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

JOHN BRUMMER

Plaintiff,

vs.

RED RABBIT, LLC and RHYS W. POWELL,

Defendants.

Index No.: 652565/12

NOTICE OF ENTRY

PLEASE TAKE NOTICE that the attached is a true copy of an ORDER and accompanying transcript in this matter that was entered in the office of the Clerk of the Supreme Court, New York County on the 28th day of July, 2014.

Dated: New York, New York
August 13, 2014

Yours, etc.

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

PRESENT: O. PETER SHERWOOD Justice PART 49

JOHN BRUMMER,

Plaintiff,

-against-

RED RABBIT, LLC, et ano.,

Defendants.

INDEX NO. 652565/2012

MOTION DATE July 23, 2014

MOTION SEQ. NO. 004

MOTION CAL. NO. ____

The following papers, numbered 1 to ____ were read on this motion for summary judgment.

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☑ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion for summary judgment is decided in accordance with the accompanying transcript, dated July 23, 2014. Accordingly, it is hereby

ORDERED that the motion and a cross-motion are GRANTED; and it is further

ORDERED that the case is DISMISSED in its entirety.

Dated: July 23, 2014

O. PETER SHERWOOD, J.S.C.

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

Check one: ☑ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: CIVIL TERM: PART - 49

----------X

JOHN BRUMMER,

Plaintiff

INDEX NUMBER:
652565/12

-against-

RED RABBIT, LLC and RHYS W. POWELL,

Defendants

----------X

60 Centre Street
New York, New York 10007
July 23, 2014

BEFORE:
HONORABLE: O. Peter Sherwood, JSC

APPEARANCES:

Balestriere Fariello
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By: Kurt Krautheim Esq.

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Krystina R. Maola, Esq.

Delores Hilliard
Official Court Reporter

Proceedings

COURT CLERK: Calling case number one on the Part-49 calendar, in the matter of J O H N B R U M M E R versus R E D R A B B I T, L L C and R H Y S W. P O W E L L. Index Number 652565/2012.

Your appearances for the record, please.

MR. KRAUTHEIM: Kurt Krautheim for the plaintiff, John Brummer.

MR. LANCIA: Thomas M. Lancia for the defendant, RHYS W. Powell and Red Rabbit, LLC.

MS. MAOLA: Krystina R. Maola, also for the defendants.

THE COURT: Have seats, please.

So, Mr. Lancia, it is your motion.

MR. LANCIA: Correct.

THE COURT: And then there is a cross motion.

MR. KRAUTHEIM: That's correct, your Honor.

THE COURT: All right. I will hear from you now.

MR. LANCIA: If it please The Court, my name is Thom Lancia. I represent Red Rabbit and RHYS Powell, the defendants in this case.

John Brummer was an investor in Red Rabbit, which was formed in 2005.

THE COURT: You should assume that I have read your brief.

MR. LANCIA: I have three points to make.

Proceedings

First, Mr. Bummer made money on his investment.

There are no cases that I could find or that we could find where there was a breach of fiduciary duty found, or an intent to defraud found or unjust enrichment where the plaintiff made money.

Mr. Brummer doubled his investment, which is far better than certainly what I did and probably most people did during that time period from 2005 to 2011 and 2012.

THE COURT: I hope you are not arguing that the mere fact that you made money ends the analysis as to whether or not there has been a breach of fiduciary duty?

MR. LANCIA: No, your Honor.

THE COURT: Presumably, one can imagine circumstances where perhaps but for the breach I would have made even more money.

MR. LANCIA: I'm merely pointing out that those are few and far between.

The second point is that Mr. Brummer admitted in his deposition that he was only concerned with getting the rest of the money owed to him. And he was not concerned with any of the other --

THE COURT: Take me to where in the papers.

MR. LANCIA: It is exhibit 42, page 217 -- I am sorry. Page 271 and 272.

THE COURT: Exhibit 42 and page what, 270?

Proceedings

MR. LANCIA: Pages 271, 272. Those are the deposition pages.

THE COURT: "And for this time, June 28, 2011, was it your sole concern of getting paid on the note?"

"Yes, I believe so."

Hold on.

"Is it your concern with Red Rabbit at this point in time getting paid the note, finishing getting paid the note, correct?"

Okay, got it.

MR. LANCIA: So, my point is that this was, even this late, at this late date in June of 2011 after he had been informed of the investment, after the investment had gone through, after Mr. Brummer had ratified the investment and voted in favor of it. After he had allowed his own shares, his own remaining membership interest to be diluted, even at that point his only concern was to finish getting paid on the note.

That goes to the issue on all of the remaining causes of action in plaintiff's complaint.

It goes to the issue of materiality.

There was nothing material to Mr. Brummer about the fact that there was a potential investor, a socially conscious investor, The Kapor Trust and Serious Change.

