

**Crede CG III, Ltd. v Tanzanian Royalty Exploration Corp.**

2018 NY Slip Op 32918(U)

November 21, 2018

Supreme Court, New York County

Docket Number: 651156/2018

Judge: O. Peter Sherwood

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**SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49**

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**CREDE CG III, LTD.,**

**Plaintiff,**

**-against-**

**TANZANIAN ROYALTY EXPLORATION  
CORPORATION,**

**Defendant,**

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**O. PETER SHERWOOD, J.:**

Motion sequence numbers 001 (plaintiff's motion for a preliminary injunction) and 002 (defendant's motion for a stay) are consolidated for decision.

**BACKGROUND**

The facts are taken from the Complaint. Plaintiff Crede CG III, Ltd (Crede) invests in small cap emerging companies with high potential, providing them with the capital to allow them to grow and succeed. Crede entered into a Securities Purchase Agreement (SPA) and a Registration Rights Agreement (RRA) with defendant Tanzanian Royalty Exploration Corp (TREC), a publicly traded company incorporated in Canada and traded on the New York and Toronto stock exchanges in 2016 to help fund some of its gold and precious metal mining projects in Tanzania. Crede invested \$5 million in exchange for common stock and warrants.

The SPA provided for two rounds of financing. The first closed on September 1, 2016. TREC received \$1.25 million, and issued Crede 1,840,400 shares of TREC common stock and Series A Warrants. The common stock was priced at \$.68/share. The warrants gave Crede the right to purchase 1,840,400 shares of common stock at \$.83/share. The second round of financing closed on September 26, 2016. TREC received \$3.75 million, and gave Crede convertible notes and warrants worth the same amount. Crede immediately converted the notes and received 5,357,143 shares of TREC stock, which it liquidated. The warrants received in the second round were five-year Series B Warrants to purchase 4,017,857 shares of common stock at \$1.10/share.

The warrants were not exchanged for stock 1:1. There was a formula applied to determine how many shares of stock each warrant would command (the Exchange Formula). In 2017, TREC's stock prices were trading below the warrants' exercise prices. On May 8, 2017, Crede exchanged Series A Warrants for 778,478 shares of TREC common stock. On July 17, 2017, it again exchanged Series A Warrants for 778,478 shares of TREC. On August 21, 2017, Crede exchanged additional Warrants for 1,112,331 shares of TREC common stock. In each instance Crede promptly liquidated the stock.

In January 2018, TREC stopped honoring the warrants. Crede made two deliveries of warrants to TREC, but TREC failed to provide stock. TREC stated that there had been no meeting of the minds about the Exchange Formula, and the effect of Crede's request would be to dilute TREC's stock in violation of Canadian law. Crede argues that the Toronto Stock Exchange had approved the Exchange Formula, that New York law applies and that both parties are sophisticated and were well counseled in this transaction.

Litigation in this court ensued. Crede realized it had erred in seeking to convert Series A Warrants instead of Series B Warrants, and discontinued that action. On February 27, 2018, Crede delivered a new Exercise Note seeking to exchange 500,000 Series B Warrants for 1,322,222 shares of common stock but TREC did not deliver the stock.

The SPA and the Warrants all state that Crede will be irreparably harmed if TREC fails to deliver the stock. Crede states that TREC is also in a precarious financial situation, and may not be able to continue as a going concern. TREC has stated that it has current assets of about \$1.3 million and debts of over \$10 million. TREC has never generated revenue, expects losses to continue, and may have problems with the Canadian Ministry of Energy and Minerals, as it has failed to pay mining licensing fees for most of its projects (which have not seen any work going on). At the time of submission of this motion, TREC stock was trading at \$.33/share. Plaintiff argues that, if TREC is not ordered to immediately turn over the stock, the stock will be rendered worthless and the remainder of Crede's investment will be lost.

Crede asserts claims for

- 1- breach of contract, seeking specific performance and injunctive relief, and
- 2- declaratory judgment that TREC is bound by the SPA, Warrants and Exchange Formula.

Crede asks for the declaratory judgment and specific performance requiring TREC to turn over the disputed stock. In the event this relief is not ordered, Crede requests an award of compensatory damages in an amount to be determined at trial.

In motion sequence number 002, defendant seeks a stay pursuant to CPLR 2201, pending disposition of an action TREC has commenced in the SDNY (the Federal Action) against Crede, asserting causes of action under the Exchange Act, breach of contract, and breach of the implied covenant of good faith and fair dealing, claiming that Crede is concealing its purchase and sale of millions of shares of TREC stock in order to manipulate TREC's share price.

