001, Mr. Ravin filed an Order to Show Cause on notice to all creditors of Betsy Ross seeking approval of the sale to National Flag subject to higher and better offers. (*Id.*, at ¶ 10). On January 19, 2001, Judge Reisner entered the Order to Show Cause and set a return date of February 9, 2001. (*Id.*, at ¶ 11). In accordance with the terms of the Order to Show Cause, Mr. Ravin caused the sale to be published in the Bergen Record on January 31, 2001. (*Id.*, at ¶ 12). In addition, in an attempt to solicit other offers Mr. Ravin served the Order to Show Cause pleadings on three (3) other flag companies. (*Id.*, at ¶ 13).

On February 9, 2001, counsel for plaintiff appeared at the hearing before Judge Reisner and voiced his objection to the sale, most particularly that it included the consulting/non-compete agreement that he claimed constituted preferential treatment to Ms. Palughi. (*Id.*, at ¶ 14). Judge Reisner approved the sale over the objections of plaintiff's counsel, and on the same day signed an Order Authorizing Sale of Assets.

For the benefit of this Honorable Court, the following colloquy was exchanged at the February 9, 2001 Order to Show Cause hearing held before Judge Reisner:

> THE COURT: All right. Mr. Ravin, I have read your application. It is an application to sell a vehicle and sell the assets of the business to National Flag.
>
> I might add, Counsel, that I am extremely familiar with this, having dealt with the foreclosure aspect of this case in which the foreclosing mortgagee was attempting to evict this company from the premises. And it is only through the forbearance of the court, that is in granting equitable relief to this company and preventing them from being essentially kicked out in the street, that they still have equipment left to sell.
>
> I just put that on the record just so everybody understands that I am familiar with this business and with its history.
>
> Mr. Ravin, you may put your application on the record.
>
> MR. RAVIN: Yes, Your Honor.
>
> As your Honor is aware, this is an order to show cause why the offer of National Flag or any higher or better offer presented today essentially should not be accepted. The assets of the corporation were appraised prior to the execution of the Deed of Assignment for the sum of $15,000.00. The offer is in the sum of $50,000.00.
>
> There is, as Your Honor has stated, immense pressure on this estate to vacate these premises. A stipulation was forwarded to your Honor between the landlord and myself essentially allowing me to stay there pending the sale of the assets. However, at a rate of $6,875 a month.
>
> I have painstakingly tried, with the court as well as with the buyer, to try to get the assets out of there as quickly as possible. The truck is essentially waiting at the door, pending the entry of this order to start moving the assets to the buyer's location. My hope is to have the assets out of the premises by the last day of this month so that no other rent is incurred.
>
> In addition to which, the insurance, which was a day before terminating, was extended for one month until the end of February at a cost of $1,200, roughly. And it's my hope that the court, based on the value of the assets and essentially the generosity of the offer, will approve the sale.
>
> * * *
>
> MR. RAVIN: There is, I should advise your Honor, inventory on the premises which was not included in the original appraisal. I asked the appraiser to essentially give me a letter as to what he felt the inventory

was worth and he did send me a letter, which I have, which is $2,000 as to the forced sale value of the inventory.

* * *

THE COURT: All right, Mr. Princiotto, what is your client's position?

* * *

MR. PRINCIOTTO: * * * And I can understand that there may be a request here that the court act quickly. However, we are concerned with the equitable nature or the inequitable nature of this particular transaction. Specifically, with what this agreement calls for.

Based upon the information that we can see here right now, and we don't know if there's anything more to it, the assets are going to be sold for $50,000.00. However, what appears to be somewhat unusual and not usual and customary and out of the ordinary is that there is a consulting agreement whereby a principal of the company who, as far as I know, was the spouse of the operator of this company, is receiving a consulting agreement guaranteeing her $150,000.

So in essence, the creditors get fifty thousand – a pot of $50,000 and an individual is guaranteed $150,000.

* * *

THE COURT: * * * What do you want the court to do. Do you want me to say don't sell these assets? What relief are you asking from the Court?

* * *

MR. PRINCIOTTO: * * * There's something that appears to be grossly wrong in this allocation of $200,000 to the detriment of not only my client as a creditor but all the creditors. * * * However, it is grossly inequitable for the creditors to divvy up a pot of $50,000 which probably is going to be pennies, depending upon the amount. * * * Yet a principal, the spouse of a principal of the company, is going to get $150,000.