So, there is nothing to indicate that Mr. Brummer

ever believed that this was, that this was a material element in which he would base his decision.

The third, and you know I understand that you have been, you have already read my brief. And I don't want to reiterate it and go over it again and again and again. But, the important thing is that Mr. Brummer kept accepting payments under the promissory note until June of 2012.

So, he continued to receive, continued to take the payments. Another example of the lack of materiality.

So, as far as fraud is concerned there is no intent to fraud. There is no evidence of fraud.

THE COURT: Well, if you are going to argue no intent, that sort of takes you outside of summary judgment, doesn't it?

MR. LANCIA: Well, there is no materiality and no intent.

THE COURT: That is a quintessential question of fact, is it not?

MR. LANCIA: Right, you're correct.

However, there is nothing in the record that would indicate that he intended to defraud the plaintiff. Nothing. There is nothing in the record.

THE COURT: All right.

MR. LANCIA: As far as a breach of fiduciary duty, again, there is no materiality here. It wasn't material for

all of the reasons I have stated, for all of the reasons stated again in the brief.

The fact that there were these potential investors on the horizon in a deal that had not been completed was not material to his determination as to whether to sell or not or at what price to sell or anything else.

And there is no evidence in the record that would support that.

THE COURT: And you say that there is no duty given the fiduciary relationship for Mr. Powell to advise Mr. Brummer that there were potential investors.

Why do you say that?

MR. LANCIA: Mr. Brummer was on notice from 2005. In fact, he had participated himself. He was on notice from 2005 to the time he sold his interest that they were looking for investors. They were always looking for investors. It would have been an obvious question.

In fact, he represented when he signed the 4th amended operating agreement in section 12 --

THE COURT: Which exhibit is that?

MR. LANCIA: I am sorry. This is exhibit 28 and it is page 27. And it is section 12.1.

THE COURT: Let me get that. Yes.

MR. LANCIA: Section 12.1B.

Such member has been provided an opportunity to ask

questions regarding this investment and receive answers from representatives of the company.

Section C. Such member has such knowledge and experience of financial affairs that it is capable of evaluating the merits and risks of investing in the company.

John Brummer signed this document. He could have asked the questions. He signed knowing that he could have asked the questions and he never did.

In fact, my client had to school him in valuations.

THE COURT: As of February of 2011?

MR. LANCIA: Yes, that's correct.

THE COURT: Okay.

MR. LANCIA: In fact, my client had to school him or give him an idea of how to do some sort of valuation of a company.

He had his own investment advisor. And as far as we know he never asked him about anything about the investment other than, hey, do you think this is a good deal. And the answer was yes, I think it is a good deal. Great.

THE COURT: All right. Why don't you --

There is a motion, a cross motion, as you know.

MR. LANCIA: Correct.

THE COURT: Well, maybe I will hear from your adversary now and come back to you.

Proceedings

MR. LANCIA: Thank you, your Honor.

THE COURT: All right. So, Mr. Krautheim.

MR. KRAUTHEIM: Your Honor, I will try to address my adversary's arguments as they came up.

The first I believe he addressed was the damages for fraud.

THE COURT: Well, he says with respect to fraud, fraudulent concealment and even fiduciary duty is that the evidence shows that no material information was withheld.

MR. KRAUTHEIM: Your Honor, I looked into that. And it is incorrect.

I found cases that say, first with respect to the fraud claim that when you have that situation where someone is deceived in giving up what they have for less than it is worth, you can recover your out of pocket damages for fraud.

And that is exactly what happened here. My client was --

THE COURT: Which case are you relying on?

MR. KRAUTHEIM: I cited to one case in my papers.

My adversary did point out that that case reflected the principle that I'm arguing right now. But, it didn't apply to the principle.

So, I did find another case, your Honor, if you would allow me.

THE COURT: It is in your briefs or not?

Proceedings

MR. KRAUTHEIM: No, your Honor.

THE COURT: It is not in your brief. Then, you have got to educate me further.

MR. KRAUTHEIM: The second case I found, I can provide copies, your Honor.

THE COURT: Just give me the name of the case and the cite, counsel.

MR. KRAUTHEIM: It is Bernstein.

THE COURT: What?

MR. KRAUTHEIM: The name of the case is Bernstein V Kelso, K-E-L-S-O, and Company.

THE COURT: Yes. What is the cite?

MR. KRAUTHEIM: 231, AD 2d, 314.

THE COURT: Yes. And what proposition does that stand for?

MR. KRAUTHEIM: It stands for the proposition, as I said, that out of pocket will apply.

Regardless of whether the plaintiff had earned a profit or not he can recover his damages, the difference in what he gave up and what the time is actually worth.

THE COURT: Do you have a copy of the case that I can take a look at?

MR. KRAUTHEIM: I do, your Honor.

(Handed)

THE COURT: What page?

Proceedings

MR. KRAUTHEIM: If you go to page 6, the middle of the page on the left side.