### ARGUMENTS

Plaintiff seeks an order to require TREC to turn over the disputed 1,322,222 shares of common stock. Crede claims that TREC is in financial distress and will likely be unable to pay a judgment, should Crede receive one after litigation. While TREC claims to have over \$52 million in assets, it has less than half a million in cash (Memo at 6, Dkt. 32). Most of the assets are in "mineral properties and deferred exploration" which "do not necessarily represent present or future values" (*id.*, quoting Peizer Aff, para 66, Dkt. 6; Exhibit H, Dkt. 14).

Crede claims it is likely to succeed in the breach of contract claim because TREC has honored its warrants in the past and used the correct Exchange Formula, but now refuses to honor the February 27, 2018, exercise note. Both sides were well counseled and negotiated terms of the contract thoroughly, including the Exchange Formula. Further, the parties' conduct surrounding the signing of the SPA indicates their intention that the Exchange Formula be implemented as written.

While TREC claims Crede failed to file a required Schedule 13D form with the SEC, informing the SEC that Crede owns more than 5% of TREC stock, that fact is irrelevant to TREC's obligation to tender the requested stock (Memo at 13-14, Dkt. 32).

Crede claims irreparable harm absent an injunction, as TREC's precarious financial position may result in it becoming insolvent or taking more financing, thereby diluting its shareholders and rendering assets immune from seizure (*id.* at 14-15). Further, while TREC may have interests in Tanzanian mines, Tanzania does not recognize United States judgments, making it unlikely Crede will be able to enforce a judgment rendered by this court against assets there (*id.* at 21).

Crede argues the balance of equities falls in its favor because it is likely that TREC will be unable to satisfy an eventual money judgment (*id.* at 23-24). Crede also claims it should not have to post an undertaking, as it was explicitly waived in the SPA and the warrants. Crede is prepared to post one, if necessary.

TREC opposes the motion. It claims that, as Crede has failed to fulfill its disclosure obligations and file a schedule 13D disclosing all of its purchases and sales of TREC stock, Crede is barred from acquiring further shares of TREC common stock pursuant to SEC Rule 13d-1(e)(2) (Opp at 1, Dkt. 47). After withdrawing its previous complaint, Crede filed a Schedule 13G, which is not the required disclosure, but instead was an attempt to appear compliant, while continuing to deceive. The Schedule 13G is only proper if the filer intends to influence control of the entity, which is not the case here. The warrants also gave Crede a certain amount of control over certain events. The form filed was also inaccurate, as Crede only declared an interest in the number of shares specified in the warrants, and its interpretation of the Black Sholes Option Pricing Model (“Model”) would result in it receiving many more shares (*id.* at 14-15). TREC also argues that there was a mutual mistake as the proper Exchange Formula, and especially as to the Model. As evidence of the mutual mistake, TREC points out that both parties reviewed and approved TREC’s registration statement filed with the SEC, which stated approximately 5.86 million shares would be issued under the warrants (*id.* at 15). Even if this is a unilateral mistake, TREC will seek rescission of that portion of the agreement to prevent Crede’s unjust enrichment (*id.*).

TREC explains that Crede could exercise the warrants in two ways. One was for a cash payment at the warrant price for the number of shares specified in the warrant. The other was the cashless exercise. The provision in the warrants explaining the cashless exercise was different from the industry standard for a cashless exercise. The warrants state that Crede may receive (the number of shares for which the warrant is being exercised) x (Model value) / (closing price of stock two days prior). The Model determines the fair price or value of an option largely relying on the current market value, and taking into account the length of the option, market factors, and so forth (*id.* at 6). Instead of using the usual Model, the formula set out in the warrants considers the exercise price of the option, rather than the current price of the shares and assumes 5 years are left on the exercise period for the option. These changes make the formula set out in the warrants entirely different from the original Black Sholes Option

Pricing Model, and lacks the latter's science and foundation (*id.*). It is clearly erroneous.

Normally, when the stock price falls below the exercise price in the warrant, the Model results in the value of the option dropping. Using the erroneous formula in the warrants, Crede would receive more stock when the price was low, so it had an incentive to manipulate the stock price lower (*id.* at 8).

That is why TREC refused to process Crede's January 2018 Exercise Notice. By that notice, Crede was attempting to exercise a right to purchase more stock than it was entitled to purchase. TREC also challenges Crede's calculation of how many shares it could demand (*id.* at 7).