Now, that is not an equitable allocation of this $200,000 in a consulting agreement that looks, on its surface, to be not usual and customary and not commercial, that somebody doesn't have to work at all, can be terminated upon 30 day's notice and is guaranteed $150,000. And it's not specific as to the type of consulting, probably lacks the background and experience to be a consultant, lives in New York, on Long Island, okay? And the agreement itself says no more than two days a week. Or two days a month, I'm sorry. So for two days a month, can get $30,000 a year.

* * *

THE COURT: I understand your position.

What do you want the court to do, though? Do you want me to say no, you can't sell the equipment or do you want me to impose some kind of restraint on the $150,000 thereby giving your client the ability to possibly pursue that?

I mean, what are you actually asking the court to do? Because I have somebody who is a foreclosing mortgagee who is going to just put this equipment out in the street if I don't order it to be sold.

That's my problem, Counsel. So I'm trying to get you to frame the relief that you want in a way that is practical.

MR. PRINCIOTTO: * * * My initial reaction was to get this objection filed, see what we can find out. Mr. Ravin has given me some information. I don't think we have all the information.

But certainly, you know, and I understand the position that they would like to sell these assets. We would like to see nothing happen until we can fully investigate this. I don't know if they have until the end of the month, how much time they have, et cetera, but certainly secondarily, yes your Honor, we would like no monies to be paid pursuant to that consulting agreement.

If the court is inclined to grant this application and sell the assets, then none of that $150,000 should be transferred pursuant to that consulting agreement until there has been some further discovery and some further investigation for the benefit of the creditors.

THE COURT: All right. Mr. Ravin, I would like to hear your response.

MR. RAVIN: Well, my position is, number one, with respect, first of all, the objecting creditor does have – his lawsuit is against the principal as well as an additional party and he can pursue whatever remedies he feels are appropriate against her in his discovery. And eventually, if he gets a judgment, levy on that $150,000 or whatever is left by the time he gets a judgment.

Secondly, as far as the principal being the wife of the former principal, that is correct. However, the formal principal passed away sometime back and Mrs. Palughi has been essentially running the company.

I assume that what she brings, and I was not involved in the negotiations between National Flag and Miss Palughi, I assume that what she brings to the table is a certain familiarity with the customer base of Betsy Ross Manufacturing which, in my opinion, is what the buyer is really buying this company for. I don't know that it has a particular need for this $15,000 worth of equipment that it's paying $50,000.

THE COURT: Okay. I understand your position.

And having listened to both sides, I'm going to approve this sale. It seems to be that, based on what the court knows already about this situation, that there is an absolutely urgent need to go through with this sale.

I also do not have before me sufficient proof to render any further relief to the objectors in this case. The court is aware that Miss Palughi has been running this company and I'm aware of that because of the foreclosure case which has been going on for months and months and months.

The interest of no creditor would be served by not approving this sale. This is really the only sale – the only light at the end of the tunnel for this business. And if the assets are not sold, they will – they are going to be lost or sold as scrap because there is a foreclosing mortgagee that has a right to possession of these premises. Therefore, it would serve no one's interest not approve this sale.

Mr. Princiotto's clients don't have a judgment, they have a lawsuit going in Bergen County. I don't know anything about the merits of that lawsuit. And it appears to the court that if that lawsuit is personally also against Miss Palughi, that her assets would certainly ultimately be available to satisfy any judgment that might be obtained in the Bergen County action.

It appears that that is where, Mr. Princiotto, you should be seeking any relief that you want with respect to collecting money from Miss Palughi.

So for all of those reasons, I'm approving the application and I'm not entering any further relief or restraints in this matter.

Mr. Ravin, you can go ahead and sell the business and equipment out as expeditiously as possible so that this estate is not further reduced by another $6,800 worth of rent for the month of March.

* * *

MR. PRINCIOTTO: So you are denying our request to withhold any payments, your Honor, pursuant to that consulting agreement?

THE COURT: Yes. I'm denying that application * * * Without prejudice to any relief you might want to seek in your action in Bergen County.