(Court peruses)

THE COURT: Well, all I can say with respect to this case, as far as I can tell it answers the question that I asked Mr. Lancia very early on in his argument.

You will recall that he started out saying, hey, this guy made money. And you recall the question I asked him and his concession.

MR. KRAUTHEIM: I believe, your Honor, that you asked if there was any scenario in which he could recover damages.

THE COURT: I think I basically said -- I don't remember precisely the question I asked. But, it basically was that certainly there are some scenarios in which the fact that you made money does not mean that there was not a breach of fiduciary duty and there was and you are not entitled to recover.

This case that you just gave me, the Bernstein case, The Court there was addressing the question of damages.

And once the fiduciary duty, breach of fiduciary duty was found, the mere fact that the plaintiff made a profit does not preclude or excuse The Court, the lower

Court here, Judge Gammerman, from considering the question of the quantum of damages, how much the plaintiff lost.

What that case addresses is not the problem that you face. So, why don't we talk about the problem that you face.

MR. KRAUTHEIM: I am sorry, your Honor, could you repeat?

THE COURT: Why don't we --

My comment was, the Bernstein decision does not address the questions that you need to address. Why don't we address the questions that you do need to address.

Everybody here now agrees that it is certainly possible that despite the fact that you made money does not mean that you cannot sue for breach of fiduciary duty, which takes care of your case.

So, let's go on.

MR. KRAUTHEIM: Your Honor, I believe the Bernstein case is very similar to -- I mean, the configuration is similar to an action for fraud that is arising out of a corporate buy out.

I believe that The Court was discussing fraud on the middle of page six when they are discussing this application that in this scenario the plaintiff is not trying to get at future profits. He is trying to get the difference of what, between what he received and what he

should have gotten.

THE COURT: The question to you, counsel, is where is the fraud? You need to show that there are the elements for fraud, assuming we are talking about fraud and not breach of a fiduciary duty.

Have you made out the elements or can you demonstrate that there is a question of fact with respect to each of the elements for fraud that you have to prove. Right?

MR. KRAUTHEIM: Yes.

THE COURT: That is the question.

What Mr. Lancia says is that there was no --

He first claims that there were no misrepresentations. And I don't think you're arguing that there was a misrepresentation. You are saying that there was really a failure to disclose; right?

MR. KRAUTHEIM: Your Honor, I do cite many misrepresentations in the complaint. I have identified several.

THE COURT: What misrepresentation are you relying on for the purposes of the motion that we have here?

MR. KRAUTHEIM: For the purposes of the motion, the misrepresentations at the time the negotiations were going on or at least prior to it that Red Rabbit could go bankrupt any day. That was a misrepresentation.

Proceedings

THE COURT: Let me ask you this.

I think the relevant time frame was around September of 2010.

MR. KRAUTHEIM: That is when the negotiations were for the partial transfer.

THE COURT: Tell me, what is the time frame we are talking about?

MR. KRAUTHEIM: Some time prior to that.

THE COURT: Like, when?

Just give me a time frame, any time. What is the time frame you have in mind?

MR. KRAUTHEIM: Within 6 months before that.

THE COURT: Okay.

Isn't it a fact that within that 6 month period and well before that Red Rabbit was running in the red consistently?

MR. KRAUTHEIM: That is correct, your Honor.

THE COURT: So, it is not unreasonable to say that the company could go bankrupt at any time; isn't that right?

MR. KRAUTHEIM: There were representations also that the company was --

THE COURT: So, with respect to the first misrepresentation that you're standing up here discussing with me, you do concede that that is not a misrepresentation; yes or no?

Proceedings

MR. KRAUTHEIM: Your Honor --

THE COURT: Yes or no?

MR. KRAUTHEIM: It would depend upon the timing.

THE COURT: We are talking about the period that you identified, of the 6 month period after September of 2010.

MR. KRAUTHEIM: I think it absolutely constitutes a misrepresentation. It occurred close to the time of the buy-out.

THE COURT: They were in the red prior to the buy-out; right?

MR. KRAUTHEIM: No, they were not in the red. There was a small profit.

THE COURT: In September of 2010 I thought that as to profits they were still in the red at that point, although they were doing better than they had in 2009?

MR. KRAUTHEIM: There is an e-mail to the effect, your Honor, that there was a profit, a small profit made.

THE COURT: Well, let's get to the real --

Your client had access to the financial records?

MR. KRAUTHEIM: Yes, your Honor.

THE COURT: Could have looked?

MR. KRAUTHEIM: He did have access to the financials. He did ask for some of the financials that were just finished by the accountant.

THE COURT: And you got it, right? Whenever he wanted them he could have them.

Is there some dispute about that?

MR. KRAUTHEIM: To the extent that he advised that the onus was on the client and that somehow this raised the duty from Powell.