As to the request for a preliminary injunction, TREC first points out that the proposed preliminary injunction would not preserve the status quo, but instead upend it, giving the plaintiff its ultimate relief immediately (*id.* at 9). Plaintiff requests extraordinary relief (*id.* at 9-10). Defendant argues Crede has not shown a likelihood of success, as Crede should not be allowed to enforce a contract which would serve to advance its own fraudulent conduct in violation of the Exchange Act and committing securities fraud (*id.* at 10). There are real questions as to whether performance of the contract and delivery of more shares of TREC would violate the law. Under SEC Rule 13d-1(e)(2), Crede is barred from obtaining more shares of TREC. 17 CFR section 240.12d-1 provides that any party which becomes the beneficial owner of more than 5% of an equity security registered under the Exchange Act, section 12(b), must file Schedule 13D within 10 days, and such ownership includes the right to acquire pursuant to an option. By entering into the SPA, Crede became the beneficial owner of 9.9% of TREC's common stock, but Crede failed to file the required form (*id.* at 11). Accordingly, 17 CFR 240.12d-1(e)(2) bars Crede from acquiring additional shares, through warrants or otherwise.

Courts generally do not enforce contracts where doing so would result in the performance of unlawful conduct. TREC notes that federal courts have issued injunctions barring the acquisition of further securities where there is a question whether a Schedule 13D form must be filed, and TREC has sought such an injunction in the Federal Action. While Crede claims it is entitled to performance regardless of its status with the SEC, it has unclean hands and equitable relief should be denied (*id.* at 13).

TREC also argues Crede has not shown irreparable harm, as Crede can be compensated with a monetary judgment (*id.* at 11, 16-19, citing *Sinclair Aff*, paras 7, 45-50). In addition to

the cash, TREC has an interest in gold deposits in Tanzania worth over \$130,000,000 (*id.* at 16). It is not required to report the value of these deposits with the SEC before the feasibility study and exploration programs have been completed (*id.* at 16-17). The language in TREC's financials which alarmed Crede is required by GAAP, and has been in TREC's financials since 2014. It was there when Crede decided to make the investment. Finally, the clause in the warrants allowing for injunctive relief is not enforceable. Courts do not defer to such clauses (*id.* at 19).

Finally, the balance of the equities fall in TREC's favor, as Crede is seeking its ultimate relief (*id.*). If TREC is forced to hand over more than 3 million shares, and Crede dumps them on the market, the TREC share price will likely drop to the point at which the New York State E-file will de-list it and TREC's future financing will be at risk.

Should this court grant the Preliminary Injunction, TREC asks the court to require a substantial undertaking, as TREC has substantial risk from the consequences of the Preliminary Injunction, and should have access to funds to mitigate the damage, should TREC succeed in the end.

In reply, Crede argues that the mutual mistake defense fails because the terms of the contract are unambiguous and were thoroughly negotiated by well counseled parties (Reply at 2, Dkt. 56). As far as TREC relies on the number of shares contemplated in the registration, Crede was not required to list the total number of possible shares implicated, and the parties decided to declare the number of shares in the document (*id.* at 3). TREC clearly understood and agreed with the formula in the warrants when it delivered stock on them on four occasions previously. At most, TREC has alleged a unilateral mistake, but that fails because the information which could have resolved that mistake, the process for calculating the stock to be converted, is clearly ascertainable in the warrants (*id.* at 4). TREC may not claim a mutual mistake to avoid the consequences of its own negligence (*id.*).

Crede also dismisses TREC's arguments about SEC violations. Regardless of Crede's status with the SEC, TREC is obligated by the SPA and warrants (*id.* at 5). Crede argues that the Schedule 13G filing was proper because Crede could not affect or control TREC, as the SPA prevents Crede from voting any shares of TREC or seeking to influence any such vote (*id.* at 6-7). Crede also sold its stock immediately. Nor do the warrants give Crede any control over TREC's actions, they only provide that TREC cannot enter into a Fundamental Transaction [sic]

unless the successor entity assumes TREC's obligations to Crede (*id.* at 7). Crede did not have a veto over TREC's actions. TREC made an absolute and unconditional promise to honor Crede's exercise notes, and should be held to it (*id.* at 9).

Crede claims it will be irreparably harmed without injunctive relief. TREC does not have the cash to cover the value of the shares in this transaction, let alone the value of the rest of the shares which Crede could demand, and TREC's other assets are unreachable in Tanzania, which is why Crede wanted the representation that a breach of the SPA and warrants would constitute irreparable harm (*id.* at 10). TREC has continued to burn cash and issue stock. Crede argues that, as far as TREC claims it has other assets, there is no evidence TREC can use or leverage those assets to cover a judgment (*id.* at 12). Nor is there any evidence of additional imminent financing.

### DISCUSSION

The issuance of a preliminary injunction is governed by CPLR 6301, which provides, in pertinent part:

“A preliminary injunction may be granted in any action where it appears that the defendant threatens or is about to do, or is doing or procuring or suffering to be done, an act in violation of the plaintiffs rights respecting the subject of the action, and tending to render the judgment ineffectual . . . .”