(*See* transcript annexed as Exhibit 2 to Certification of Glenn R. Reiser dated February 20, 2002, at pp. 2-13)(Emphasis added).

Shortly thereafter the judicially approved sale, on February 20, 2001 plaintiff filed an Amended Complaint questioning and challenging the validity of the entire transaction between the assignee and National Flag, including the purchase price and terms of the consulting/non-compete agreement.[1] Although plaintiff has not sued Mr. Ravin, plaintiff is alleging that the sale to National Flag was not in the best interests of Betsy Ross' creditors.

LEGAL ARGUMENT

THE COURT SHOULD GRANT SUMMARY JUDGMENT DISMISSING PLAINTIFF'S AMENDED COMPLAINT AGAINST DEFENDANT, DIANE PALUGHI

A. The Summary Judgment Standard

R. 4:46-2 provides that summary judgment shall be granted "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact challenged and that the moving party is entitled to a judgment or order as a matter of law." In *Judson v. Peoples Bank & Trust Company of Westfield*, 17 N.J. 67, 74 (1954), our Supreme Court stated that the moving party has "the burden of showing clearly the absence of a genuine issue of material fact." *In Brill v. Guardian Life Insurance Company of America*, 142 N.J. 520 (1995), the Court refined this standard by allowing the trial court to weigh the competent evidentiary materials, in light of the evidentiary standard of proof to be used at trial, to determine whether there is a genuine issue of material fact. *Id*. at 523, 533-34, 535-36 and 539-40. In essence, the moving party is required to show that there is no genuine issue of material fact to be resolved by a fact finder because the evidence is so one-

[1]The Sixth Count of plaintiff's Amended Complaint includes the following allegations appear:

8. "The aforesaid transaction [with National Flag] and consulting and noncompetition agreement amounts to a fraud upon the creditors, creation of an unlawful preference to an individual and as a mechanism to transfer assets away from the corporation and to an individual."
9. "The agreement is not a bona fide agreement and not consistent with the obligations, background and experience of the Defendant, Diane Palughi. The agreement is designed to reduce the funds available to creditors of the corporation and amounts to compensation for the accounts and goodwill of the Betsy Ross Manufacturing Company."

sided that a rational fact finder could not decide the issue in favor of the opposing party. *Ibid*. (Emphasis added).

The substantive law identifies the facts that are material. "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 106 S.Ct. 2505, 2510 (1986). In general, facts supporting or contradicting a cause of action or defense are considered material. *Celotex Corp. v. Catrett*, 106 S. Ct. 2548, 2552 (1986). This Court's function in connection with the within motion is not to decide the issues of material fact, *Judson*, 17 N.J. at 73, nor should it "weigh the evidence and determine the truth of the matter." *Brill*, 142 N.J. at 540. Rather, the Court must only "determin[e] whether there is the need for a trial -- whether, in other words, there are any genuine factual issues that properly can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Liberty Lobby*, 106 S.Ct. at 2511.

Here, summary judgment is appropriate for the reasons articulated below. There are no genuine issues of material fact regarding the terms of the judicially approved sale of assets by the assignee to National Flag, or the good faith conduct of National Flag, the assignee and Ms. Palughi. Plaintiff's Amended Complaint represents nothing more than a collateral attack of the judicially approved sale and the assignee's business judgment. As such, plaintiff's Amended Complaint lacks any merit from either a factual or legal standpoint.

B. Plaintiff's Claims Are Barred By The Failure To Include The Assignee As A Necessary And Dispensable Party

Mandatory joinder of parties is governed by R. 4:28-1. "Subparagraph (a) [of R. 4:28-1] defines those persons whose joinder is desirable both in terms of granting complete relief to the parties already before the court and in terms of the public interest in avoiding subsequent lawsuits concerning the same subject matter, recognizing the importance of protecting the persons whose joinder is in question against practical prejudice resultant from disposition of the action in his absence." Pressler, *Current New Jersey Court Rules*, Comment R. 4:28-1 (Gann).