THE COURT: So, the short answer to my question is, yes, he had access to the financials; right?

MR. KRAUTHEIM: Yes, your Honor.

THE COURT: And so he could verify for himself whether or not the company could, quote, "go bankrupt any moment."

By the way, I'm not even challenging when the statement was made as to when regarding the bankruptcy. But, my point to you is he could have checked.

MR. KRAUTHEIM: Yes, your Honor.

THE COURT: So, where is the fraud?

MR. KRAUTHEIM: Another misrepresentation, there were negotiations about the value of the company.

THE COURT: You mean, the valuations?

MR. KRAUTHEIM: The defendant received valuations that were far higher than what he represented to the company was worth to my client.

THE COURT: Do you know what the valuations are?

What is the nature of a valuation, fact or opinion?

MR. KRAUTHEIM: I think it would depend upon the context.

THE COURT: Any context where you're doing, quote, "valuations," particularly where you're talking about a company that is not trading on a public market and especially a company that is operating in the red, that's numbers that people make judgments about. It is not a fact, is it?

MR. KRAUTHEIM: Your Honor, there are formulas out there to figure out to determine what the value of the company is.

THE COURT: To help you make a judgment; isn't that right?

MR. KRAUTHEIM: There are facts that, the valuation on the facts that you rely on to make a judgment.

THE COURT: But, it's a judgment, nevertheless, isn't it, counsel?

MR. KRAUTHEIM: Based upon a formula and a complex analysis and the circumstances.

THE COURT: Why can't you just say, yes, it is, but?

MR. KRAUTHEIM: Your Honor, numbers --

THE COURT: And in that case, in this case, isn't it the case that this is once again a valuation in that somebody is making a judgment saying here is what we think the company is worth? Isn't that right? That is the nature

of valuations.

Maybe I have just been misinterpreting it all of these years I have been doing these cases.

Go ahead.

MR. KRAUTHEIM: In another misrepresentation --

THE COURT: Which one, the valuation?

MR. KRAUTHEIM: The next one.

THE COURT: Hold on a minute. Let me check on something. I think there is another question.

Do you believe if an existing investor is given an evaluation for a company of $100 and knows that the company is constantly seeking new investors, is the company bound in its negotiation with the new investor to never assert that the valuation of the company is more than $100 without going back to the existing investor?

MR. KRAUTHEIM: I would argue, your Honor, that he should have checked with his fellow members of the LLC before.

THE COURT: You what?

MR. KRAUTHEIM: I would argue, your Honor, that you should have confirmed with the other members of the LLC.

THE COURT: So, the way in which businesses who are trying to raise money have to operate is that with respect to existing investors before you can go out and try to get the best valuations you can and the best price you can for

new stock, before you can do that you effectively have to go to existing investors and say, before we go to Mr. Jones' new investment we are going to give you the opportunity to come in and buy out Mr. Jones' price. Is that the way it works?

MR. KRAUTHEIM: No, your Honor.

THE COURT: Not a chance.

That is exactly what you're arguing. That you somehow have to go back to your existing investors to check in with them as to the new opinion that you have with respect to the value of your stock. And you have to do that before you talk to Mr. Jones to encourage him to buy your stock at the higher price.

And you think that there is a duty to existing investors to do that? Is that what you think?

MR. KRAUTHEIM: No, your Honor.

I do have another misrepresentation.

THE COURT: So, where is the misrepresentation here or the breach of fiduciary duty with respect to the failure to give Mr. Brummer a valuation number that is at the same level that the company is trying to negotiate with the incoming investor?

MR. KRAUTHEIM: The value of the company was higher than he represented that to my client it was worth.

Another misrepresentation --

Proceedings

THE COURT: Where is the fact that the company was worth more than that?

It was worth at a higher value, the number asserted by Mr. Powell to the incoming investors, right?

MR. KRAUTHEIM: Their very existence.

The fact that the discussions had progressed to the point they were having very advanced discussions about letters of intent and so forth. That was never disclosed. Also --

THE COURT: And you think you've got the obligation to tell an existing investor, here's what we are negotiating, here's the price, here's the valuation?

And have you to do that to each and every one of your existing investors before you negotiate with a new investor. That is your view?

MR. KRAUTHEIM: My view is that you, you're having negotiations with an investor that has come along that far and it was more likely enough that they are going to invest in the company. You should disclose it to someone you're trying to buy out his interest and you have a fiduciary duty to the person.

If I can go on.

THE COURT: All right. What else?

MR. KRAUTHEIM: If I can go to the third misrepresentation.

THE COURT: What else?

MR. KRAUTHEIM: There is a misrepresentation that Mr. Powell had over estimated the amount the company was worth in e-mails.

THE COURT: So, wait a minute. Your first argument was that he underestimated to your client the amount that the company was worth.

MR. KRAUTHEIM: Right.

THE COURT: And followed by another representation that underestimated the value.