“The party seeking a preliminary injunction must demonstrate a probability of success on the merits, danger of irreparable injury in the absence of an injunction and a balance of equities in its favor” (*Nobu Next Door, LLC v Fine Arts Hous., Inc.*, 4 NY3d 839, 840 [2005]). Because a Preliminary Injunction acts as a substantial limitation on the non-movant's interests prior to any determination on the merits, injunctive relief should only be granted sparingly, reluctantly any only “with great caution” *Wm. Rosen Monuments, Inc. v Phil Madonick Monuments, Inc.*, 62 AD2d 154 (2d Dept 1976). Injunctive relief is designed to preserve the status quo pending an adjudication of the merits of the case. It should not be used to determine the ultimate rights of the parties (*see Olympic Towers Condominium v Coccoziello*, 306 AD2d 159, 160 [1<sup>st</sup> Dept 2003]). Where as here, the movant seeks a mandatory injunction compelling action, movant must demonstrate that “such extraordinary relief is essential to maintaining the status quo” *Lehey v Goldburt*, 90 AD3d 410, 411 (1<sup>st</sup> Dept 2011).

Here, Crede has shown it has a contractual entitlement to exchange warrants for shares based on the Exchange Formula set forth in the parties' contracts. That the Exchange Formula



fails to track the Black Sholes Option Pricing Model does not render the warrants, negotiated by sophisticated well counseled business people, unenforceable (*see DeSilva v Musso*, 53 NY2d 543, 552 [1981]). TREC's defense of "mutual mistake" must be rejected as the parties do not share a substantially similar erroneous belief as to the facts (*see Yurman Design, Inc. v Garden Jewelry Mfg Corp.*, No 99-cv-10507, 2003 WL 22047896\*3 [SDNY August 29, 2003]). In fact, TREC does not dispute it exchanged warrants for stock based on the Exchange Formula four times in 2017.

Nevertheless, Crede is seeking a mandatory injunction which would require TREC to affirmatively deliver shares to Crede. Such extraordinary relief is not appropriate because it would alter, not maintain, the status quo (*see Lehey*, 90 AD3d at 411).

The motion must be denied for an additional reason: the failure of Crede to show irreparable harm. It has long been held that a Preliminary Injunction is not available in an action seeking solely money damages (*see Campbell v Ernest*, 64 Hun 188 [1892]). Harm is not irreparable if an adequate remedy at law exists (*see Learon v Feinberg*, 13 AD2d 90, 93-94 [1<sup>st</sup> Dept 1961]). Crede's damages consists of the value of publicly traded TREC stock. The monetary value of the 1,332,222 shares Crede seeks and, based on past practice, will liquidate upon receipt, can be readily calculated.

Crede claims it will be irreparably harmed if the requested relief is not granted because TREC is on the "verge of insolvency," threatening Crede's ability to collect on a judgment issued at the conclusion of the case. It disputes TREC's claim that it has assets that exceed \$54 million, noting that those assets are located in Tanzania where the law of that country does not currently recognize United States judgments (Memo at 21, Dkt. 32).

A preliminary injunction cannot be issued based on the prospect that funds may not be available to satisfy the judgment a court might issue at the end of the case. In *Credit Agricole Indosuez v Rossiyskiy Kredit Bank*, 94 NY2d 541 (2000), the New York Court of Appeals held that the grant of a preliminary injunction barring an insolent defendant from transferring its assets to another bank pending the outcome of the action was improper. The court held that an unsecured creditor has no cognizable interest in a debtor's property until the creditor obtains a judgment and thus has no equitable prejudgment remedy that will interfere with the debtor's use of its property. This is so even when defendant threatens to strip itself of assets. "The decision

to grant or deny provisional relief, which requires the court to weigh a variety of factors, is a matter ordinarily committed to the sound discretion of the lower courts” (*id.*).

Accordingly, it is hereby

**ORDERED** that the motion of plaintiff Crede III Ltd., for a preliminary injunction is DENIED; and it is further

**ORDERED** that the motion of defendant, Tanzanian Royalty Exploration Corporation for a stay pending the outcome of a recently filed action by said defendant is DENIED; and it is further

**ORDERED** that counsel for the parties shall appear at a preliminary conference at Part 49, Courtroom 252, 60 Centre Street, New York, New York on Tuesday, December 18, 2018 at 10:30 AM.

This constitutes the decision and order of the court.

**DATED: November 21, 2018**

ENTER,

A handwritten signature in black ink that reads "O.P. Sherwood". The signature is written in a cursive, flowing style with a horizontal line underneath the name.

**O. PETER SHERWOOD J.S.C.**