Parties who are subject to mandatory joinder are generally referred as being an "indispensable party". Whether a party is indispensable depends upon the circumstances of the particular case. As a general proposition, a party is not truly indispensable unless he has an interest inevitably involved in the subject matter before the court and a judgment cannot justly be made between the litigants without either adjudging or necessarily affecting the absentee's interest. *Id.*

Considering Mr. Ravin's fiduciary duties as assignee of Betsy Ross and that it was within his business judgment to proceed with the sale to National Flag, he most certainly is a necessary and indispensable party to this lawsuit. *See e.g., In re George Mather's Sons Co.*, 52 N.J.Eq. 607 (Ch. 1894)(The receiver of an insolvent corporation who is in possession of its franchises and assets is a necessary party to a petition by the state to restrain the transaction of business because of nonpayment of the franchise tax); *Wilson v. Bellows*, 30 N.J.Eq. 282 (E. & A. 1878)(A bill to set aside a deed to purchasers under a judgment and sale by an auditor in attachment which fails to make creditors and the auditor parties is subject to demurrer).

New Jersey common law has long recognized a judicial officer's authority and powers in making a sale. *See, e.g., EH Yacht, LLC v. Egg Harbor, LLC*, 84 F.Supp. 443 (D.N.J. 2000)(Under New Jersey law, receiver's right to insolvent corporation's property vests at time of filing of receivership action); *Hackensack Water Co. v. DeKay*, 36 N.J.Eq. 548 (E. & A. 1883) (An officer selling under judicial process has naked power to sell according to the mandate of the court. He may adopt conditions of sale amply sufficient to secure compliance by purchasers with their bids, etc.); *National Bank of Metropolis v. Sprague*, 20 N.J.Eq. 159 (Ch. 1869)(A master, charged with the conduct of a judicial sale, has considerable latitude of discretion in prescribing such terms of sale as will exclude puffers and fraudulent bidders, and secure the confidence of real purchasers in offering their bids).

The statutory provisions governing assignments for the general benefit of creditors unequivocally establish Mr. Ravin's status as a necessary and indispensable party to this lawsuit.

Pursuant to *N.J.S.A. 2A:19-13*, Mr. Ravin was vested with "full power and authority to dispose of all of the assignor's [Betsy Ross] property." *Id.* This statute further describes the broad general powers of an assignee:

> He may sue for and recover in his own name everything belonging or appertaining to the estate. He may compromise, settle and compound all claims, disputes and litigation's of the assignor, refer the same to arbitration, agree with any person concerning the same, redeem all mortgages and conditional contracts, and generally act as and do whatsoever the assignor might have lawfully done in the premises.

Ibid. (Emphasis added).

By statute, the assignee is also vested with the powers of acting as representative of his assignor's creditors. Pursuant to *N.J.S.A. 2A:19-14*:

> The assignee, in addition to the powers which he may exercise as the successor to the assignor, shall also at all times be the representative of the creditors of the assignor, and shall have the same power to set aside conveyances, and to recover or reach assets for the benefit of the creditors as a creditor would have who was the holder of a judgment and levy against the assignor and his property at the date of the assignment. All conveyances, mortgages and transfers of property, real or personal, made by the assignor, which are void or voidable as against the creditors of the assignor, shall in like manner be void or voidable as against the assignee.

Ibid. (Emphasis supplied).

Since plaintiff's Amended Complaint alleges that the entire transaction between Mr. Ravin and National Flag constitutes a fraud upon Betsy Ross' creditors, in essence plaintiff is challenging Mr. Ravin's conduct as well. However, plaintiff is time-barred from pursuing a cause of action against him in his capacity as assignee of Betsy Ross, pursuant *to N.J.S.A. 2A:19-20*. This statute states, "[A]ll actions at law or in equity which may be brought against any assignee on account of the taking, appropriating, selling or disposing of any property by him as a part of the trust estate, shall be commenced within 9 months from the time when the cause of action shall arise, and not afterwards." *Ibid.* (Emphasis added). Mr. Ravin consummated the court ordered sale of Betsy Ross' assets to National Flag on February 9, 2001. Thus, plaintiff is

well outside the 9-month limitations period to pursue a claim against him. In any event, plaintiff has the ability to present its claim for its unpaid invoices to Mr. Ravin in the assignment proceeding. *See N.J.S.A. 2A:19-22* ("Any creditor may present not only any debt due, but any debt to become due, making in such case a reasonable rebate when interest is not accruing on the same.").