MR. KRAUTHEIM: There was another misrepresentation.

THE COURT: Must be that your client was on notice that he had better check for himself.

MR. KRAUTHEIM: There is a representation that the company was worth $900,000.

The defendant came back to my client and said, okay, I was wrong about that. It was not worth $900,000. I am sorry, I over estimated the value of the company.

I believe that constitutes a misrepresentation in view of the company, misrepresented more than the company was worth.

THE COURT: Take me to the exhibit that you have in mind.

MR. KRAUTHEIM: Okay. Exhibit F.

THE COURT: F. To whom is it?

MR. KRAUTHEIM: That is an e-mail to John Brummer from RHYS Powell dated Tuesday, December 21, 2010.

THE COURT: That is at the top of the page?

MR. KRAUTHEIM: It is at the bottom of the page, your Honor.

THE COURT: At the bottom of the page. Tuesday, September 21st. Okay.

MR. KRAUTHEIM: If you look at the bottom.

THE COURT: John --

MR. KRAUTHEIM: It says, I apologize if I over estimated the company's value at dinner. It was not my intent. I was just very excited you would be the first investor that actually made a positive return when investing in one of my companies.

THE COURT: It was not my intent. I was just excited you would be the first investors that actually made a positive return by investing in one of my companies.

MR. KRAUTHEIM: If you look at the e-mail directly above it, this is my client saying they put an estimated valuation on the company at $900,000.

Now, we have Mr. Powell saying I over estimated, it is not worth $900,000.

THE COURT: Okay.

Well, so that proves my point, doesn't it, about

the nature of valuations?

But, even beyond that why is that, explain to me how that representation is material.

MR. KRAUTHEIM: How it is material?

THE COURT: Yes.

Or more importantly, what detrimental reliance your client put on it.

MR. KRAUTHEIM: I can start with the materiality.

THE COURT: Well, let's try detrimental reliance.

MR. KRAUTHEIM: My client, he wasn't given an opportunity to negotiate, to address the fact, an important fact that the new investors were coming in. To address the fact that this is going to effect the value of the company as it is and in the future value of the company. He had no opportunity to address that in negotiations.

THE COURT: Maybe I misunderstood.

The representation that you just pointed me to was one that had an opinion with respect to a value of the company that was higher than the company was according to the e-mail; right? Right? Did I get that right?

Let's go back. Total value -- let's see.

MR. KRAUTHEIM: So, your Honor --

THE COURT: No, wait.

The buy-out I'm offering you for the company is apparently 665 K. This is between last year's revenue 475

and the projected revenue of this year between 8 and 900 K.

And he was negotiating with this new investor for some number slightly above 900 K; is that right?

MR. KRAUTHEIM: No.

THE COURT: No? They weren't negotiating with the new investor for some number above 900 K?

MR. KRAUTHEIM: I don't think I have been very clear.

Yes, he was talking to outside Venture Capitalist. They were talking numbers much higher than that. It was one million two fifty.

THE COURT: Okay. The number is all over the place, right? Yes?

MR. KRAUTHEIM: Sorry?

THE COURT: The numbers are all over the place; right?

That is the nature of valuations. People make judgments all of the time about them.

But, in any event, so, I apologize that I over estimated the company's value at dinner.

Right?

MR. KRAUTHEIM: That is the defendant saying the company is even worth less than we thought.

THE COURT: Okay.

MR. KRAUTHEIM: At the same time it's receiving

estimates of the company to be worth well over a million, $1.2 million, and a million and a half after they received investment funding.

THE COURT: Okay. Go ahead.

MR. KRAUTHEIM: Your Honor, I want to just back-up.

There was an issue with damages that I didn't address, I feel like I should address.

For the breach of fiduciary duty claim we have found cases that do show that my client, Dr. Brummer, would be entitled to some part of the future profits. So, that is also part of our damages theory.

I just wanted to point that out.

THE COURT: We haven't gotten to the damages issue. I'm trying to figure out where the liability is. That is really the issue.

MR. KRAUTHEIM: We also list a number of omissions. I'm happy to go through the omissions.

THE COURT: Okay.

Your client at the point we are talking about knew that the company was doing a lot better and so was sort of headed towards a profit, wasn't it? He was aware of that, wasn't he?

MR. KRAUTHEIM: That's correct.

THE COURT: And so, he could have assumed --

Well, he had access to the financial facts. And he

also was fully aware of the fact that the company was doing better in '10 than it was in '09, substantially so, right?

MR. KRAUTHEIM: That the company was poised to do better.

THE COURT: Was doing better, not poised to do better. Yes, it was also poised to do better based upon the fact that it was doing better, right?

MR. KRAUTHEIM: That's correct.

THE COURT: And in fact it had a number of new contracts with schools, right?

MR. KRAUTHEIM: That's correct.

THE COURT: And throughout this period your client was aware of all three of those facts; correct?

MR. KRAUTHEIM: Yes.

THE COURT: Okay. Go ahead.

MR. KRAUTHEIM: So, the omissions --

THE COURT: Yes?

MR. KRAUTHEIM: The discussions that were and negotiations were with Venture Capital.

THE COURT: The negotiations with Venture Capital.

And you say that a company has obligations to all of its investors to tell them about negotiations, ongoing negotiations with Venture Capital?

MR. KRAUTHEIM: If they are negotiating a transfer of their membership interest to themselves.

THE COURT: They are negotiating with an existing investor to buy back shares, then they have an obligation to tell you about the negotiations they are having with third parties. That's your view?

MR. KRAUTHEIM: That could effect the value of the company, your Honor. Yes, that's my view.

THE COURT: And the case that supports that proposition?

MR. KRAUTHEIM: The breach of fiduciary duties cases.

(Pause)

MR. KRAUTHEIM: I can go through the case law if your Honor would like.

THE COURT: I'm listening.

MR. KRAUTHEIM: There are a number of cases that obligate fiduciary to disclose material facts.

THE COURT: Yes?

MR. KRAUTHEIM: To a fellow co-venturer.

THE COURT: So, what say you about the application of the Centro case?

MR. KRAUTHEIM: I'm sorry, which case, your Honor?

THE COURT: Centro. Court of appeals, 17 NY3d at the beginning at page 269.

It is cited in the briefs as to the duty to disclose in advance of some transaction. Particularly,

where you're selling your shares or you're releasing a claim for that matter.

MR. KRAUTHEIM: I'm sorry, your Honor, I don't understand the question you're asking.

(Short pause)

THE COURT: Well, I suppose I'm looking at the language that says where a principal and fiduciary are sophisticated parties and engage in negotiations to terminate their relationship or change it, however, the principal cannot bind a trust to the fiduciary's assertions.

And it goes on and says, there is really no obligation to -- This is in the context of a settlement. To confess all one's wrong doings.

It applies here because here you are talking about your client selling shares back to the person he is negotiating with who is a fiduciary.

And the question is whether you have to tell your, the person you're negotiating with, all of the thoughts you have in your head.

What The Court of Appeals says is, especially among sophisticated parties there is no such obligation.

Isn't that what Centro says, counsel?

MR. KRAUTHEIM: I don't think Centro, your Honor, would apply to the facts here.

THE COURT: Because?

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MR. KRAUTHEIM: Because, the omissions that were made and the representations that were made were more material than just thoughts in someone's head.

THE COURT: Well, wait a minute.

So, you are saying that the omissions that were made here were more material than the admissions made in Centro where the negotiating parties were the buying -- yes, the buying party knew that it was in negotiations with a 3rd party to make the enterprise much more profitable?

Aren't those the basic facts of Centro; yes or no?

MR. KRAUTHEIM: Yes, your Honor.

THE COURT: Well, isn't that pretty much your facts?

MR. KRAUTHEIM: No, your Honor. Because, this case is different.

THE COURT: Because there are fewer zeros, is that why?

What else do you want to tell me?

MR. KRAUTHEIM: Just, I should probably address the other arguments, the ratification argument.

Your Honor, the application in front of the defense is not anywhere in response to the pleadings.

THE COURT: You are talking about --

(Record read)

THE COURT: I don't understand.

MR. KRAUTHEIM: The defense of ratification that the defendants are making that my client approved the deal, he accepted, he was happy about it.

First of all, the facts, that is not true. The facts under the facts, the timing when my client learned about all of this was later. He didn't know.

He may have been told that there were investors coming in in general terms. He really wasn't informed of the names of the investors until March of 2011.

And at no point at any of these discussions or meetings was it disclosed to my client that during the time of this buy-out there were other negotiations happening at the same time of the incoming investors.

THE COURT: Okay. You're repeating the same thing that we talked about before. Right? Or is there something new here that I'm missing?

MR. KRAUTHEIM: My point, one of my points is the extent that the defendants are claiming ratification as an affirmative defense here, they didn't even put it in their responsive pleadings. It should be waived.

THE COURT: Well, I don't think they are arguing ratification. I think they are arguing, in fact, I know they are arguing that the misrepresentation, the fraudulent concealment that you're arguing was not material as is evidenced by your client's conduct.

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Isn't that what you are saying?

MR. LANCIA: Correct. Yes, your Honor.

MR. KRAUTHEIM: To that I would respond --

THE COURT: It is not ratification.

MR. KRAUTHEIM: The defendants are applying a purely subjective test to the analysis.

It is an objective test. If you look at the case, the case even says that it is an objective test.

The analysis being applied by the defendants is purely subjective. It's all about speculation involving what my client should have done, what he should have known, what he would have done under a different circumstance.

THE COURT: No. The question is whether it was material to him.