Based on the foregoing, the Court should dismiss plaintiff's Amended Complaint for failure to include Mr. Ravin as a necessary and indispensable party. Even if plaintiff were to request leave to amend his pleadings to include Mr. Ravin as a defendant, plaintiff is time-barred from pursuing any claims against Mr. Ravin pursuant to the 9-month statute of limitations period of *N.J.S.A. 2A:19-14*.

C. Plaintiff Lacks Standing To Sue On Behalf Of All Creditors

In circumstances analogous to the case at bar, in *Portage Insulated Pipe Co. v. Costanza*, 114 N.J.Super. 164 (App. Div. 1971), the Court held that a single creditor is prohibited from bringing an action to set aside or recover preferences unless the suit is brought for the benefit of all the corporation's creditors. At page 167 of its decision, the Appellate Division explained:

> An action to set aside such preferences, if brought by a single creditor instead of by a receiver or trustee in bankruptcy of the corporation, must be brought for the benefit of all the creditors of the corporation. *See Central-Penn National Bank v. N.J. Fidelity, etc., Co.,* 119 N.J.Eq. 265 , 271-271 (Ch. 1935); *Landis v. Sea Isle City Hotel Co.*, 53 N.J.Eq. 654 (E. & A. 1895).
>
> The creditor may not, as plaintiff here has done, bring an action at law to recover from the beneficiaries of the preferential payments only the amount due on the judgment which the creditor had recovered against the corporation. *Thompson-Houston Electric Co. v.* Murray, 60 N.J.L. 20, 22 (Sup. Ct. 1897).

Id. (Emphasis added).

Plaintiff herein is attempting to do exactly what the Appellate Division frowned upon in *Portage Insulated Pipe Co., supra*. Plaintiff's Amended Complaint alleges that the entire transaction between Mr. Ravin and National Flag constitutes a fraud upon Betsy Ross' creditors.

However plaintiff seeks to recover only the amount of its unpaid invoices, $14,412.30. This is the same legal theory rejected by the Appellate Division in *Portage Insulated Pipe Co., supra.* Because Betsy Ross designated a statutory receiver with the responsibility of marshalling its assets for the benefit of all creditors, plaintiff lacks standing to sue Betsy Ross and Ms. Palughi to recover only its debt. *See e.g., Cohen v. Miller*, 5 N.J. Super. 451 (Ch. Div. 1949)("The receiver of an insolvent corporation represents the creditors and all parties having an interest in the corporation. While a receiver merely stands in the place of and has no greater right than the corporation over whose property he has been appointed receiver, as against strangers to the record who hold adversely property of the insolvent corporation or who are indebted to the insolvent corporation, the receiver must proceed against them by independent plenary suit,…."))(internal citation omitted)(emphasis supplied)). The decision to question or challenge the validity of the consulting agreement belongs to Mr. Ravin, the assignee of Betsy Ross. Plaintiff's assertion of this claim on behalf of all creditors of Betsy Ross is an attempt to usurp the assignee's powers. Since plaintiff lacks standing to maintain such a claim solely for its own pecuniary interests, the Court should dismiss plaintiff's Amended Complaint for failure to state a claim.

D. Plaintiff's Amended Complaint Constitutes An Impermissible Collateral Attack On The Judicial Sale Of Betsy Ross Assets

Plaintiff's Amended Complaint is an end-around attempt to set aside the judicial sale confirmed by Judge Reisner. Although Judge Reisner expressed to plaintiff's counsel that his remedies were more appropriate for adjudication in this lawsuit, the doctrine of collateral estoppel nonetheless bars plaintiff's attempts to relitigate the terms of the judicial sale. Collateral estoppel or "issue preclusion" is a tool that courts use to increase efficiency of the judicial process by avoiding needless relitigation of fact issues already decided in another proceeding. *Galbraith v. Lenape Regional High School Dist.*, 964 F.Supp. 889 (D.N.J. 1997). The doctrine of collateral estoppel means that when an issue of ultimate fact has once been

determined by a valid and final judgment, that issue cannot again be litigated between the same parties in a future lawsuit. *State v. Redinger*, 64 N.J. 41 (1973). The ultimate question to be decided on whether the doctrine applies is whether the party has had his day in Court on an issue, rather than when he has had his day in Court on that issue against a particular litigant. *Colucci by Colucci v. Thomas Nicol Asphalt Co.*, 194 N.J. Super. 510 (App. Div. 1984).

A party asserting collateral estoppel must demonstrate the following elements: (i) the issue to be precluded is identical to issue to be decided in the prior proceeding; (ii) the issue was actually litigated in the prior proceeding; (iii) the court in the prior proceeding issued a final judgment on the merits; (iv) the determination of the issue was essential to the prior judgment; and (v) the party against whom the doctrine is asserted was party to or in privity with the party to the earlier proceeding. *Matter of Estate of Dawson*, 136 N.J. 1 (1994). As demonstrated below, sales conducted by judicial officers and approved by the judicial process are viewed with a great degree of finality and thus enjoy the benefits of collateral estoppel.

Because a receiver is an officer of the Court, a receiver's sale is a judicial sale. *In re Fairfield General Corp.*, 75 N.J. 389, 411 (1978), *citing Silverman v. Kolker*, 149 N.J. Super. 162, 166 (Ch. Div. 1977), and *Campbell v. Parker*, 59 N.J.Eq. 342, 346 (Ch. 1900). "Such sales normally involve an order of sale, a public or private sale conducted by the receiver, and an order by the court confirming the sale." *Fairfield General Corp.*, 75 N.J. at 411 (internal citations omitted). "The sale is completed only through confirmation of the court." *Id.* "A judicial sale arising out of a statutory receivership is for the benefit of the creditors of the insolvent corporation." *Id.* at 412. The Chancery Court can order a receiver to sell the whole or part of property of an insolvent corporation when interests of the parties demands a sale. *Taylor v. Phox Bus. Co.*, 129 N.J.Eq. 610 (Sup. Ct. 1941). Whether the interests of parties demand that the Chancery Court so act depends on the circumstances. *Ibid.* In the context of judicial sales by statutorily appointed receivers, the Supreme Court of New Jersey has recognized that public

policy favors expeditious settlement of receiverships. *See Fairfield General Corp.*, 75 N.J. at 412.

When a court orders a judicial sale, the policy of the law is against interfering with the orderly prosecution thereof. *Murray v. D'Orsi*, 98 N.J.Eq. 548 (Ch. 1925). *Accord Crane v. Bielski*, 27 N.J. Super. 448 (App. Div. 1953), *rev'd*, 15 N.J. 342 (1954)(Public policy ordains that power to set aside judicial sales based on competitive bidding should be sparingly exercised). Judicial sales based upon competitive bidding should be vacated only when necessary to correct a plain injustice, determination of which lies in the Court's sound discretion guided by considerations of justice and equity. *Karel v. Davis*, 122 N.J.Eq. 526 (E. & A. 1937). In order to set aside a judicial sale there must be a showing of fraud, accident, surprise, or mistake, irregularities in the conduct of the sale and the like. *In re Simmons*, 202 B.R. 198, 204 (Bankr. D.N.J. 1996); *First Trust National Assoc. v. Merola*, 319 N.J.Super. 44 (App. Div. 1999). Where a judicial sale is not void, but voidable, it cannot be collaterally attacked. *See Becker v. Kelsey*, 9 N.J.Misc. 1265 (Sup. Ct. 1931). *See also Clark v. Costello*, 59 N.J.L. 234 (E. & A. 1896)(Where an order of the orphan's court for the sale of lands is collaterally attacked, the court will be presumed to have had before it, and to have passed upon, all matters necessary to authorize the making of the order). *But see In re Old Colony Coal*, 49 N.J. Super. 117 (App. Div. 1958)(Court held that an order approving judicial sale of assets by corporation's assignee was improper and subject to vacation upon application because of procedural infirmities where the assignee filed an inventory, valuation and bond subsequent to entry of the order approving the sale and the court made no finding that the sale was necessary to protect the insolvent estate).