If it were material to him he would have acted differently. That is all they are arguing.

It is mere additional evidence on the question of materiality. That's all they are arguing.

MR. KRAUTHEIM: Your Honor, if you look at the testimony I think there is plenty of testimony and plenty of evidence even in the e-mails that the facts were material to my client, that he attached significance to them.

And you see that the e-mails where he is negotiating the buy-out, he is obviously concerned with the future earnings of the company, what the company is worth.

THE COURT: Is that what he was really interested in?

MR. KRAUTHEIM: He keeps one percent of the company because he believes in the company and wants it to do well.

All I'm saying, your Honor, it is an objective test. It involves some component of what a reasonable investor would do.

And that's not the application that the defendants are making here.

THE COURT: Well, I guess it is your adversary that points out your client's deposition testimony where he says-- It is a draft letter that is dated, I guess, June 28, 2007.

And then he was asked, and it relates to --

The exact question I don't remember. "But, at this time, June 28, 2011, was it your concern, sole concern getting paid on the note?"

"Yeah, I believe so."

"With regard to Red Rabbit, I am sorry?"

"Yes. My concerns were."

"Was your sole concern with Red Rabbit at this point in time getting paid on the note, correct?"

"Finishing getting paid on the note, correct."

That's your client's testimony.

MR. KRAUTHEIM: That testimony was later than the

time period. We are talking about other issues. We are talking about the time period where the shares --

THE COURT: Even as late as June 28, 2011 all he was concerned about was getting paid on his note.

MR. KRAUTHEIM: After the transaction was consummated.

At that point he still didn't know that , he didn't have a full idea of the extent of what was being not disclosed to him during the negotiations.

You know, and the defendant even acknowledges in their reply that had Brummer known these facts he would have acted differently.

If you look at page 10 of their reply they acknowledge it. The bottom of page 10. It says, if he had known there were going to be discussions with incoming investors he would have tried to negotiate different buy-out terms.

THE COURT: You know, I'm sure it is the case --

MR. KRAUTHEIM: That is the valuation.

THE COURT: I'm sure it is the case that if an investor, an existing investor or anybody knew of a pending deal that would enhance the value of the company, they would definitely want to know it so that they could jump in and take advantage of it; right?

MR. KRAUTHEIM: Or hold onto the investment.

There is already evidence.

THE COURT: And depending on the facts and circumstances people get prosecuted for acting on that kind of information. Not our case, but you know what I mean.

The point of my comment is that I don't know of any case in which, and I have said this to you before, a company is obligated to tell its existing investors about transactions that it is making with others that would enhance the value or decrease the value of their existing interests in the company.

And that's what you're arguing, there was somehow an obligation to let Mr. Brummer know that they were negotiating for a better deal. Right?

MR. KRAUTHEIM: Not exactly the same facts. You add concurrently.

THE COURT: And if you were talking about publicly traded securities, you know what you call that?

MR. KRAUTHEIM: Yes, your Honor.

THE COURT: Okay. It would get you a room with a view paid for by the state.

All right. What about your cross motion?

MR. KRAUTHEIM: The cross motion seeks summary judgment and calling the defendant's counter claims.

There are counterclaims in their amended answer. A counter claim to the effect that Brummer somehow violated

the operating agreement by not being an expert in nutrition. By not securing fund raisers. By not getting investment funding.

THE COURT: And your short answer to that is, you were never obligated to do anything.

MR. KRAUTHEIM: Yes, your Honor. That is the short answer.

And I think the defendants at least acknowledged that in their reply when they move away from that argument. And now they seem to be setting forth the argument that by doing all of this, that somehow constitutes.

Of course, those allegations are not in the amended answer, but their position seems to be.

THE COURT: All right. Let me hear from Mr. Lancia.

What about the cross motion?

MR. LANCIA: The third agreement, the third amended operating agreement states that a member that is engaged in the negligence or wrong doing to the detriment of the company may have his or her interest in the company acquired by the company for an amount of his initial capital contribution plus interest at the rate of 10 percent.

THE COURT: You are saying, number 1, he didn't participate. He didn't go raise money.

MR. LANCIA: Correct.

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THE COURT: And therefore that , those two failings violates the operating agreement; right?

MR. LANCIA: Correct.

THE COURT: Where is the duty for him to go out and raise money or to otherwise participate in the business?

MR. LANCIA: It arises out of this clause in the operating agreement.

His wrong doing to the detriment of the company.

He made a representation and, in fact, it is in the complaint that he went out and he had nutritional expertise.

THE COURT: Where is the duty? Where is the duty?

MR. LANCIA: Well, it says negligent or wrong doing.

THE COURT: But, you have to have a duty. You get negligent if you have a duty. Okay. You have to have a duty before you even get to the negligent question.

Identify for me the duty and the source of the duty.