In *Karel v. Davis*, 122 N.J.Eq. 526 (E. & A. 1937), the former court of Errors and Appeals carefully noted that exercise of the power to set aside judicial sales is entrusted to the court's sound discretion:

> For obvious reasons, public policy ordains that the power to set aside judicial sales based upon competitive bidding should be

> sparingly exercised. The integrity of the process, designed as it is to secure the highest and best price in cash then obtainable for the property, demands that a sale conducted shall be vacated only when necessary to correct a plain injustice. Thus, it is that in such matters the court is enjoined to exercise a sound discretion, guided by considerations of justice and equity and not by whim or caprice.
>
> The doctrine is implicit in the cited statutes providing for confirmation of judicial sales. Those statutes expressly condition the sale upon the Court's 'approval;' only in that case is confirmation required to be given. But the statutory approval is to be given or withheld in the exercise of sound discretion, consonant with the requirements of equity and justice. * * * It was plainly not within legislative contemplation to invest the judicial authority with a discretion 'unlimited' in the sense of arbitrary.

122 N.J.Eq. at 529, 531 (internal citations omitted).

Public policy reasons, including the assignee's need for expeditious disposition of Betsy Ross' assets, should discourage this Court from serving the functions of an appellate court by reviewing Judge Reisner's February 9, 2001 Order approving the sale. In fact, Judge Reisner's February 9, 2001 Order constitutes a final order which was subject to appeal within 45 days pursuant to *R. 2:4-1*.. A judgment becomes final, for claim preclusion purposes, once the time for appeal has expired. *Peduto v. City of North Wildwood*, 696 F.Supp. 1004 (D.N.J. 1988), *aff'd*, 878 F.2d 725 (3rd Cir. 1989). It is "well settled that in order for a final judgment to be appealable, it must be final both as to all issues and all parties." Pressler, *New Jersey Court Rules*, Comment *R. 2:2-3* (Gann). Whether a judgment should be considered final for purposes of collateral estoppel turns on such factors as nature of decision, adequacy of hearing, and opportunity for review. *Glicktronix Corp. v. American Tel. & Tel. Co.*, 603 F.Supp. 552 (D.N.J. 1984).

Plaintiff's Amended Complaint constitutes an impermissible and untimely appeal of Judge Reisner's final order of February 9, 2001. Plaintiff's remedies in challenging the sale lied before the Appellate Division, not before another county trial court. Notwithstanding the lapse of the 45-day time for appeal, even if this Court were inclined to review Judge Reisner's

February 9, 2001 Order, plaintiff has not demonstrated any of the criteria necessary for this Court to overturn it. Plaintiff cries "foul" merely because Mr. Palughi became employed by National Flag post-sale. However, that allegation in-an-of-itself will not support a finding of fraud to vacate the judicial sale. *See e.g., Hecht v. Hoogmoed*, 111 N.J.Eq. 331 (E. & A. 1932)(That a judgment creditor purchasing debtor's business at judicial sale employed debtor for a short period after the sale held not evidence of fraud under the circumstances).

In the instant case, the judge who approved the sale of Betsy Ross' assets is the same judge who presided in the related foreclosure proceedings and who was familiar with Betsy Ross' plight. The assignee provided notice of the sale to all creditors, he possessed a written forced sale appraisal, he advertised the sale in the Bergen Record, and he submitted the offer to three (3) other flag companies in an attempt to solicit higher and better offers. The ultimate purchaser, National Flag, was the only party who bid on the assets. The consulting agreement was appended to the assignee's moving papers, and thus Judge Reisner was well aware of it. In sum, the assignee brought his sale application before the Court with full disclosure of all terms and conditions. There was no attempt by the assignee, National Flag, or Ms. Palughi to conceal the consulting agreement or brush it "under the rug!" Further, plaintiff had an opportunity to object to the terms of the consulting agreement at the sale hearing, but Judge Reisner approved the sale notwithstanding such objections. Since plaintiff is attempting a collateral challenge of Judge Reisner's ruling approving the sale, the Court should dismiss plaintiff's Amended Complaint as a matter of law based on the doctrine of collateral estoppel. It should not escape this Court's attention that irrespective of the consulting/non-compete agreement, plaintiff has no independent basis to establish personal liability against Ms. Palughi to satisfy a corporate debt of Betsy Ross!

E. Plaintiff's Amended Complaint Is Barred By The Business Judgment Test

The Business Judgment Rule protects directors' actions from being questions by a court in the absence of a showing of fraud, self-dealing or unconscionable conduct, as long as he or she acts reasonably and in good faith in carrying out his or her fiduciary duties to the corporation. *Papalexiou v. Tower West Condominium*, 167 N.J. Super. 516, 527 (Ch. Div. 1979); *Maul v. Kirkman*, 270 N.J. Super. 596, 614 (App. Div. 1994). The rule presumes that disinterested directors of a company act "on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest." *Maul*, 270 N.J. Super. at 614. The rule is a rebuttable presumption, and the burden of proof shifts to the defendant to show the intrinsic fairness of self-dealing or other disabling factor. Rowe, *N.J. Business Litigation*, §1-2:4, at p. 5 (2000).

As assignee of Betsy Ross, Mr. Ravin was cloaked with the requisite business judgment as a fiduciary officer of Betsy Ross. Pursuant to statute, Mr. Ravin had authority to sell the assets of Betsy Ross in the manner that he thought would maximize the value for the benefit of Betsy Ross' creditors. In complaining about the sale price and alleging fraud against both the purchaser (National Flag) and the recipient of the consulting agreement and alleged preferential transfer (Ms. Palughi), plaintiff is challenging Mr. Ravin's business judgment in selling the assets to National Flag. Plaintiff simply cannot meet its heavy burden of overcoming the presumption that Mr. Ravin acted in good faith and that his actions in making the sale to National Flag were in the best interests of Betsy Ross and its creditors.

Because the sale was supported by a written appraisal of the assets and received judicial approval, plaintiff cannot prevail in overcoming the presumption in favor of the assignee's exercise of good business judgment. Even if the Court were inclined to review the terms of the sale, the assignee obtained more than three (3) times the estimated forced sale value of the assets

in the transaction with National Flag. Accordingly, the Court should dismiss plaintiff's Complaint as a matter of law.

F. Plaintiff's Amended Complaint against Ms. Palughi is Barred by the Corporate Veil Doctrine.

"In New Jersey, a corporation is treated as an entity wholly separate and distinct from the individuals who compose and control it. Absent fraud or injustice, courts generally will not pierce the corporate veil." Rowe, *N.J. Business Litigation,* §1-2:9, at p. 18. Two (2) factors must be present to pierce the veil: (1) there must be such unity of interest between the corporation and its owners that separate personalities do not exist, and (2) the acts complained of are treated as those of the corporation alone, a fraud or injustice will result. *State of New Jersey department of Environmental Protection v. Ventron Corp., 94 N.J. 473, 501 (1983); Craig v. Lake Asbestos of Quebec Ltd., 843 F.2d 145, 149 (3rd Cir. 1988).*

"Dominance over the offending corporation also must be shown when seeking to pierce the veil." Rowe, N.J. Business Litigation, § 1-9, at p. 18. Corporate dominance may be shown by the following factors: (1) gross undercapitalization; (2) failure to observe corporate formalities; (3) non-payment of dividends; (4) insolvency of the debtor corporation; (5) siphoning of corporate funds by the dominant shareholder; (6) non-functioning of other directors or officers; (7) absence of corporate records; and (8) the fact that the corporation merely is a façade for the operations of the dominant stockholders. *Craig v. Lake Asbestos of Quebec, Ltd., 843 F.2d at 150.*

In the instant case, Ms. Palughi executed the Deed of Assignment of Betsy Ross assets' to Mr. Ravin in her capacity as administratrix of the estate of the deceased sole shareholder, Michael Palughi, Sr. Ms. Palughi never served as an officer, director or shareholder of Betsy Ross. She merely served as its General Manager after the death of her husband and did her best to keep the company afloat. Any actions taken by Ms. Palughi in her capacity as General Manager of Betsy Ross were taken on behalf of its president and sole shareholder, the Estate of

Michael Palughi, Sr. In sum, plaintiff cannot establish a basis to pierce the corporate veil of Betsy Ross as a means of establishing a theory of liability against Ms. Palughi. Even if plaintiff could fabricate such a theory against Ms. Palughi, its Amended Complaint fails to plead a cause of action for piercing the corporate veil. Accordingly, the Court should grant summary judgment dismissing plaintiff's Amended Complaint as a matter of law.

CONCLUSION

For the foregoing reasons and authorities cited, the Court should grant defendant's motion for summary judgment dismissing plaintiff's Amended Complaint in its entirety and with prejudice.

Respectfully submitted,

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By:----------
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Dated: February 22, 2002