MR. LANCIA: His duty was that he represented that he could go out and get investors. That he could get, he had nutritional expertise that he never had.

Plus, he brought this lawsuit which has cost the company a substantial amount.

THE COURT: Every investor in a company, particularly if you are in hedge funds you say, okay, you

know, I know people who can invest.

Because they say they can get money they then have an obligation to go out there and get money for the company that's trying to raise money? Is that what you're telling me?

MR. LANCIA: No. I'm saying that in this particular case.

THE COURT: There has got to be a duty somewhere. There is no promise here.

And if there is some where in the record some operating agreement, some signed writing in which he says, you know, I'm going to go do thus and such, please take me to it.

You know and I know it is not there.

MR. LANCIA: Yes, your Honor.

THE COURT: Okay. No duty.

MR. LANCIA: But, there is also wrong doing to the detriment of the company.

THE COURT: What was the wrong doing?

MR. LANCIA: The wrong doing is that he --

THE COURT: He didn't go out and raise money.

MR. LANCIA: Well, he didn't go out and raise money. And he didn't do anything on nutrition.

THE COURT: Where is his obligation to do either one of those?

MR. LANCIA: It arises out of the agreement.

THE COURT: Out of those words?

MR. LANCIA: Out of those words.

THE COURT: Someone reading those few words, a member who is engaged in wrong doing.

So, it is a wrong doing for an investor not to go out and raise more money for the company. That is your position?

MR. LANCIA: When he said he could do that, yes, under this clause.

THE COURT: It is a wrong doing?

MR. LANCIA: It is --

THE COURT: Where an investor, somebody puts his cash in the business. Says, you know what, I can raise money or better than that I even have more money I could put in the business. And if he fails to do that you believe that that constitutes a wrong doing that's enforceable in a court of law?

MR. LANCIA: Because, of this contractual term.

THE COURT: Where is the obligation?

MR. LANCIA: Outside of this contractual term, the obligation arises from this operative.

THE COURT: This contract says if you engage in wrong doing.

The problem is, we don't know where that , what

constitutes that wrong doing.

Find me somewhere in which Mr. Brummer is obligated to go out and raise money.

If he is not obligated to go out and raise money and he fails to do it, I guess there is no wrong doing, is there, Mr. Lancia?

MR. LANCIA: No, your Honor. Not in that context.

THE COURT: Or in any context, for that matter.

Where is the wrong doing?

MR. LANCIA: The truth of wrong doing is bringing this lawsuit.

THE COURT: Okay. All right.

What else do you want to tell me?

MR. LANCIA: I think that's it, your Honor.

THE COURT: All right. So, The Court is going to grant your motion for summary judgment.

MR. LANCIA: Thank you, your Honor.

THE COURT: Because, you have demonstrated that there is no triable issue of fact.

On the question of fraud, fraudulent concealment, breach of fiduciary duty, there are no misrepresentations of a material fact that was shown here nor was there any detrimental reliance on that has been identified for me with respect to the plaintiff's claim.

As to the breach of fiduciary duty the company

clearly, as I have indicated in my long conversation with Mr. Krautheim, the company was under no obligation to advise Mr. Brummer of ongoing negotiating with perspective investors.

I think that comes out quite clearly in the Centro case, The Court of Appeals case.

And as I have suggested, if one were to engage in that kind of conduct in a publicly traded company it is likely to be a felony.

So with respect to those three causes of action the motion must be granted.

With respect to, let's see, I guess the unjust enrichment claim, the units there, we didn't get to this issue. But, the units there they had no value at the time of the buy back.

The assignment, obviously, had the approval of Mr. Brummer. And there is no evidence that any information was withheld.

And I would point out, with respect to all of the claims in terms of what was concealed or not concealed, the facts were readily available to Mr. Brummer if he elected to make himself to seek them out, that is the financials of the company. In particular, what its contracts were. What its sales were. That kind of information.

He was clearly aware of the fact that the company

had additional contracts for schools. They were making more in 2010 than they were making in 2009. He saw where the company was going. All of those facts were available to him.

It seems to me that under those circumstances you have made out all of the elements of the proof. And there is no triable issue of fact with respect to any of those.

With respect to the cross motions for summary judgment with respect to the counterclaims that motion is granted, as well. There is no evidence here that there is any duty that Mr. Brummer had to the company either to go out and raise money for the company or to go work for the company.

He was an investor. An investor and a lender to the company. He had no such obligation. There is no evidence anywhere that I have seen that he had an obligation to do any of those things.

And the one clause that you're referring to certainly doesn't impose a duty on him to engage in any of the activities identified by the defendants here.

So, the cross motion with respect to the counter claim will be granted.

Accordingly, the complaint will be dismissed as well as the counter claim.

MR. LANCIA: Thank you, your Honor.

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THE COURT: Thank you.

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Certified to be a true and accurate transcription of said stenographic notes.

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Official Court Reporter